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**NAME: STEWARD EMMANUEL ELIKANA MIGIDO**

**COURSE: POST GRADUATE DIPLOMA IN PROCUREMENT AND SUPPLY CHAIN MANAGEMENT**

**CODE: PGD008**

**DURATION: 12 MONTHS**

**MODULE FIVE (5) ASSIGNMENTS**

**DATE OF SUBMISSION 30/08/2019**

1. **Discuss why financial management is important to NGO’s**

Financial management is one of the most important aspects in business. In order to start up or even run a successful business, you will need excellent knowledge in financial management. So what exactly is this form of management and why is it important? Read on to find out more.

**What is financial management?**

Financial management refers to the strategic planning, organizing, directing, and controlling of financial undertakings in an organization or an institute. It also includes applying management principles to the financial assets of an organization, while also playing an important part in fiscal management. Take a look at the objectives involved:

* Maintaining enough supply of funds for the organization;
* Ensuring shareholders of the organization to get good returns on their investment;
* Optimum and efficient utilization of funds;
* Creating real and safe investment opportunities to invest in.

**Financial management is also made up of certain elements. These include:**

* Financial planning: This is the process of calculating the amount of capital that is required by an organization and then determining its allocation. A financial plan includes certain key objectives, which are:
* Determining the amount of capital required;
* Determining the capital organization and structure;
* Framing of the organization’s financial policies and regulations.
* Financial control: This is one of the key activities in financial management. Its main role is to assess whether an organization is meeting its objectives or not. Financial control answers the following questions:
* Are the organization’s assets being used competently?
* Are the organization’s assets secured?
* Is the management acting in the best financial interests of the organization and the key stakeholders?
* Financial decision-making: This involves investment and financing with regards to the organization. This department takes decisions about how the organization should raise finance, whether they should sell new shares, or how the profit should be distributed.

The financial management department of any firm is handled by a financial manager. This department has numerous functions such as:

* **Calculating the capital required:** The financial manager has to calculate the amount of funds an organization requires. This depends upon the policies of the firm with regards to expected expenses and profits. The amount required has to be estimated in such a way that the earning capability of the organization increases.
* **Formation of capital structure:** Once the amount of capital the firm requires has been estimated, a capital structure needs to be formed. This involves debt equity analysis in the short-term and the long-term. This depends upon the amount of the capital the firm owns, and the amount that needs to be raised via external sources.
* **Investing the capital:** Every organization or firm needs to invest money in order to raise more capital and gain regular returns. Hence, the financial manager needs to invest the organization’s funds in safe and profitable ventures.
* **Allocation of profits**: Once the organization has earned a good amount of net profit, it is the financial manager’s duty to efficiently allocate it. This could involve keeping a part of the net profit for contingency, innovation, or expansion purposes, while another part of the profit can be used to provide dividends to the shareholders.
* **Effective management of money:** This department is also responsible for effectively managing the firm’s money. Money is required for various purposes in the firm such as payment of salaries and bills, maintaining stock, meeting liabilities, and the purchase of any materials or equipment.
* **Financial control:** Not only does the financial manager have to plan, organize, and obtain funds, but he also has to control and analyses the firm’s finances in the short-term and the long-term. This can be done using financial tools such as financial forecasting, ratio analysis, risk management, and profit and cost control.

**Why is Financial Management important?**

Financial Management is important for various reasons in management for the following reason as follows.

* Helps organizations in financial planning;
* Assists organizations in the planning and acquisition of funds;
* Helps organizations in effectively utilizing and allocating the funds received or acquired;
* Assists organizations in making critical financial decisions;
* Helps in improving the profitability of organizations;
* Increases the overall value of the firms or organizations;
* Provides economic stability;
* Encourages employees to save money, which helps them in personal financial planning.

**Why study financial management?**

* **Diverse career opportunities:** Studying financial management opens up a lot of diverse career opportunities. It could be in the private or public sector. Some of the career options include investment banking, entrepreneurship, financial analysis, financial and managerial accounting, and strategic financial management.
* **Improve interpersonal skills:** Doing a course in this field will allow you to build better communication and teamwork skills through developing relationships with your colleagues.
* **Builds personality:** Doing a course in this field also helps in improving your soft skills. This is because people who wish to work in this sector must be extroverts, and should be able to talk about finance for hour’s altogether. This helps in improving their personality, knowledge, and communication.
* **Greater job prospects:** According the USA’s Bureau of Labor Statistics (BLS), there has been a spike in demand for finance manager jobs in US due to a “growing range of financial products and the need for in-depth knowledge of geographic regions”.
* **Higher salary packages:** People working in this sector are usually paid very well, whether it is at the entry level or at the management level. Additionally, this is a highly skilled job role that is always in demand, even during recessions.
* **Career growth:** There is always an opportunity to develop your professional skills and climb the career ladder. You can quickly acquire in-depth knowledge of financial management systems and financial management software once in this field. If you possess this knowledge and great aptitude skills, this field is perfect for you.

