FINANCIAL PLANNING

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Regardless of whether you are managing a for-profit business or a non-profit organization, your job is to make more money than you have to spend (*net profit*). In the non-profit world, this called making a net surplus, which can then be used to replace old equipment, fund new services, etc. So what really matters is not the size of the funds you bring in but how much profit you will make on that contract. Think for a second: Which contract is better for your organization, a $500,000 contract that costs you $550,000 to administer, or a $50,000 contract that costs you $35,000?

To make money (*revenues*) you have to spend money (*expenses*). The trick is to get paid for your services before or as soon after you have to disburse funds. During the period between your delivering the service and getting paid for the service, you are financing your clients. Usually, without realizing it, you are providing this financing free — at least for 30 days!

The purpose of your finance function is to *acquire and administer the funds needed to operate and expand your business*. For many professionals not trained in accounting, finance is an unfamiliar and esoteric area. This is the one area of your managerial responsibilities that you can delegate to someone trained in accounting and finance. Often professional service firms contract out this function to an accounting firm. If you choose to do that, you still need to set the parameters of how you want to finance your firm and what types of costs you need to track.

To make sure you have enough money to do your ongoing professional work *plus* do any market development (domestic or export), you need to plan ahead regarding your finances. You need to predict not only *how much* money you will need but also *when* you will need it. How do you do this? First, you need to deal with the *how much* by creating a budget that shows your likely revenues and expenses, commonly called a *pro forma income statement*. Typically this budget is shown in months or quarters, and is projected for a period of three to five years (see Box 1). You will need to decide the balance between enough detail regarding revenues and expenses so that the forecast is reasonably accurate and more detail than you can easily calculate.

Box 1: Sample Pro Forma Income Statement

Item	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Revenues (billed)				
- Net contract expenses				
- Operating expenses (incurred) [net of taxes] - Inflation factor				
Net Profit (Loss)				

If you are not used to creating this kind of pro forma statement, you will need to take note of several conventions. First, notice the terms "billed" and "incurred." These are terms from *accrual accounting*, and they refer to when you invoice clients or sign for an expense rather than when the cash changes hands. Second, "net contract expenses" refers to what you have to spend on a specific contract, less the expense reimbursement you receive from your client. These are known as *variable expenses*. Third, your operating (or *fixed*) expenses do *not* include the purchase of computers or office furniture or other equipment that you need to run your business. In accounting terms, equipment and furniture are *fixed assets* rather than expenses. Rather than charging the total cost against revenues in the year of purchase, you have to *depreciate* them (i.e., charge off only a percentage of their cost) over time to show that they are still available for your use after the end of a given fiscal year. When someone suggests that you consider renting or leasing rather than purchase, they are alerting you to the fact that it may be more beneficial to be able to write off an annual expense rather than have your money tied up in an asset that has to be depreciated. Finally, by convention, you do not include what you will have to pay in corporate taxes because that amount is linked to your overall tax strategy rather than your actual expense structure.

You also need to look at the *when*. In the pro forma income statement, we were dealing with when you expect to invoice clients and when you expect to incur expenses (known as "accrual accounting"). But that does *not* tell you how much cash you actually have. So we need to also look at your *cash flow* — i.e., when you actually receive money and pay it out. So you need to create another set of financials, known as a *pro forma cash flow projection*, that predicts timing (see Box 2). In this one, you can include the money you plan to pay out for purchasing equipment and other fixed assets.

Box 2: Sample Pro Forma Cash Flow Projection

Sources/Uses of Funds	**Quarter 1**	**Quarter 2**	**Quarter 3**	**Quarter 4**
Beginning cash balance				
+ Payments received				
- Expenses paid - Payment for fixed assets				
Ending cash balance				

If you approach your banker or personal friends who might loan you start-up funds, they will expect to see these two types of statements.