Now is the time to revisit plans, forecasts and budgets

With the beginning of the easing of the COVID-19 restrictions, it is important to regularly revisit your business plan, and with that, your financial forecasts and cash flow projections.

> ***Tony argues that in any environment it is always important to ensure that forecasts and projections are always based on up to date information. The business and economic environment is constantly changing, particularly in recent months, and it is therefore vital for your plan or road map to reflect this.***

Your business plan is basically your route map, from where you are now to where you want your business to be, especially in terms of profitability, cash flow and market share, at a specific point in time, or at specific points in time, what we would term as, 'Key stages'.

Here are our three simple recommendations to consider when making plans and preparing forecasts:-

1. Be realistic

In an environment which is changing at a very fast pace, building a plan or forecast based on past activity is almost certainly unrealistic. Demand has changed, as have costs of materials, and methods of producing your product or delivering your service will probably have changed too. All this has a financial impact which needs to be reflected within your forecasts and projections.

What about your key objectives and key stages, have they also changed? It might be that the growth plans that were agreed at the end of 2019 are just not possible. Are they to be delayed, or scrapped altogether? Are there now new opportunities with new products and services within existing or new markets to consider?

Based on careful and detailed research, set your objectives and focus your plans on achieving those objectives. Set key dates for achieving specific shorter term objectives, and focus your time and resources on achieving your targets. Be SMART:-

S – Specific
M – Measurable
A – Attainable
R – Relevant/Realistic
T - Timely

2. Complete

Ensure that your forecasts are not just realistic and up to date, but make sure that they are complete. Much emphasis is placed on the cash flow forecast, because without sufficient cash a business will simply not be able to operate. As I wrote in a previous article, Cash is not just 'King', cash is the very life of a business, without sufficient cash resources, a business will not be able to operate.

We encourage 3 way forecasting. That is, for a specific period in time, we would expect a forecast profit and loss account, a forecast balance sheet and, a cash flow forecast. Each statement/forecast gives different information in relation to the projected activity and performance of the business.

I. Forecast Profit and Loss Account

The profit and loss account will identify the total expected sales, the effect of movement in stock and direct costs. From this you will be able to identify your gross profit and gross profit margin. This is sometimes described as the trading profit.

Against this, total expenditure relating to the various types of overhead (day to day running expenses of the business) and fixed costs, such as rent, business rates, etc., are deducted to arrive at the expected net profit of the business. Make sure that you include other provisions, such as depreciation.

The purpose of the projected profit and loss account is to identify the profitability of the business.

II. Cash Flow Forecast

Profit is good, but it is only of any real value if that profit is turned into cash. The sales or turnover figure in the profit and loss will include items that have been sold on credit. In other words, invoices that have been raised (the sale), but not yet paid for. The cash flow forecast will only include monies actually received and monies actually paid out. Think of it as a summary of your bank statement.

The purpose of the cash flow forecast is to identify expected movements in the future bank/cash balances of the business. It will highlight peaks and troughs and identify short term funding requirements.

III. Forecast Balance Sheet

A Balance Sheet identifies the assets and liabilities of a business at a particular and specific point in time. This differs from the profit and loss account and cash flow statement which lists, income, expenditure, receipts and payments over a specific period of time.

The balance sheet will tell us what our working capital is. Below is an extract from a balance sheet to illustrate this

Business Name
Forecast Balance Sheet
As at 31 January, 2021

Current Assets		
Stock/Inventrory	120,000	
Accounts Receivable	80,000	
Bank/Cash	15,000	
		215,000
Current liabilities/creditors due within one year		
Accounts Payable	50,000	
Short term funding	30,000	
		80,000
Net current assets (working capital)		**135,000**

Working capital is a cycle. Stock/Inventory becomes accounts receivable. Accounts receivable changes to deposits into bank/cash. Cash and deposits into the bank are used to settle accounts payable (suppliers). More materials are purchased from suppliers to purchase more stock/inventory; and so the cycle continues.

It is important that the working capital figure is always positive. A negative figure would indicate that the business is insolvent.

3. Review and compare

Forecasts are only predictions. To remain realistic and to be in control of your business it is always important to compare actual activity and results with that which has been forecast. This will almost certainly mean making ongoing changes, at least each month, based on what you know based on new and up to date information.

When preparing forecasts, test them. What would be the effect if that order which we believe will be placed in two months is delayed until the end of the next quarter? What will be the effect on the; profit and loss account, working capital and cash flow? This will almost certainly mean considering delaying the purchase and holding of stock (this will reduce the total accounts payable figure) and maintain cash reserves.

Another scenario is that an order is brought forward or that you have added a new product and demand for that product is high. What effect will this have on cash flow? Do you need to agree a short term funding solution in order to secure orders of materials.

Summary

Be realistic. Identify what you want to achieve. Your business plan and financial forecasts will be your route map from where you are now, to where you want to be as a business at a specific point in time. Test your forecasts for different and unexpected changes in activity such as a delay in an order, delay in being able to access stock and changes in demand.

Ensure that you prepare a '3 way forecast'. That is; the profit and loss account, cash flow and balance sheet. Remember the purpose of each one, and make sure that they align. Four key areas to look out for:-

Sales/Turnover
Profit
Working capital
Cash/bank

Finally; constantly review. As soon as you have new information, include it in your forecasts.

About the author

Tony Down FCCA is a Chartered Certified Accountant with many years of experience advising owner managed businesses. He acts as a consultant CFO for businesses throughout the UK, the majority of which trade nationally and internationally.

His speciality is within the turnaround and growth sectors, where the needs are often similar. For over a decade, he has delivered many seminars relating to financial management to new start and growth businesses, most recently to entrepreneurs from overseas opening businesses in the U.K.

He can be contacted at tony@tonydown.com