Chapter 11
Financial planning and forecasting

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Learning outcomes

• Discuss the purpose of a financial plan detail
• Define ‘financial plan’ and financial policy’
• Discuss the purpose of a financial policy in detail
• Name and discuss the different components of a financial policy and their influences
Learning outcomes (cont.)

• Determine a break-even point
• Name and discuss the various types of finance
• Discuss the importance of cash flow in a small business venture
• Define ‘forecasting process’ and discuss this concept
• Develop the three financial statements used in the forecasting process
Planning

Planning: thinking what and how a required outcome, result or objective should be obtained. Planning involves:

- Identification and formulation of objectives
- Gathering all necessary data
- Analysing the data
- Drawing up the plan
- Implementation of the plan
Financial policy

Policy: sets out guidelines or principles according to which an enterprise must act in obtaining its objectives. Components of financial policy:

- Forecasting and planning
- Major investment and financing decisions
- Coordination and control:
  1. Setting standards
  2. Compare actual results with standards
  3. Evaluation of deviations
  4. Take corrective action when necessary
- Risk management
Financial plan

- Is concerned with:
  - Investigating the choice between two or more alternatives
  - For reaching a specific objective
  - Determining how each specific goal is to be achieved
- Involves the effective acquisition, use and control of financial resources
Purpose of financial plan

• Provides specific outcomes of future activities in monetary terms
• Provides the necessary figures to back the various choices made
Purpose of financial plan (cont.)

- Factors to consider when developing a financial plan:
  - The industry and competition
  - The market
  - Current economic and political circumstances
  - Technology
  - Social environment
  - Ecological environment
Break-even point

Quantity = \frac{\text{Fixed costs per unit}}{(\text{Price} - \text{Variable costs})}
Limitations of break-even point analysis

• Not easy to classify all costs as either fixed or variable
• Elements of fixed and variable costs are not always constant
• Excludes qualitative factors
• Instability of monetary value not taken into account
Financial forecasting

Financial-planning process steps:

- Project financial statements
- Determine funds to support five-year plan
- Forecast funds available for next five years
- Establish and maintain system of controls
- Develop procedures for adjusting basic plans
Reasons for forecasting

• Forecasting enhances quality of planning
• Control function is made easier
• Enhances integration and coordination of various opinions and needs
• Actual performance of various departments and personnel can be measured more easily
The forecasting process

- Information needed:
  - Operating budget
  - Projected cash budget
  - Projected statement of profit or loss and other comprehensive income
  - Projected statement of financial positions
Pro-forma financial statements

The pro-forma statement of cash flows

• A statement of an entity’s planned cash inflows (money physically coming into the business)

• Cash outflows (money physically going out of the business)

• It is used to estimate an entity’s short-term cash requirements.
The pro-forma statement of profit or loss and other comprehensive income

• A statement used to plan whether an entity will be making a profit or a loss
• During a given financial year
• Taking into account all the income that is to be received
• All the expenses that has to be paid
The pro-forma statement of profit or loss and other comprehensive income (cont.)

• To prepare:
  o Compile sales or fee-received projection
  o Compile operating schedule
  o Determine any other expenses
  o Calculate projected profit
The pro forma statement of financial position

- A planned financial statement on a certain date to determine the financial position of the entity with respect to its capital generated and the application thereof