Forecasts and funding

IN THE FINAL ARTICLE IN THIS SERIES, SARAH BOYCE OUTLINES POINTS TO CONSIDER WHEN IMPLEMENTING A CASH FORECAST PROCESS

Access to funding, whether for short-term liquidity or long-term structural debt, is vital to the survival of an organisation. Cash forecasts, which are an important component of efficient funding, are therefore important not only to treasury, but to the whole company.

How to establish a cash forecast process

As cash forecasting is a continuous process, and not a one-off exercise, planning the details of the process in advance will be time well spent. Consider the following:

◆ **The importance of senior management sponsorship.** Although treasury may be the principal users of cash forecasts, little of the information required normally resides within treasury and therefore forecasting must be a company-wide effort. Getting FD support when implementing a forecast cycle can make a crucial difference to the quality and hence usefulness of the forecasts.

◆ **The purpose of the forecast.** An appropriate forecasting technique needs to be selected to suit the purpose of the forecast (for example, for short-term liquidity or long-term funding decisions) and its time horizon. This will influence the level of detail required, frequency of update and the extent of any sensitivity analysis to be undertaken.

◆ **Design the output.** Agree with all users of the forecast what it needs to look like. For example, the FD may want a graphical dashboard presentation, while treasury may require a summary spreadsheet. Many companies use spreadsheets for generating cash forecasts, although there is increasing use of treasury management systems, enterprise resource planning (ERP) or consolidation systems, any of which may influence the design of the output.

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◆ **Information sources.** Having agreed what data is required, in what format and when, the data must be sourced. Sources will vary between companies even within the same industry, but may include:

- Bank balance reporting systems;
- Accounts payable and receivable data;
- Investment plans (capital budgeting plan) including acquisitions; and
- Tax and dividend payments.

It is always preferable to use the skills of those who know a particular aspect of the business best when sourcing information.

◆ **The feedback loop.** In order to ensure accuracy and a continuing focus by the business on forecasting, a feedback mechanism is required.

The forecast should always be reconciled to actual results and refined to improve future accuracy. This accuracy may be related to the nature of the business (for example, a small number of large cash flows with uncertain settlement dates) or to internal processes and systems (timeliness of input, accessibility of data from systems). Accurate information may also be more difficult to obtain in decentralised groups or in those with cross-border operations where time zones or cultural differences can cause confusion.

The challenge is in communicating the value and importance of forecast information to the operating units, rather than it being perceived as merely an exercise in control by head office. Remember to celebrate success and communicate when things are working well.

Conclusion

Cash flow forecasting can be very time-consuming and needs to be justifiable on a cost/benefit basis, but it can be an invaluable tool for the business. Yet it will only be truly useful if it is:

◆ Prepared using reliable base data provided by individuals who understand the importance of what they are doing;

◆ Produced using time horizons appropriate to the purpose for which it will be used;

◆ Updated regularly to reflect changes or known future events; and

◆ Checked against actual numbers and refined by feeding back to contributors over time to improve accuracy.

If you'd like more information on cash management and an opportunity to learn from some of the best in the business, why not consider attending the Annual Cash Management Conference run by the ACT each year? The next conference takes place 12-13 February 2014. For more information, see www.treasurers.org/cashmanagement

ADVICE FROM THE PROFESSIONALS

EXPERIENCED TREASURERS OFFER THE FOLLOWING HINTS AND TIPS BASED ON REAL-LIFE EXPERIENCES THAT MAY BE HELPFUL IN SAVING YOU TIME AND MONEY:

◆ The accuracy required in forecasting depends on the company's circumstances. For a company up against borrowing limits, accuracy is vital. If a company is planning for the longer term, less accuracy is required (it never turns out as you expect, so don't waste effort on spurious accuracy). Think cost/benefit and specify the cash flow forecast accordingly.

◆ Accuracy initiatives can include:
- Process improvements: improving the administrative processes of the 'purchase-to-pay' and 'order-to-cash' cycles;
- Systems improvements: improving cash forecasting systems, for example, by creating automated interfaces between the treasury and ERP systems, to retrieve payables and receivables data;
- Training: aimed at improving the knowledge of cash forecasting and the processes; and
- Performance measurement: measuring the accuracy of the forecast can lead to a better understanding of variances, which can be discussed with the business.

◆ It was the intercompany that seemed to throw our forecasting out. No two units would ever agree on what they thought they would trade between themselves, or on the timing.

◆ Beware trapped cash – it's useless unless you can get it back to the group.

◆ Consider the currency of the flows (not necessarily the reporting currency generally used by the business).

◆ Timing differences impact the opening position – check that the cash forecast excludes items that have already cleared the bank, but includes those that have yet to clear the bank. Understand the approach to value dating taken by your banks.

◆ If business units are responsible for supplying information, that information needs to be concise, on time and in an agreed format:
- Data is impacted by time zones, organisation culture, integration and quality of data from various sources; and
- Be careful about currency issues. A proper short-term forecast needs to be by bank account, medium-term ones by currency, whereas consolidation systems often used in cash forecasting actually destroy this information.

◆ Is the overall cash number realistic given what you know of the business?
- Most people will think of a number and divide by 12 to get an annual budget, so get a feel for the rhythm of your cash flow. Use judgement in assessing whether the forecast is consistent with the shape of the business.
- Understand that everyone has their own agenda – for example, marketing is almost always optimistic; production may always expect to spend capital and get the new line working sooner than they ever do. Treasury can always adjust the forecast manually, but record what's been done and why for future reconciliations.

◆ Produce a range of forecasts – optimistic to median to pessimistic. Such a range can give more information than a single-point type of forecast.

◆ Take care at quarter-end and financial reporting dates, especially in shorter-term forecasts, since the focus in the business may switch to financial accounting and give misleading information about cash.

◆ Operating units won't/can't focus on cash unless they are measured on an interest charge or credit. (Which means you need to be able to calculate/charge it.) Neither can you expect them to manage cash 'properly' unless they have the same view over their balances as you do, and they get the reports, etc.

◆ Most people don't understand that an accounting cash balance (book) is a million miles from real cash (bank). Depending on the purpose of the forecast, it may be advisable to do a reconciliation between the opening accounting balance and the cash/net debt balance.

◆ Forecasting is not a one-off activity; it is a learning process. Actual events will rarely, if ever, match the forecast. Understand variances and use this to improve the next forecast.

◆ Ensure that managers use the information provided and demonstrate to the wider business that they are using it – otherwise the whole process will lose momentum and falter.


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