

10. Forecasting Assumptions

Introduction

Forecasting assumptions are one of the factors that help frame the right debate. This section considers the preparation and disclosure of forecasting assumptions.

Why are forecasting assumptions so important?

Forecasting assumptions are one of the building blocks of the financial forecasts in your LTCCP. This is an area 'armchair expert' readers will pay attention to, and their views on the quality of the assumptions will shape their views on the LTCCP. This strongly suggests that your significant forecasting assumptions need to be:

- realistic - including a check that your plan is within your capacity to deliver
- evidence-based - especially where assumptions are outside industry norms
- consistent with each other, and
- applied consistently across the LTCCP (unless there is good reason not to and the difference in treatment and reason are both disclosed in the LTCCP).

How do forecasting assumptions relate to the legislation?

Schedule 10, clause 11 of the LGA requires disclosure of assumptions, the level of uncertainty and quantifying the potential effect of the uncertainty on the estimates. All financial information must be prepared in accordance with GAAP. FRS 42 deals with the preparation of prospective financial information and requires that the statements reflect the best knowledge that your local authority has about the 10 years covered by the plan.

The auditor is required to express a view on the quality of the forecasting assumptions in their report. In 2006, two local authorities received non-standard opinions for matters relating to forecasting assumptions (both were related to the treatment of price change).

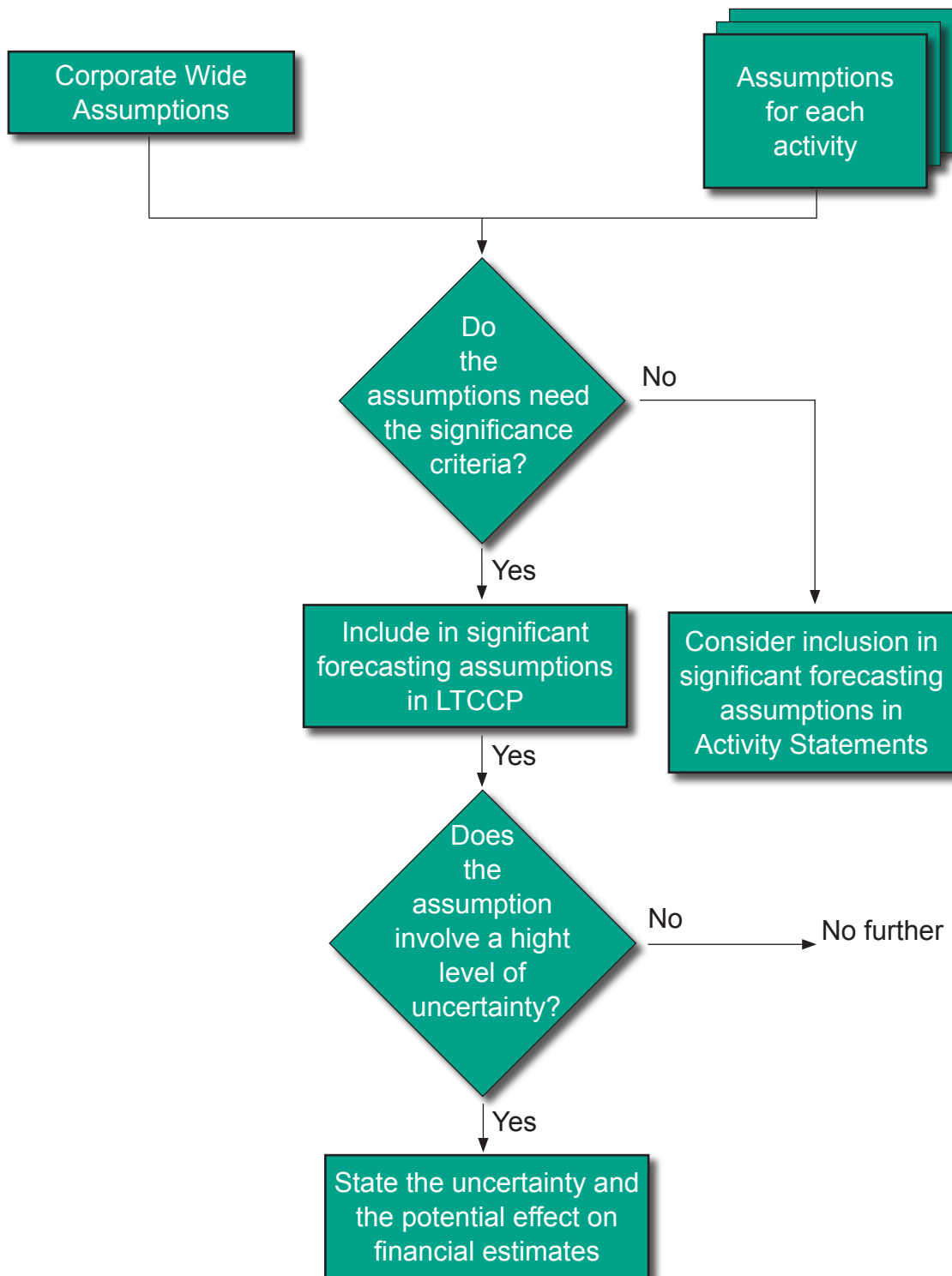
What information sources exist from which to draw forecasting assumptions?

