Accounts Payable Forecasting Guide



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To better plan for the future, start-up's, established small businesses, and multi-million dollar corporations all rely on financial forecasting or financial modeling to better manage revenues and expenditures.

Forecasting involves estimating future revenues and expenses making it easier to

plan for future events such as business expansion, an increase in the workforce, or an economic downturn.

One of the most important areas to forecast is accounts payable. Once deemed a back-of-the-house process at most, accounting departments today are starting to realize the importance of accounts payable and its impact on cash flow.

What Are Accounts Payable?

Accounts payable refers to the money that is owed to vendors and suppliers for goods and services that have been purchased on credit.

A business's accounts payable balance is always displayed as a current liability or short-term liability a balance sheet, since it's money that will be flowing out of the business in a short time.

What Are Accounts Payable Forecasting?

Accounts payable forecasting is the process of calculating future accounts payable obligations to better plan for the future.

Accounts payable forecasting uses historical data such as vendor payment history along with trends specific to the business.

For example, if your business is traditionally busier in the summer, you would consider that information when estimating accounts payable totals for the summer months.

Why Is Accounts Payable Forecasting Important?

Accounts payable forecasting provides business owners with a view of future expenses, allowing them to make better business decisions.

While many businesses consistently forecast sales and revenue, the importance of forecasting accounts payable is frequently overlooked.

But forecasting accounts payable offers multiple benefits:



- ## Better Cash Flow Management

  Forecasting accounts payable helps you better manage cash flow; by predicting expenses in future months, you can better manage available cash on hand.

- ## Eliminates the Surprise Factor

  When you forecast accounts payable, you eliminate the surprise factor that unexpected invoices can bring.

- ## Helps Identify Trouble Areas

  Forecasting accounts payable provides a glimpse into future expenses, and when coupled with sales and revenue forecasting, can help business owners identify and better handle any issues that may arise.

  When combined with other forecasting methods, accounts payable forecasting can prove to be an invaluable tool for better financial management.

How Do You Forecast Accounts Payable?

The best way to forecast accounts payable is to refer to your current spending patterns.

If you tend to spend more money in the spring because your busy season is the summer, you already know that your accounts payable balance will be higher in the months right before summer.

Knowing when certain expenses are due can also help you accurately forecast accounts payable.

If you have several subscriptions and other services that renew quarterly or annually, they can be easily included in any forecast that you create.

You can also use historical data to forecast accounts payable. Except for one-time expenses, historical data from a previous year can often help build the foundation of your forecast fairly accurately.

Aside from referencing historical data, there's another way that you can estimate accounts payable expenses for the future; by calculating days payable outstanding.

What Are Days Payable Outstanding?

Days payable outstanding or DPO is a metric used to measure the average number of days it takes your business to pay suppliers and vendors.

Calculating DPO is helpful for forecasting accounts payable since knowing how long it takes to pay an invoice allows you to make more accurate estimates when completing your accounts payable forecast.

How Do You Calculate DPO?

You'll need to use your balance sheet totals to calculate DPO, using the beginning and ending balances of the period you're calculating DPO for to find your average accounts payable balance for that period.

For example, if you're calculating DPO for the third quarter, you would use your beginning AP balance as of July 1 and your ending balance as of September 30, adding the two together, and then dividing by two to obtain your average AP balance for the quarter.

If your July beginning balance was $41,000 and your September ending balance

was $43,000, you would add those together, which equals $84,000, then divide by 2 to obtain your average AP balance, which would be $42,000.

You would then obtain your cost of goods sold or COGS from your income statement which we'll say is $390,000. Next, you'll determine the number of days in the quarter. For the third quarter, the number of days would be 92.

Let's calculate the DPO based on the numbers above:

($42,000 / $390,000) x 92 = 9.9

That means that it takes your business an average of 10 days to pay accounts payable invoices.

When DPO results are used along with historical data, it can help businesses better forecast their accounts payable, including when they're likely to be paid.

What Is a Good DPO?

