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What Makes a Good Financial Model

What makes a good financial model? You should have a bit of an idea by now of what makes a good financial model. Let's have a look.

Well documented assumptions are number one. Making sure everything is very clearly laid out and documented. It should explain the functionality, so explain what to do, where. It should flow logically; go left to right, top to bottom. It shouldn't jump around, it should be very clear and logical where to go next. Your inputs, outputs, workings and results are clear and easy to understand. It should be clear where to find everything and everything should be well labelled.

A good financial model always contains error checks. You can also have a separate page with all the error checks in, so these should be scattered right throughout your model. It should be easy to navigate and find the information that you need. You can create a table of contents at the front with some hyperlinks in there, so you click on the hyperlinks and it will take you to various parts of the model. But otherwise you should just have very clearly labelled and in logical order what the different tabs are for. It should contain instructions but people generally are not very good at reading instructions though, so in my experience, if you create a tab and label it Instructions, you can't rely on anybody reading it. It is much more effective to create your instructions and put them right throughout the model. You can do that using in cell comments or data validation comments or you can just type them in as instructions. Think about what your model looks like when it's printed. Modelling is very much a soft activity. You're always looking at it on the screen because you are modelling inputs and outputs so we don't always think about what it looks like when it prints. Make sure that your model fits onto a single page, especially if you are going to send it to

Financial Modelling in Excel

somebody. You want to make sure that the printer is not going to have twenty pages where it prints out across lots of different pages. Do a print preview and make sure it fits cleanly and nicely onto a single page. It looks nice when you use tables or when you use the dark graphs but when you print it out, it is not very practical. Those are some user friendly features.

Let's look now at some structural features that make a good financial model. The only hardcoding should be inputs or source data. We never type numbers into a formula, everything else is linked. When you're putting in an assumption, if you have a tax for example as an input assumption, you would never type that into the formula. You would have a separate cell, put in your tax amount and then you would link to that particular cell so that if you decide to change that, it would then flow right throughout the model. That is an important feature. Duplication is minimised. Don't have lots of different inputs everywhere, try and keep it succinct. Names, formulas and formats should follow a consistent convention. Think about your named ranges. If you've got Price Year One and then Year Two Price, make sure that it is consistent and make it easy and tidy for somebody to follow. It should be modular and scalable. Make it so that it can be made bigger or smaller. Lastly make sure the most efficient function is used. Try to make sure that your functions are not really long and messy. Try to make your formulas neat, clean and clear. Those are a couple of things that can help. Think about what your model is like to make sure that you've built the best financial model that you possibly can.

The points that I have just taken you through, I have put them into a checklist for you. You can download and have a look at this checklist. It's an assessment report that takes you through all of the things that I have just talked about. You can rate those and put comments. If you have a model that you need to assess, if somebody sends you a model and you want to see how it stacks up against best practice, you can use that as a bit of template.

I hope that those points have been helpful for you in building better financial models.