Projecting an Income & Expense Statement

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Forecasting for a new business can be difficult at first glance. After all, how could you accurately predict your business finances, when you've never even opened your doors? It's simple, you don't! This exercise is not about accuracy; it is about **"reasonably predicting & planning"** for your business operations.

This means:

- Use your common sense
- Apply what it is you do know
- Find out what you don't know, and
- Ask others who might know

You then take this information and make an assumption. An assumption is your best guess based on the information you have collected. Your ability to accurately forecast financial statements is increased by your ability to make assumptions. Remember, the task is not to be 100% accurate, but to be confident that your forecasts are reasonable and that you can back them up.

FINANCIAL PROJECTIONS

Financial projections are important planning tools to ensure that you see your business as a whole. Although each financial projection is completed for a different reason, each one will help you:

- Learn more about your business
- Choose between alternative courses of action
- Measure your performance, and
- Plan for next year

It is important to complete your financial projections to ensure that you:

- Are financially prepared for seasonal changes in your business
- Are properly financed
- Do not run short of money to operate
- Do not tie up too much money in inventory
- Are able to revolve your line of credit

Financial projections generally include the following:

1. Projected Income & Expenses Statement
2. Projected Balance Sheet
3. Projected Cash Flow Statement, and
4. Break Even Point

The process of completing your projected statements begins with the development of a Cash Flow Statement. A cash flow statement is a monthly projection of the money you ACTUALLY receive in a month and the amount of money you ACTUALLY spend in that month. The key word is **ACTUALLY**. It is a powerful management tool. It will:

1. Help you see the sales cycles in your business
2. Let you know when you are over-spending
3. Highlight the top products or services you offer
4. Help to develop your marketing strategy
5. Identify variances in your sales and expenses so that you can adjust

It is recommended that you develop your cash flow statement using Excel or an equivalent spreadsheet program. This will allow you to make changes as needed and all rows and columns will automatically correct themselves.

To determine the dollar value for each line item in your projections, you will need to make assumptions.

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MAKING ASSUMPTIONS

Assumptions are not guesses in the dark, but are specific things you can assume based on:

- Your knowledge of your industry
- Facts you have gathered from others in your type of business
- Seasonal fluctuations of sales (which months are better than others)
- Price fluctuations in your costs of raw materials, supplies or product
- Awareness of upcoming legislative or changes to regulations

For example, a toy store can be confident that sales will increase in the fall & winter months just before Christmas. On the other hand, the manufacturers of these toys will have their busiest season during the spring & early summer, when the toy stores are ordering product for their Christmas lines. Furthermore, the businesses that supply the toy manufacturers with raw materials can expect winter to be their busiest time as manufacturers gear up for the coming year.

Use the following questions to help you think about what types of assumptions you can make about your business at this time. Businesses can use a variety of different measures to forecast their sales. In one business it may make sense to use industry averages, another may assume that they would have 1500 customers who would spend on average $25.00 each month. The range of assumptions is very broad. Preview the following list of assumptions that businesses have used to forecast their sales:

- The total number of customers you would have in a day, a week, a month, a year.
- How much, on average, each customer would spend?
- How often a customer would buy your product? (i.e. daily, holidays only, monthly, seasonally, quarterly, in winter only, yearly, once in a lifetime?)
- How many units or hours on average would each customer buy in any given day, month, or year?
- Will your customer base be consistent or will it grow or change over time?
- Will sales increase or decrease in certain months?

Based on your answers to the above questions, reasonably project what your sales will be each month, for each sales category.

This is the layout for the Cash flow statement. The example here is for 6 months, you will be doing yours for 12 months.

Cash In	Jan	Feb	March	April	May	June	Total
Item 1							
Item2							
Item 3							
Item 4							
Total Cash In							
Cash Out							
Rent							
Utilities							
Vehicle expenses							
Telephone/Internet							
Bank Charges							
Loan Interest							
Advertising							
Licenses/Permits							
Insurance							
Office Supplies							
Professional Fees							
Owners Withdrawal							
Total Cash Out							
Cash Available							
Cumulative Cash							

In the **Cash In** section, you want to list each item that you sell or at the very least groupings of items that you sell. As you are trying to determine the dollar value or revenue you will generate from each item in each month, it often helps to visualize your target customer and try to determine how much they will spend or how many units you will sell.

