

Public organizations engage in a capital budgeting process due to the unique nature of managing and administering capital assets¹ and expenditures related to those capital assets (Marlowe, Rivenbark, & Vogt, 2009, pp. 3-5). Because of the inherently long-term commitment and consequences generally connected with these capital assets, governments need to engage in this separate capital budgeting process to allow sufficient time for planning and administration of these assets (pp. 3-5).

There are five main steps to administration of an effective capital budgeting process: (1) planning; (2) evaluation; (3) decision making; (4) control and (5) examination, but all steps have some element of planning (Wendorf, 2005, p. 77). Included in the first step, planning, is the creation of and maintenance of a capital improvement plan (CIP)² (p. 78). Similar to the CIP, financial forecasting is a management tool that aides the public organization in planning its capital budget (Marlowe, Rivenbark, & Vogt, 2009, p. 56).

According to Marlowe, Rivenbark, and Vogt (2009), financial forecasting allows the public organization to analyze its CIP to determine the CIP's budget implications over several operating years, most commonly a five-year period (p. 48). This analysis allows the public organization to tie its proposed capital expenditures to its operating budget (p. 48). By doing so, the public organization is able to identify potential funding sources and potential challenges in time to allow the organization to plan on how to take advantage of opportunities or to address and overcome challenges (p. 48).

¹ Marlowe, Rivenbark, and Vogt (2009) define a "capital asset" as "[p]roperty that has an initial useful life longer than one year and is of significant value. The useful life of most capital assets extends well beyond one year" (p. 251). In general, significant value is a value of \$5,000 or more.

² Marlowe, Rivenbark, and Vogt (2009) define a CIP as "a multiyear forecast of major capital building, infrastructure, and equipment needs" (p. 252).

In order to most effectively use the financial forecasting tool, however, the public organization must make several initial decisions about how they will implement and use the tool including: (1) its scope; (2) its audience; (3) effect on decision making; and (4) its methodology (Marlowe, Rivenbark, & Vogt, 2009, pp. 48-50). First, the public organization must determine the financial forecast's scope. The purpose of the forecast usually will be determined by its scope (p. 48). Most commonly, a public organization will use financial forecasting planning tool by preparing individual financial forecasts for its most important funds, such as its general fund (p. 48). The public organization must also determine the audience for its financial forecasts (p. 49). Most commonly, the audience/recipient for a public organization's financial forecast is the public organization's elected officials (p. 49). Next, the public organization must determine in what way it will use the financial forecasts in its decision-making process (p. 49). Most commonly, the public organization uses it as a planning tool to determine the financial impact of its current decisions including its decisions related to capital projects over a longer period of time (p. 49). Next, the public organization must determine which methodology to use in creating its financial forecast: (1) judgement-based forecasting; (2) trend analysis forecasting; (3) deterministic forecasting; or (4) econometric modeling (pp. 49-50). The most simplistic methodology, and one that is commonly used by small and local governments, is the judgement-based forecasting. The most complex method and the method most commonly used by state governments and other large public organizations is econometric forecasting (50).

An essential element, however, included in some form in all four possible methodologies is trend analysis (Marlowe, Rivenbark, & Vogt, 2009, pp. 49-50). In its simplest form, trend analysis forecasting uses data from prior years, commonly the last five years, to discern trends in revenue and expenditure changes (p. 49). Based on those historic trends, assumption regarding future

years' revenue and expenditures are made (p. 49.) Additional variables and details may be added, such as those included in deterministic forecasting and econometric modeling to help increase its accuracy and usefulness (p. 49-50). This use of trend analysis is essential to more accurate financial forecasting (p. 49-50). With accurate financial forecasting, the public organization can obtain a more accurate and, therefore, more effective CIP.

References

- Marlowe, J., Rivenbark, W. C., & Vogt, A. J. (2009). *Capital Budgeting and Finance - A Guide for Local Governments*. Washington, D.C.: International City/County Management Association.
- Wendorf, J. (2005, May 1). Capital Budgeting from a Local Government Perspective. *SPNA Review*, 1(1), 73-86.