

PUBLIC COMPANY MANAGEMENT SERVICES

WHITE PAPER

Developing Financial Projections for Non-Finance People

This White Paper gives you the tools to answer the two most important questions any business must ask: “Are you financially prepared to begin? Are we able to sustain ourselves?”

You'll learn:

- What's on financial statements and how they get there
- How to develop and understand income statements
- How to set up and read balance sheets
- How to use common formulas to evaluate cash flow
- How to create a budget using standard guidelines
- How to read and evaluate income projections
- How to develop your own financial projections through a “fill in the blanks” approach”
- How to accurately determine the value of your idea or business

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A Budget and Financial Worksheet Overview

Managers must ask, 'is the business financially prepared to begin/continue'? Understanding basic budgeting guidelines, income projection statements, balance sheets and common formulas to evaluate cash flow help ensure successful operations. This financial knowledge significantly impacts a company's short term and long term success.

START-UP BUDGET

- personnel (costs prior to opening)
- legal/professional fees
- occupancy
- licenses/permits
- equipment
- insurance
- supplies
- advertising/promotions
- salaries/wages
- accounting
- income
- utilities
- payroll expenses

An operating budget is prepared when you are actually ready to open for business. The operating budget will reflect your priorities in terms of how you spend your money, the expenses you will incur and how you will meet those expenses (income). Your operating budget also should include money to cover the first three to six months of operation. It should allow for the following expenses.

OPERATING BUDGET

- personnel
- insurance
- rent
- depreciation
- loan payments
- advertising/promotions
- legal/accounting
- miscellaneous expenses
- supplies
- payroll expenses

- salaries/wages
- utilities
- dues/subscriptions/fees
- taxes
- repairs/maintenance

Other questions that you will need to consider are:

- What type of accounting system will your use? Is it a single entry or dual entry system?
- What are your sales and profit goals for the coming year? If a franchise, will the franchisor set your sales and profit goals? Or, will he or she expect you to reach and retain a certain sales level and profit margin?
- What financial projections will you need to include in your business plan?
- What kind of inventory control system will you use?

Sample balance sheets, income projections (profit and loss statements) and cash flow statements are included below along with detailed instructions for completing same.

INCOME PROJECTION STATEMENT

- Total net sales (revenues)
- Costs of sales
- Gross profit
- Gross profit margin
- Controllable expenses
- Salaries/wages
- Payroll expenses
- Legal/accounting
- Advertising
- Automobile
- Office supplies
- Dues/Subscriptions
- Utilities
- Miscellaneous
- Total controllable expenses
- Fixed expenses
- Rent
- Depreciation
- Utilities
- Insurance
- License/permits
- Loan payments
- Miscellaneous

- Total fixed expenses

Total expenses

- Net profit (loss) before taxes

Taxes

- Net profit (loss) after taxes

INSTRUCTIONS FOR INCOME PROJECTIONS STATEMENT

The income projections (profit and loss) statement is valuable as both a planning tool and a key management tool to help control business operations. It enables you to develop a preview of the amount of income generated each month and for the business year, based on reasonable predictions of monthly levels of sales, costs and expenses.

As monthly or quarterly projections are developed and entered into the income projections statement, they can serve as definite goals for controlling the business operation. As actual operating results become known each month, they should be recorded for comparison with the monthly projections. A completed income statement allows you to compare actual figures with projections and to take steps to correct any problems.

Industry Percentage

In the industry percentage column, enter the percentages of total sales (revenues) that are standard for your industry, which are derived by dividing

Costs/expenses items x 100%

These percentages can be obtained from various sources, such as trade associations, accountants or banks. Industry figures serve as a useful bench mark against which to compare cost and expense estimates that you develop for your firm. Compare the figures in the industry percentage column to those in the annual percentage column.

Total Net Sales (Revenues)

Determine the total number of units of consulting service you realistically expect to sell each period (per month or quarter) in each area of your business at the prices you expect to get. Use this step to create the projections to review your pricing practices.

