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Profit forecasts

Business Link

What is a profit forecast and why is it important?

Profit or income forecasts set out what an enterprise expects to happen in the future. The forecast establishes the timing of activities, such as sales of products or delivery of services, month by month.

The activity is given a financial value, i.e. how much income you expect to generate. The forecast also sets out the cost of selling the product or delivering the service. Other costs associated with supporting the enterprise to function are also listed in the profit forecast.

How a profit forecast is broken down

The forecast seeks to explain the “legal” impact of your actions. For example, if you deliver employment training in January and you are entitled to invoice the work that month, you record the invoice in January in the profit forecast. You have an obligation to pay the subcontractor for the work in February, so you record the liability in February.

The profit forecast is also used to show the “normal” course of trading activities. This means that some items, such as a large capital purchase which happens irregularly and the size of which has a significant impact on finances, would distort the underlying trading pattern. For this reason these are shown only in the cash flow - what actually happens in reality, i.e. when you really expect to receive and pay money, is reported in the cash flow forecast.

By convention items of income are recorded first and subtotalled. Items of expenditure are listed next and subtotalled. The difference between the two will give you your monthly expected Profit (income greater than expenses) or Loss (income less than expenses). Losses and negative figures are shown in brackets.

What does a profit forecast look like?

An example of a profit forecast is set out below:

Profit Forecast for 12 months to 20XX					
	Jan	Feb			Total
Income					
Fees activity 1	1,500	2,000			000
Fees Activity 2	2,000	2,250			000
Total Income	3,500	4,250			000
Expenditure					
Salaries	1,500	1,500			000
Subcontractors fees etc.	1,000	1,200			000
Rent	1,000	1,000			000
Total expenditure	3,500	3,700			000
Profit/(Loss)	0	550			000

It is unusual for a new enterprise to show profitability within the first 12 months of operation. Most experts expect an initial loss followed by periods of break even and then profits.

Income/sales growth may be visualised as set out below:

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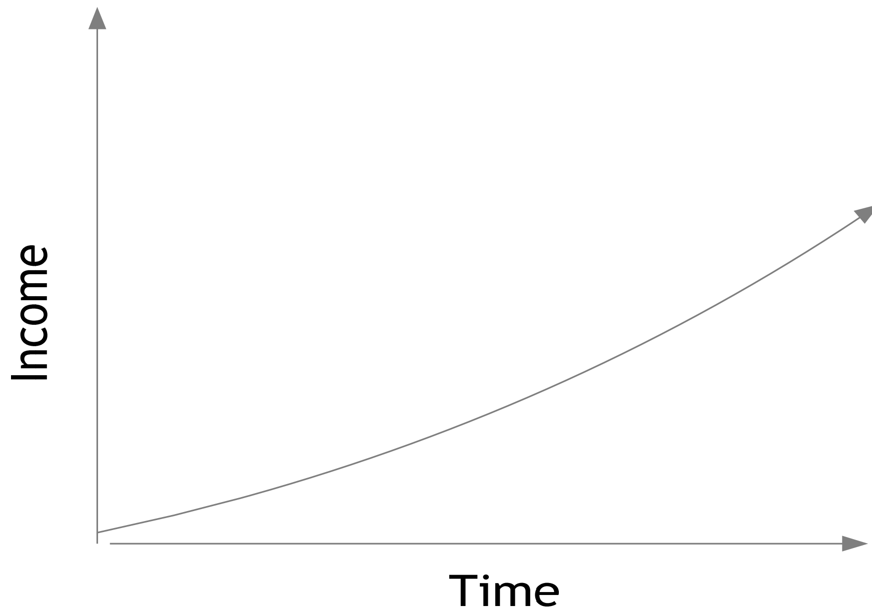

Many enterprises destroy their credibility by showing instant profits in their forecast. This reflects badly on the management's grasp of reality, and they are unlikely to find many supporters.

In practice it always takes longer to get to profitability than you expect, so play it safe and allow sufficient time to get there. Ensure that you account for all sources of income and can justify both the quantity and the timing.

Similarly, you should ensure that all costs have been captured and listed. There should not be any glaring errors. A sample list is shown below:

- salaries
- Employer's National Interest Contribution
- cost of goods
- sub contractor fees
- consultancy
- travel
- rent
- rates
- utilities
- insurance
- telecommunications
- web support
- office supplies
- postage and stationery
- bank charges and interest
- equipment and asset depreciation
- licences
- subscriptions
- training
- conferences
- legal fees
- accountancy and audit fees
- accountancy/ book keeping costs
- sundry costs

It is always best to "pad" out the expenses a bit. You are likely to incur more costs than you anticipate. It is better to show that you under spent and trumpet your financial management skills than having to admit an underestimate of costs.

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Items such as rent, rates, utilities, insurance, legal and audit fees tend to be divided equally across the year.

What shouldn't be in your profit forecast

There are some items that need special attention.

Some common items that should appear in the cash flow and not the profit forecast are:

- capital purchases – equipment, assets etc.
- VAT
- loans
- loan repayments
- investments received
- investments made

These are items that are:

- not trading activities – loans, investments etc. and so are not part of the profit and loss account.
- not legally "owned" by the enterprise – VAT is collected and paid on behalf of the Government, loans belong to the lender etc.
- exceptional or distorting items – capital/equipment/ assets purchases.

Items that appear in the profit forecast and not the cash flow are:

- Depreciation

Depreciation is a method of measuring the use of assets/equipment that allows the enterprise to trade. This is an accounting entry and not an actual cash movement and so is not part of the cash flow (the purchase of assets/equipment is shown in the cash flow forecast and not in the profit forecast).

Further information

Read our guide on Financial forecasts:
www.bllondon.com/SocialEnterprise/Fundingandfinance/Financialplanning/Financialforecasts.aspx

Read our guide on Balance sheets:
www.bllondon.com/SocialEnterprise/Fundingandfinance/Financialplanning/Balancesheets.aspx

Read our guide on Developing assumptions for financial forecasts:
www.bllondon.com/SocialEnterprise/Fundingandfinance/Financialplanning/Developingassumptionsforfinancialforecasts.aspx

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Web: www.businesslink.gov.uk/london/socialenterprise Email: info@bllondon.co.uk
Enquiry Line: 0845 6000 787