In the **Cash Out** section you want to record each expense that you will pay in each month, keeping in mind that some items may be quarterly or annually. You also need to ensure that you put in owners withdraw as you will need to draw money to live so plan for it now even if you can’t have it at the very beginning. The cash available row tells you what is left after all bills are paid. The cumulative cash row at the bottom of the spreadsheet is the amount of money that is left in your company each month after all expenses have been paid – Cash in the Bank! To determine the cumulative cash balance is quite simple. In Jan it is the total cash available for that month. In February it is the cash available in February plus the cumulative cash from January and so on.

In the above example, the total column, tells you how much you have made in those six months (total cash in); how much you have spent (total cash out) and if there is any profit. **Your** cash flow statement will provide that information for a full year. It is recommended that you compare what actually happened in each month against what you projected, at least quarterly, so that if you are way off you can make the necessary adjustments.

Every number on this cash flow statement will be transferred to your projected income and expense statement. Therefore, putting lots of thought into the development of your cash flow statement will save you time in the end.

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Here are some examples of common expenses (**cash out**) items that many businesses have.

Property Taxes	Business Taxes
Office/Bldg Rent	Equipment Rent/Lease
Accounting & Legal Fees	Utilities (power, gas, water)
Advertising (business cards, flyers, newspaper ads)	Promotion (brochures, trade shows)
Delivery, Freight Charges	Insurance
Licenses, Permits	Telephone/Internet
Bank Service Charges	Loan Interest
Vehicle-Fuel	Vehicle-Repairs/ Maintenance
Shop Supplies	Office Supplies (paper, files, postage, stapler, invoices)
Wages for employees	Employers share of EI, CPP
Owner’s withdrawals	

PROJECTED INCOME & EXPENSE STATEMENT

A projected income & expense statement is done annually and should be done for a three-year period. The numbers for the first year will come from the total column on your cash flow statement. In the second year you can anticipate a bit of an increase and in your third year you can show a 5% increase in your revenue streams. In most cases a new business will **not** show significant gains until at least year 5.

This statement may also be referred to as a:

1. Pro-forma Income Statement
2. Projected Revenue & Expense Statement
3. Projected Statement of Earnings
4. Projected Statement of Operations

This statement will forecast:

- How much money you will make (gross sales)
- How much money you spent in expenses
- How much taxable profit you will make

The first step in forecasting an Income & Expense Statement is to determine your categories of:

- Revenue
- Cost of Goods Sold (COGS) *
- Expenses

*** COGS only applies when you are producing a product to be sold (a manufacturer) or buying the product from a wholesaler (retail). It is very rarely used in a service business.**

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Revenue Categories

This information is in the Cash Flow statement and includes all items in the **Cash In Section**. Below are two examples:

ABC Convenience Store	XYZ Creative Designs
- confectionary	- custom sewing
- groceries	- alterations & repairs
- printed materials	- sewing workshops
- tobacco	

You will notice in ABC Convenience Store the revenue items are groups. In the XYZ Creative Designs the revenue items are very specific.

Cost of Goods Sold (COGS) Categories

The categories for your Cost of Goods Sold will be exactly the same as your revenue categories. The only difference is that you will put COGS in front of each category:

- Revenue item: "Custom Sewing"
- COGS item: "COGS-Custom Sewing"

The Cost of Goods Sold will include all input costs associated with producing that product. It is important to figure out your Cost of Goods on a per unit basis. Refer to the "Pricing your Product/Service" module for formulas and examples. Some of the most common inputs will be:

- Raw material
- Consumables
- Direct Labour

In the custom sewing example, the inputs would be:

- Raw Materials – the fabric used
- Consumables – needles, thread, buttons, zipper, etc
- Direct Labour – the amount of time it takes you to sew the item

Your cost to buy, manufacture or provide products can be directly influenced, over time, by factors other than price. A change in the price you pay a wholesaler is generally the result of something else going on. Do not assume in your projections that you will always buy at the same price.

Although there is only one line per revenue category, to enter your Cost of Goods, remember that this line should include **all** those expenses that are directly related to your costs to produce the product. It is often referred to as a direct variable cost, which is a cost you would not incur if you didn't produce the product.

