Cash Flow Forecasts and Statements - A Brief Explanation

Glyn Davies

First Edition, November 2019

DTC Don't Think, Check!® Ltd.

Cash Flow Forecasts and Statements Explained

Terms of Use

Limit of Liability/Disclaimer of Warranty

The publisher and author have used best efforts and intent to provide value by publishing this book, but they make no representations or warranties concerning the contents of this book regarding the accuracy or completeness or fitness for any purpose. The advice provided in this book may not be suitable for your situation. You should consult with professionals as appropriate. Contact the author if you need help. In using this book, you indemnify the publisher and author of all liabilities and or losses and or damages.

Cover Photo

Making sense of it all, Tiritiri Matangi, by Caroline Davies.

Resources

For corrections, clarifications, and additional material, please use this link[1].

Glyn Davies
Business Resultant™
W: DontThinkCheck.co.nz

Powered by Don't Think, Check!® Limited.

[1] https://www.dontthinkcheck.co.nz/blog/cash-flow-forecasts-and-statements-a-brief-explanation-resources/

Cash Flow Forecasts and Statements Explained

Contents

Cash Flow Forecasts and Statements Explained

Introduction

Cash Flow Forecast

A Cash Flow Forecast (CFF) is a forecast or projection of *future* cash performance over a period such as six or twelve months.

A CFF can help to answer the questions, “where will my money come from, where will it go, and how much, if any, will I have left?”

As a projection, a CFF is an estimate about how you think the future will unfold concerning cash flowing into and out of your business. The CFF can inform you of the likely timing and the amount of future cash flows; you use this information for budgeting. For instance, with a CFF, you might predict that you will run short of cash during the upcoming holiday period when revenue will be lower, but your overhead bills, such as rent and utilities, will still need to be paid. Armed with this foresight, you can then approach the bank for a loan before you run out of cash. As a forecast, banks and investors also use the CFF to assess how realistic your plans are and how viable your business is likely to be.

Cash Flow Statement

A Cash Flow Statement (CFS) is similar to a CFF, except that a CFS is a summary of *past* cash performance.

A CFS can help to answer the questions, “where did my money come from, where did it go, and how much, if any, have I got left?”

A CFS wraps up or rolls up income and expenditures for a period into generalised aggregate categories, such as *cash flow from operations, investing, and financing*. Whereas a CFF typically has a column in a table or spreadsheet for every month of the period, a CFS only has one column for the entire period.

A CFS can be compared against the CFF previously created as a projection. They will never precisely agree, but it is informative to learn about any differences and what those differences mean. For instance, are your overheads higher or lower than initially estimated? If so, then why? Is your cash surplus accumulating at approximately the rate you anticipated? If not, then why not?

Cash Flow Forecasts and Statements Explained

Terminology

A word about cash - it's not necessarily the folding stuff in your pocket or the shoebox under your bed or at the bank. It could be what Accountants call, *near-cash equivalents*, assets that can ordinarily be quickly exchanged for cash. Near-cash equivalents are investments that have original maturities of three months or less, at which point they are available as cash. For example, shares or short-term investments.

In looking at CFFs and CFSs, we begin to enter the world of Accountants and Bookkeepers, and as with all professions, they have their share of jargon.

Their seemingly impenetrable jargon is not, as some cynical people would say, to protect their profession - jargon naturally develops in all occupations as a shorthand for commonly understood facts, concepts, and results. Jargon saves time by not having to explain in full every time a concept needs to be mentioned. Jargon, when used correctly, is clear, succinct, and useful.

Entering the business world means that you have to understand and use business jargon; in this case, that of accountancy and bookkeeping. It's hard, but what will be even harder is not understanding the jargon or making up your own where you won't be understood. Accountancy terms are a part of the language of business. If you want to play in the field of business, you need to learn the vocabulary, the jargon, and the rules of the game.

Arithmetic Refresher

About negative numbers:

> When you add a negative number to another number, it's the same as subtraction. For example, 5 + (-3) = 2 is the same as 5 - 3 = 2.