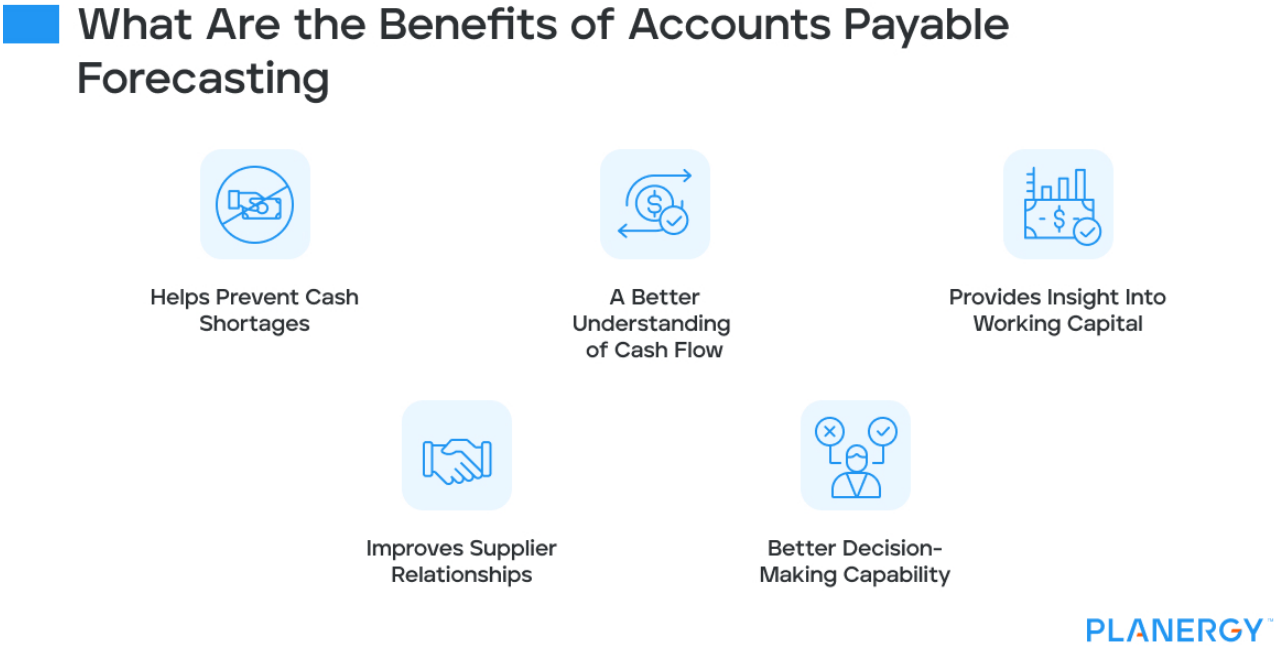
It's difficult to determine what a good DPO is. In some cases, higher days payable outstanding results may be better because it indicates that you have generous credit terms from suppliers and vendors and can hold onto cash longer.

On the other hand, a lower DPO means that you pay your bills faster, which may indicate an abundance of cash on hand, or it can indicate that you have less lenient credit terms and may need to pay invoices faster.

DPO can also vary widely from industry to industry, so you should always compare your DPO results to those of similar companies to get a better idea of how your business is performing.

What Are the Benefits of Accounts Payable Forecasting?

Setting aside some time to prepare an accounts payable forecast offers plenty of benefits.



- **Helps Prevent Cash Shortages**

  Forecasting accounts payable regularly can help you better manage potential financial issues more proactively.

- **A Better Understanding of Cash Flow**

  Forecasting accounts payable provides you with a better understanding of your cash flow, helping you predict and manage potential downturns and cash shortages.

- **Provides Insight Into Working Capital**

  Accurately forecasting accounts payable provides businesses with the option to better utilize working capital.

- **Improves Supplier Relationships**

  Accounts payable forecasting can improve supplier and vendor relationships by ensuring that payments are processed timely and accurately.

- ### Better Decision-Making Capability

  Accurate accounts payable forecasting helps create an accurate cash flow forecast. Both provide business owners with the information they need to create accurate budgeting scenarios and make better financial decisions.

What Are the Challenges With Accounts Payable Forecasting?

As we've seen, creating an accurate short-term accounts payable forecast is fairly simple, and certainly worth the time.

But along with the benefits, there are several challenges you'll need to consider.



1. ### Unexpected Expenses That Pop Up

   The number one reason why your accounts payable forecasting may not be as accurate as you like is unexpected expenses.

   From faulty equipment that needs to be replaced to an increase in rent, unexpected expenses can wreak havoc with your AP forecast.

Inaccurate Data

Inaccurate data can be a common occurrence if you're using a manual accounting system. Duplicate invoices, incorrect invoice amounts, and missing data all contribute to an inaccurate balance sheet and income statement, which in turn directly impacts your accounts payable forecast.

The best way to avoid this issue is automation. An automated application like PLANERGY can reduce manual errors and the likelihood of duplicate or inaccurate payments.

3. ## Supplier Increases

You may be able to accurately estimate which vendors you'll need to pay in the upcoming months, but last-minute price increases or the need to shop for a new vendor or supplier can seriously impact your accounts payable forecast.

There are numerous reasons why suppliers and vendors may raise prices, including sourcing issues, labor and materials costs, and potential disruptions such as market fluctuations, all of which will directly impact your forecast.

4. ## Lack of Expense Visibility

It's difficult to accurately predict spending when your current spending levels aren't transparent.

If your accounts payable invoices are sitting on someone's desk waiting to be approved, it's impossible to include them in your forecasting estimates.

