

I. PREPARING THE CASH BUDGET

A. PURPOSES: *forecast our future cash position, any cash shortages and surpluses, and how long they might last*

B. DIFFICULT ASPECTS: *cash collection of credit sales, cash payment of purchases, handling the minimum cash balance, interpreting the required total financing*

C. STEPS:

1. Lay out the Forecasted Cash Receipts
 - a) Practice the cash collection of credit sales part
2. Lay out the Forecasted Cash Disbursements
 - a) Practice the cash payments for credit purchases
3. To get Net Cash Flow for each month, do a subtraction:
 - a) $\text{Net Cash Flow} = \text{Cash Receipts} - \text{Cash Disbursements}$
4. To get Ending Cash for each month, do an addition:
 - a) $\text{Ending Cash} = \text{Beginning Cash} + \text{Net Cash Flow}$
 - b) Note: this ending cash assumes no investing or financing other than items that you were told to include (if any) in the cash receipts or cash disbursements
 - c) You will be given the first month's Beginning Cash; after that, one month's Ending Cash becomes next month's Beginning Cash

5. To get the Required Total Financing (Shortage) or Excess Cash Balance (Surplus) for each month, do a subtraction:

a) $RTF \text{ or } ECB = \text{Ending Cash} - \text{Minimum Cash Balance}$

b) Minimum Cash Balance is “frozen cash” that you can’t or don’t want to touch anytime

c) If that subtraction gives a negative number, change the sign and list it in the Required Total Financing row (put a zero for Excess Cash Balance for that month)

d) If that subtraction gives a positive number, list it in the Excess Cash Balance row (and put a zero for Required Total Financing for that month)

e) INTERPRET those last two rows: they represent a cumulative amount, or running total; if Excess Cash Balance is \$20 in January and \$40 in February, you have invested \$20 more (check if Net Cash Flow is +\$20 as a check figure) in your Short-Term Investment Account—so these represent account balances either for a credit line loan or some investment account

f) Be ready to answer: How large of a credit line should I arrange for the entire forecast period? It should be either \$0 if RTF is always 0, or 50% more than the *largest number shown in the RTF row*. This is so because you want a cushion, intra-month flows can wipe out your cash position, and the cash budget is just a forecast (with uncertainty) after all. In practice, lending officers note that small businesses are usually on the low side when asking for loans, so they bump up the businesses’ request by 50%.