**Management Accounting**

Management Accounting refers to the application of professional knowledge, techniques and concept in preparing the accounting information in such a manner, which helps the management of the organization in the formulating plans and policies, controlling the operations of the organization, decision making, optimising the use of resources, disclosure to management and safeguarding assets.

In finer terms, management accounting can be understood as the processing and presentation of accounting and economic data, so that it would help in the evaluating performance of the management, formulating strategies, making comparisons, budgeting, forecasting, etc.

**Characteristics of Management Accounting**

* **Decision-making system**: The financial data provided by the management accounting, is helpful to the management in framing policies and assisting the day to day operations.
* **Future-oriented**: Management accounting is future-oriented as it helps in planning and deciding the future course of action.
* **Qualitative and Quantitative Information**: In management accounting, qualitative information relating to the performance of the managers and other staff is also considered, along with the other financial data.
* **No set format**: there is a set format for the disclosure of the information. Management accounting usually presents information in the form which is easily understandable to the managers and other users.
* **Discretionary activity**: Management accounting is not compulsorily required by the statute. Indeed, management accounting is done as per the requirement of the organization and hence, it can be done weekly, monthly, quarterly, half-yearly, etc.

**Management Accounting Techniques**

The following tools and techniques are used in management accounting for better decision making:

1. **Financial Planning**: Financial Planning refers to the activity of deciding beforehand, what is to be done to reach the desired financial objectives, i.e. it is the process of managing the finances of the organization to get the maximum return. It includes cash flow planning, investment planning, tax planning, etc.
2. **Financial Statement Analysis**: It refers to the process of analysing the financial data of the organization for rational decision making. This includes comparative statement analysis, ratio analysis, cash flow analysis, trend analysis, etc.
3. **Statistical and Graphical Techniques**: Various statistical and graphical techniques are used by the management to make better economic decisions. These techniques include statistical quality control, linear programming, investment chart and so forth.
4. **Control Techniques**: Standard costing and budgetary control are the techniques used by the management to keep a check on the utilization of resources.
5. **Reporting**: The management accountant processes the data and presents it in reports to provide the relevant information required by the managers.

For this purpose, the selection of information to be presented, an organization of information and the way in which it should be presented must be carefully chosen by the management accountant.

**2. Discuss the principles of financial management**

Organizing your finances is the first step to creating wealth. Credit cards, bank accounts, personal loans, brokerage accounts, mortgages, car loans and retirement accounts should to be tracked. Budgeting software can provide complete solutions to track all such accounts, make on-time payments and more. Jeff Morris, a certified public accountant in Bethesda, Maryland, points out: "Once you enter your accounts and balances into budgeting software, you will be able to spend less time getting organized and more time making sense of your situation."

## Spend Less Than You Earn

Personal financial software provides powerful tools to help you track and budget you’re spending and take steps to achieve your long-term goals.

If you learn to track your finances and know where you spend the most, you'll be able to control your money. "The best way to ensure that you either overcome debt or avoid it in the first place is to never spend more than you make,"

Morris says.

## Put Your Money to Work

Take advantage of the time value of money. Morris gives the following example: "A 21-year-old who invests $17.50 a day until retiring at the age of 65 at a 5 parent average annual investment return can be a millionaire. At age 30, the required daily savings amount almost doubles. At age 40 the amount quadruples." So save early and often, even if the amount is small.

## Limit Debt to Income-Producing Assets

With credit cards and car loans, every penny you spend to repay that debt is money flushed down the drain. All but a few models of cars depreciate to zero and require more in repairs and finance charges than can be reasonably expected to be returned to the owner upon being sold.

Morris explains, "With their ultra-high interest rates, credit cards utilized to buy household goods and clothes that quickly wear out are bad bargains. If you have to be in debt, stick to financing items that retain their value over time, like real estate and education."

## Continuously Educate Yourself

Budgeting software often links to hoards of research that puts the collective knowledge of Wall Street at your fingertips. "Read every financial periodical, book and blog you can find from well-regarded financial authors," Morris recommends. "Understand why you are investing so that you will stick to your plan. Periodically gather research so you do not miss excellent investment opportunities."

## Understand Risk

The key to understanding return on investments is that the more you risk, the better the return should be. This is called a risk-return trade-off. Investments like stock and bonds that have a higher rate of return often have a higher risk of losing the principal that you invested.

