

Information Sheet: Financial Forecasting & Planning

Introduction

Financial forecasting and planning is usually an essential part of the business plan, and would be done as part of setting up the organisation and obtaining funds.

Financial forecasting and planning is also an essential activity to ensure good management – keeping the organisation solvent is a key objective. The governing body of the organisation has responsibility for financial management, both day to day basis and long range. In order to carry out this responsibility, financial information needs to be organised and analysed so that the long-term implications of decisions can be understood.

Financial forecasting and planning involves:

- Assessing the nature and scope of the enterprise to determine what resources will be needed and where they will come from;
- Projecting financial requirements and resources needed into the future to draw up a budget;
- Setting up procedures and accounting systems to ensure financial control and accountability (please refer to Social Enterprise Works Information Sheet 'Financial Accounts')
- Utilising various forms of financial analysis to guide major financial decisions and ensure the organisation is always able to cover its outgoings.

Legal Issues

The governing body may be held personally liable if the organisation trades without sufficient funds to pay creditors. Refer to IPS and charity legislation to find out more.

Sources of Funds

It is likely that all necessary funding will come from one source and it will be necessary to put together a 'package' of funding. This may include:

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- Income from trading
- Grants and equity for start-up
- Overdrafts, loans
- Fundraising, donations, sponsorship
- Leasing arrangements for major capital expenses (vehicles, photocopiers)
- In-kind (non-financial, but money-saving) items (e.g. Premises)
- Owners/shareholders
- Financial planning will involve consideration of which type of funding is suitable for different parts/purposes of the enterprise, and which sources are appropriate at different stages. Most community enterprises seek to become sustainable in the longer term of they obtain grant and other one-off types of support to help with starting-up.

Budget

A budget for the first year is the basic financial planning tool, and is useful to:

- Assign a value to assets and resources needed in the business;
- Identify needs and possible problems in advance;
- Help identify areas of record-keeping;
- Monitor actual income and expenditure.

The budget generally sets out Income (source of funds) and Expenditure, with expenditure broken down into Capital expenditure and Revenue expenditure: -

- Capital Expenditure: one-off expenditure, usually on fixed and long-term assets. These would include property and equipment, purchases;
- Revenue Expenditure: costs of day-to-day running of the business, which are expended within the financial year. These are divided into;
- Direct Costs: linked to level of use/service/production e.g. materials;
- Fixed Overheads (indirect): which generally remain the same with any level of activity (rent, rates);
- Variable Overheads (indirect): e.g. travel, telephone.

These classifications are important in determining the minimum level of income necessary to avoid a loss (see 'Breakeven point' below), and for calculating the Profit and Loss Account.

The objectives of the budget is to show that over a year the income and expenditure are at least equal, and hopefully the income would be greater than the expenditure (profit).

Cash Flow

The budget gives an overview of income and expenditure for the year, but on a monthly basis the organisation could still find they do not have enough funds (cash) to cover expenses.

A cash flow forecast helps to avoid this situation by looking at individual items of income and expenditure on a monthly basis to form a 'matrix' (months across the top, items down the side), with a balance shown at the end of the month.

The cash flow chart can include a column showing the budget for that item, which allows potential problems to be highlighted. Where actual income and expenditure differ from those set out in the budget, it is called "variance", and in turn the scale of monthly "variance" will trigger the need for action. Some of the most likely problems are: -

- Rising costs - compare actual figures with forecasts. Look particularly for rising overheads – (lighting, heating, advertising)
- Under pricing – which leads to inadequate income. Check that the selling price of products/services is covering costs.
- Over-trading – income delayed so to doesn't cover up-front costs (e.g. rent, rates)

Profit and Loss Accounts

The Profit and Loss Account, also called trading accounts, is normally used to show the performance of the business over the past year in terms of Gross Profit (after subtracting direct costs but before subtracting indirect costs) and Net Profit (after subtracting tax). It can be projected forward to give a "Profits Forecast", so that potential for business growth, or any potential losses, can be anticipated.

Balance Sheet

Balance Sheets show the overall value of the business at a fixed point in time, and show it is "in the black/red" (solvent or not). They usually are part of the end-of-year accounts, but are often produced more frequently to provide projections for a future point in time to help with financial management decisions.

The Balance Sheet includes:

- What the organisation owns (assets), including Fixed Assets (property and major capital items) and Current Assets (stock, debtors, investments, cash); and
- What the organisation owes others (liabilities), including Current Liabilities (creditors) and Long Term Liabilities (such as loans).

The “Bottom Line” of this account shows whether the assets are greater than the liabilities (and the organisation is solvent) or are less than the liabilities (in which case the organisation may be insolvent and in most cases should not be trading).

Breakeven Point

A useful financial technique is the calculation of the Breakeven Point, which is the point at which the income equals the expenditure. The technique is most helpful when income is linked to units of actual service provision or products sales, so that the Breakeven Point is the level of income that will cover both direct costs associated with that level of output as well as overheads (see budget above).

Risk Analysis

Good financial planning includes “risk analysis” anticipating aspects of the business where things might go wrong, assessing the possible impact and having “contingency plans” prepared to counteract the impact. Risks will be different for different enterprises, but the governing body will need to ask a series of questions such as “What if costs increase?” or “What if the worst should happen?”