FORECASTING CASH FLOW AND DRAWINGS

Rising costs and falling income make cash flow forecasting crucial, says accountant Ian Tongue

In the current financial climate GPs are feeling the squeeze on their finances. The delayed effect of increased tax payments and superannuation shortfalls in conjunction with rising costs and falling income makes cash-flow forecasting a vital part of running a modern general practice.

There is a temptation to produce overly complex spreadsheets or to purchase a software package to assist in cash-flow forecasting, but the old adage 'keep it simple' has never been more appropriate.

What is cash flow forecasting?

There is a fundamental difference between 'cash flow' and 'accounting profit'. Cash flow is the available cash or 'liquidity' of the practice. Accounting profit takes account of income and expenditures not yet received or paid by the practice and therefore is a different concept to the available 'cash' funds.

Take superannuation. Any shortfalls are paid at least a year in arrears, but the liability arises in the accounting year to which it relates and therefore these amounts are included within the practice accounts.

The current accounts are driven by accounting profit and drawings so they should not be viewed as 'available cash' at the date of preparation. However, if all tax and superannuation liabilities have been included it would represent the balance you could expect to have once all income was received, liabilities settled and assets sold (at book value) in the hypothetical scenario of the surgery ceasing on that date.

The balance on the current accounts represents a mixture of investment in the practice and undrawn accounting profit.

Cash-flow forecasting in simple terms involves looking at the cash due into the practice and the expenditures payable usually over a 12-month period, but this can be extended over many years. This lets the practice assess the underlying cash needs of the practice and decide on drawings levels.

Key stages for a forecast

A forecast can only ever be viewed as an estimation exercise with the goal of producing the 'best estimate'. A good starting point is to look at the latest available accounts. This will give you an indication of future incomes and expenditures. Key points are:

- Identifying income and expenditures
- Determining the timing of the above
- Identifying income and expenditures that were 'one-offs' last year, such as certain enhanced services
- Look for new sources of income – again, such as certain enhanced services
- Talk to your accountant about other expenditures, such as income tax or superannuation if paid through the practice.

The most common use of cash-flow forecasting is in drawings decision-making. This is one of the trickiest areas to get right because of the number of uncertainties that form the basis of the calculations. When making such decisions it is important that both cash and accounting aspects come together, as these are not mutually exclusive.

Drawings

Drawings are a combination of the amounts that a practice can pay each doctor and payments made on behalf of the doctor. The payments on behalf of the doctor will be those already paid and those payable in the future, such as superannuation or income tax.

Since the introduction of the superannuation certificates, drawings projections have been made more difficult as the amount of superannuation to be paid is dependent on so many factors. These include:

- amounts deducted by PCT/LHB per doctor
- level of personal expense claims
- non-NHS income and expenditure
- outside earnings
- date of entry into pension scheme, for example subject to earnings cap.

The combination of the above will result in each partner having differing levels of superannuation adjustments, which will have a direct impact on the current account balances and therefore available drawings.

A very common query put by GPs to their accountants is 'Why is Dr X's current account higher than Dr Y's when they have taken the same level of cash drawings and have the same profit share?' The answer is likely to lie in the dynamics of superannuation adjustments identified above. Practices that pay tax through the practice also have to consider the differing tax liabilities each doctor will face as a result of:

- Differing allocations, such as seniority
- Earnings outside the practice
- Other tax factors specific to each doctor.

Once all the above have been considered it is likely there will be differing levels of drawings per partner even though they may be entitled to the same profit share.

Current account considerations

An important financial decision to make is how much should be in each partner's current account. Each practice will have differing funding requirements based on the timing of its income and expenditure streams and the number of partners.

This makes it impossible to identify a generic balance that should be retained. However, in practice it is common to see current accounts in the region of £10,000 to £20,000 per whole-time partner.

The aim should be to maintain the current account balances in proportion to the profit shares of the partners. Therefore, it would be reasonable for a half-time partner to maintain 50% of the current account balance of a whole time partner.

On an annual basis an equalisation exercise is common to adjust for variances in calculations and restore each partner's current account to the agreed levels.

Cash-flow forecasting and drawings decision making is not an exact science. Some degree of inaccuracy is inevitable. But placing more focus in this area will reward the practice with finances that are under control and hopefully avoid any nasty surprises.

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