- Exclude any revenue that is not strictly related to the business.

Cost of Sales

The key to calculating your cost of sales is that you do not overlook any costs that you have incurred. Calculate cost of sales of all services used to determine total net sales. Do not overlook transportation or travel costs if you're working at a distance. Also include all direct labor.

Gross Profit

Subtract the total cost of sales from the total net sales to obtain gross profit.

Gross Profit Margin

The gross profit is expressed as a percentage of total sales (revenues). It is calculated by dividing gross profits by total net sales

Controllable (also known as Variable) Expenses

- Salary expenses-Base pay plus overtime.
- Payroll expenses-Include paid vacations, sick leave, health insurance, unemployment insurance and social security taxes – may or may not be applicable.
- Outside services-Include costs of subcontracts, overflow work and special or one-time services.
- Supplies-Services and items purchased for use in the business.
- Repair and maintenance-Regular maintenance and repair.
- Advertising-Include desired sales volume and classified directory advertising expenses.
- Car delivery and travel-Include charges if personal car is used in business, including parking, tools, buying trips, etc.
- Accounting and legal-Outside professional services.

Fixed Expenses

- Rent-List only real estate used in business.
- Depreciation-Amortization of capital assets like computers.
- Utilities-Water, heat, light, etc.
- Insurance-Fire or liability on property or products.
- Include workers' compensation.
- Loan repayments-Interest on outstanding loans.
- Miscellaneous-Unspecified; small expenditures without separate accounts.

Net Profit (loss) (before taxes)

- Subtract total expenses from gross profit.
- Taxes - Include inventory and sales tax, excise tax, real estate tax, etc.

Net Profit (loss) (after taxes)

- Subtract taxes from net profit (before taxes)
- Annual Total - For each of the sales and expense items in your income projection statement, add all the monthly or quarterly figures across the table and put the result in the annual total column.

Annual Percentage

- Calculate the annual percentage by dividing Annual total x 100%

Sample BALANCE SHEET

Assets

Current assets

Cash \$ _____

Petty cash \$ _____

Accounts receivable \$ _____

Inventory \$ _____

Short-term investment \$ _____

Prepaid expenses \$ _____

Long-term investment \$ _____

Fixed assets

Land \$ _____

Buildings \$ _____

Improvements \$ _____

Equipment \$ _____

Furniture \$ _____

Automobile/vehicles \$ _____

Other assets

- 1. \$ _____
- 2. \$ _____
- 3. \$ _____
- 4. \$ _____

- Total assets \$ _____

Liabilities

Current Liabilities

Accounts payable \$ _____

Notes payable \$ _____

Interest payable \$ _____

Taxes payable

Federal income tax \$ _____
State income tax \$ _____
Self-employment tax \$ _____
Sales tax (SBE) \$ _____
Property tax \$ _____
Payroll accrual \$ _____
Long-term liabilities
Notes payable \$ _____
Total liabilities \$ _____

Net worth (owner equity) \$ _____

Proprietorship

or

Partnership

(name's) equity \$ _____

(name's) equity \$ _____

or

- Corporation

Capital stock \$ _____

Surplus paid in \$ _____

Retained earnings \$ _____

Total net worth \$ _____

- Total liabilities and
- total net worth \$ _____

(Total assets will always equal total liabilities and total net worth)

INSTRUCTIONS FOR BALANCE SHEET

Figures used to compile the balance sheet are taken from the previous and current balance sheet as well as the current income statement. The income statement is usually attached to the balance sheet. The following text covers the essential elements of the balance sheet.

At the top of the page fill in the legal name of the business, the type of statement and the day, month and year.

Assets

List anything of value that is owned or legally due the business. Total assets include all net values. These are the amounts derived when you subtract depreciation and amortization from the original costs of acquiring the assets.