Investments like certificates of deposit and money market accounts with a lower rate of return have a lower risk of losing principal. Since no one knows the future, you cannot be 100 per cent sure any investment will do well.

Morris explains, "If you diversify your investments, one can go sour without severe impact to your overall portfolio."

## Diversification Is Not Just for Investments

Find creative ways to diversify your income. Everyone has a talent or special skill. "Turn your talents into a money-making opportunity. Investigate ways to make money from home and launch a home-based business," Morris says.

The extra income can supplement your full-time income or even result in an exciting career change. Good financial management software can show you how even a slight improvement in income can positively change your financial profile.

## Maximize Your Employment Benefits

Employment benefits like a 401(k) plan, flexible spending accounts and medical and dental insurance yield some of the highest rates of return that you have access to. "Make sure you are taking advantage of all the ways benefits can save you money by reducing taxes or out-of-pocket expenses," says Morris.

## Pay Attention to Taxes

Financial planning software helps you manage your tax information. For example, Quicken quickly analyses taxable investments and provides powerful organizing tools that make year-end tax filings go much smoother. Morris emphasizes, "We all know that any money you make is going to be taxed. That is why it is important to consider the related tax implications for every investment."

## Plan for the Unexpected

Despite of your best efforts, you'll face unforeseen emergencies. Morris urges, "Save enough money and stock up on insurance to be able to weather extended unemployment, accidents, catastrophic medical care, large car or house repairs and natural disasters." Increasing the amount of money you save when times are good can help you manage the cost impact of hedging against bumps in the road, making sure unexpected financial exposure does not derail your long-term goals and your family's financial security.

**3. Which are the building blocks of financial management?**

Financing and refinancing public debt requires responsible policies that are consistent with existing commitments and allow for new liabilities to be undertaken only if they can be serviced. However, changes in political cycles can destabilize the balance of commitments and capabilities. As taxpayers thrive on transparency, a consistent accounting framework that highlights and links current decisions to future commitments is necessary to stabilize expectations.

There is a need for more sophisticated accounting techniques and skilled professionals to ensure that government’ financial positions are properly understood and managed. Improved public financial management cannot be achieved through improved reporting alone. Ultimately, it is public finance professionals who are at the heart of the system.  
  
ICAEW has, therefore, published a toolkit that takes users through the practical steps needed to put into place a system of modern public financial management (PFM).

**What Are the Building Blocks?**

The cash to accruals accounting toolkit provides a framework to deliver a successful change management program.

1. **Structures and ownership:** the political and wider organizational and leadership structures that need to be in place to deliver the change
2. **Strategy:** an effective, prioritized plan to deliver the change, manage critical dependencies and risks, and ensure staff and stakeholders understand what is required of them and when
3. **Project delivery:** setting up the project team and running the project with appropriate governance and oversight
4. **People and resources:** the right people, with the right skills, knowledge and approach, to drive the reforms supported by adequate resources
5. **Standards and policies:** the standards in accordance with which financial statements will be produced, the process for setting them and the policies that will be adopted
6. **Systems and processes:** putting in place the right infrastructure, corporate governance and business processes to enable high-quality information so policymakers can make informed decisions and achieve optimal outcomes

**Who Will Find the Toolkit Useful?**

The toolkit will be most useful for government entities that have made the decision to implement accrual accounting as well as potential project sponsors and all those charged with its delivery.

It is also a useful guide for policymakers, standard setters, senior administrative officials, and auditors or regulators who will have involvement in the project.

Its relevance extends to both countries whose governments are still planning their transition as well as those whose governments have already begun the process.

**Strong PFM is Vital for Strong Economies**

Improving the quality of public services is vital to citizens and the economy but it’s a complex task. With better information and tools, public finances can be better managed and lead to stronger economies. Strong PFM is central and critical to all parts of the public sector.

**4. Discuss briefly the tools of financial management**

**Financial Management Tools**

In this age of declining reimbursements and rising costs, physicians keep running faster, seeing more patients, and cutting staff in order to remain in business. Physicians must instead learn to work smarter. But to do so requires solid, readily available management information.

In the past, many myths led to bad business decisions. "Big is better." "Staff represents the biggest expense; therefore if we cut staff we'll save money." "Never write off old accounts." "Add physicians and the patients will come.

While "gut feel" and tips picked up in the physicians' lounge may work sometimes, they are an unreliable - and risky - way to do business. Computers, on the other hand, hold lots of data, but converting it into useful reports requires knowing what you need and how to organize it.

### Practice Management Toolkit

This toolkit contains a series of spread sheets intended to give the owner physician or office manager templates for monitoring key financial indicators within the practice. These reports can be used for a variety of purposes and, if used wisely, can help you work smarter.

