Why the balance sheet is so important when budgeting and cash flow forecasting.

The balance sheet in forecasting is the bridge between the P&L and the cash flows. The net result of all activity from those two reports (P&L and cash flows) is displayed on the balance sheet. Therefore it is very important that after the completion of the P&L and cash flows that a forecasted balance sheet be prepared and complete review of the balances sheet takes place.

The primary items to review are cash balances, accounts receivable, inventory, accounts payable and accrued expenses.

If any of the above items are not reasonable based on past experience then check the following items in your forecast:

1. Review sales collections and how the opening accounts receivable are being collected.

2. Review how expenses are being paid within the forecast and how you handled the payment of opening payables.

3. Inventory purchases (if applicable) have a profound impact on cash flow. Make certain the inventory levels make sense. The inventory levels will be the determining factor of what inventory will be purchased throughout the forecast which directly impacts cash balances and accounts payable.

4. Check term loan balances and credit line. Make certain that term loans have been properly amortized through the forecast and the credit line is at an appropriate level.

5. If after checking the above items and you are satisfied they are correct and the balance sheet still seems to be unreasonable I suggest you review the P&L and cash flows in great detail to make certain they are correct.
If your are using a spread sheet to prepare the reports you may need to check the formulas developed.

The balance sheet will tell you whether your P&L forecast and cash flow forecasts are right or wrong.