Guide 20: Forecast revenue and build an income statement

Your goal

Estimate your business's first-year financial performance. Show how sales and expenses lead to profit or loss.

An estimate is useful when its assumptions are clear. A large forecast profit does not prove that customers will buy your product.

What to produce

A revenue projection and an actual or projected income statement for year one. Include revenue, cost of goods sold or cost of sales, gross profit, operating expenses, and pretax income.

Use actual figures only for events that happened. Use projected figures for expected future results. The suggested CED activity also uses quarterly breakdowns; ask your teacher how to present these.

Key terms

- **Sales volume:** the quantity sold in a stated period.
- **Revenue:** income earned from selling goods or services, before expenses are deducted.
- **Cost of goods sold (COGS):** the cost of the goods sold during the period. A service business may use cost of sales (COS).
- **Gross profit:** revenue minus COGS or COS.
- **Operating expenses:** costs of running the business that are separate from COGS or COS.
- **Pretax income:** income after relevant expenses and before income tax. If borrowing creates interest expense, include it appropriately before calculating this figure.

Step 1: Estimate sales volume

Use your customer research, pricing tests, market size, channel plan, and production capacity. Explain why the quantity is possible.

People saying they like an idea does not guarantee purchases. Consider how many people you can reach, how many might buy, and how many units you can deliver. Record the main assumptions.

Step 2: Calculate revenue

For a single product sold at one price:

Revenue = price per unit × units sold.

If prices or products differ, calculate each group separately and add the amounts. State the currency and period.

Step 3: List and classify expenses

Use your startup costs and production plan. Include relevant materials, direct labour, packaging, promotion, space, and other expenses. Explain the categories you use.

Do not count the same cost in COGS and operating expenses. Money borrowed is not revenue. Repaying loan principal is not an income-statement expense, although it reduces cash. Interest is a borrowing cost.

Equipment purchases and unused materials stock are not automatically full expenses for the period. Ask your teacher how to account for equipment use and other applicable costs. A startup cash budget and an income statement answer different questions.

Example: Ready Pouch

Ready Pouch is our fictional example business. Its proposed product is a small pencil pouch for students.

These are fictional, simplified year-one projections in US dollars. They are not evidence of customer demand. Assume 300 pouches are made and sold at USD 6 each.

The USD 2 cost per pouch includes USD 1.20 materials, USD 0.60 direct labour, and USD 0.20 packaging.

- Revenue: 300 × 6 = **USD 1,800**.
- COGS: 300 × 2 = **USD 600**.
- Gross profit: 1,800 - 600 = **USD 1,200**.
- Operating expenses: **USD 600**.
- Pretax income: 1,200 - 600 = **USD 600**.

The operating-expense estimate includes launch promotion of USD 100, later promotion of USD 200, and other operating expenses of USD 300. Launch promotion is counted once.

This teaching example assumes no interest expense and leaves other applicable accounting adjustments for further review. Your statement must include costs that apply to your own business. Do not use the example as permission to omit them.

Step 4: Check the effect of uncertainty

Try a lower sales quantity. Under the same simplified assumptions, selling 150 units would produce revenue of USD 900 and COGS of USD 300. Gross profit would be USD 600. After USD 600 of operating expenses, pretax income would be zero.

This result depends on the unit costs and operating expenses staying as assumed. It is not a guaranteed outcome. Explain what would happen if material prices rose or sales fell further.

Your turn

1. State your period, currency, price, and estimated sales quantity.
2. Explain the evidence and assumptions behind sales.
3. Calculate revenue and each required statement line.
4. Check that costs are complete and counted once.
5. Explain a change that could make the forecast better or worse.

Check your work

- The statement covers year one and is labelled actual or projected.
- Sales, capacity, and price assumptions agree with my other plans.
- Calculations and units are correct.
- I distinguished revenue, profit, funding, and cash.
- I explained uncertainty rather than promising profit.

Next: Assess your skills

In Unit 4, Task 1, you will consider the skills needed to carry out your business plans.

Independent guidance based on the AP Business with Personal Finance CED, printed pages 149 and 170-171. This is not an official College Board resource.