# Business Plan Financials *Simplified*

CEDF

## Objectives

One of the crucial skills for success is learning how to understand the standard ways of describing the performance of a business.

We have to rely on certain standards, agreed terminology and measurements. It wouldn't be sensible if everyone relied on their own ways of judging performance. But that's the situation if you don't conform your understanding to the rules the business world uses.

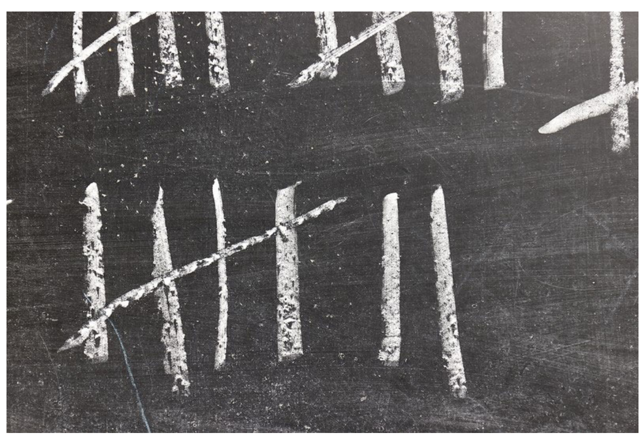
So we've got to become familiar with the basics. We're calling these financial fundamentals. And we're going to use simplified examples and terminology to give you enough of a grasp of this subject to help you begin to converse in the language of business.

## The Three Questions

It seems that there three questions always on the mind of a business owner. Here they are:

**1. Am I making money?**
**2. What's my business worth if I were to sell it?**
**3. What's the future hold?**

These are clearly important questions and the answers are potentially complicated. So it's well worth our time to learn how to answer them.



You can think of business being like a game and a game needs rules for scorekeeping. After all it wouldn't make much sense to invest a lot of energy and effort if you didn't know the outcome. Unfortunately, that's the way some business owners try to play the game. They haven't learned enough of the rules to be able to tell you the score. And that can lead to some bad results.

The accounting profession has developed customs and rules for scorekeeping in business. That's really the main purpose of one aspect of accounting called bookkeeping — keeping score. Fortunately you don't have to be an expert to run a successful business.

Accountants have developed standardized financial reports including the Income Statement and Balance Sheet (discussed below) and methods of analysis to help keep score. These provide the ways we can answer the three crucial questions business owners ask:

**Business owners think**
1. Am I making money?
2. What's my business worth if I were to sell it?
3. What's the future hold?

| Accountants say | Accountants use |
| --- | --- |
| Is the business making a profit? | Income Statement |
| What's the business' equity (or net worth)? | Balance Sheet |
| What do the forecasts tell us? | Cash Flow Forecast |

# What's Profit?

Proper evaluation of business performance requires that we measure profit. It gets so much attention that you might think that profit is the only important measure and that's not the case. But it does provide an interim score of sorts for a particular period of a game, like an inning in baseball, a half in football or periods in hockey.

Time is an important concept when measuring profit. It should be obvious that very short periods like a minute, an hour or a day would not be sensible to use. Such short periods would not provide meaningful intervals over which to gauge a business' performance. Longer periods like a month, a quarter (three months) or a year make more sense. The closest comparison we might have to a final score in a sports contest might be the profit for a particular year in business.

To understand the measurement of profit, we need to look at what profit is not.

It is not the same as how much money we have. Money in our pocket or in our bank account may be important, but it can't tell us everything about our profitability. Money comes and goes as we take it in and pay it out. But what we are owed by others or what we owe to others may have to be considered as we will see later.

A major mistake some business owners make is simply watching their bank balance to evaluate the performance of their business. This can lead to big mistakes.

Profit also can't be measured based on business activity. Lots of work and lots of sales doesn't guarantee lots of profit (or any profit at all). This is the second major mistake — judging results based on the tempo of activity.

The basic formula for profit you probably already know:

**Revenue minus Expense equals Profit**

The complexity comes in defining exactly what those terms mean under varying circumstances.The financial report that accountants use to explain this is called an Income Statement. Many people also use the terms such as Profit and Loss or P&L or Income and Expanse statement. It refers to the same report.

Just like the English language, the world of accounting is full of terms that are used interchangeably at times, sometimes imprecisely. You'll have to accept this inconvenience.

For instance, when talking about a corporation's profitability, the business world uses the term Income.
Net Income and Net Profit mean the same. But simply referring to "income" could raise questions such as before or after income taxes?

Also people tend to interchange income and revenue which are very different concepts. It might be an easy mistake. Income sounds like what "comes in." But a better definition of Income or Profit is "what's left over" (after subtracting expenses).


## What's Revenue?

For simplification, we will consider Revenue and Sales to be the same thing. More complex businesses can have types of Revenue unrelated to sales, such as the profits of another company it owns. But we'll keep it simple. Revenue is Sales and Sales is Revenue.