What makes an assumption significant?

It is likely that there will be two levels of assumptions. First, corporate level assumptions or those that are organisation wide and applicable to all activities of your local authority. Second, assumptions about individual activities should be developed.

The terms 'significance' and 'significant' are defined in section 5, LGA as relating to matters that have a high degree of importance to or consequences for

- the wellbeing of the district/region, or
- persons particularly interested in or affected by the matter, or
- the capacity of your local authority to perform its role, or cost of it doing so.



The majority of forecasting assumptions will qualify for 'significant' status through the third of those tests. Be particularly sure to look for any of the following

- a material effect on your overall revenue, or
- a material effect on your overall operating expenditure, or
- a material effect on your ability to finance and fund future operating expenditure and capital expenditure as outlined in the LTCCP, or
- a material effect on assets employed by your local authority, particularly strategic assets, or
- a material impact on the overall ability to deliver intended levels of service.

What are the Information Sources?

Information for assumptions could be sourced from (this list is not exhaustive)

- your previous LTCCP (but ensure these are still relevant and you may also need to reconsider the 'significance' or otherwise of these)
- Reserve Bank and trading bank forecasts (in respect of interest rates)
- Statistics New Zealand
- growth projections for population (both in terms of the numbers and the composition of the population) households, and rating base
- historical trends (such as the trend of decreasing people per household)
- asset management plans (useful lives of assets)
- governance structures (representation arrangements)
- Land Transport strategies (subsidies)
- Statements of Intent (for CCOs)
- growth strategies
- property market trends (for development contributions)
- other local authorities
- accounting policies and asset valuations
- asset/activity management plans (demand levels), and
- existing and known future government policy.

Who should be involved in preparing the forecasting assumptions?

The preparation of corporate assumptions will draw on a range of input but is likely to come mainly from finance, planning and asset managers.

Preparation of activity assumptions will be by activity and asset managers.

There may be value in your local authority and its neighbouring local authorities (and the regional council) coming to a joint view on some key assumptions.

The LTCCP project team should decide which assumptions are significant.

The finalised package of significant assumptions should be approved by the senior management, with a 'for information' paper to elected members.

When should the forecasting assumptions and risk information be prepared?

Assumptions should be agreed upon prior to issuing budget templates to all departments. If possible assumptions should follow the update of asset management plans, the preparation of water and sanitary assessments, and revaluation of assets.