The purpose is to condense, organize, and present critical information in the way you need it to run your practice and to make effective management decisions. We have included a list of source reports that are likely to be available from most standard practice management systems (billing software).

If some data are not available, you may need to modify the tools and/or the formulas. Simply insert, delete, or modify to suit your individual practice needs.

Although these spread sheets summarize data from various financial reports, it is vitally important that you also become familiar with and regularly review the key financial reports themselves, including the balance sheet, income statement, and budget.

Other valuable sources of financial information include reports from your accountant (or accounting software such as QuickBooks) - general ledger, accounts payable, payroll, and banking-related information, such as cash deposits, bank balances, and debt payments.

Benchmarking is another means of evaluating practice performance. It is an exercise that compares your practice to others or to yourself as a way to strive toward improvement. The reports in this toolkit can help you benchmark your practice against its own historical performance.

**How to use this toolkit:**

**The Monthly One-Page Financial Report** - includes a series of key indicators that you should watch each month. These monitor collections, productivity, and expenses. Trends can often indicate very specific problems or needs.

**The Annual Report** - includes greater detail and longer-term trends that can indicate more fundamental growth, problems, strengths, weaknesses, and other attributes. These trends describe your business results over time and may help assess the effectiveness of your practice management team.

**The RVU Report** - tracks productivity based on relative value units. If good RVU data are available, this information can be very useful in negotiating managed care contracts, revising provider income distribution formulas, setting fees, cost accounting, or tracking relative resource use within your practice.

**Evaluating Payors** - There are many times when you might need to evaluate your payors. You may be trying to decide whether to renegotiate your contract or to drop it altogether. You may have been approached by a new payor and want to do some modeling based on your experience with other similar payors or overall.

**Payor Profitability** - allows you to evaluate an existing contract based on overall profitability or to negotiate a fee schedule based on cost per CPT code from the RVU Report. This tool, in conjunction with the Collections Monitoring Report, can provide you with valuable financial information about the contract and thus assist you in deciding whether to keep or drop the payor.

**Collections Monitoring Report** - is used to monitor how each of your insurance contracts is performing. (This report is often called a payor mix report.) This tool can indicate if payors are paying claims promptly, monitor the effectiveness of your billing staff, and track the relative size of each payor as a percent of your business.

**Fee Schedules** - This spreadsheet lists your practice fees next to those of each of your payors, including Medicare. This tool can also help the billing staff verify that the payment received is correct. If you are negotiating a new contract, insert a column for the fees of the proposed contract to see how the proposed fees compare to those of existing contracts.

**Adding a New Service - Cost vs. Benefit Analysis** - One way that many practices are combating the continued reimbursement constraints and rising expenses is to add new revenue-generating services. But you need to make sure the new services will in fact generate enough new revenues to cover the new expenses.

**Source Reports** - This is a suggested list of reports to use to fill in all the numbers for these six reports. Your practice management and accounting systems' capabilities and/or availability may determine which of these reports are possible to run and how often. You may also find that other reports are available containing useful information about your practice.

**Suggested Reading** - For those who want to go into more depth about the financial management of medical practices, this list of publications may prove helpful.

**5. Define financial accounting and management accounting**

Management accounting, also called managerial accounting or cost accounting, is the process of analysing business costs and operations to prepare internal financial report, records, and account to aid managers’ decision making process in achieving business goals. In other words, it is the act of making sense of financial and costing data and translating that data into useful information for management and officers within an organization.

Management accountants (also called managerial accountants) look at the events that happen in and around a business while considering the needs of the business. From this, data and estimates emerge. Cost accounting is the process of translating these estimates and data into knowledge that will ultimately be used to guide decision-making.

**The differences between** [**management accounting**](https://en.wikipedia.org/wiki/Management_accounting) **and** [**financial accounting**](https://en.wikipedia.org/wiki/Financial_accounting) **include**:

1. Management accounting provides information to people within an organization while financial accounting is mainly for those outside it, such as shareholders
2. Financial accounting is required by law while management accounting is not. Specific standards and formats may be required for statutory accounts such as in the I.A.S [International Accounting Standard](https://en.wikipedia.org/wiki/International_Accounting_Standard) within Europe.
3. Financial accounting covers the entire organization while management accounting may be concerned with particular products or cost centers.

Managerial accounting is used primarily by those within a company or organization. Reports can be generated for any period of time such as daily, weekly or monthly. Reports are considered to be "future looking" and have forecasting value to those within the company.

Financial accounting is used primarily by those outside of a company or organization. Financial reports are usually created for a set period of time, such as a financial year or period. Financial reports are historically factual and have predictive value to those who wish to make financial decisions or investments in a company.

