

Forecasting Through Managerial Accounting

07/24/06

I'm learning how to use QuickBooks, and need some advice. What reports should we be looking at, and how frequently. It's past mid year, and I want to know how well I'm doing, and figure out how to apply what I learn to the rest of the year.

Our bookkeeper set up the chart of accounts, after reviewing the list with our accountant. We've entered all of 2005 and 2006's checks, invoices, and payments from customers. At the end of 2005 our accountant was able to take a copy of Quickbooks and prepare our tax returns – which was great. Now I'd like to learn more about how to use Quickbooks to manage the business.

What our reader is talking about is the switch from tax accounting to managerial accounting. Tax accounting is a rear-view analysis: looking backwards at what has already happened. It can be informative to look back, but, as the old saying goes, you can't change the past. You have to look to the future if you want to make changes. Let's talk about looking to the future and how that relates to your use of Quickbooks.

Mid-year is a great time to work on switching from rear-view to forward view. You have some comparative data you can use, to test your hypotheses. And to finish out the year, you only really need to guess at ½ a year –

which for many people is much less intimidating.

In order to look into the future, you have to develop some confidence that you can predict the future. This is one place that many business owners get stuck, feeling that events

move too quickly, and changes in plans make it impossible to accurately tell what is going to happen down the road. I make the case that you can learn to predict the future, with accuracy, if you're willing to invest some time, practice, and brainpower in the project.

Start with building a budget. Take the 2005 expenses, and establish a 2006 month-by-month budget, using 2005 numbers. Use all of the same detailed accounts you used in 2005, so that you have lots of boxes of information filled out. Now review all of your budget items, to note where you will make changes in 2006. For example, you probably had some expenses in 2005 that won't happen again in 2006 – those you can delete from your 2006 budget. You may have planned to do some hiring in 2006, which you should reflect in your budget in the form of higher payroll and benefits cost.

Once you have made all of your changes, ask your bookkeeper to create a recap report. Summarize expenses into a few main categories, such as cost of goods sold, general and administrative,

marketing and sales, salaries and benefits, and other income and expenses, which will include taxes and payouts to shareholders. Run the report for 2005, first half of the year to get a feel for how things played out, expense wise, last year. Run the report for the 2006 budget, and see how different / similar it is to how you spent your money in 2005.

Once you're okay with your 2006 budget, run a budget vs. actual report for 2006, period of January – June. Start with two totals for the entire 6 month period, one for budget and one for actual. See how well you did at predicting the future. Make notes on the adjustments you need to make to the budget for the second half of 2006. Enter those changes into the QuickBooks budget, and then you can start monitoring expenses by week / by month / by quarter / semi annually and annually.

After you've been through this exercise of budgeting a few times, it will seem easier. As your understanding goes up, of what changes, by how much, and what stays the same, you'll increase your expense-prediction accuracy significantly.

Now let's go over to the sales side and see what we can do there to better forecast. First, if you don't have some kind of contact management system on computer, get one or build it

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yourself. Start simple. You can use excel to build a file of all the people you contact, their name, address, company name, phone number, etc. Put in a half dozen columns for activities you go through, from first contact to final close. You might want to include qualifying the contact, defining the client's need, establishing the client's budget, identifying any competitors, confirming the offer in a proposal, and final negotiations.

You can use these stages to track progress of your prospects. You can review activities by stage, across all prospects, to see what's happening. Are you getting stuck at a particular stage? Take a guess at how many closes you need, between now and the end of this year, to hit the income you want the company to have. Figure out how much that means in revenue, and enter that number into QuickBooks, in the income forecast section of your P&L. Do you have enough prospects moving through the pipeline to hit your sales targets?

Once you have a list, you can evaluate it in a number of ways. You can track industries you're calling on – and then ask yourself, are there enough, are there any new industries we should look into? Are we running the risk of being stuck with old industries that are drying up, or jumping into too many new industries at once? You can also

track activity, or progress through your sales forecast system, in order to be sure you're not dropping any balls.

Put together your income estimate, from your sales forecast system, and your expense forecast from your budget, and see what kind of bottom line you come up with. If you like the result, keep going, If you find you're in negative territory, decide on what changes have to be made, to get back in the black. Make those changes now, before it's too late!

Once you have a budget you can live with, forecasting both income and expenses, run a report called budget vs. actual for the first half of 2006. See how well you are doing in reality, and where you need to make adjustments, in order to come in on plan and in budget. Make any changes you need to, to the second half of 2006 budget and income forecast. Now you're ready to start running budget vs. actual reports, and making decisions based on the financial rules you've laid out, by predicting how you want the future to come into focus for yourself and your company.

To really excel at forecasting the future, you'll want to develop several ways of looking at the past. For example, you may want to try activity based costing, where you figure out how much activity it takes to produce or

deliver what you sell. This may help you properly allocate overhead costs. Job cost analysis, looking at how profit varies by customer or job, can help you identify best customer attributes, and focus on getting more of the good ones, getting rid of, or fixing the bad ones.

Life cycle costing is another tool. Managers look at what things cost starting in the design phase. They can change how they design a new product or service, in order to get the best cost / quality mix, before they are committed to going into production.

All of these tools, once in place, can give you counterbalancing views of what the past was, and how the future might be. Any variances that are unexplained help point you towards the next layer of analysis. Having 3-4 ways you estimate what things will cost, where customers will come from, how growth in business will relate to expenditures and growth in profit, means that you'll be more able to find the common, and close to correct, ground.

Looking for a good book? You can try: Management Accounting: The Cornerstone for Business Decisions, by Maryanne M. Mowen, and Don R. Hansen. It's pricey, at just over \$100, but has some good advice. It gets into more of the control tools you can



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