It is very important to recognize what Revenue isn't. In the same way some people mistakenly think of "income" as "what comes in," you would be on the wrong track if you think "anything that comes in" as Revenue. If a business raises money by borrowing bringing on an investor that's not Revenue. We'll explain that scorekeeping later.

## What's an Expense?

There are lots of things that a business can spend money on. But good scorekeeping in the world of accounting requires that we narrow the definition to just costs of running our business that goes to making Revenue. Some examples are paying the rent, paying for insurance, or the utility bills.

It is very useful to separate out what is *directly* related to making sales. Think of what it takes to make one more sale. If you run a hot dog stand, selling one more hot dog to a customer requires one more wiener and one more bun. But the rent, the insurance or the telephone bill doesn't change. We group these direct selling costs (hot dog and bun) into an item called Cost of Goods Sold (COGS).

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This leads to a useful formula:

**Sales minus Cost of Goods Sold equals Gross Profit**

Knowing Gross Profit helps us to judge other important aspects of business performance. But most importantly, an accurate measure of Cost of Goods Sold leads us to a more accurate measurement of Net Profit once all of the other appropriate Expenses are subtracted.

Let's look at an example Income Statement to see why.

Income Statement
Reggie's Delicious Hot Dogs
June 1 - 30, 20xx

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | | | | |
| **Revenue** | | | | | | |
| | Sales | (1,024 hot dogs @ $3 each) | | | $3,072 | |
| | | | | | | |
| | COGS | (1,024 weiners @ .50 each) | | | -$512 | |
| | | (1,024 buns @ .25 each) | | | -$256 | |
| | Gross Profit | | | | | $2,304 |
| | | | | | | |
| **Expenses** | | | | | | |
| | Rent | | | | $1,000 | |
| | Insurance | | | | $100 | |
| | Utilities | | | | $400 | |
| | Total Expenses | | | | | $1,500 |
| **Net Profit** | | | | | | $804 |

In principle, this is the right way to calculate our Net Profit. But if a business owner doesn't keep track of how much per wiener or bun he pays his suppliers, it's impossible to do this scorekeeping.

The problem is that Reggie may only know he buys hot dogs from the meat company by the case. A case is 2,000 hot dogs and costs $1,000. He buys buns in packages from the bakery by the gross (that's a dozen times a dozen packages. Each package has 8 buns). So ordering one gross of bun packages gets him 12 x 12 x 8 = 1,152. At 25 cents each, that costs $288.

Here's how this Income Statement would look.

Income Statement
Reggie's Delicious Hot Dogs
June 1 - 30, 20xx

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | | | | |
| **Revenue** | | | | | | |
| | Sales | (1,024 hot dogs @ $3 each) | | | $3,072 | |
| | | | | | | |
| | COGS | (1 case @ $2,000) | | | ($2,000) | |
| | | (1,152 buns @ .25 each) | | | ($288) | |
| | Gross Profit | | | | | $784 |
| | | | | | | |
| **Expenses** | | | | | | |
| | Rent | | | | $1,000 | |
| | Insurance | | | | $100 | |
| | Utilities | | | | $400 | |
| | Total Expenses | | | | | $1,500 |
| **Net Profit** | | | | | | ($716) |

Which is the right way to measure the performance of the business? On the assumption that the unsold hot dogs and buns can be properly stored instead of being thrown away, surely you will agree that the business is making money because the leftover inventory is used promptly next month.

If Reggie uses the second method, depending on future sales, he might not buy as many hot dogs or buns in the next month, and this will create an unusually profitable result. This leads to "rollercoaster" Income Statements that cause business owners to make mistakes in planning or to completely give up on proper bookkeeping, thinking the reporting doesn't tell them anything useful. Income Statements tell the story for a specific period. If you imagine a series of photographs of a horserace, knowing your business performance on a periodic basis (such as monthly) tells an unfolding story of performance.

Different industries have different complexities with regard to COGS. A bakery that buys raw materials and labor to make buns or the meat company that makes the hot dogs has a different kind of calculation but the recognition of specific time frames (such as a month, quarter or year) are still important for coming up with a rational calculation of Net Profit. And so is understanding what our unit costs truly are whether we are talking about a single wiener or a case.

It should be obvious that our example business only sells one product and that's not the way the real world works. Without getting into the weeds of accounting procedure, just remember that the use of electronic cash registers and point of sale terminals that tie in to computer inventory control software make it much easier for a business owner to track Cost of Goods Sold. An alternative is to track purchases of inventory and then by taking regular, careful inventory counts, you can, theoretically determine what has been sold using arithmetic. But this is subject to other issues too complex for this discussion.