Current Assets

- Cash-List cash and resources that can be converted into cash within 12 months of the date of the balance sheet (or during one established cycle of operation). Include money on hand and demand deposits in the bank, e.g., checking accounts and regular savings accounts.
- Petty cash-If your business has a fund for small miscellaneous expenditures, include the total here.
- Accounts receivable-The amounts due from customers in payment for merchandise or services.
- Inventory-Includes raw materials on hand, work in progress and all finished goods, either manufactured or purchased for resale.
- Short-term investments-Also called temporary investments or marketable securities, these include interest- or dividend-yielding holdings expected to be converted into cash within a year. List stocks and bonds, certificates of deposit and time-deposit savings accounts at either their cost or market value, whichever is less.
- Prepaid expenses-Goods, benefits or services a business buys or rents in advance. Examples are office supplies, insurance protection and floor space.

Long-term Investments

Also called long-term assets, these are holdings the business intends to keep for at least a year and that typically yield interest or dividends. Included are stocks, bonds and savings accounts earmarked for special purposes.

Fixed Assets

Also called plant and equipment. Includes all resources a business owns or acquires for use in operations and not intended for resale. Fixed assets may be leased. Depending on the leasing arrangements, both the value and the liability of the leased property may need to be listed on the balance sheet.

- Land-List original purchase price without allowances for market value.
- Buildings
- Improvements
- Equipment
- Furniture and Computers
- Automobile/vehicles

Liabilities

Current Liabilities

List all debts, monetary obligations and claims payable within 12 months or within one cycle of operation. Typically they include the following:

- Accounts payable-Amounts owed to suppliers for goods and services purchased in connection with business operations.
- Notes payable-The balance of principal due to pay off short-term debt for borrowed funds. Also includes the current amount due of total balance on notes whose terms exceed 12 months.
- Interest payable-Any accrued fees due for use of both short- and long-term borrowed capital and credit extended to the business.
- Taxes payable-Amounts estimated by an accountant to have been incurred during the accounting period.
- Payroll accrual-Salaries and wages currently owed.

Long-term Liabilities

Notes payable-List notes, contract payments or mortgage payments due over a period exceeding 12 months or one cycle of operation. They are listed by outstanding balance less the current position due.

Net worth

Also called owner's equity, net worth is the claim of the owner(s) on the assets of the business. In a proprietorship or partnership, equity is each owner's original investment plus any earnings after withdrawals.

Total Liabilities and Net Worth

The sum of these two amounts must always match that for total assets.

MONTHLY CASH FLOW PROJECTION

1. Cash on hand (beginning month)

2. Cash receipts

- (a) Cash sales
- (b) Collections from credit accounts
- (c) Loan or other cash injections (specify)

3. Total cash receipts

(2a+2b+2c=3)

4. Total cash available

(Before cash out) (1+3)

5. Cash paid out

- (a) purchases (merchandise)
- (b) Gross wages (excludes withdrawals)
- (c) Payroll expenses (taxes, etc.)
- (d) Outside services
- (e) Supplies (office and operating)
- (f) Repairs and maintenance
- (g) Advertising
- (h) Car, delivery and travel
- (i) Accounting and legal
- (j) Rent
- (k) Telephone
- (l) Utilities
- (m) Insurance
- (n) Taxes (real estate, etc.)
- (o) Interest
- (p) Other expenses (specify each)
- (q) Miscellaneous (unspecified)
- (r) Subtotal
- (s) Loan principal payment

- (t) Capital purchases
- (specify)
- (u) Other start-up costs
- (v) Reserve and/or escrow
- (specify)
- (w) Owner's withdrawal

6. Total cash paid out (5a through 5w)

7. Cash position (end of month) (4 minus 6)

- Essential operating data
- (non-cash flow information)
 - A. Sales volume (dollars)
 - B. Accounts receivable
 - (end on month)
 - C. Bad debt (end of
 - month)
 - D. Inventory on hand (end
 - of month)
 - E. Accounts payable (end
 - of month)