For example:

> $450 = $300 + $200 +(-$100) +$50

Is the same as:

> $450 = $300 + $200 - $100 +$50

Cash Flow Forecasts and Statements Explained

Cash Flow Explained

The formula for either Cash Flow Forecasts (CFF) or Cash Flow Statements (CFS) is the same:

> Cash at the end of a period **equals the** Cash received during the period **less the** Cash spent during the period **plus the** Cash at the start of the period

Explanation of terms:

Terms	Description
Cash at the end of a period (Closing balance)	This is the amount of cash, probably in the bank, that remains after the end of the period where cash performance is either being predicted (with a CFF) or analysed (with a CFS), say after a month or twelve months.
Cash received during the period	This is the cash received during the period, probably from selling things.
Cash spent during the period	This is the cash spent during the period when paying your bills.
Cash at the start of the period (Opening balance)	This is the amount of cash, probably in the bank, at the beginning of the period, say at the start of the month or the twelve months being examined.

Using an Accountant's jargon, the above cash flow formula would be:

> Closing balance = Cash received - Cash spent + Opening balance

Example:

Let's say that at the beginning of the month you have $100 in the bank; this is your opening balance. During the month you sell some products for $600, this will be your cash received, but you paid $250 for raw materials and labour to make the products, this will be your cash spent. The result will be that your closing balance at the end of the month will be:

> $450 = $600 - $250 + $100

Closing balance	$450
Cash received	$600
Cash spent	$250
Opening balance	$100

You might have noticed the sleight of hand there; I went from a horizontal format to a vertical format for our equation. The reason for this is that it becomes increasingly difficult to write, read, and understand *the numbers* when we represent them in a single sentence wrapped over several lines, and it's something we will need to get used to as Accountants use the vertical format as well.

Cash Flow Forecasts and Statements Explained

But wait, there's more. Accountants rearrange the above table to something like the following. Also, because Accountants know to subtract *Cash spent* they may not explicitly indicate that the value is negative, say -$250, as in our example.

Cash received	$600
Cash spent	$250
Opening balance	$100
Closing balance	$450

To make the table easier to read, we add a sub-total called *Net change in cash* as a partial calculation:

Cash received	$600
Cash spent	$250
Net change in cash	$350
Opening balance	$100
Closing balance	$450

Net change in cash $350 = $600 - $250

Closing balance $450 = $100 + $350

Businesses may not simply be selling a single item or range of items such as fishing gear. Some businesses buy and sell products and services in an activity called operations, they may take our money as investments, and they may, in turn, make investments themselves, and they may seek finance for all their activities as well as repaying that finance.

CFSs recognise this generalised view of businesses and use categories such as those in the following table:

Cash flow from operations	$700
Cash flow from Investing	$150
Cash flow from financing	-$100
Net change in cash	$750
Opening balance	$50
Closing balance	$800

Net change in cash $750 = $700 + $150 - $100

Closing balance $800 = $750 +$50

But we're just getting started - business is a little more complicated than that.

Cash Flow Forecasts and Statements Explained

Structure of Cash Flow Forecasts

The following CFF follows the format of previous examples, but has more details:

Terminology	Description
Receipts • Sales • Other revenue Total Receipts	Cash received
Less Payments Direct costs • Materials • Stock • Packaging • Other Overheads • Accounting • Bank Fees • Cleaning • Insurance • … • Power • Rent • Repairs and maintenance • Tax • … • Other Total Payments	Cash spent
Net Cash Flow	Sum of the above (net change in cash).
Opening balance	Initial opening balance, or closing balance of previous sub-period.
Closing balance	Sum of the above.

For a complete template, please see this NZTE Cash Flow Forecast.

Structure of Cash Flow Statements

The CFS presented below, follows the same outline as previously introduced, but unlike the CFF which is categorised by the direction of cash flow, the CFS is organised by the generalised categories of operations, investing, and financing, and ultimately, the aggregate totals of those specific categories.

Terminology	Description
Cash flow from operations	Cash received or spent. Operations are activities your business performs with cash: • Cash from customers. • Cash paid to suppliers. • Cash paid for operating expenses, for example, power, rent. • Changes in inventory. • Changes in accounts receivable. • Interest paid. • Tax paid.
Cash flow from investing	Cash received or spent. These are cash flow activities when you buy and sell: • Shares. • Land. • Intellectual property. In your case, these may be zero.
Cash flow from financing activities	Cash received or spent. These are cash flow activities from: • Taking out a loan. • Cash you spend on paying dividends if any. • Cash you spend on repaying a long-term loan.
Net change in cash	Sum of the above.
Opening balance	Initial opening balance.
Closing balance	Sum of the above.

In the above, if you look closely at the descriptions, you will realise that some cash flows are inflows (positive) into the business, and some are outflows (negative) out of the business.