## Expense Accounts

When we talk about Expense accounts we don't mean what an executive gets to spend on customer lunches. In the world of accounting (bookkeeping) Accounts refers to a system for recordkeeping. And the Chart of Accounts is a list of these groupings of similar transactions. So thinking just about Expense accounts, our Rent account is a listing of all of the rent payments. The Insurance account is a list of all of the payments to the insurance companies. A Utilities account would include the payments made for electricity, gas, phone, etc.

While an accountant usually helps set up a Chart of Account for a business based on common listings, there are no rules that keep a business from adapting the list. Charts of accounts can be customized for the particular attributes of different businesses and industries.

Here is a longer list of Expense accounts commonly encountered. But this doesn't represent every possible account. There are many others and many different ways to group or categorize them. We chose only three accounts on the previous page in the hot dog stand example for simplicity.

Advertising
Rent
Insurance
Interest
Office Administration
Payroll
Professional Fees
Supplies
Taxes and Licenses
Travel and Vehicle
Utilities

There are other expenses that show up on a company's Income Statement after an accountant prepares it for a complete year. But we will ignore things like Depreciation and Income Taxes in this discussion. It is a distraction from learning about what business owners tend to concentrate on during a year in progress when looking at reports from a bookkeeper or their own QuickBooks Income Statement.

This is how the Income Statement for Reggie's business would look in more complete form for a six month period.

Income Statement
Reggie's Delicious Hot Dogs
June 1 - 30, 20xx

| | | | |
|---|---|---|---|
| **Revenue** | | | |
| | Sales | $39,040 | |
| | | | |
| | COGS | ($9,760) | |
| | Gross Profit | | $29,280 |
| | | | |
| **Expenses** | | | |
| | Advertising | $500 | |
| | Rent | $12,000 | |
| | Insurance | $600 | |
| | Interest | $1,310 | |
| | Office Administration | $240 | |
| | Payroll | $0 | |
| | Professional Fees | $450 | |
| | Supplies | $649 | |
| | Taxes and Licenses | $150 | |
| | Travel and Vehicle | $340 | |
| | Utilities | $2,400 | |
| | Total Expenses | | $18,639 |
| **Net Profit** | | | $10,641 |

# Profit & Loss Doesn’t Tell All

There are other important measures of business performance and condition to be measured by good accounting. The Income Statement report doesn’t tell us everything we might want to know. This highlights an unfortunate situation with business owners. The Income Statement is a little more easily visualized for some and therefore it becomes the only report they use to make decisions. A lot more can be known by using the Balance Sheet. It has its own special list of accounts.

Balance Sheet accounts do not appear on an Income Statement nor vice versa. So already, you can judge that only looking at a business’ Income Statement won’t tell you the whole story.

# What Condition is My Condition in?

Balance Sheets tell us a lot about the financial condition of the business beyond the specific period shown by an Income Statement. Simply stated, the Balance Sheet tells us what we *own*, what we *owe*, and what the business is *worth*. This is shown in the three major divisions of the Balance Sheet:

**Assets**
**Liabilities**
**Equity (Sometimes called Net Worth)**

It should not surprise you that the first report a lender is usually interested in reviewing is not an Income Statement, but a Balance Sheet.


In the introduction, we said the second key question that business owners usually ask is “What is my business worth?” The answer comes from reading the Balance Sheet. What your company is worth has a lot to do with what it owns. But even being “rich” by *owning* a lot of assets, might not matter if you *owe* a lot more to others. The difference between these two divisions on the Balance Sheet helps define what a company is *worth*, called Equity or Net Worth.

Most people are already familiar with this concept as applied to homeownership. The price a house can be sold for minus the mortgage owed tells us if the owner has any *equity* in the house.

# What You Own

What a business owns might be a very broad concept. For the most part we are talking about tangible, physical things. But assets might include intangible things that have value. That's a little too complicated for this discussion so we'll ignore things like the value of trademarks.

As we stated, there are specific Accounts on the Chart of Accounts to track Assets. Let's list the most common accounts for a small business. This is customarily done in order of what's called liquidity. The most liquid asset of all (and therefore the best!) is:

**Cash**

We mean all of the money that the business has ready access to such as money in the bank, not just currency in the owner's wallet.

The next best asset is money that others owe you (that presumably can be collected). We call this:

**Accounts Receivable**

Not every business sells on terms or credit (that is on an internal account) We don't mean selling by credit card, but in theory this is the same thing for a retailer. The merchant just happens to get paid in a day or two with pretty predicable certainty by Visa or Mastercard, for example. The next most liquid Asset is:

**Inventory**

In a matter of days, typically, some of the Inventory will be turned into Cash by selling it. All of the above Asset accounts are grouped together on a Balance Sheet report under a heading called Current Assets because they can be more readily turned into cash.

