Cash management interactive worksheet

Reconciling budgeted cash flow with actual cash flow

One of the uses of a cash budget is as a tool for monitoring and controlling cash flows. This is done by comparing the forecast receipts and payments in the budget with the actual receipts and payments that occurred during the budget period.

It is expected that differences will occur between what was forecast to happen and what actually happened. These differences are described as variances.

Key point
A variance is the difference between the expected cash flow and the actual cash flow

Some variances will be good for the business because they show an improved cash position. These are known as favourable variances and occur when cash received is higher than expected or cash payments are lower than expected. Other variances are not good for the business and result in a decrease in the expected cash position. These are known as adverse variances and occur when cash received is lower than expected or cash payments are higher than expected.

When analysing variances that have arisen between the budgeted cash flow and the actual cash flow it is important to understand whether the variance is adverse or favourable. Sometimes you may be required to identify the nature of the variance and the standard convention is to use F to denote a favourable variance and A to denote an adverse variance. However minus signs may also be used to denote adverse variances. In an assessment task it is essential that you follow the instructions given on how your answer should be presented.

Key point
Favourable variances occur when actual receipts are higher than expected and actual payments are lower than expected. Adverse variances occur when actual receipts are lower than expected and actual payments are higher than expected

Example 1

Calculate the variance for each of the cash flows given and enter F or A in the final column to denote whether the variance is favourable or adverse.

Click to display/hide the solution.

	Budget £	Actual £	Variance £	F/A
Receipts from sales	94,200	91,600		
Payment for purchases	33,650	36,842		
Labour costs	27,695	26,412		
Capital expenditure	20,000	17,500		

Reconciling budgeted and actual cash flows

Once variances have been calculated they can be used to reconcile the closing balance on the cash budget to the actual closing balance. This is useful because it shows management exactly where differences have occurred and also the value of those differences. This will enable them to take corrective action where appropriate. Remember that the closing balance could be described as a cash balance or a bank balance and simply refers to the amount of cash available to the business.

A reconciliation of budgeted and actual cash flows usually begins with the budgeted closing bank balance.

Example 2

Frome Ltd prepared a cash budget for August. The table below contains both budgeted and actual cash flows for the month. The opening bank balance at the beginning of August was £2,000.

Calculate the budgeted and actual closing bank balance for August.

Click to display/hide the solution.

Figures for August	Budget £	Actual £
Receipts		
Shop takings	65,000	59,220
Internet sales	72,000	76,482
Payments		
Purchase of goods for resale	57,500	68,520
Delivery costs	7,200	7,650
General expenses	15,825	14,313
Capital expenditure	16,000	0
Net cash flow	40,475	45,219
Opening bank balance	2,000	2,000
Closing bank balance		

Is the actual closing cash position better or worse than budgeted?

Click to display/hide the solution.

Solution

Reconciliation statement

There is a standard format for reconciling budgeted cash flows with actual cash flows. As mentioned earlier it starts with the budgeted closing bank balance. The variances between the budgeted figures and the actual figures are then calculated on a line by line basis (one variance for each type of receipt or payment). These are then added to or deducted from the budgeted closing bank balance as follows.

- Favourable variances for receipts and payments are added to the budgeted bank balance because these represent an improvement to the expected cash position.
- Adverse variances for receipts and payments are deducted from the budgeted bank balance because these represent a decline in the expected cash position.

The term variance may be unfamiliar to many business owners and managers and therefore when an accountant produces the reconciliation they would usually state whether there has been an increase or a decrease in the receipts and payments.

Example 3

The following pro-forma reconciliation statement needs to be completed using the figures for August from the earlier example of Frome Ltd.

You need to begin by entering the budgeted closing bank balance since this was the expected closing position. Next, for each receipt or payment, identify whether there has been an increase or a decrease from the expected position by ticking the relevant column. The variance between budgeted and actual can then be entered. Adverse variances should be denoted with a minus sign. The final column should then be totalled and the resulting balance should be the same as the actual closing bank balance.

Click to display/hide the solution.

Reconciliation statement			**£**
Budgeted closing bank balance			
Increase	**Decrease**		
		Shop takings	
		Internet sales	
		Purchase of goods for resale	
		Delivery costs	
		General expenses	
		Capital expenditure	
Actual closing bank balance			

Explanation

From the reconciliation column it is easy to see that the item that has had the greatest impact on the budgeted cash balance is the saving on capital expenditure. Overall sales were lower than expected and purchases were considerably higher. The business may have bought additional stock or the cost of the items purchased could have increased. The increase in delivery costs is to be expected given that internet sales have increased.

A final thought

In an assessment make sure that you read the task instructions carefully. You may need to calculate the variances before doing the reconciliation or they may be provided and you will just need to incorporate them into a pro-forma. You should pay careful attention to whether minus signs are required for indicating adverse variances.