INSTRUCTIONS FOR MONTHLY CASH FLOW PROJECTION

- 1. Cash on hand (beginning of month) -- Cash on hand same as (7),
- Cash position, pervious month
- 2. Cash receipts-
 - (a) Cash sales-All cash sales. Omit credit sales unless cash is actually received
 - (b) Gross wages (including withdrawals)-- Amount to be expected from all accounts.
 - (c) Loan or other cash injection-Indicate here all cash injections not shown in 2(a) or 2(b) above.
- 3. Total cash receipts ($2a+2b+2c=3$)
- 4. Total cash available (before cash out)(1+3)
- 5. Cash paid out -
 - (a) Purchases (merchandise)--Merchandise for resale or for use in product (paid for in current month).
 - (b) Gross wages (including withdrawals)-- Base pay plus overtime (if any)
 - (c) Payroll expenses (taxes, etc.)-- Include paid vacations, paid sick leave, health insurance, unemployment insurance, (this might be 10 to 45% of 5(b))
 - (d) Outside services-This could include outside labor and/or material for specialized or overflow work, including subcontracting
 - (e) Supplies (office and operating)--Items purchased for use in the business (not for resale)
 - (f) Repairs and maintenance-Include periodic large expenditures such as painting or decorating
 - (g) Advertising-This amount should be adequate to maintain sales volume
 - (h) Car, delivery and travel-If personal car is used, charge in this column, include parking
 - (i) Accounting and legal-Outside services, including, for example, bookkeeping
 - (j) Rent-Real estate only (See 5(p) for other rentals)
 - (k) Telephone
 - (l) Utilities-Water, heat, light and/or power
 - (m) Insurance-Coverage on business property and products (fire, liability); also

worker's compensation, fidelity, etc.

Exclude executive life (include in 5(w))

- (n) Taxes (real estate, etc.)-- Plus inventory tax, sales tax, excise tax, if applicable
 - (o) Interest-Remember to add interest on loan as it is injected (See 2© above)
 - (p) Other expenses (specify each)
-

Unexpected expenditures may be included here as a safety factor

Equipment expenses during the month should be included here (non-capital equipment)

When equipment is rented or leased, record payments here

- (q) Miscellaneous (unspecified)--Small expenditures for which separate accounts would be practical
- (r) Subtotal-This subtotal indicates cash out for op
- (s) Loan principal payment-Include payment on all loans, including vehicle and equipment purchases on time payment
- (t) Capital purchases (specify)--Nonexpensed (depreciable) expenditures such as equipment, building purchases on time payment
- (u) Other start-up costs-Expenses incurred prior to first month projection and paid for after start-up
- (v) Reserve and/or escrow (specify)-- Example: insurance, tax or equipment escrow to reduce impact of large periodic payments
- (w) Owner's withdrawals-Should include payment for such things as owner's income tax, social security, health insurance, executive life insurance premiums, etc.
- 6. Total cash paid out (5a through 5w)
- 7. Cash position (end on month) (4 minus 6)-- Enter this amount in (1) Cash on hand following month-

Essential operating data (non-cash flow information)--

This is basic information necessary for proper planning and for proper cash flow projection. Also with this data, the cash flow can be evolved and shown in the above form.

- A. Sales volume (dollars)--This is a very important figure and should be estimated carefully, taking into account size of facility and employee output as well as realistic

anticipated sales (actual sales, not orders received).

- B. Accounts receivable (end of month)-- Previous unpaid credit sales plus current month's credit sales, less amounts received current month (deduct "C" below)
- C. Bad debt (end on month)-- Bad debts should be subtracted from (B) in the month anticipated
- D. Inventory on hand (end on month)-- Last month's inventory plus merchandise received and/or manufactured current month minus amount sold current month
- E. Accounts payable (end of month) Previous month's payable plus current month's payable minus amount paid during month.
- F. Depreciation--Established by your accountant, or value of all your equipment divided by useful life (in months) as allowed by Internal Revenue Service