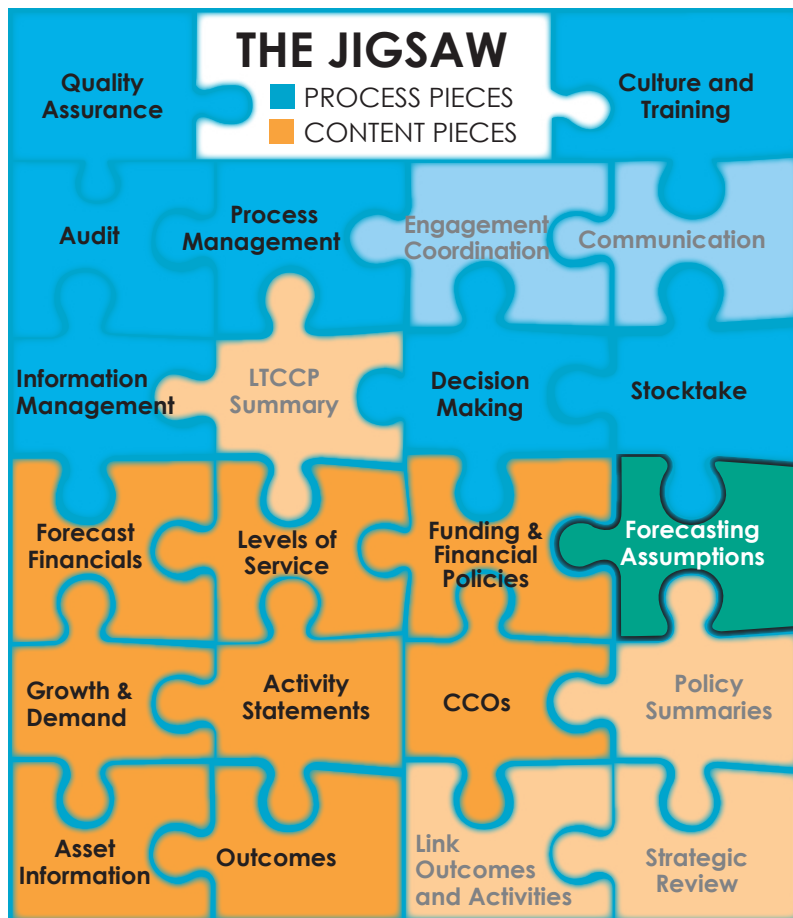
It may be necessary to review the assumptions midway through the process to ensure that they still represent the best information available to your local authority.

Where should the forecasting assumptions appear in the LTCCP?

We suggest that assumption information be presented in two forms:

- (a) significant forecasting assumptions should be located in a table immediately adjacent to the forecast financial statements.
- (b) within the activity or group of activity statements it may be helpful to record assumptions which are relevant to a particular activity but not significant across your local authority.

What processes do the forecasting assumptions link to?



What were the apparent weaknesses with forecasting assumptions in 2006?

Assumptions were not always consistently applied with no discussion explaining the differences in treatment.

Some assumptions were phrased as statements of fact rather than as an assumption (for example stating a resource consent expiry date rather than impact of not getting another consent or the likely conditions attached to a new consent).

Some assumptions were clearly copied from others, and were not relevant to the local authority preparing the LTCCP.

Some capital programmes appeared ambitious and experience with amendments in the 2007 Annual Plans has borne this out, often simply because no-one was available to do the work.

The forecasting uncertainties were not always identified and the impact of the financial estimates was quantified in only a few cases.

Good practice tips/what good practice information is available?

OAG Guidance for the Assessment of Significant Forecasting Assumptions - this document discusses the identification and reporting of risk and uncertainty, and includes guidance around the sorts of assumptions Audit expects an LTCCP would have. Note that this guidance was issued in 2004, but is still reliable.

[CLICK HERE](#) for the document

Price Level Adjustors – in 2005 SOLGM prepared the attached overview document explaining why adjusting financial statements for price change is important. SOLGM has commissioned BERL to produce a set of price adjustors on an annual basis – these can be found on the Good Practice Toolkits website (www.solgm.co.nz).

[CLICK HERE](#) for the document