Cash flow forecasting is an essential tool for all companies. Forecasts help manage risk, avoid liquidity crises and guide planning of company operations. Unfortunately, the only certainty of cash flow forecasts is that they are going to be wrong. However, there are a number of best practices that corporate treasurers can implement to greatly improve the accuracy of their forecasts.

Importance of Cash Flow Forecasting

Forecasting provides treasurers with numerous benefits. Among the most important is that forecasts can serve as an early warning system that alerts treasurers to potential cash shortfalls so they can be dealt with before becoming serious issues. Forecasts can also be used to determine a company’s future borrowing needs and to make the best use of cash.

A deeper awareness of a company’s cash position and forecast gives treasurers strategic insight and analysis for decision making far beyond treasury. Such insight can help treasurers earn a seat at the table as an organization charts its strategic direction. For example, forecasts can help to test the viability of new ventures, such as the expansion into a new market or the launch of a new product. They can also assess the impact of a potential acquisition and help determine the ideal capital structure and financing options for the transaction.

In addition, forecasts are increasingly being scrutinized by external stakeholders such as banks, financial analysts and ratings agencies. Accurate forecasts play a vital role in how these stakeholders interact with an organization in terms of lending, reports and ratings.

Most Cash Flow Forecasts are Inaccurate

Despite the importance of forecasts, most treasurers believe theirs are inaccurate, according to a 2014 Kyriba survey of 200 treasury professionals. About one-third considered their forecasts to be simply “accurate,” half considered them “somewhat accurate,” and 8% said their forecasts were “very inaccurate.” Not a single respondent believed their forecast to be “very accurate.”

According to the same survey, treasurers reported that the biggest challenge to forecasting accuracy is a lack of visibility into all forecast data inputs. That may include a lack of understanding as to where to source the data required, outdated technology that lacks the necessary levels of control and visibility, or the inability to monitor and manage the complete cash management process.
Other impediments to accuracy may include:

- Lack of communication and authority with and between business units
- No standardized forecasting methodologies for business units
- Insufficient time and resources
- No performance measurement process
- Lack of mandated improvement from the C-suite

Improving Forecast Accuracy
Treasurers looking to improve the accuracy of their forecasts should consider the following three-step approach:

- Determine the objectives of the forecast.
- Understand the patterns in the data available.
- Choose a forecasting method.

The first step is to determine which objectives you’re trying to meet. Common objectives include determining a cash surplus or deficit at a given point in time, estimating how much should be left in each bank account to avoid overdrafts and optimize earnings credits, determining how much borrowing is needed and for how long, and providing input into investment strategies. In setting objectives, treasurers should work with business process owners to assess the drivers of cash flow at their organization—the things that have the most impact on cash or cause surprises. Given a set of categories to focus on, treasury professionals can prioritize what to address first, second, and so forth. They should balance priorities on different factors such as relative complexity, availability of data, importance to the organization and its leadership, and the age of the last forecast refresh for the category. Rather than trying to do everything at once, it is best to focus on areas where meaningful improvements can be achieved and to set expectations about how progress will be measured.

The next step, and one of the most important factors in improving a forecast, is to understand data patterns. Large volumes of data are required to do so. Inputs for use in the analysis should include actual cash flows from bank statements and information about upcoming cash events. Treasurers should talk with business process stakeholders to understand relationships between business events and cash flow. Often, all parties will learn something during this collaboration. Next, they need to find patterns and seasonality in cash flow by using pivot tables, graphs and statistical analyses. Reports on the actual cash flows need to be developed to show patterns and trends that emerge over a period of time and the behavior of different categories. The reports can also be used to improve the liquidity impact of a forecast category—they can be used as evidence to compel changes to the business process, or simply as input to an updated forecast.
Once the pattern is determined, the method for forecasting can be selected. If a system is generating cash flow, perhaps an automated feed can be established for the forecast. It is important to keep in mind that the system might not have the exact date logic required. If the forecast targeted for improvement is already from a systematic feed, treasurers need to make the business case to ask the system owner for help in improving their output. In both cases, the benefits of improved accuracy in terms of increased investment yield, reduced borrowing cost or reduced effort should cover the cost of the system or interface changes. If the cash flow type is being forecasted manually, once the pattern is established, it can be extrapolated into the future.

The bottom line is that if the evidence shows that a method is not measuring up, it’s time for a change. Treasurers should make sure to get buy-in and executive support that the “right approach” is being used. As more forecasts are developed and depended upon, expectations about accuracy, scope and methods must be understood.

Best Practices for Improving Cash Flow

- **Automate everything as much as possible.** Create a universal interface layout for publisher systems; this will provide the right granularity and a consistent data model.
- **Synchronize forecast reporting with financial reporting.** Map everything out so stakeholders understand the relationship between treasury cash, accounting cash and business performance metrics.
- **Every day is a brand new day.** Go with the latest and greatest every day via effective dating at the source level. Do not track changes at a record level. Instead, do forecast delta comparisons via reporting, along with forecast to actual variance reporting.
- **Leverage a data mart.** Don’t run data through the transaction processing system unless the transaction system is moving the money or the data is needed for cash positioning. Consolidate forecast information through a reporting tool instead of the transaction processing system.
- **Manage capability and benefits via releases.** Set expectations that the system is a platform for continuous improvement and provide ROI for all releases to maintain sponsorship.
- **Build a robust and flexible scheduling infrastructure.** While challenging, it can be done. Integration leads to dependence on other systems that are sometimes unreliable. Create tolerance for missed feeds and accept that sometimes data will be stale.
Cash Flow Forecasting Checklist

- Understand actuals, know the patterns and be able to explain them.
- Understand business processes and their relationship to cash flows; this helps treasurers become a consultant to their business.
- Evaluate different forecasting methods and use the one that best fits the process.
- Monitor and adjust the forecast based on variances.
- Automate as much as possible.
- Always manage expectations about the scope and accuracy of the forecast.

Forecasting is extremely important and can be a big value-add that treasury practitioners bring to their organization. While most professionals are not satisfied with the accuracy of their forecasts, they can be greatly improved by implementing the best practices outlined above.

For more information and insights from our treasury and forecasting expert, contact Lynda Umbreit at Lynda_Umbreit@KeyBank.com or 800-821-2829.