**The need for accurate forecasting**

Cash flow forecasting, like weather forecasting, is an inexact science. No one can see into the future and therefore there may be huge differences between the predicted cash flow and the actual cash flow.

The difference between predicted performance and actual performance is known as variance. If the variance is large and adverse (actual performance is worse than predicted performance) it can cause huge problems for the business. If the firm does not have enough cash to meet its commitments it may be forced to shut down.

Even when a firm is able to remain in business it may have to arrange an overdraft or short term loan to cover its cash flow problem. Alternatively, the firm may decide to sell some of its assets to free up cash.

**Knowledge review/Key terms**

   **Cash flow** refers to the money that enters and leaves the business over a period of time as it makes and receives payments. Net cash flow is calculated by subtracting cash outflows from cash inflows.

   A **cash flow forecast** is an estimate of the likely cash inflows and outflows over a period of time.

   **Cash inflows** are the money received by the firm from sales, investments and other sources.

   **Cash outflows** are the money paid out by the business on wages, raw materials and other items.

* **Revision questions:**
1. Explain how a viable firm may experience cash flow problems.
2. Give 3 reasons why a firm should carry out a cash flow forecast.
3. Explain the three main sections of a cash flow forecast.
4. What is meant by the term variance?
5. Explain 3 consequences of an inaccurate cash flow forecast.