Another grouping that comes next is Fixed Assets. It is made up of accounts such as:
**Equipment,**
**Vehicles,**
**Furniture and Fixtures**
and an account (for small businesses that rent their premises) called
**Leasehold Improvements.**

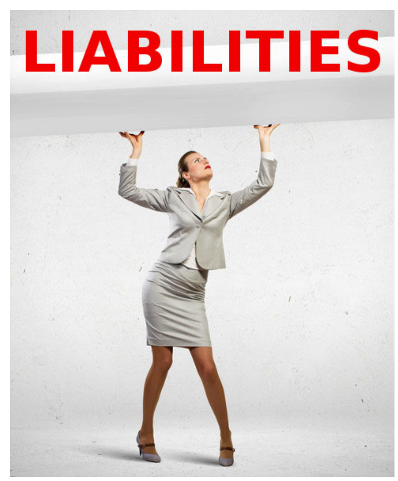
When a business rents a space for an office or a store, it might install new windows, paint the walls or install new electrical or plumbing. Accountants need to keep track of the value of these improvements because generally there's a substantial amount of money involved.

Over time the value of Fixed Assets diminish as they wear out. A bookkeeping process called Depreciation reduces the value carried on the business' books. But we are going to ignore these transactions in this discussion because it distracts from the broader lessons we are trying to emphasize.

In summary we might visualize Reggie's hot dog stand as having part of a Balance Sheet that looks like this:

| | | | | | | |
|---|---|---|---|---|---|---|
| Balance Sheet | | | | | | |
| Reggie's Delicious Hot Dogs | | | | | | |
| As of June 30, 20xx | | | | | | |
| | | | | | | |
| **ASSETS** | | | | | | |
| | | | | | | |
| **Current Assets** | | | | | | |
| | Cash | | | | $6,230 | |
| | Accounts Receivable | | | | $0 | |
| | Inventory (Food) | | | | $1,210 | |
| | Total Current Assets | | | | | $7,440 |
| **Fixed Assets** | | | | | | |
| | Equipment (Grill, refrigerator, toaster) | | | | $8,500 | |
| | Vehicles (Weinermobile van) | | | | $35,600 | |
| | Furniture and Fixtures (Tables, chairs, cabinets) | | | | $9,400 | |
| | Leasehold Improvements (windows, partitions, bathroom, etc.) | | | | $21,375 | |
| | Total Fixed Assets | | | | | $74,875 |
| **Total Assets** | | | | | | $82,315 |
| | | | | | | |

# What You Owe




The value of your Assets might make you feel rich or not so much so depending on what you owe to others, which is called Liabilities. These are broken down into categories depending on when they come due – Current Liabilities (under one year) or Long Term Liabilities (more than one year).

Current Liabilities has accounts such as these:

**Accounts Payable**

These are recurring bills that the bookkeeper is preparing for payment as the money is available (hopefully all paid on time). Examples would be Rent, Insurance, Utilities, Advertising, Supplies and such.

Although we stated that Income Statements and Balance Sheets have their own accounts, don't get confused. Our objective here is not to teach bookkeeping procedure. You just have to know that a bookkeeping entry usually impacts more than one account. So recording the Rent bill raises the Rent expense on the Income Statement and also the Accounts Payable on the Balance Sheet. Once the Rent is paid, the Accounts Payable drops and so does Cash. That's as much as we want to say about this for now.

Another Current Liability might be called:

**Trade Payables**

In Reggie's situation, these would be bills from the meat company and the bakery because he has arranged to buy his food inventory on credit. The bookkeeper keeps these in a separate account because it is important to the business that they be paid on time.

Reggie runs the hot dog stand alone, but if he had employees, he would need an accounts for:

**Wages Payable**

**Employment Taxes Payable**

As you can imagine, these are tracked separately because the employees and the government must be paid on time.

His state levies a 5% tax on fast food sales, so he also has this account:

**Sales Tax Payable**

That's why his customers pay $3.15 for a hot dog. His bookkeeper separates the tax amount when recording sales because Reggie can't touch that money that belongs to the state. Note the Income Statement only recorded his Net Sales ($3 per hot dog) excluding the sales tax in keeping with correct bookkeeping practice.

After the Current Liabilities the Long Term Liabilities are listed. An accountant might be very particular about splitting loans into current and long term portions, but that's a distraction from learning the basics. So in Reggie's case he has two accounts:

**Ford Motor Credit (Weinermobile van)**

**Last National Bank Term Loan**

In summary, we can show how the Liabilities section of his Balance Sheet would look.

| | | | |
|---|---|---|---|
| **LIABILITIES** | | | |
| | | | |
| **Current Liabilities** | | | |
| | Accounts Payable | $3,200 | |
| | Trade Payables | $2,288 | |
| | Wages Payable | $0 | |
| | Employment Taxes Payable | $0 | |
| | Sales Tax Payable | $154 | |
| | Total Current Liabilities | | $5,642 |
| **Long Term Liabilities** | | | |
| | Ford Motor Credit | $19,065 | |
| | Last National Bank Term Loan | $22,754 | |
| | Total Long Term Liabilities | | $41,819 |
| **Total Liabilities** | | | $47,461 |

Now that we have looked at the first two divisions of a Balance Sheet, here are some questions you can ask.

