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Keep it Simple: Five Steps to Excellence in Cash Forecasting

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We all know that good cash forecasting drives improvements in investment yields, borrowing costs and working capital ratios. With FAS 133/IAS 39 requirements to report the consequences of hedged forecasts to the P&L, we also know it's important. And, for those blessed with the requirement to comply with Sarbanes Oxley, it's a control issue that can't be ignored.

Unfortunately, many of us also know that developing effective cash forecasts can be difficult and time consuming. This article offers five steps that form the core of any successful cash forecasting process.

Simplicity - A cash forecast requires two pieces of accurate information; how much cash is on hand and how much will be received. Add the dimensions of time and currency; when will the cash be received, and in what currency and you have a reasonable and very effective cash forecast. When asking business units to forecast cash, it's essential to keep it simple. Don't make them report cash on hand by bank or account. And don't ask for a weekly flow of funds report requiring forecasts of inter-company receipts/payments, loans/investments and third party receipts/payments. The objective is a cash forecast, not a weekly balance sheet and cash flow statement.

Cooperation - Good quality forecasting input is the primary determinant of a good quality forecast. And the quality of the input is in the hands of your business partners. Keeping things simple is the first step in getting their cooperation. Building trust is the next step. If forecasting is used as a punitive tool by treasury, units will hedge forecasts and dilute their value. Finally, make sure that the forecast can be completed quickly and easily. Your goal is 100 per cent compliance in submitting a simple, best efforts, forecast on time.

Communication - Forecasting in a global company adds the challenge of multiple currencies plus language and culture. It is critical that all business units adopt common definitions of terms used in the cash forecasting process. Cash in bank ledgers and available cash are two different concepts, familiar to treasury associates but less familiar to accountants or others completing the forecast. Assume nothing, make sure that everyone completing the forecasts understands and uses the same definitions of the terms used.

Structure - Cash forecasting problems arise when business units lose faith in central treasury's ability to respond to their urgent funding needs in a timely manner. They respond with excessive caution in forecasting receipts diluting the accuracy and value of the forecast. The solution is to have an efficient account



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structure serviced by a reliable network of banks. This can take time to develop but also pays dividends in reduced administration, transaction and other costs.

Technology - You can increase simplicity, cooperation and communication with the effective use of technology. Gathering forecast information through an intranet is a case in point. And using an intranet adds security and administrative efficiency as well. Work with your technology team to develop a form for collecting the forecast input. These are relatively simple to develop and the data gathered in this way is typically stored in a database on one of your servers. This is a winning approach from a number of perspectives; it's consistent, enterprise-wide, secure and administratively efficient. And unlike the above step, this can be done in relatively short order.

This article does not attempt to address all of the issues a treasurer will face in developing a cash forecast. Key issues to be aware of include the time horizon for the forecast, complexity of the supply chain, degree of centralization and the nature of the company's business model or models. These issues are complex, technical and company specific.

What should come from reading this article is that clarity in your objectives and simplicity in your approach are the critical elements to keep in mind as you develop a cash forecasting procedure.

For additional information on cash forecasting visit treasuryalliance.com, email partners@treasuryalliance.com or call +1 630-717-9732.