

Financial Modeling Best Practices: How to Give Your Excel Files a “Makeover”



Structure, Formatting,
Links, Drivers, Color
Coding, and More

Financial Modeling Best Practices

This is a “**higher-level**” tutorial that zooms out and discusses common mistakes in financial model setup, mechanics, and formatting.

To illustrate, I’ve created a “**bad model**” and a “**makeover model**” with all the fixes applied (based on real life).

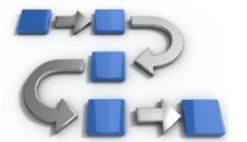
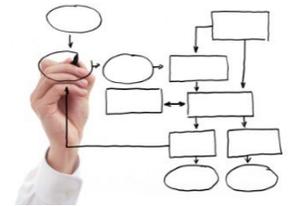
Financial Modeling Best Practices

A lot of this is applicable to **internships and jobs**, but it's also useful for **case studies** because time is essential there.

Set up your model incorrectly, and you will **waste a lot of time** on fixes, edits, and other problems rather than answering the questions.

Financial Modeling Best Practices

- **Scope:** We're limiting this to **3-statement models**, or we'd be here for hours discussing valuations, M&A models, LBOs, etc.
- **COMMANDMENT #1:** Always list the Income Statement, Balance Sheet, and Cash Flow Statement **on the same tab or worksheet**
- **COMMANDMENT #2:** Do **NOT** mix drivers and assumptions with the historical and projected numbers; separate them
- **COMMANDMENT #3:** Simplify and consolidate the statements; aim for ~5 items on each side of the BS, with a max of ~10



Financial Modeling Best Practices

For the written version, images, and Excel files, go to:

<https://breakingintowallstreet.com/kb/finance/financial-modeling-best-practices/>

Outline for This Tutorial:

- **Part 1: The Three Commandments** **5:54**
- **Part 2: How to Give Your Excel Files a Makeover** **10:41**
- **Part 3: Smaller Issues and Best Practices** **16:57**

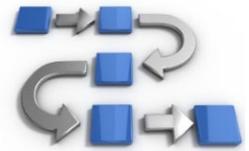
Part 1: The Three Commandments

- **COMMANDMENT #1 (Single Tab):** It is **FAR** easier to “debug” and modify 3-statement models when everything is in one spot; very cumbersome to jump to different sheets
- **Separate Tabs:** Fine for *supporting schedules* or more detailed revenue/expense drivers, but avoid them otherwise – unless they require you to use them (silly)
- **COMMANDMENT #2 (Separate Assumptions):** Very bad practice to mix assumptions and actual numbers because it makes summations and Balance Sheet checks awkward



Part 1: The Three Commandments

- **Exceptions:** If you are just setting an item to \$0 or 0%, or it's very small and forecast in an extremely simple way, it might be acceptable in certain models
- **COMMANDMENT #3 (Consolidation):** Most line items on the statements are small and do not matter; use the 80/20 rule
- **Specifics:** Consolidate Long-Term and Short-Term versions of Debt, Deferred Revenue, Investments, etc.
- **Equity:** Never show all the individual components; just the total and Preferred Stock and NCI if necessary



Part 1: The Three Commandments

- **Group anything** with similar-sounding names (“Prepaid” X, “Accrued” Y, etc.)
- **Method:** Be **VERY** aggressive with both the BS and CFS and just make sure there’s a corresponding line on the other statement for each line item



Part 2: How to Give Your Excel Files a Makeover

- **Step 1:** Cut and paste the IS, BS, and CFS to the same tab as the assumptions and drivers; then re-link or delete the main tab name in formulas



- **Step 2:** Remove all the in-line assumptions and consolidate the BS and CFS aggressively; we could go even further here



- **Step 3:** Separate out the assumptions and put them in an area at the top under the Revenue Drivers; may have to rename, relabel, and recalculate some

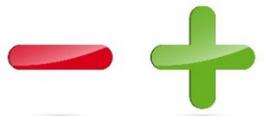


- **Step 4:** Polish and verify that the numbers roughly match



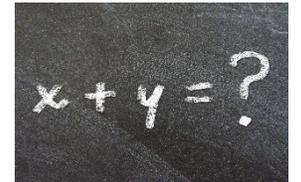
Part 3: Smaller Issues and Best Practices

- **Reality:** Dozens of small issues also make models worse (see the written article); we'll cover just a few here
- **Color Coding:** Blue for hard-coded historical #s, black for text and formulas, green for links to other worksheets, and yellow background for input boxes
- **Sign Conventions:** Always use positives for income sources and cash inflows and negatives for outflows and expenses; makes it much easier to sum up different sections and check work
- **Don't Hard-Code Projected #s:** Bad if anything changes!



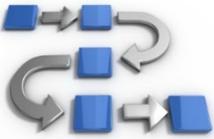
Part 3: Smaller Issues and Best Practices

- **AVOID:** Hidden sheets, hidden rows, hidden columns...
- **AVOID:** Hard-coded numbers in formulas and cell references (exceptions for items like 12 for Months in Year, -1, 0, etc.)
- **AVOID:** Links to external files (always break and copy/paste as values) and links to multiple other sheets in a single formula
- **USE SPARINGLY:** Named cells and ranges; IF and nested IFs; custom number formats; circular references (always build in a breaker or the ability to disable)



Recap and Summary

- **Part 1: The Three Commandments**



- **Part 2: How to Give Your Excel Files a Makeover**



- **Part 3: Smaller Issues and Best Practices**

