Chapter 26

Cash flow forecasting

1. The importance of cash

: Cash is the most liquid of all business assets.

1.1 To pay supplier, overheads and employees

: Overheads - Money spent regularly on rent, insurance, electricity and other things that are needed to keep business operating.
: Suppliers have to be paid for the materials and components that have been purchased.
: Finally employees have to be paid every week and every month.

1.2 To prevent business failure

: If business runs out of cash, it may become insolvent, This means that the business cannot pay its debts.

2. The difference between cash and profit

Cash ≠ Profit

2.1 Some goods are sold on credit. So, at the end of the period, some customers will still owe money. Therefore, profit is greater than cash.

2.2 Sometimes owners might put more cash into the business. This will increase the cash balance, but have no effect on the profit made.

2.3 Purchases of fixed asset, such as equipment, will reduce cash balances, but have no effect on the profit a company makes. This is because the purchase of assets is not included for the purpose of calculating profit.

3. Cash inflows and outflows

- Cash inflow : flow of money into a business
- Cash outflow : flow of money out a business
- Net cash flow : The difference between cash inflows and cash outflows

4. Cash flow forecast:

: This is a financial document and shows the expected cash inflows and cash outflows over a future period. It also shows the closing cash balance at the end of each month.

Total cash inflow
This is the total amount of cash Kamal Motor Services expects to generate during the month, i.e. EGP 8950 during June

Total cash outflow
This is the total amount of cash Kamal Motor Services expects to pay out during the month, i.e. EGP 7500 during June

Closing balance
This is the opening balance plus the net cash flow for the month. For June it is EGP 1900 (EGP 450 + EGP 1450). The closing balance for June is also the opening balance for July

	June	July	August
Cash inflows			
Petrol sales	2500	2600	2700
Repairs	4200	4000	4500
Car sales	1500	2000	1500
Miscellaneous sales	750	750	800
Total cash inflows	8950	9350	9500
Cash outflows			
Wages	800	800	800
Petrol	2100	2100	2300
Parts	2150	2200	2400
Car purchases	1000	1000	3000
Other expenses	1450	1500	1500
Total cash outflows	7500	7600	10000
Net cash flow	1450	1750	–500
Opening balance	450	1900	3650
Closing balance	1900	3650	3150

Net cash flow
This the difference between the total cash inflow and the total cash outflow. For June it is EGP 1450 (EGP 8950 – EGP 7500)

Opening balance
The amount of cash the business has at the beginning of the month, i.e. EGP 450 at the beginning of June

▲ Figure 26.2 Cash flow forecast for Salah Motor Services

5. Why are cash flow forecasts important?

5.1 Identifying cash shortages

: A forecast can help to identify in advance when a business might need to borrow cash. The forecast clearly shows how much cash is left at the end of each month. This will help to identify when, or if, a bank overdraft will be needed.

5.2 Supporting application for funding

: When trying to raise finance, lenders often insist that businesses support their allocations with a cash flow forecast.

5.3 Help with planning the business

: Careful planning in business is important. It helps to clarify aims and improve performance.

5.4 Monitoring cash flow

: A business should compare the predicted figures in the cash flow forecast with those actually occur. It could then try to investigate the reasons why the figures were different.

\