



Fiona Bevan
Financial Management

presents:

your guide to... forecasting



your guide to forecasting

what can forecasting do for me?

Having a robust forecast can be an invaluable tool in managing your business finances. If done thoroughly it can show where deficits in cash flow may occur and give you a clear picture of the profits you may earn if your sales strategy is successful.

As well as reviewing the next 12 months you may want to include broad brush forecasts for up to five years.

As with any business planning tool it is important that it is reviewed as more up-to-date information is available. This will give you more accuracy when looking at expected future results.

Although there are specially written forecasting tools, a spread sheet is all you need to get started.

An effective forecast will include both profit and loss and cash flow projections.

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profit and loss

However difficult it might be, it is important that you forecast the sales and costs you believe will result from all the activities you will undertake in the coming year.

For each month try to predict as closely as possible what your sales and costs will be. Don't forget to include your salary. With some cost items it can be difficult to predict when exactly spend will happen, so it may be better to spread the total spend on these items evenly over the year.

If you use the same reporting format to present both your forecast and your actual profit and loss then you will find it easy to compare your predictions with actual results.

See example of profit and loss on next page (please note that restrictions on page space mean that not all regular overhead costs lines could be included):

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Profit and Loss Account
 Marvin the Paranoid Android Industries
 Forecast for the year ended 31st March X13

	Jan	Feb	Mar	
	£	£	£	
Turnover	5,000	6,000	4,000	
Cost of Sales	(1,500)	(2,000)	(1,200)	
Gross Profit	3,500	4,000	2,800	
Overheads:				
Wages and Salaries	1,000	1,000	1,000	
Rent and Rates	500	500	500	
Utilities	100	100	100	
Motor and travel expenses	50	50	250	
Stationary, telephone, IT	250	250	850	
Bank charges and interest	5	5	5	
Subscriptions	650	0	0	
Marketing and Advertising	1,000	200	250	
Depreciation	250	250	250	
Total Overheads	3,805	2,355	3,205	
NET PROFIT	(305)	1,645	(405)	
CUMULATIVE PROFIT	(305)	1,340	935	...

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sales

Although none of us have a crystal ball there are ways you can approximate the level of sales you think you will achieve.

By having a separate line for each type of sale (whether you are breaking down by contract, customer or product area) you may well find it easier to picture where your sales are coming from.

Make sure you include any price increases you plan and allow for new customers, contracts or products.

cost of sales

As you have split your sales into different line items it is advisable to split the cost of sales on the same basis.

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overheads

Overheads can be relatively easy to predict if you make sure you have a clear idea of your current spend.

Again, you may find it easier to break down expenditure further - especially if the total is quite large. It also makes it easier to understand the spend. For example, the £1,000 marketing costs in January might be broken down into £500 for website revamp, £150 for networking and £350 for an advert in the local paper.

Wages and salaries

Your salary should be included here so make sure you have a realistic view of what you need to earn in the forecast year. If you pay yourself in the form of drawings (which do not normally appear in a profit and loss statement) still include them here. Likewise include predicted dividend payments if you use them as your chief form of payment.

As with sales have a separate line per employee and total them to give the total wages and salaries.

Remember to include employer's National Insurance on top of the gross salary per person. Currently this is 13.8% of gross salary over the NI free threshold.

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If you are looking to take on staff, in addition to any staff you employ currently, make sure you include them from the date you expect their employment to start. Don't forget any recruitment expenses.

Rent and rates

Your rental agreement should lay out your financial commitments to your landlord along with when any rental increases will kick in.

Business rates will increase year on year so even if you don't know the exact level of future rate payments, it is wise to build in a percentage rise.

Utilities

Gas, electricity and water will also increase year on year but are more difficult to predict than rates. It is better to err on the side of caution and over state any price rise.

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Motor expenses

Unless you expect your mileage to increase dramatically over the coming year, you should be able to use current levels as the basis for your forecast. Inland Revenue accepted mileage rates have recently changed so make sure you use the new current rates (45p per mile for the first 10,000 miles, 25p per mile thereafter¹).

If you use your actual motor expenses you may wish to allow for increasing petrol/diesel prices.

Travel, office, bank expenses

Monthly variances in expenditure for each of these categories can be difficult to predict, so you may find it easiest to take your annual expenditure and divide it into 12 equal amounts.