Management Accounting is the branch of Accounting that deals primarily with confidential financial reports for the exclusive use of top management within an organization.

These reports are prepared utilizing scientific and statistical methods to arrive at certain monetary values which are then used for decision making. Such reports may include:

* Sales Forecasting reports
* Budget analysis and comparative analysis
* Feasibility studies
* Merger and consolidation reports

Financial Accounting, on the other hand, concentrates on the production of financial reports, including the basic reporting requirements of profitability, liquidity, solvency and stability. Reports of this nature can be accessed by internal and external users such as the shareholders, the banks and the creditors.

**6. What makes good financial policies?**

Financial policies are key to defining financial management practices and establishing internal controls for any government. The Government Finance Officers Association (GFOA) makes available the Best Practices for Adopting Financial Policies which stresses the importance of financial policies and their ability to help governments.

In addition, financial policies will define a shared understanding of how the government will develop its financial practices and manage its resources as well as defining boundaries and roles for each position within the government.

The GFOA Best Practices listed five steps to consider when making effective financial policies. Those steps include:

* Scope
* Development
* Design
* Presentation
* Review

It is important that Management of all governments review at least annually all their financial policies to verify any changes that have occurred have been revised in their policies. By reviewing and revising financial policies annually, this will ensure that all employees have a full understanding of expectations and roles and that the government is providing the best value to the community in which it serves.

**7. Discuss the importance of financial planning**

Financial planning is a process, not a product. It is the long-term method of wisely managing your finances so you can achieve your goals and dreams, while at the same time negotiating the financial barriers that inevitably arise in every stage of life. In order to create a sound financial plan, goals must first be established.

Data is then gathered to analyse and evaluate your financial status. Once complete, your plan can be developed and implemented. Monitoring the plan on an on-going basis is essential in order to make necessary adjustments to reach your goals.

Procrastination is the greatest enemy of financial independence, and using a financial planner will keep you on track.Financial planning helps you determine your short and long-term financial goals and create a balanced plan to meet those goals.Here are ten powerful reasons why financial planning – with the help of an expert financial advisor – will get you where you want to be.

1. **Income:** It's possible to manage income more effectively through planning. Managing income helps you understand how much money you'll need for tax payments, other monthly expenditures and savings.
2. **Cash Flow:** Increase cash flows by carefully monitoring your spending patterns and expenses. Tax planning, prudent spending and careful budgeting will help you keep more of your hard earned cash.
3. **Capital:** An increase in cash flow, can lead to an increase in capital. Allowing you to consider investments to improve your overall financial well-being.
4. **Family Security:** Providing for your family's financial security is an important part of the financial planning process. Having the proper [insurance coverage](https://www.blueshorefinancial.com/Insurance/) and policies in place can provide peace of mind for you and your loved ones.
5. **Investment:** A proper financial plan considers your personal circumstances, objectives and risk tolerance. It acts as a guide in helping choose the right types of investments to fit your needs, personality, and goals.
6. **Standard of Living:** The savings created from good planning can prove beneficial in difficult times. For example, you can make sure there is enough insurance coverage to replace any lost income should a family bread winner become unable to work.
7. **Financial Understanding:** Better financial understanding can be achieved when measurable financial goals are set, the effects of decisions understood, and results reviewed. Giving you a whole new approach to your budget and improving control over your financial lifestyle.
8. **Assets:** A nice 'cushion' in the form of assets is desirable. But many assets come with liabilities attached. So, it becomes important to determine the real value of an asset. The knowledge of settling or cancelling the liabilities comes with the understanding of your finances. The overall process helps build assets that don't become a burden in the future.
9. **Savings:** It used to be called saving for a rainy day. But sudden financial changes can still throw you off track. It is good to have some investments with high liquidity. These investments can be utilized in times of emergency or for educational purposes.
10. **On-going Advice:** Establishing a relationship with a [financial advisor](https://www.blueshorefinancial.com/Advisors/OurAdvisoryTeam/FinancialAdvisors/) you can trust is critical to achieving your goals. Your financial advisor will meet with you to assess your current financial circumstances and develop a comprehensive plan customized for you.

**A cash flow forecast can help you**:

* plan out how much you expect to make in sales this year
* plan how much you expect to spend in costs
* understand when cash will come into your bank account and leave it

## Forecasting: before you start

A financial forecast should be as comprehensive as you can make it, so you should try and remember to include all your sales, costs and cash transactions. However, your forecast doesn’t have to be penny-accurate and it also doesn’t have to be difficult to compile.

## How far should I forecast into the future?

It’s up to you how far in advance you forecast, but bear in mind that the further in the future you try to look, the less likely it is that your forecast will be realistic. Nobody can predict what effect future changes to business rules and the global economy will have on your business - a good rule of thumb is to forecast one year ahead.

