

## a vital mapping tool

["Projections can provide a vital mapping tool but if you don't have a destination any map is ineffective..."](#)

### **Financial projections – why bother and how to prepare?**

#### **A question of time**

The most often repeated reason for not producing a set of financial projections is 'time'. However, we would contest that having a set of financial projections can be 'time saving' for a number of reasons, specifically:

- a) projections can give advance warning of 'pressure points' for cash and thus enable proactive cash management and/or discussions with existing and potential financiers (as opposed to crisis management of cash shortfall when it materialises); and
- b) projections can be used as 'targets' for the delegation of certain aspects of the business for example sales targets, cost control or cash collection.

(Note: we can present similarly compelling arguments against the other favourite reasons including; 'my business cannot be projected' and 'it is crystal ball gazing'.)

## clearly documented

["One aspect that is essential, whatever package is used to prepare the projections, is for assumptions to be clearly documented."](#)

### **Projections are often required by third parties...**

Even if you are not swayed by our arguments above in some cases your business goals may only be achievable with the aid of external finance. In such cases financial projections are often a 'prerequisite' to a successful finance application.

#### **Good practice**

In terms of what constitutes 'good financial projections' we set out 5 key aspects below:

##### **1. The projections must be yours!**

The projections must be 'your document' – you must believe the underlying assumptions and that the projections are aligned with your goals. Assumptions will be challenged and you must be prepared to defend (with supporting information if possible).

##### **2. Use the opportunity to make your strategy real**

Projections can provide a vital mapping tool but if you don't have a destination any map is ineffective: one approach is to think about what your business must look like in 4-5 years for your/ the strategic objectives to be attained and work back to consider what the current year must look like and start the modelling on this basis.

**Under this head you should also consider;**

- a) What must happen for the business to develop as projected; and,
- b) What could prevent success and what can be done to mitigate and manage that risk?

## understand your audience

"You need to understand your audience when preparing a set of projections so that you can focus (in the presentation) on the aspects that will be important to them"

### 3. Use standard software

We suggest using an 'off the shelf' piece of forecasting software for preparing financial projections as:

- the software produces integrated profit/loss, balance sheet and cash flow projections;
- the internal 'integrity' of the software is 'validated'; and
- the software is designed to look at 'what if' scenarios.

### 4. Document assumptions

One aspect that is essential, whatever package is used to prepare the projections, is for assumptions to be clearly documented. We try and summarise these into two or three pages of narrative, plus spreadsheets for significant variables.

### 5. Understand the context of the projections

You need to understand your audience when preparing a set of projections so that you can focus (in the presentation) on the aspects that will be important to them. E.g., it is likely that a debt investor will be primarily concerned with ability to 'service the debt' whereas the equity investor is likely to be interested in the longer term picture in assessing their potential return.

### Our approach to the preparation of financial projections...

We have developed a five stage approach to working with owners/ managers on financial projections and would suggest this can be modified to suit most situations:

- Produce a projected profit and loss account – we find that owners/ managers feel most 'comfortable' projecting a profit and loss account;
- Input the profit and loss captions into the forecasting software for the production of integrated projections and consider cash flow.

#### Items to think about include:

- credit terms for cash receipts and payments;
  - capital expenditure;
  - stock cycle;
  - one off costs to make step change to business;
  - tax (including VAT, PAYE/ NI and tax on profits); and
  - opening balances
- Prepare assumptions document and read through 'cold'.
  - Review the projections for 'reasonableness' in the context of business plan and historic performance. Specifically review the balance sheet to consider the validity of the assumptions made / modelled on cash flow e.g., a significant decrease in trade debtors at the end of a period of growing turnover may indicate that the assumption on credit actually taken by customers is not what actually occurs at present...
  - Last checks, including:**
    - Consistency with any business plan?
    - Are any specific issues raised by financier dealt with?
    - Are projections consistent with goals?
    - Do you believe the figures?

### And finally...

It can be argued that the 'real value' of projections is as a management tool and to realise this, actual results need to be compared to the projections. But that is for another factsheet...

If you would like to discuss any issues raised in this guidance note, please contact:

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