1. Will Reggie have enough cash to pay all of his bills due at the end of the month?
2. Does he owe more or less than he owns?
3. Has the business accumulated any value?

# What You're Worth

Finally we arrive at the section that answers the question asked by many business owners, "What's my business worth?" We need to face facts here that the real world is more complicated than just looking at the "book value," or value on a financial statement to get the true answer. But book value is important. There are a lot of considerations we don't have time to explore here. But learning what Equity or "book value" means and how it's calculated is important.

The Accounts typically found in the Equity section in a Balance Sheet begin with what the owner of the business put in as his opening stake. Usually, businesses are founded with savings contributed by the owner(s). Reggie's Equity section would have this account:

**Owner Contribution (Reggie)**

If Reggie had a business partner, there would be an account for each owner showing what they put in. The next account typically found in a small business' Equity section is one used to track what is withdrawn. Many small business owners depend on their business for their living. It may seem strange that a business owner puts money into a business and then turns around and takes it out again. This is certainly not a smart idea when the capital being withdrawn exceeds the earnings (the Net Profit). But it has to be tracked. With the exception of businesses organized or paying taxes like corporations, owners can't be employees of their own enterprises. So this is the account we would see:

**Owner's Draw (Reggie)**

Again, if there were multiple owners, there would be multiple accounts for each. Two other accounts show up commonly in a small business Equity section. There has to be a way to track the cumulative profit and loss of the business over the time since it was created. This is because a Balance Sheet, although it carries a specific date, shows not just the activity for a particular period like an Income Statement might show the activity for a month, quarter or a year. A Balance Sheet always shows the cumulative activity since the business started (as of the date it is prepared). So the account that we use is:

**Retained Earnings**

The account tracks how much the business has earned or lost since it started. Since the entries to the account are customarily made at the end of the business year, we also need an account that shows the profit or loss for the current period, such as the year to date. This is shown as:

**Net Profit or Loss (Current Period)**

If all the bookkeeping entries are made properly, the Equity section will always be the difference between Assets and Liabilitis, so the formula is:

**Assets equals Liabilities plus Equity**

or stated another way

**Assets minus Liabilities equals Equity**

Here's how Reggie's Equity section reads. He has never taken any money out of the business because he has a day job and he only runs the hot dog stand on weekends near a park.

| | | | |
|---|---|---|---|
| **EQUITY** | | | |
| | | | |
| | Owner's Contribution | $12,000 | |
| | Owner's Draw | $0 | |
| | Retained Earnings (since opening thru last year) | $12,213 | |
| | Profit and Loss (Current Period i.e. six months) | $10,641 | |
| **Total Equity** | | | $34,854 |
| | | | |
| **Total Liabilities and Equity** | | | $82,315 |

Notice the total of Liabilities and Equity equals the Assets? That's because a Balance Sheet always must balance. If it doesn't there was a bookkeeping mistake that must be found and corrected.

Is Reggie's business worth anything on paper? Yes, he has positive net worth. Even though he borrowed money to run the business, he has made modest but steady profits and kept all the profits in the business and not eaten his own capital. How much he could sell it for depends a lot of factors besides book value, such as his annual sales, the condition of his Assets, the stability of his business, growth prospects, etc. But that's another discussion.

When we put the whole Balance Sheet together, this is what it looks like:

| | | | |
|---|---|---|---|
| Balance Sheet | | | |
| Reggie's Delicious Hot Dogs | | | |
| As of June 30, 20xx | | | |
| | | | |
| **ASSETS** | | | |
| | | | |
| **Current Assets** | | | |
| | Cash | $6,230 | |
| | Accounts Receivable | $0 | |
| | Inventory (Food) | $1,210 | |
| | Total Current Assets | | $7,440 |
| **Fixed Assets** | | | |
| | Equipment (Grill, refrigerator, toaster) | $8,500 | |
| | Vehicles (Weinermobile van) | $35,600 | |
| | Furniture and Fixtures (Tables, chairs, cabinets) | $9,400 | |
| | Leasehold Improvements (windows, partitions, bathroom, etc.) | $21,375 | |
| | Total Fixed Assets | | $74,875 |
| **Total Assets** | | | $82,315 |
| | | | |
| **LIABILITIES** | | | |
| | | | |
| **Current Liabilities** | | | |
| | Accounts Payable | $3,200 | |
| | Trade Payables | $2,288 | |
| | Wages Payable | $0 | |
| | Employment Taxes Payable | $0 | |
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| **Total Equity** | | | $34,854 |
| | | | |
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## What's the Future Hold?

Business owners have good reason to be constantly nervous about the future. Sales, business expenses, availability of labor and the performance of employees all seem to be in constant flux. You'd think that once a business is established, some of these variables might settle down and while that is true, it is surprising that even a small bump in the wrong direction can lead to unseen problems.

