Cash Flow Budgeting & Short-term Borrowing

Cash Flow Forecast

It is the responsibility of the treasurer to manage a community's cash and ensure that account balances are sufficient to cover municipal or district obligations in a timely manner. In the performance of their cash management duties, treasurers often find that a cash flow forecast can be a useful tool to help anticipate periods of low balances and to better manage any short-term borrowing needed to fill gaps. Conversely, it can also reveal periods when account balances are positive and the potential to maximize investment income exists. In this way, the concept of cash flow forecasting runs in tandem with short-term borrowing or short-term investing.

For additional guidance on the subject of municipal cash management, see Chapter 11 of the Treasurers Manual published by the Massachusetts Collectors and Treasurers Association.

Typically, a cash flow forecast should be developed after approval of the annual budget and before July 1 each year. At this time, the treasurer can rely on the revenue projections that fund the budget and on the appropriations that were approved. By adjusting past patterns of monthly spending and collections to current year revenue projections and appropriations, a reasonable forecast of a community's cash flow needs will emerge.

The level of revenue or expenditure detail displayed in a cash flow forecast can vary. As a starting point, municipal and school payroll warrants together with vendor warrants can provide very general perspective. We encourage a slightly more sophisticated approach where additional detail provides greater safeguards against inadvertently omitting a required payment. For example, if debt service payments are among the separately listed categories, it serves as a reminder to review source documents, i.e. the treasurer's debt schedule, for specific amounts that are due during the fiscal year.

Revenues can be combined into major groups, such as, tax levy, state aid, motor vehicle excise, other local receipts and other/miscellaneous. As noted, total annual amounts should be based on revenue projections which support the annual budget. How that total amount gets allocated to each month in the forecast can be based on trends indicated by prior year monthly revenue reports. The monthly forecast should be refined by accounting for anticipated deviations from the prior year, special circumstances or other expectations in the coming fiscal year. At the end of each month through the course of the fiscal year, the cash flow projections should be replaced by actual monthly expenditures or receipts. If revenues are insufficient to cover costs and short-term borrowing is used to fill the gap, the note proceeds must be added to the forecast as revenue, and later payments of interest and principal must be inserted as expenditures.

Here are two examples in Microsoft Excel of a cash flow forecast.

Short-term Borrowing

To protect against the possibility that cash balances might be insufficient to fund payroll and other expenses, some communities borrow a large, lump-sum amount early in the fiscal year in the form of revenue anticipation notes (RANs). These communities usually lack adequate reserves (such as stabilization) from which to draw internally, thus making it necessary to borrow from an external source. Though the borrowing is temporary, the repayment period is often prolonged, giving rise to high annual interest costs. In some cities and towns, a simple reluctance to deviate from past practice seems to be the only reason why the lump-sum borrowing approach has remained the norm for many years.

As an alternative, we suggest that municipalities and school districts could save money on interest charges by staggering RAN borrowing in a way that mirrors short-term cash needs. Rather than carry a large loan principle for a longer duration, treasurers should use the cash flow forecast to precisely determine the timing of cash needs and borrow accordingly. However, RANs should only be issued to cover operating expenses. Expenses related to capital projects authorized for long-term borrowing should be funded through bond anticipation notes (BANs).

To help communities with the borrowing process, the Division of Local Services (DLS) offers assistance through its State House Notes Program. State House Notes are debt instruments for cities, towns, counties and districts certified by the Director of Accounts. The notes are attractive, most often to smaller communities, because certification fees are low and neither an official statement nor full disclosure is required. Communities should contact the Public Finance Section at DLS or consult their financial advisor for more details.