Cash Flow – How planning for sufficient cash within your business is vital for success

(to be read in conjunction with the disclaimer at the end of this briefing)

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According to a news report last week, it is estimated that many businesses will run out of cash within the next four weeks. Many of these businesses, although profitable, will have to close permanently simply because cash has been exhausted. It is also estimated that many of these same businesses will not realise that cash flow is a problem until it is too late, or very close to being too late.

You may have heard of the phrase; "Cash Is King". For us, cash is better described as the life, or the blood, that runs through the veins of a business. Without positive or enough cash inflow, a business will simply die. Cash is needed in order to pay suppliers and team members. It is also required to repair, renew and improve assets and to reinvest back into the business in order to grow the business.

As professional accountants and consultant CFOs, our advice is always (irrespective of the pandemic that we are currently experiencing) to plan well. Realistic and up-to-date budgets and forecasts are key for successful planning and for there to be sufficient resources available; cash being the key one. Equally important is up to date management information in the form of regular management accounts whereby you can compare actual activity against the budgets and forecasts, enabling the business to measure true performance and assist in revising and building future budgets and forecasts.

Key areas to look out for when preparing a cash flow forecast:-

Remember what it is: The forecast is a "Cash Flow" forecast. It lists and identifies the inflow of cash into the business and the outflow of cash from the business for a future period. That time period might be for one month, three months (a quarter) or even for a year. Basically, think of it like a prediction of the future receipts and payments to be shown in the bank statements of your business.

We generally recommend to our clients to prepare daily cash flow projections. This is because spending and receiving money is a daily occurrence, it doesn't all take place at the end of the month. Monthly and quarterly forecasts are for guidance only, whilst daily cash flow projections and comparisons will aid you in actually managing your business finances.

What to include:

Cash in from sales of your product or service: If you sell on credit, then the raising of the invoice will not be included in your cash flow forecast. Instead, you will input to the forecast, the gross sale (inclusive of VAT), into the week/month column that you expect to receive the money into your bank account. If normal credit days are, say, 28 days then list the receipt into your forecast for 28 days after you realistically expect to make the sale. If a particular customer or client generally pays earlier than the normal credit terms, then input the expected receipt when you expect to receive the money. If however, according to past history, a customer or client pays later, then again; be realistic.

For early payers, and where you offer discount for early payers, don't forget to input into the forecast the amount net of any discount. The clue is in the title; it is a Cash Flow forecast.

When there is a downturn in business, you may have assets (plant and machinery) that are surplus to requirements, and are no longer useful in the business; they are no longer earning the business any money. If there is a market for these assets, why not sell them and inject the sale proceeds into the business? The proceeds are an inflow of cash into the business and into the business bank account, so if you are realistically expecting to dispose of any such assets, then include the disposal proceeds into the forecast, accounting for the receipt at the time when you expect to receive the money.

You may be in the latter stages of agreeing a business loan and either personally, or jointly with others, making an investment into the business. This will represent an inflow of cash, so this needs to be included and reflected within the forecast.

Tax repayments:

Now that the 5th April has passed you will now be able to submit your 2019/2020 personal tax return, which all individuals who are self-employed (whether sole traders or in a partnership) are required by law to do. Do you know whether you are due a repayment? If so, why wait until January 2021 to submit your personal self-assessment return. Submit it now and claim back the repayment as soon as possible.

If you and/or your business is due a tax repayment, identify how much the repayment is expected to be, prepare the appropriate tax return and make the claim. Allow for up to 4 weeks to receive the repayment, and input the figure under the appropriate date in the cash flow forecast.

Similarly if you trade through a limited company then there are a number of areas that you should be looking at. For example; changing your company year end, carrying back losses to previous years, etc. Speak to your accountant, who should be able to advise you with regard to your best options.

The government announced early on in the COVID-19 crisis, that payments of VAT due between the 20th of March, 2020 and 20th June 2020 can be deferred. However, if the business is due a repayment of VAT then claim it back as soon as it is possible to do so.

Don't forget to claim for any grants that you might be entitled to under the Government backed Corona Virus provisions. Some of these payments are being made to businesses quite quickly, but look at the .Gov portal and your local authority website, in order to identify what grants are available and the likely dates when the money might be paid into your business account together with the amount.

Once all possible inflows of cash have been input, carry out the same exercise for the expected outflow of cash, then input the expected payments into the forecast, under the appropriate time period column. Examples of payments that should be included are; operational costs, wages and salaries (have any workers been furloughed?), balances showing on your aged creditor balances.

What will the forecast tell you?

It identifies when and how much money will come in and when and how much money will go out. By taking the total money expected in, then deducting the total money that is expected to flow out, you can identify a positive or negative cash flow. By adding that positive or negative cash flow to your expected opening cash balance at the start of each period (a day, week or month) you can predict the expected closing cash balance at the end of that period.

You will then be able to identify 'peaks and troughs'. Times when you have excess funds, and more importantly, times when you don't have sufficient funds. What can be done if you identify a period where insufficient funds are predicted?

Communicate:

This may firstly be with your customers. Are they able or willing to settle their invoices earlier? What would be the effect if you were to offer a discount for earlier settlement? If that option is taken up, change the forecast and don't forget to account for the discount. What is the effect on the forecast bank balances?

It might mean that you will have to communicate with suppliers. A conversation with suppliers might mean that you can spread payments over a longer period of time in order to settle purchase ledger balances. Speak to asset finance companies and banks with regard to offers of repayment holidays. Be very careful not to stop any direct debits in relation to loans and or finance agreements until you have an agreement to defer the payments from the bank or finance company. As soon as you know what the repayment terms, dates of payment and amounts are, change your forecast to reflect this change.

Identifying when and how much any deficit will be, will then help enable you to plan for any funding requirement either through further investment or in the form of a loan into the business.

Any bank, loan company, or investor, will require up-to-date year-end financial accounts which are showing as filed at Companies House, or if your business is not incorporated, you will need to be able to show that your latest self-assessment tax return has been filed, and also to make available both your tax calculation and tax overview.

In addition the bank will require up to date management information, including up to date profit and loss account, balance sheet, aged debtors and creditors, up to date forecasts, and depending on the amount of cash you are looking for, a written plan for your business.

Rarely will forecasts be 100% accurate

The future has a habit of not always turning out how it was originally envisaged. For example, who could have imagined six months ago the situation that we all face today? Therefore, not only do we recommend that you list your assumptions when building your forecast, we also strongly recommend that you carry out a number of; 'What If's'. What if my business activity only turns out to be 80% or 50% of capacity instead of full capacity? What will the effect then be on my projected bank/cash balance? If I currently predict my business activity to be 80% but there is a possibility that activity might be higher (say 90%), again we need to be able to forecast the effect on our cash and bank requirements.

We are grateful to our colleagues at Practical CFO Limited who are willing to make available forecasting templates. If you would like access to this resource, please contact:-

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Important – Disclaimer

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