Forecasting the Balance Sheet

by Sophia

WHAT'S COVERED

In this lesson, you will learn about the role of the pro forma balance sheet in strategic planning. Specifically, this lesson will cover:

1. Pro Forma Balance Sheet

As mentioned in the last lesson, the sales forecast drives the pro forma income statement. You will recall that we wanted to find the AFN, the additional funds needed. The pro forma balance sheet will show the effects of our revenue and expense projections and how the organization chooses to finance them.

1a. Assets

A pro forma balance sheet will require us to forecast our current assets, including cash, accounts receivable and inventory. Fixed assets, such as property, plant, and equipment, along with **intangible assets**, will also be forecast.

The starting point for the forecast for each of these items is usually a percentage of sales, using the same percentage as the prior accounting period. All of these can be adjusted.

> EXAMPLE Accounts receivable may need to be additionally adjusted due to changes in the credit policy. Inventory may change due to changes in inventory management practices, or even the content of inventory if new products are offered or if product lines are changed.

TERM TO KNOW

Intangible Assets
Identifiable non-monetary assets that cannot be seen, touched, or physically measured, and are created through time and effort, and are identifiable as a separate asset.

1b. Liabilities

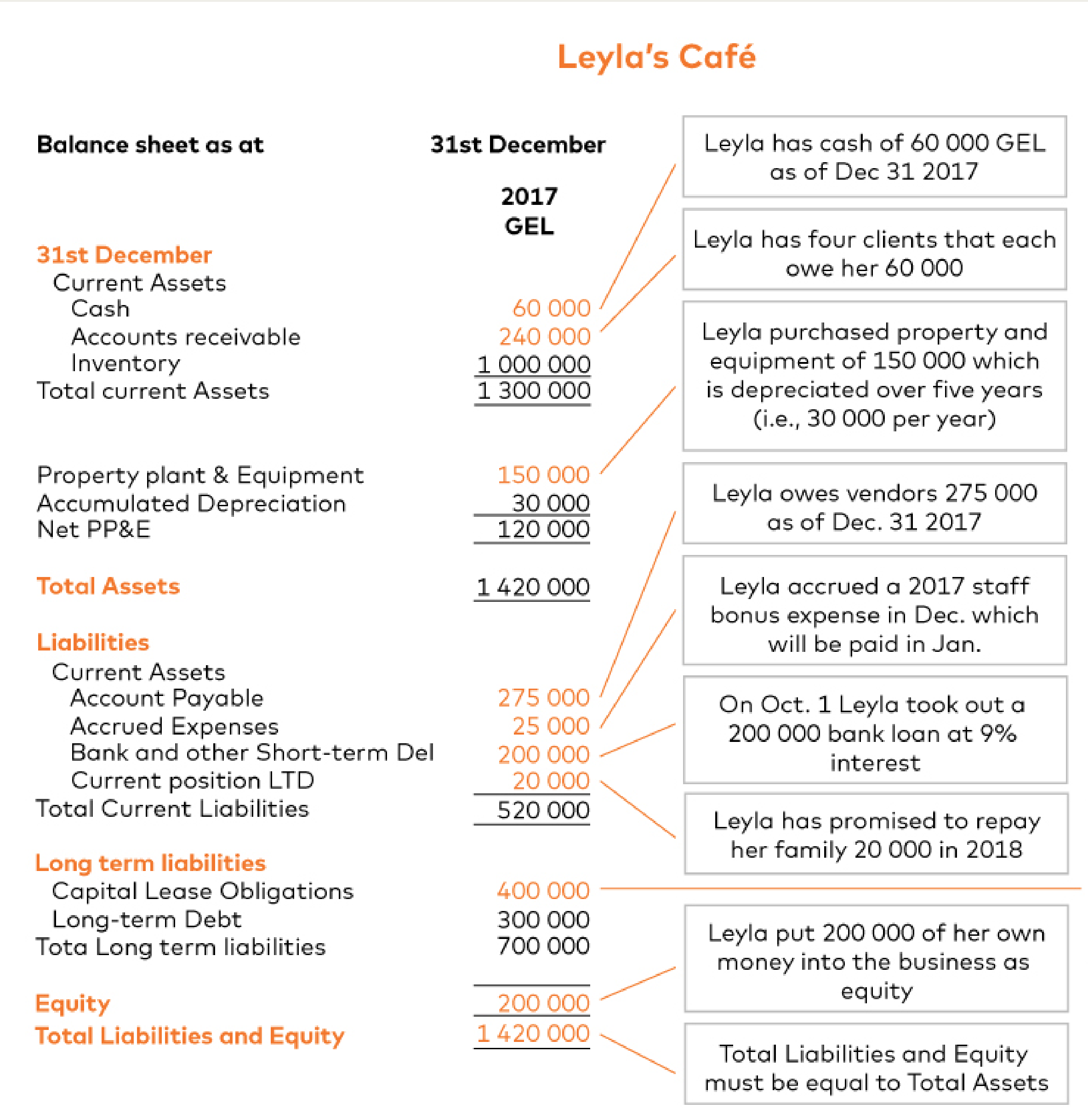
The forecast for liabilities also begins using the same percentage of sales as in the previous accounting period. Adjustments will be made here to accommodate changes in policies, such as vendor payments or other accounts payable issues, and if any additional funds needed or financing is required through current liabilities, such as short-term borrowing.

1c. Equity

Finally, the equity section will be adjusted to accommodate any changes in the issuance of common stock. In the end, the equity will be adjusted to balance the balance sheet so that assets equal liabilities plus owner's equity.

IN CONTEXT

Here is a pro forma balance sheet for Leyla's Cafe.



On this balance sheet, Leyla has projected total current assets of $1,300,000. Looking at other assets, such as property, plant, and equipment that equals $150,000, Leyla projects her total assets at $1,420,000.

Her current liabilities will total $520,000, where she will take on some short-term debt of $200,000 to finance the additional cash she needs. The long-term liabilities remain the same at $700,000, and the total equity is $200,000. Therefore, the balance sheet balances at $1,420,000.

BIG IDEA

As a business moves through the planning process, it will perform a ratio analysis on its pro forma statements. This will allow the company to examine the impact of the strategic and financial statement changes it is planning to make. It also allows it to examine the projected earnings per share (EPS), the return on assets (ROA), and the return on equity (ROE) to ensure that these align with the projected growth goals.

SUMMARY

In this lesson, we learned that the **pro forma balance sheet** will project **assets**, **liabilities**, and **equity** changes that are required from the changes in the pro forma income statement in the next period. There is a planning process that involves a ratio analysis to make sure that all the decisions that are being made will keep the performance of the organization in line with the strategic plan.

Best of luck in your learning!

Source: THIS CONTENT HAS BEEN ADAPTED FROM LUMEN LEARNING'S “Forecasting the Balance Sheet” TUTORIAL.

TERMS TO KNOW

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