Retail businesses should include:

- The price to purchase the product
- Shipping & freight charges to receive the product from the supplier

Manufacturing businesses should include:

- Cost of raw materials
- Shipping & freight charged on raw materials
- Shop supplies used to produce the product
- Direct labour costs
- Direct overhead costs (only those costs associated to operate the production facilities)

Complete the following exercise to help you determine what other assumptions you might have to consider in your forecast. Be aware of which factors may influence the situation and try to compensate for possible changes in prices.

Which factors could influence the cost of your goods? Check those that apply and using an arrow determine if they could increase or decrease.

Labour	______	Shipping	______
Available supply	______	Packaging	______
Competition	______	Season	______

1. Are you or your industry anticipating any significant changes in this area over the coming year that would impact your pricing?

   Yes ____ No _______

2. Will you incur shipping or freight charges to receive your goods?

   Yes ____ No _______

3. Do you know what these costs will be?

   Yes ____ No _______

Once you determine which types of costs may be affected, adjust your forecasts accordingly. For example, you got a good buy for the first order of goods, but you know when you re-order in three months, your cost to buy will be higher. Or maybe the freight company has told you their rates will be increasing by 10% effective June 1st.

Expense Categories

Now list the major types of expenses you will have over the course of the year. Remember, these line items will be found on your Cash Flow Statement under the **Cash Out Section**.

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PROJECTED REVENUE & EXPENSE TEMPLATE

Company Name

Projected Income and Expense

For the 3 years ending 20___

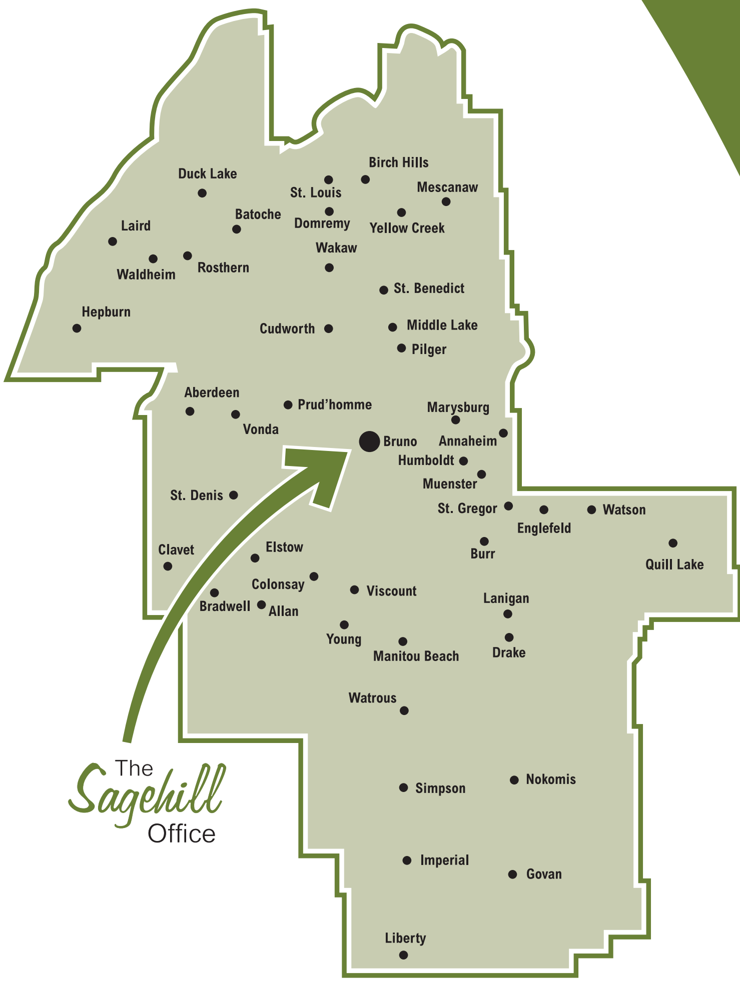
Revenue	Year 1	Year 2	Year 3
Total Revenue			
Cost of Goods Sold			
Profit Margin (Revenue-COGS)			
Expenses			
Total Expenses			
Profit/Loss (Profit Margin-Total Expenses)			

Profit Margin: Total Revenue less COGS.

- The Profit Margin is the amount of money left to pay all other expenses and generate a profit.

Profit/Loss: Profit Margin less Total Expenses

- The Profit/(Loss) is the amount of profit you have made (lost if negative) after all expenses have been paid for a given period.



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