

**Statement of
Financial Accounting Standards
No. 16**

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Preparation of Financial Forecasts

I Introduction

- (1) A business should follow this Statement when it prepares financial forecasts.
- (2) Definitions contained in this Statement are explained as follows:
 - (a) *Financial forecast*: the appropriate estimation of future financial conditions, operating results and cash flows made by management according to the business plan and operating environment of an entity.
 - (b) *Key factors*: the important events that affect future operating, investing and financing activities of an entity.
 - (c) *Basic assumptions*: the assumptions made by management in accordance with the key factors' most possible future development of the entity.
 - (d) *Financial forecast corrections*: the corrections made when financial forecast errors occur after the incorrect forecast is released.
 - (e) *Financial forecast renewal*: the corrections made on the released financial forecasts due to changes in basic assumptions.

II Preparation criteria

Trustworthy principle

- (3) Financial forecasts involve many uncertainties. If not based on reasonable assumptions and proper awareness, financial forecast information may be misleading. Therefore, a company should conform to the *trustworthy principle* when preparing financial forecasts.
- (4) The *trustworthy principle* requires that management should establish reasonable assumptions, devote professional attention, and disclose the related information properly, based on this Statement.

Suitable preparers

- (5) Financial forecasts should be prepared by suitable preparers to assure the quality, reasonableness and reliability of the financial forecasts.

Suitable preparers refer to those who have knowledge in production, marketing, accounting, financing, research, environmental protection, engineering and other related areas to the company and the industry in which it operates.

Appropriate accounting principles

- (6) Appropriate accounting principles should be used when preparing financial forecasts, and they should be consistent with the principles used when transactions occur.
- (7) If management expects to change the accounting principles, the change should be properly reflected in the financial forecast.

Best information

- (8) Information used in preparing financial forecasts comes from many different sources, both internal and external. Management should establish effective financial forecast procedures to collect timely information so as to match the assumptions made when preparing forecast information.
- (9) The degree of reliability of information used in preparing financial forecasts varies. Therefore, management should consider reliability, relevancy, and appropriateness of the information when preparing financial forecasts.
- (10) When collecting information, costs are usually involved, and these expected costs should be weighed against the expected benefits.
- (11) Numerous data and complicated calculations may be required when preparing financial forecasts. The preparation process, due to a lack of self-correction and balancing functions, may lead to errors. Therefore, management should establish procedures for the prevention, detection, and corrections of errors.

Consistency with the business plan

- (12) Management should prepare financial forecasts according to the expected results of the business plans. The information contained in the business plan may come from various sources, therefore, suitability of information should be evaluated when preparing the financial forecasts.

Key factors

- (13) When preparing the financial forecast, management should confirm the key factors related to its operations and establish reasonable assumptions as a basis for financial forecasts (eg, if labor is one of the

key factors in operations, then the company should establish basic assumptions related to human resources, wages, etc.)

Appropriate assumptions

- (14) The quality of the financial forecast depends on the quality of the basic assumptions. Therefore, financial forecasts should be based on appropriate basic assumptions.

Assumptions should be made based upon reasonable and appropriate information, and they should be evaluated by the highest levels of management.

- (15) Management may use marketing research information, macro economic indices, industrial activity information, historical operating trends and patterns, and internal data to make an overall analysis to determine basic assumptions.

Sensitivity analysis

- (16) Financial forecast results have different degrees of sensitivity to changes in assumptions. Some assumptions will have significant impact on financial forecasts with only minor changes. Some assumptions have an entirely opposite effect. Therefore, to avoid such significant differences, assumptions with the following characteristics should be carefully examined during the financial forecast process:

- (a) Assumptions sensitive to the expected results. That is, assumptions with a minor change would have a significant impact on the expected results.
- (b) Assumptions probable in causing large differences. Assumptions in this category should be studied, analyzed and checked by the highest levels of management.

Documentation

- (17) An enterprise should prepare appropriate written documentation evidencing the financial forecasts and the related procedures in order for related department managers to check, approve and compare the actual and expected results. When such written documentation is prepared, management should record the related basic assumptions and supporting information.

Periodic comparison

- (18) Financial forecasts should be periodically compared with actual results. The differences should be analyzed in order to improve forecasting methods. For the periodic comparisons, overall financial results, as well as key factors and basic assumptions such as sales quantity, sale price and production rates, should be included.

Checking and approving

- (19) Documents supporting the financial forecasts must be examined and approved by the management of related departments. Management must assure that the preparation of financial forecasts comply with the stipulations of this Statement. Furthermore, senior management should take final responsibility for forecasted information.

III Disclosure criteria

- (20) Financial forecasts should adhere to the historically comprehensive format of the basic financial statements. If not expressed in a comprehensive format, it should at least contain the following items:
- (a) sales revenue;
 - (b) cost of goods sold;

- (c) income from continuing operations;
- (d) discontinued operation segment or extraordinary gains or losses;
- (e) income tax;
- (f) net income;
- (g) earnings per share;
- (h) significant changes in financial condition;
- (i) the declaration of an enterprise's financial forecast which is estimated and may not be fully attained in the future;
- (j) overall explanation of significant accounting policies; and
- (k) overall explanation of basic assumptions.

Subsections (i) to (k) are disclosures of events, and they are part of the financial forecast.

- (21) Financial forecasts should be marked 'Forecast' and 'Refer to important accounting policies and overall basic assumptions' on each page.
- (22) The significant accounting policies used to prepare financial forecasts should be fully disclosed. If accounting principles are changed, they should likewise be disclosed.
- (23) Since the disclosure of important assumptions may increase the usefulness of financial forecasts, the significant assumptions and their theoretical foundations should be disclosed.

The assumptions made in financial forecasts include:

- (a) the assumptions possibly causing differences or having significant effects on future results;
 - (b) the assumptions that cause significant differences in expected and actual conditions; and
 - (c) other events that have significant impact on the information and their explanations.
- (24) The completion date of the financial forecast should be disclosed.
 - (25) Financial forecasts are usually expressed in singular amounts, but can also be expressed in upper and lower bound amounts. The ranges of the upper and lower bounds usually reflect the forecast uncertainty of management. The higher the extent of uncertainty, the bigger the range. However, management should consider that it may be meaningless for the users if the range is too large.
 - (26) The period covered by the financial forecast is usually one year. It can be extended or shortened based on its usefulness to users and on the forecasting abilities of management.
 - (27) When an enterprise discloses current year financial forecasts, it may also disclose prior years' financial statements and financial forecasts for a comparative analysis. Furthermore, each statement should be clearly marked for users.
 - (28) If management discovers errors when preparing a financial forecast, it should first consider if the financial forecast misled users' judgments. If the error may have misled users, management should publish an explanation of the error and announce that the original published information is not suitable for any use. Furthermore, the corrected forecast information should be republished as soon as possible.
 - (29) When a basic assumption is changed and the change has significant effect on the financial forecast, management should renew the financial forecast and explain the reasons for renewal. When

renewing the financial forecast, management should re-analyze the key factors and basic assumptions. If unable to release renewed financial forecasts immediately, management should announce that the originally published financial forecasts are not suitable for any use and explain the reasons.

IV Notes

- (30) This Statement was issued on December 28, 1989, and should be adopted for financial forecasts in fiscal years beginning on or after July 1, 1990.