

Tools and templates



Creating and maintaining a financial forecast

As your business grows, you will need to manage cash flow and have forecasts you can act on. The more comfortable you get with the forecasting process, the more you'll be able to control your business and take advantage of opportunities.

This tool will help you create a financial forecast. It's important to remember that every business is different and you'll need to customise what's included and add additional layers of detail. That normally requires seeking external financial support from an adviser or accountant.

1) Compile a profit and loss report

A profit and loss report details your income and expenses, and the profit that's generated. Financial forecasts start with historic data. You need to compile monthly data for:

Income: Money you have earned.

- It needs to relate as closely as possible to when work was completed, rather than when you were paid, so you can accurately calculate your profit. That often means you'll base income on invoice date but every business is different.
- If you have more than one type of revenue (eg. you rent bikes and sell parts) splitting them up allows you to get a better handle on their impact on profitability. This is important when the Cost of Goods Sold is distinct.

Cost of goods sold (COGS): The direct costs of producing goods, including the cost of materials and labour directly related to producing it.

- COGS are variable costs, which depend on sales volumes.
- Moving COGS expenses to match the revenue they generate will make reporting more accurate. This can be done using journal entries in your accounting system or within your forecast.

Operating expenses: The costs a business incurs through its normal day-to-day operations.

- You might look to reduce or increase operating expenses in response to changing demand, but these are expenses that you need to pay whether or not you sell anything, such as rent, salaries and your accountant's fees.

Total outgoings: The sum of your COGS and operating expenses, ie. the total amount of cost that's being attributed to a particular month.

Profit and loss reports don't include tax, which is calculated elsewhere and appears on the cash flow statement, or dividends.

Historic data is normally taken from an accounting software package like Xero or Sage. These tools have detailed guidance on how to create the reports you need.

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2) Calculate profitability

Once you've inputted historical data for income and expenses, you can work out how profitable your business is.

Gross profit: The money a company makes after deducting the costs directly related to the goods or services that have been sold.

- Add a line calculating your gross profit under your COGS

Net profit: The amount of money left after you subtract your business expenses from your revenue.

- Add a line calculating your net profit under your operating expenses.
- Monitor this closely; if your business isn't making a profit in a given month you're eating into your cash reserves, if that carries on for too long you will run out of money.

Gross and net profit margins can be added, as well as gross profit per revenue line, to better understand how particular activities are performing.

3) Prepare a cash flow statement

Income: Money you have been paid.

- This is generated from your profit and loss statement. Use a formula to pull the information from that tab of your spreadsheet.
- The key is to manage any delay between when money has been attributed in your profit and loss report and when it's received. A business might complete a consultancy contract in March and invoice at the end of the month, but not be paid until April or May.

Expenses: The amount of money you've spent.

- Your cash flow statement will record the same COGS and operating expenses as your profit and loss, however, expenses need to be recorded when money leaves your account.
- There are several other types of expenses that don't appear on your profit and loss, which need to be included to make sure you have a complete picture of money flowing through your business:
 - Loan payments
 - VAT
 - Corporation tax
 - Dividends

Cash position: The opening balance for the month (the amount you have in your bank account) and the closing balance (the amount you have at the end of the month).

- Use a formula that takes your opening balances, adds any income and subtracts your expenses to give a closing balance. Compare the to the actual balance in your bank account each month to check if there are any discrepancies.

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4) Estimate the trend going forward

Once you have added historic data to your cash flow and profit and loss reports, you can start to estimate what's going to happen in the future. Try to plan at least 12 months in advance. When your business gets bigger or more complicated, you may need to forecast further in advance.

There are several inputs that can help you model what's going to happen:

- Fixed costs like rent and accounting fees are easy to project forwards. Make sure you update your forecasts when you find out about any changes, such as an increase in your rent.
- Wherever possible, try to plan one-off costs like a legal expense for creating contracts or an investment in staff training.
- If you're planning to hire, calculate the increase in staff costs (it can be helpful to do this in a separate tab) and update your expenses line accordingly.
- Rolling averages can reduce the noise created by month to month fluctuations. For example, you might forecast next month's sales based on an average of what was generated in the previous three months.
- Look at how your business performed in the same period in the previous year, which helps reduce the impact of seasonality. Do you expect sales to increase or decrease? If so, why? Make sure it's based on something tangible, like winning contracts or investing in sales resources.
- Using sales forecast data from a CRM like Pipedrive or Salesforce, which record what's in your sales pipeline, is a great way to estimate what's likely to come in over the next few months.
- It may be worth building a separate sales forecast.

5) Update your forecast on a monthly or weekly basis

Each month you need to add the actual amounts spent or received, and adjust the forecast for coming months accordingly. This includes:

- Income
- Expenses
- Your bank balances

Again, this information is readily available in accounting software.

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6) Add a balance sheet

A balance sheet is a financial statement that reports a company's assets, liabilities and shareholders' equity. This information is produced from your cash flow statement and profit and loss report, as well as bank balances, liabilities and equity.

It's an important piece of the forecasting puzzle. If you're just starting out, you could rely on your accounting software to calculate your balance sheet, but it's important because it helps you understand the value of your business.

Top three action items

Now that you understand more about preparing a forecast and have collated the information you need, you can start building your financial forecast. It's likely you'll need help from an accountant or financial advisor to keep developing your forecast.

1) _____

2) _____

3) _____