Remember that your forecast is not set in stone. You can - and should - change the figures in your forecast if you realise that your original plan is not coming to pass, for example if a new product sells better than you expected.

## The ingredients of a cash flow forecast: sales, profit and loss, and cash flow

To build a cash flow forecast, we recommend creating three separate forecasts: sales, [profit and loss](https://support.freeagent.com/hc/en-gb/articles/115001222364-A-guide-to-your-profit-and-loss-account/), and cash flow. We’ve created a cash flow template with example data that you can follow along with as a guide. The template also includes a section for your own data.

## ****Step 1**** Create a sales forecast

The first forecast you should create is your sales forecast, because that’s the starting point of your profit and loss forecast, which will, in turn, help you create your cash flow forecast.

**What is a sales forecast?** A sales forecast is a plan of how much you expect to sell in the future, normally broken down by month. Look at Sheet D in the [cash flow forecast template](https://www.freeagent.com/guides/downloads/Cash%20Flow%20Forecast%20Template.xlsx). You’ll see that we’ve set up the template with a column for each month and a row for each product (or service) that you sell. We’ve also included a total column and total row. The total row is particularly important because it’ll feed across to your profit and loss forecast.

**Step 2** creating a profit and loss forecast

Now that you’ve forecast your sales, it’s time to forecast your costs and pull the two together in a profit and loss account forecast.

**What is a profit and loss forecast?**

A profit and loss forecast is a forecast that combines the business’s income and its day-to-day running costs, giving you a view of your projected profit into the future.

**Why a profit and loss forecast is useful**

* If you have an idea of how much profit you expect your business to make, then you’ll be able to estimate how much tax it will be liable for.
* If you are planning changes in your sales, these will almost certainly affect your costs, either by increasing or reducing them. For example, if you want to start selling products overseas, there’ll be extra charges for shipping.
* If you find you have to spend more, you could find yourself at increased risk of running out of cash. You may need to put your prices up or borrow some more money to mitigate this risk.

**How to make a profit and loss forecast**

Look at Sheet E of your [cash flow template](https://www.freeagent.com/guides/downloads/Cash%20Flow%20Forecast%20Template.xlsx), called “Profit and Loss”. This is already set up with a column for each month. The first row of this will be for total sales, which should be automatically copied across from your sales forecast in Sheet D.

Remember to include costs in the month that you incur them, rather than the month that you pay for them. Your cash flow forecast will be prepared on the basis of payment dates, but this profit and loss forecast must be prepared on the basis of when you incurred your costs.

**First, Steve pulls across his sales from his sales forecast.**

His costs of sales would be his pens, rough sketch pads and drawing paper. The more cartoons Steve draws, the more of these items he will need, but in some of his quieter months he doesn’t expect to need to buy any more. He puts his best estimate of that cost into his profit and loss forecast.

Steve has a website, which he uses to attract potential new customers with displays of his work. The website also has a customer portal, where Steve can share samples and finished work securely with his customers. He includes the cost of hosting this each month.

Steve’s accountant invoices him in March each year. Steve includes this cost in his forecast based on the invoice date.

Steve includes the costs of his landline, mobile phone, and broadband internet in the “telephone and internet” area of the forecast.

He puts in an allowance for office consumables, such as batteries for his mouse and bulbs for his angle-poise lamp.

Steve can clearly see his business’s seasonal peaks and troughs. He makes little profit, sometimes a loss, in the early part of the year, but makes higher profits in the later part of the year when his sales are higher.

## ****Step 3**** creating the cash flow forecast

## Now that you’ve created your sales and profit and loss forecasts, you can use them as a starting point to map your cash forecast.

**How to create the cash flow forecast**

Go to Sheet F of the forecast template - we’ve created a column for each month and a row for each type of money coming in or going out.

**Money in from your sales forecast**

Firstly, you need to record on your cash flow forecast how much money you’re expecting to come in. Use your sales forecast to bring across your sales income, but don’t just copy and paste the figures through - your sales forecast should report income when it’s invoiced, while this cash flow forecast should list income when it’s actually paid. It’s good to be realistic here - some customers may pay early or late, so try to reflect that in your forecast.

**Non-sales income**

Next, think about any income other than sales that you may have, for example if you're expecting a capital injection from a loan. Add this income on a separate row for each type of income.

Finally, total up all the money in - we’ve done this for you automatically in the “total money in” row of the template.

**Money out from your profit and loss forecast**

Remember to include your costs in the months you plan to pay for them, not when you plan to incur them. For example, you may pay your staff in arrears, so you should add the money going out in the month that you actually pay them.

