

Analyzing pro forma statements

[Finance](#)



Analyzing Pro forma mental affiliation: Financial forecasting involves determination of the future financial requirements of the firm and is achieved through financial planning which includes use of budgets. The significance of financial forecasting include; it facilitates financial planning which is the determination of cash surplus or deficit likely to be faced in the near future, it facilitates control of entity expenditure so as to significantly reduce wastage of financial resources. It also serves as a motivation to employees who aim at achieving set targets if the forecasting has used targets and budgets. The methods used in financial forecasting are use of cash budgets, regression analysis and percentage of sale method which is going to be applicable for ABC Ltd.

The new initiative would be to market another product of the company. This would lead to an increase in the company's sales over the forecasted period. Due to increased number of sales, the net fixed assets by acquisition of new machinery to increase production will also increase. For current assets, an increase in sales will be as a result of increased stock of raw materials, work in progress and finished goods. An increase in credit sales will also increase debtors while more cash will be required to buy more inventories in cash.

The retained earnings will also increase with sales if the firm is operating at a profit. The current liabilities will increase because the increased sales will lead to the purchase of more inventories. Long term capital items such as common stock and additional paid in capital will not change or increase because they are not directly impacted by an increase in sales as they are always used to finance long term projects (Robert, 2009).

For ABC Ltd, the assumption of marketing of a new product will result to an increase in sales by 20%. The other items affected will also increase by the <https://assignbuster.com/analyzing-pro-forma-statements/>

same percentage. The property, plant and equipment will increase due to the increased capacity and hence will use up capital. The sources of capital will be the increase in accounts receivables and other liabilities and the cash. Assuming that the company retains 6% of its profits in its structure, the retained earnings will also increase. Over the five year period, there will be sources of capital and also uses of capital and any deficit is catered for by the 5 year loan which is 49303 in this case. The loan will need to be obtained by the company in order to fulfil its financial forecast in the five years because it is a source of capital though its interest has not been catered for which would be an additional expense of periodical nature to the company. For its achievements, the capital sources should be equal to the uses of capital (Robert, 2009).

The proforma balance sheet for the five year period shows the balance sheet items after their percentage change with respect to sales. The current portion of the long term loan will not be reflected after the five year period because it is a current liability payable in the current year and the cash amount is present fully in the fifth year so the whole amount has to be reflected. The percentage of retention is at the hands of the management to determine their retention percentage.

The five year forecast is good for ABC Ltd because it is attainable and is for the better good of the company. It leaves ABC with a greater amount of retained earnings and assets though with a loan to repay back with interest.

Reference

Robert Allan. (2009) " Strategic Financial Management." Hill and Ventus Publishing Aps