Rewriting the earlier formula:

Closing balance = Cash received - Cash spent + Opening balance

becomes:

Closing balance = Cash flows from (Operations + Investing + Financing) + Opening balance

It’s effectively the same formula, but it’s using a different categorisation (and jargon) because in this form it is more useful for the more general cases.

Cash Flow Forecasts and Statements Explained

Notes:

- Any of the three cash flows in the formula above can be positive, meaning that you have collected more cash than you have spent, or negative, meaning that you have spent more cash than you have received.
- In a table format such as this, the numbers are added, regardless of whether they are positive or negative. It is the sign (positive or negative) of a specific number which will determine whether the ultimate effect of addition is adding numbers together or subtracting one from another. See Arithmetic Refresher on page 5 above.
- One more thing about Accounting jargon, or really in this case conventions, Accountants typically represent negative numbers such as -$100 like this ($100) or ($100); it's the same value, but a different way to represent it.

Cash Flow Forecasts and Statements Explained

A More Detailed Look at a CFS

The simple example table above hides a large amount of information. The table below introduces you to more:

Cash flow from operations	Cash flows from business activities producing and selling goods and services.
(+) Cash from customers	Cash from selling things.
(+) Other cash received (if any)	Cash from other operating activities.
(-) Cash paid to suppliers	Inventory, insurance, advertising, …
(-) Cash paid to employees	Wages and salaries.
(-) Cash paid for operating expenses	Rent, power, …
(-) Interest paid	Interest paid on loans.
(-) Tax paid	
Net cash from operations	Sum of the above operations cash flows
Cash flow from investing	Cash flows from the buying and selling of non-current, also known as long-term assets. Includes the purchase and sale of stock, bonds, securities, equipment, buildings, and land, as well as lending money and receiving loan payments.
(+) Sale of long-term assets	
(+) Sale of land	
(-) Purchase of long-term assets	
Net cash flow from investing	Sum of the above investing cash flows
Cash flow from financing	Cash flows from borrowing or repaying money, issuing stock, paying dividends, and withdrawals and distributions.
(+) Cash from loans	Money borrowed from any source.
(-) Repayment of loans	All forms of loans.
(-) Payment of dividends/distributions	Payments to owners and partners.
(+) Cash from issuing stock	Cash from selling shares in the business.
(+) Owner/partner cash injection	Cash contributions.
Net cash flow from financing	Sum of the above financing cash flows
Net change in cash	Sum of cash flows Operations + Investing + Financing
Opening balance	Cash on hand at the start of the period
Closing balance	Net change in cash + Opening balance

Please also look at this example CFS from business.govt.nz.

Cash Flow Forecasts and Statements Explained

Comparison of Cash Flow Forecasts and Statements

The table below is provided to compare CFFs and CFSs. Please note that because of the differences in categorisations, with CFFs categorised by the direction of cash flow, and CFSs organised by the generalised categories of operations, investing, and financing, the comparisons are not *black or white*, there are some overlaps.

Cash Flow Forecast (CFF)	Cash Flow Statement (CFS)	Description
Receipts - sales Direct costs Overhead costs	Cash flow from operations	Operations are activities your business performs with cash: • Cash from customers. • Cash paid to suppliers. • Cash paid for operating expenses, for example, power, rent. • Changes in inventory. • Changes in accounts receivable. • Interest paid. • Tax paid.
Payments - other (assets bought) Receipts - other (assets sold)	Cash flow from investing	These are cash flow activities when you buy and sell: • Shares. • Land. • Intellectual property. In your case, these may be zero.
Initial opening balance - loan Receipts - receive loans Payments - repay loans Payments - dividends	Cash flow from financing activities	These are cash flow activities from: • Taking out a loan. • Cash you spend on paying dividends if any. • Cash you spend on repaying a long-term loan.
Net change in cash	Net change in cash	Sum of above cash flows Operations + Investing + Financing
Opening balance	Opening balance	Cash on hand at the start of the period
Closing balance	Closing balance	Net change in cash + Opening balance

Appendix - Further Reading

From business.govt.nz:

How to read financial statements:

- Sample Cash Flow Statement
- Sample Balance Sheet Statement
- Sample Profit and Loss Statement

Example Cash Flow Forecast:

- From the eBook *Sally Starts a Business - With Facts*, see Sally's CFF

In-depth:

- How to Prepare a Cash Flow Statement