**Other costs**

Once you’ve worked through your day-to-day running costs from the profit and loss forecast, think about other money your business will spend. This could be on buying new equipment, for example, or paying certain taxes. If you’re a [sole trader](https://www.freeagent.com/glossary/sole-trader/), it might also include money that you withdraw from the business for your own personal use. Include all these costs on a new row for each type of spend.

Finally, add this to your bank balance as at the end of the previous month to see how much you expect to have in the bank at the end of the current month. If your bank balance is consistently falling, do you need to borrow more money perhaps, or put up your prices, or try to cut your costs? If your bank balance is consistently rising, could you recruit a new team member, move into a different market, or rent a workspace? Or do you want to invest your cash against a rainy day?

**Money In**

Steve looks at his sales forecast to plan the first line of his money in. He decides to add extra rows, to make it easier to plan when the money comes in, because different customers take varying times to pay him.

Steve is [registered for VAT](https://www.freeagent.com/guides/vat/registering/), and the standard [rate of VAT](https://www.freeagent.com/rates/vat/) is 20%, so he must remember to include the VAT that his customers will pay him.

Rob pays Steve straight away, so Steve includes those sales in his cash flow forecast in the same months that they appear in his sales forecast.

The payment terms for Steve’s potential comic strip illustration contract are one month in arrears, so Steve will include those sales in his cash flow forecast a month later than he’s put them into his sales forecast.

**Money Out**

Steve looks at his profit and loss forecast to plan when money will leave his bank account. He pays most costs in the same month as he incurs them, so he includes them in his cash flow forecast in the same month as they appear in his profit and loss forecast, remembering to put in the costs inclusive of sales tax as appropriate (called “grossing up”). Travel, for example, has sales tax at 0% and so will not be grossed up.

Because Steve is using formulae to bring his costs across from the profit and loss forecast and grossing them up, some of them appears with decimals - this is okay.

Steve pays his accountant one month in arrears, so he puts that cost into his cash flow forecast a month after it appears in his profit and loss forecast, grossing it up because his accountant also [charges him VAT](https://www.freeagent.com/guides/vat/charging-and-reclaiming/).

Once Steve has brought in all the appropriate day-to-day running costs, he must then think about other cash payments his business might make.

**Steve’s cash flow and cash position**

Steve can see that his business has a net cash outflow in several months, which means that he’s spending more than he earns in those months.

He puts in the business’s bank account balance as at the start of January, and looks to see how much he expects to have in the bank at the end of each month.

Steve is expecting to be overdrawn, so he will need to look at putting an overdraft facility in place and perhaps to arrange a formal loan with the bank. He also decides to think about putting up his prices and to look for more sales, perhaps through an e-commerce site of his own.

## Using your cash flow forecast

Drawing up three simple forecasts for your business needn’t take long, and will give you vital information about your business’s chances of survival in different scenarios.

Taking the time to create these forecasts now and adapting them as the year unfolds will help give your business the best possible chance of success in the year ahead.

The forecast estimates what the cash inflows into the bank account and outflows out of the bank account will be. The result of the cash flow forecast is an estimate of the bank balance at the end of each period covered (normally this is for each month). An example of a simple cash flow forecast is shown below:

**8. Discuss the tips that are involved in preparing a cash flow forecast**

Knowing when cash flows in and out of your business in advance is one of the best things you can do to manage your liquid cash and avoid running out of cash. Whether your business is profitable or not, you need to know when your bills are due and when clients are likely to pay, so that you in turn can pay your expenditures.

A cash flow projection, forecast or budget, gives you a clear view of when money is predicted to hit your bank account, when it needs to go out again and any cash remaining after you have paid your expenses and recorded your income.

Here’s what you need to know about creating a basic cash flow forecast and running some basic analytics to understand what those numbers are telling you:

**Start with your Template**

SCORE offers a useful free [cash flow template](https://www.score.org/resources/cash-flow-template-excel) that you can use to create your forecast. You can also use the cash flow templates included in accounting software like Fresh books, Xero, and QuickBooks.

**Account for Incoming Cash**

Now you can start inputting numbers. To get an idea of your estimated revenues for the period (quarterly, half-year or even annual), refer to your sales forecast including any costs of goods sold.

Your cash forecasts can be complicated by any number of factors, including late paying clients and clients who negotiate 60+ day payment terms. But your sales forecasts will give you an idea of what’s coming in. You can also refer to the past 12 months to get a sense of trends or seasonal patterns.

**Account for Outgoings**

What are your monthly expenses (fixed and variable)? Things to include are wages, supplies, rent, utilities, etc. What about occasional costs like vehicle maintenance, new software, etc.? Don’t forget to account for quarterly costs also (like your estimated taxes).