Having an automated accounts payable process in place can recognize and account for invoices as they're received, better predicting future expenses while avoiding late payments.

2.

Why Is Accounts Payable Forecasting Important for Cash Flow?

Accurately forecasting accounts payable can be of tremendous assistance when preparing cash inflows and outflows for a cash flow statement.

An increase in accounts payable can be beneficial to your cash position since the balance represents money that has not yet been paid.

An increase in accounts payable for a period means that your cash flow increases for that timeframe as well.

Even though a decrease in accounts payable has a positive impact on your financial statement, since it decreases your liabilities, it also reduces your available cash flow, which means less money available for other expenses.

Vendor and supplier payment terms also directly impact your cash flow as well, since a Net 60 payment term allows you to retain funds in your business longer than Net 30 terms.

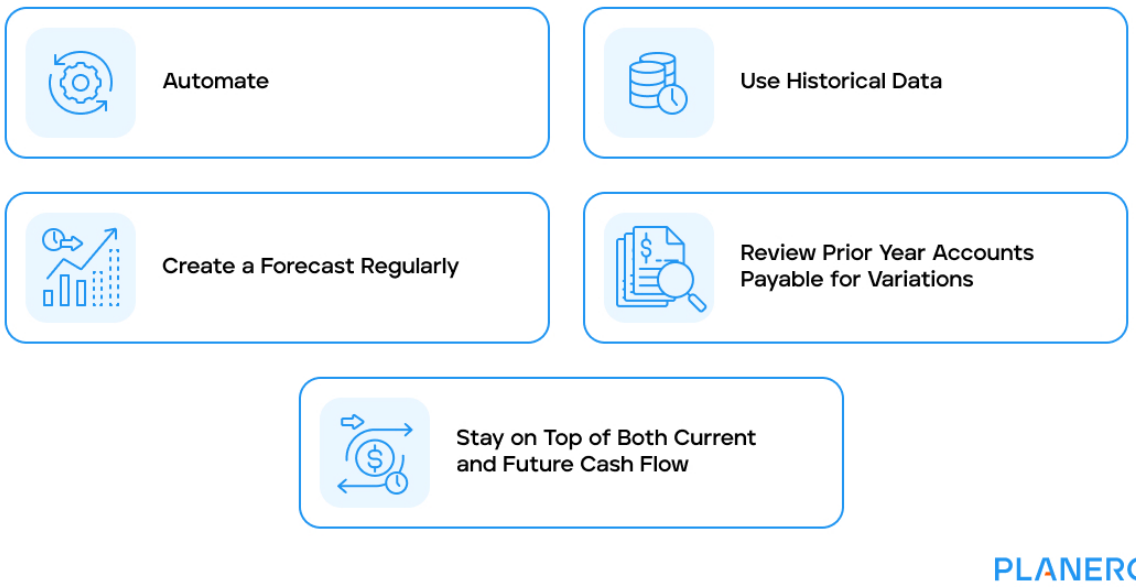
What Are the Best Practices in Accounts Payable Forecasting?

Like everything in finance, the quality of the numbers used in your accounts payable forecast plays a large role in how accurate and ultimately how useful your forecast is.

While it’s certainly possible to create and manage your forecast using manual processes and Microsoft Excel spreadsheets, the process is time-consuming at best, and you’re sacrificing both transparency and accuracy as well.

To get the most benefit from creating an accounts payable forecast, start with these best practices:

What Are the Best Practices in Accounts Payable Forecasting



- **Automate**

  Even the best template is no match for a cloud-based software application like PLANERGY, which provides transparent access to all spending data.

  In turn, having access to this data regularly will allow you to create a more accurate accounts payable forecast.

- **Use Historical Data**

  Historical data is the backbone of your accounts payable forecast. Having access to real-time reports allows you to create a much more accurate forecast.

- **Create a Forecast Regularly**

  While a one-time forecast can be helpful in the short term, creating an accounts payable forecast regularly will help business owners identify payment patterns to better forecast upcoming expenses.

- **Review Prior Year Accounts Payable for Variations**

  For example, if you found that accounts payable expenses were up three times in the prior year, make sure that you include those variances when creating your new accounts payable forecast.

- **Stay on Top of Both Current and Future Cash Flow**

  Accounts payable plays an important role in cash flow so take advantage of that knowledge by proactively managing your cash flow balance.

Automation Is a Necessity for Accurate Accounts Payable Forecasting

Automation is key to creating an accurate accounts payable forecast.

Using AP automation, you have ready access to all accounts payable data, which is a must for accurate forecasting.

An automated accounting software application also provides you with the functionality you need to streamline the entire financial planning process, leaving your business with accurate results and a more sustainable future.

What's your goal today?

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Download a free copy of our guide to future proofing your accounts payable department. You’ll also be subscribed to our email newsletter and notified about new articles or if have something interesting to share.

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