The major reason businesses fail it that they run out of cash. When the bank account runs dry, you can't pay employees, buy inventory, order crucial supplies, or meet tax and payment obligations. Everything can unravel quickly. And this is the worst time to try to seek financing. Getting a loan or finding an investor is extremely difficult when your ship is on the rocks.

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## The Cash Flow Forecast

The best way to predict trouble far enough in advance to take effective action is to maintain a constantly updated spreadsheet that tracks inflows and outflows of cash based on your estimates of future activity. This document is called a Cash Flow Forecast, Analysis or Projection.

Some business owners who are not comfortable using spreadsheet software attempt to do the same sort of thing in their heads or "on the back of envelopes." And while these methods are better than no planning at all, they are subject to a lot of omissions, errors and hidden surprises.

Some businesses owners become acquainted with the Cash Flow Forecast for the first time when submitting a loan application to a lender along with a business plan. The Cash Flow Forecast is easily the most significant part of a business plan in the mind of a loan officer or other investor. If the numbers don't support a positive trend, then there is little that written or verbal explanations can do to sway their opinion.

Business plans often land in the back of a filing cabinet when business owners obtain their financing, but this is a shame. Learning how to complete and use a Cash Flow Forecast is a crucial skill for keeping your boat on top of the water.

## What and Why?

A Cash Flow Forecast is a spreadsheet filled with mostly estimated numbers (perhaps based on historical information such as prior period business expenses). The primary purpose is to predict whether you will have positive or negative cash balances at the end of future periods. If a period appears to be headed for a negative balance, then some action can be taken to raise more cash or reduce outflows. Business and life is filled with much uncertainty, but prudent planning requires that we make some effort to look into the future.
Although a Cash Flow Forecast looks a lot like an Income Statement (Profit & Loss) it adds in other movements of cash that would be missed if we did all of our planning based only on a projected Inceome Statement. This tutorial will explain what those items are and why keeping a Cash Flow Forecast up to date in a young or growing operation is the only smart way to manage a business.
The usefulness of a Cash Flow Forecast goes beyond internal business planning. Customarily, a lender or investor requires submission of this kind of report as evidence that the business will be able to meet its financial obligations or performance goals.

# About the Words "Cash Flow"

**Which definition did you mean?** Like several other accounting terms with multiple meanings, "cash flow" can cause confusion for those new to business.

*A report showing projections of beginning and ending cash balances?*
Proving to your lender that your venture has a chance of success typically involves preparing projections that show not just profitability but sustainability. Borrowed money creates a large cash inflow, but operating expenses and especially business cycles that mismatch revenues and expenses can exhaust cash reserves. So it's not just enough to show that a business will have revenue month after month. We need to also be sure that there is a sufficiently positive bank balance each month.

So beware. A "cash flow" is a slang term generally given *to the very spreadsheet we are explaining in this tutorial* that illustrates beginning and ending cash balances. Cash Flow Forecast is the complete name that more clearly refers to what we are learning here. But there are other uses of the words that might create confusion for you. Read on.

***The financial term?***
Cash flow can have a general meaning which is the *resulting revenue or expense generated by business activity over time.* Because of peculiarities in the way net profit is calculated, profit and cash flow are not the same. Expenses such as depreciation are deducted from profit calculations, but depreciation does not represent cash going out of the business. So one can have a period where depreciation knocks the net profit into negative territory (a net loss) but the business may still have positive cash flow.

Situations where cash expenses exceed collected revenue are best avoided. Negative cash flow is a hole in the boat.

*The standard financial report called a Statement of Cash Flows ?*
After the Balance Sheet and Income Statement, the most commonly used financial report, and one seen typically in the required reporting of publicly owned companies is a "Statement of Cash Flows."

By dividing the business activity into operations, investing and financing, the answer to the important question "where did the money go?" can be answered more accurately. A Statement of Cash Flows can illuminate what the income statement and balance sheet cannot easily show. For example, did we increase or decrease inventory during the period? Did we purchase assets? Did we borrow money? The answers to these questions might be extracted from a Balance Sheet prepared with a comparative prior period, but a Statement of Cash Flows, by grouping like activity, provides analysis with more clarity. Although this report can be created in QuickBooks at the touch of a button, its use is often neglected by small business owners who are not familiar with its value.

# Completing the Spreadsheet

But again, we are dealing with the Cash Flow Forecast in this tutorial. While it is possible to use a pencil and the blank printed form, a computer program like Excel, Numbers or Sheets would be much easier to work with. Here now is a line-by-line explanation of the entries so you can complete your Cash Flow Forecast correctly. See the form, pg. 19.