**Review Inventory**

Inventory purchases can eat into cash flow, so be sure to conduct an audit of what’s in stock so that you can gauge whether you can meet the demands of your sales forecast. Any purchases made in the near future should be made with cash flow in mind.

**Set Your Cash Balance**

As you input your numbers, make sure you have a clear view of what your ending cash balance needs to be each month. This is your cash in hand; try to keep this number constant each month.

**Analyze Your Findings**

To ensure a cash flow positive situation, the monthly flow of cash into your business should be greater than your out-flow.

If your assumptions are right and your cash flow has the potential to turn negative as you look across the quarter or year, you’ll need to come up with a plan.

This might include having a line of credit available from your bank or borrowing money from friends or family. If late paying clients are a perpetual problem, consider [Fundbox](http://www.fundbox.com/partner/welcome?utm_medium=content&utm_source=cross-blogging&utm_campaign=0915-tsheets).

This popular service can help you cover the costs of unpaid invoices (a common cause of cash flow problems) by advancing payments for those outstanding invoices, without the need to dip into savings.

Your forecast can also help reassure any lenders that your finances will be sufficiently cash flow positive to repay any financing.

**1. How Much Money Will You Be Bringing In?**

The first step in any cash flow forecast is to estimate how many sales you think you will be bringing in either weekly or monthly. A great way to come up with these estimates is to reference your previous sales history. Look at the past couple of years and try to get a good idea of, considering the past year’s performance at that time, what kind of weekly or monthly sales you expect to see.

Obviously your sales won’t always be consistent, so take into consideration patterns that are the same each year (seasons and holidays, for example) and factors that could change each year, such as trade shows or promotions, when making your projections.

**2. Consider the Terms on Which You Will Be Paid**

If you’re an experienced business owner, than you know that you don’t always receive the money you earn immediately. For many of your sales, you could be waiting 30+ days to see that cash. Therefore, it’s crucial when doing a cash flow forecast to estimate when you expect payment from your sales.

**3. How Much Money Will You Spend?**

When making your cash flow forecast, it’s absolutely crucial you are able estimate how much your company spends. Of course, these costs are going to be both fixed and variable, but you need to do the best you can.

Your fixed costs are such things as rent and how much you’re paying employees, where variable costs are, most of the time, associated with the sale of the product or service you are providing.

Be sure to go through your expenses last year, as well, to make sure there aren’t any annual fees that you forget about as they only come once a year. Once estimated, be sure to add these costs to your cash flow forecast.

**Why should every business prepare a cash flow forecast?**

You need sufficient cash coming into your business to cover all of your overheads and to pay your staff and suppliers. If you don’t have sufficient cash coming in to cover your bills as they fall due, your business will be insolvent and will be forced to close.

Therefore, you must concentrate your efforts on generating positive cash flow for your business. This means there must be more cash coming in than going out. However, cash must be coming in profitably if you’re to have a sustainable business.

**How to prepare a simple cash flow forecast**

The forecast needs to be updated on a weekly basis (I do mine as one of my first jobs on a Monday morning) and as each week passes I delete the previous week and add another week to the forecast. It doesn’t matter when you choose to update your cash flow forecast, but it works best the more consistent you are in keeping it updated.

Personally, I list all my expenses separately but some can be grouped together to make it more manageable. For example, I would list payroll as one expense if you pay all your staff on the same day. I wouldn’t list each employee individually. The final heading after you have listed all your expenses is your “closing balance”.

Each weekly column starts with the opening balance, and then to this you add the income you expect to receive this week. I add all the expected income together, rather than listing each individual invoice I expect to be paid.

**Calculating expenses**

You will have some regular expenses which come out of your account at the same time each month, for example rent, payroll, any subscriptions you have etc. These are easy to predict and add into the spread sheet.

Other expenses are less regular so you will add these in when you receive an invoice from a supplier. For example, if the payment terms are 30 days you can add it into the spread sheet in the relevant week so you know when it has to be paid.

Income works in exactly the same way. You may have some regular income that you know is coming in each month which can be added into the spread sheet at the relevant points.

**The closing balance**

You may also find that the closing balance on your cash flow forecast doesn’t exactly match your bank balance at the end of the week. If it’s just a few pounds out, don’t worry. Update your opening balance on the spread sheet at the beginning of the next week.

If the closing balance is significantly different to your bank account balance it could indicate that you have missed some expenses or income. So, take a closer look at your spread sheet to find out what the problem is.

When you can predict any shortfalls in cash you can plan accordingly. For example, if your business is seasonal and you know you will have less income coming in at a particular time, you can use the forecast to plan expenditure to help you through the quieter times.

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