However, do not forget to include any overdraft renewal fees, or loan arrangement fees, in the months they will be charged.

¹ Costs correct at time of publishing

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Networking

Networking costs will be split between annual subscriptions to the individual groups you use, regular costs for meals at meetings and ad hoc meetings with customers and 121s.

You should know when subscriptions are due and be able to include them in the correct month. For meal and ad hoc meeting costs, it may be easiest to predict the annual cost and split into 12 equal amounts.

Professional fees

Professional fees often come in large one-off expenditure, unless you have an accountant who breaks their fixed fee into monthly payments. You should have a clear idea from your past year's experiences when these fees will be payable.

Subscriptions and training

Don't forget to include your personal development costs in terms of subscriptions to trade organisations and training.

Marketing and advertising

Here you should include the costs of any specific marketing initiatives, advertising campaigns, web site development costs, or general expenditure on business cards, leaflets or other promotional material.

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Depreciation

You should know the monthly depreciation on existing assets - it will simply be the annual depreciation divided by 12. To this add depreciation on new assets you plan to purchase during the year.

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cash flow

Once you have prepared your month by month profit and loss forecast, you can then look at how your cash flow might look.

See next page for an example:

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Cash flow

Marvin the Paranoid Android Industries
Forecast for the year ended 31st March X13

	Jan	Feb	Mar	
	£	£	£	
Opening bank balance	475	2,336	(1,753)	
Receipts:				
Sales	6,250	5,750	6,900	
Payments:				
Cost of sales purchases	1,725	1,725	1,955	
Wages and Salaries	1,000	1,000	1,000	
Rent and Rates	500	500	500	
Utilities	115	115	115	
Motor and travel expenses	57	57	287	
Stationary, telephone, IT	287	287	997	
Bank charges and interest	5	5	5	
Subscriptions	650	0	0	
Marketing and Advertising	50	1,150	230	
Purchase of van	0	5,000	0	
VAT			765	
Total Payments	4,389	9,839	5,854	
Net cash flow	1,861	(4,089)	1,046	
Closing bank balance	2,336	(1,753)	(707)	...

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There will be a number of items which appear on the profit and loss but do not affect cash flow, and vice versa. There are also items which will appear with different values:

→ VAT

The figures on your profit and loss should not include VAT. However, your payments and receipts will include VAT (where applicable) and so your cash flow will show the VAT inclusive amount.

Every three months or so you need to budget to pay/reclaim any VAT owed.

→ Sales

Any delay in your customers paying your invoices will affect your cash flow. You may find receipts lag sales by a month or two. Conversely, if you collect deposits from your customers you may find your receipts precede sales.

→ Purchases/overheads

If you are buying in items for resale, you may well pay for the goods earlier than you sell them on. In this case the costs will appear in the cash flow before they appear on your profit and loss.

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Also, even if you incur the costs at the same time as you invoice the customer, there will be a lag if you take advantage of credit terms from your suppliers.

→ Fixed assets

Any fixed assets bought in the period will have a direct impact on cash flow, unless loan financing is used to fund their purchase.

Conversely, depreciation in the profit and loss will not impact on cash flow.

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making your forecast part of your decision making process

By the time you have completed your financial forecast, you will have reviewed your plans for the coming year in a very detailed manner.

It makes sense to use this information to make effective decisions.

For example, you will have a clear idea of the profit you can achieve given the spending you predict. Even if you spend your marketing 'budget' on a different mix of initiatives, as long as the total does not exceed the amount in the forecast, you will not see a change in the overall profit. This can give you the freedom to make decisions on opportunities which present themselves.

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Similarly, the cash flow forecast gives you an idea of the peaks and troughs in cash flow your business may experience. You can use this information when you are planning key purchases. If you have flexibility in when you make the purchase, it makes sense to do so when there is cash in the business to do so. If you cannot match the purchase to cash availability, you know in advance that you will need to use your overdraft facility, or find loan or HP funding.

The ability to plan ahead can be invaluable in making your business as financially stable as possible.

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and finally...

None of us have a crystal ball with which to predict the future. But that does not mean that forecasting is wasted effort.

Indeed, if you can plan for the things you do have control over, you are better placed to deal with those you don't.

Also, don't forget that help is at hand and there are professionals who can work with you to create a comprehensive forecast.