***Period ****
***Month***
A forecast is a plan for the future. New businesses don't just start activity or operations on January 1. Many Cash Flow Forecast blank forms are deceptively labeled Jan. thru Dec. If your new venture is launching later in the year then label the periods in such a way that makes sense by entering the month names below the number. Keep in mind that Month 1 is not necessarily the month operations begins. For instance, the initial months of a retail business might include a month or months when the store is under construction and no sales are taking place. But it is still crucial to project the cash in from investment or borrowing and the cash out for relevant expenses, addition of equipment, building costs, inventory, etc.

***Beginning Cash Balance***
Make an estimate of how much money you will have in the bank at the start of the forecast spreadsheet. It might be zero if new funds are coming in from investment or borrowing that month or later. Or if you have an existing business, but you are using the Cash Flow Forecast to chart a new venture, you might be able to determine what your balance will be at the point you begin your spreadsheet. An estimate is sufficient to start. You can update the number later when the actual day comes.

***Cash Inflows***
***Capital Contribution from Owner(s)***
***Loan from Owner(s)***
***Draws on Bank Loan or Line of Credit***
The first three lines in the Cash Inflows section is for plotting when you will get investment or loan money. It's not given this all arrives at the beginning of a venture. For instance an investor might plan to provide an injection later after a milestone is met. Or you might choose not to draw on your bank line of credit until your analysis shows you will need it to maintain positive cash flow. Business owners can loan money to their own operations instead of making a permanent capital injection (when properly documented; ask your accountant). This is an alternative solution to keeping your boat "floating on top of the water."

***Cash Inflows***
***Sales***
***Customer Deposits***
***Accounts Receivable Collections***
***Other:***
These lines are used to record the cash coming in from regular business operations. Without getting into the complexities of Cash and Accrual accounting, you just need to recognize that some businesses sell on credit, some for cash and some do both. If you sign a contract for a job, but don't collect for 30, 60 or 90 days, you obviously can't record the money until you have it in hand. But cash sales are recorded immediately. Sometimes customers must provide deposits before they are earned (when you complete the work). We provide an Other line for exceptional situations.

***TOTAL CASH INFLOWS***
***Available Cash Balance***
Now run totals on your column showing how much new cash has come in. Add this to your Beginning Balance to get your Available Cash Balance. This is an imaginary number. You will never have a day when this will be the bank balance. But it provides a number to weigh against how much spending you project will be taking place.

***Cash Outflows***
***EXPENSES AS ON YOUR P&L (Income Stmt.)***
***SUBTOTAL***
The Cash Outflows section begins with a listing of common Expense accounts as found on an Income Statement. You don't need to use these exact accounts or all of them if they don't apply. A better approach might be to use the Chart of Account titles from your Income Statement as set up by your bookkeeper or accountant. It would make your work of adding expense estimates for future months easier if they are aligned with how your books are kept. Just change the names, add or subtract accounts as needed.

Keep in mind you are making estimates of future activity. Your historical experience should be a good guide.
Here's one other variation from the accounts on an Income Statement. Interest gets split from loan principal in an Income Statement. For a Cash Flow Forecast you just account for all of your loan payments in the Other Cash Outflows section discussed below.

**RELATED TO COST OF GOODS SOLD**
**Inventory Purchases (Some businesses)**
**Materials (Some businesses)**
**Direct Labor (Some businesses)**
**Other:**
**SUBTOTAL**
This section tracks more outflows, but here we are focusing in on the items related to your Cost of Goods Sold. Every business has its own particular outlays it needs to make sales. But while an Income Statement provides the most informative results when COGS matches up with the sales activity, in a Cash Flow Forecast we are concerned only with the timing of payments. For example, for a manufacturer when a check is written for a large shipment of materials is what's important.

**OTHER CASH OUTFLOWS**
**Start Up Expenses**
**Equipment/Fixture Purchases**
Now we get to the payments for things that don't get tracked in an Income Statement but are very necessary to track in a Cash Flow Forecast. Imagine that you are opening a new business and doing a physical build-out of your office, store or shop. For instance, the Leasehold Improvements are tracked on your Balance Sheet by your accountant, but the big payments to the contractor should be shown on the Cash Flow Forecast. You can use the Start Up Expense line as a catch-all for outflows that don't seem to fit in other buckets. Likewise the purchase of big pieces of Equipment, Furniture or Fixtures can go in this section. They are examples of items that would not appear on an Income Statement because they are tracked on the Balance Sheet.

**Term Loan Payments**
**Line of Credit Payment**
**Business Credit Card Payment**
As mentioned earlier, loan payments get split up in normal bookkeeping practice between the Income Statement and Balance Sheet. You can enter the whole loan payment here without need for that. Credit card payments also represent purchases that likely include Income Statement items in various Expense categories. But circumstances vary. You might be, for instance, paying off an old balance on purchases that were made months ago. Or you might be making a payment to pay the current balance in full. Just be sure not to double count the outflow by recording a purchase in both this and an Expense section.

