

BEST PRACTICES IN CASH FORECASTING

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This article is condensed from The Treasury in Practice Series by Nilly Essaides, director of Practitioner Content Development at the Association for Financial Professionals, published October 2015 at AFPonline.org. She sat down with a number of financial decision-makers, including PNC's Bill Booth, to talk about the definition of cash forecasting and how to implement it most effectively.

Other contributors included David Neshat, treasurer of Akamai Technologies; Brad Larson, principal at consulting firm ReCa; Michael Lenihan, founder of TMXpert Group; Greg Lattanzi, CTP and treasury manager at a startup company; Jim Gilligan, assistant treasurer of Great Plains Energy and Kansas City Power & Light Company; Gina Powers, assistant treasurer at Dunkin' Brands Inc.; and Jeff Cappelletti, a principal with Upper Third Consulting.

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The purpose of the forecasting process has evolved in the past five years, according to William Booth, head of national large corporate and specialty businesses, Treasury Management Division at PNC Bank, N.A. Five years ago, the dynamic was different: "Liquidity was a precious commodity, and short-term financing was tight and hard to get," he said. "Companies had to know their cash position to fund their day-to-day obligations."

With the market flush with liquidity, the outlook has changed. Today the focus is on the ability to react to the many strategic initiatives that require potentially tapping liquidity sources, according to Booth. Those initiatives may include a strategic acquisition or a stock buy-back program. "Treasurers have to have a good handle on how much they can fund from cash flow, and how much they need to turn to external sources," Booth said. "Over a relatively short time, cash forecasting has shifted from a function of survival to the ability to be nimble and react to strategic opportunities."

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Cash forecasting means so many different things to companies depending on their size and complexity, according to Booth. At small companies, the process is often very linear, focused on a small number of bank relationships and a spreadsheet. At a large, multinational corporation, data is gathered from multiple sources and internal systems and is pulled together through a sophisticated treasury workstation. "Cash forecasting is an art and not a science despite all the technology that evolved around this task," Booth says. "There are simply too many variables. You can have access to every bit of information on every financial transaction, but how and when it hits the cycle can vary due to many factors."



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BEST PRACTICES

- **Define the purpose** of the forecast to drive the outcome.
- **Use appropriate detail** to make the process simpler and faster.
- **Understand the types of receipts and disbursements** in terms of predictability and timing.
- **Disclose assumptions, understand actuals and dive into their history.**
- **Validate and make necessary adjustments** using variance analysis on a timely and consistent basis, but focus on its materiality to cash flow.
- **Cooperate and communicate.**
- **Ensure usability.** Make sure you know what the model output is used for so you can provide the correct information for users.
- **Align the short-term cash forecast with the long-term corporate model.**
- **Use statistical analysis**, for example, regression of historical patterns.
- **Make the forecasting process simple** yet detailed and understand your variances. Dig into the actuals.
- **Judiciously integrate technology** to gather key data, exhibit financial acumen and encourage team participation to best reflect the reality of your financial business needs.
- **Don't make it a one-way street.** Rely on business units to supply their input, but don't forget to return the important forecast information to ensure that they can make decisions that will positively impact cash flow.
- **Understand where the numbers come from** and the processes others use to create them.
- **Sit down with all involved in the process** and talk about what you want out of the forecast. Discuss how much time and effort should be put into it and at what level you need to forecast. Reach agreement on everyone's definition of the cash forecast, acceptable output and accuracy measurements.
- **Step away from the forecast model** and use the role of treasury to connect with A/P, A/R, sales, marketing, and corporate development or corporate finance to understand the business and likely cash needs, e.g., is the company investigating altering its terms to encourage vendors, or considering paying faster to achieve some benefits? What are the impacts of a card program on working capital?

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