**Owner's Draw**
For many small business owners, the only source of income to pay for personal expenses comes from the business. We should say "the profits of the business" because if there is no profit, an Owner's Draw amounts to eating your own capital. And that can't go on very long without wrecking the health of your enterprise. If you must withdraw capital, this is where you will record it in your plan.

**Other:**
**SUBTOTAL**
**TOTAL CASH OUTFLOWS**
**Ending Cash Balance**
You can use the Other line for any exceptional payments not covered above or as a way to split out another line item. Subtotal the section and then create a total for all outflows. Reveal what your projected Ending Cash Balance would be by subtracting your Total Cash Outflows from the Available Cash Balance near the top of the form. If the number is positive that's good! If negative you need to be sure you reduce expenses or make efforts to increase the cash coming in. If the number is small, you're on thin ice and you'd better be more conservative.
Post the Ending Cash Balance to the top of the form in the next column in Beginning Cash Balance and repeat your process. The succeeding months can be filled in faster because you likely will have developed a model for estimating your routine expenses. You will drop off exceptional payments or perhaps increase some. Perhaps you can see that the person who owns and manages the business is best qualified to think through these details. While the help of a bookkeeper or accountant is welcome for tasks related to accounting practices, a Cash Flow Forecast demands the knowledge of operational details that likely can only come from your thoughtful, careful estimation. *But seek help rather than ignoring the use of this crucial business tool. Lenders consider these submissions essential.*

# Cash Flow Forecast

| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Period ** | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | Total |
| *Month* | | | | | | | | | | | | | |
| **Beginning Cash Balance** | | | | | | | | | | | | | |
| | | | | | | | | | | | | | |
| **Cash Inflows** | | | | | | | | | | | | | |
| Capital Contribution from Owner(s) | | | | | | | | | | | | | |
| Loan from Owner(s) | | | | | | | | | | | | | |
| Draws on Bank Loan or Line of Credit | | | | | | | | | | | | | |
| Sales | | | | | | | | | | | | | |
| Customer Deposits | | | | | | | | | | | | | |
| Accounts Receivable Collections | | | | | | | | | | | | | |
| Other: | | | | | | | | | | | | | |
| **TOTAL CASH INFLOWS** | | | | | | | | | | | | | |
| **Available Cash Balance** | | | | | | | | | | | | | |
| | | | | | | | | | | | | | |
| **Cash Outflows** | | | | | | | | | | | | | |
| ***EXPENSES AS ON YOUR P&L*** | | | | | | | | | | | | | |
| Advertising and Marketing | | | | | | | | | | | | | |
| Bank Service Charges | | | | | | | | | | | | | |
| Credit Card Fees | | | | | | | | | | | | | |
| Delivery/Shipping/Postage | | | | | | | | | | | | | |
| Insurance: Health | | | | | | | | | | | | | |
| Insurance: Gen. Business | | | | | | | | | | | | | |
| Miscellaneous | | | | | | | | | | | | | |
| Office/Administrative | | | | | | | | | | | | | |
| Payroll | | | | | | | | | | | | | |
| Payroll Taxes / Workers Comp. | | | | | | | | | | | | | |
| Professional Fees | | | | | | | | | | | | | |
| Rent or Lease | | | | | | | | | | | | | |
| Subscriptions & Dues | | | | | | | | | | | | | |
| Supplies | | | | | | | | | | | | | |
| Taxes & Licenses | | | | | | | | | | | | | |
| Utilities & Telephone | | | | | | | | | | | | | |
| Other: | | | | | | | | | | | | | |
| **SUBTOTAL** | | | | | | | | | | | | | |
| ***RELATED TO COST OF GOODS SOLD*** | | | | | | | | | | | | | |
| Inventory Purchases (Some businesses) | | | | | | | | | | | | | |
| Materials (Some businesses) | | | | | | | | | | | | | |
| Direct Labor (Some businesses) | | | | | | | | | | | | | |
| Other: | | | | | | | | | | | | | |
| **SUBTOTAL** | | | | | | | | | | | | | |
| | | | | | | | | | | | | | |
| **OTHER CASH OUTFLOWS** | | | | | | | | | | | | | |
| Start Up Expenses | | | | | | | | | | | | | |
| Equipment/Fixture Purchases | | | | | | | | | | | | | |
| Term Loan Payments | | | | | | | | | | | | | |
| Line of Credit Payment | | | | | | | | | | | | | |
| Business Credit Card Payment ** | | | | | | | | | | | | | |
| Owner's Draw | | | | | | | | | | | | | |
| Other: | | | | | | | | | | | | | |
| **SUBTOTAL** | | | | | | | | | | | | | |
| **TOTAL CASH OUTFLOWS** | | | | | | | | | | | | | |
| | | | | | | | | | | | | | |
| **Ending Cash Balance** | | | | | | | | | | | | | |

* Numbered instead of named months for flexibility; not every business starts in January, for example.

** Don't duplicate outflow in Expense section.

A copy of this template is available for download at: **CEDF.com/cashflowform**

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