BEST PRACTICE

Use of Cash Flow Forecasts in Treasury Operations (2005, 2008 and 2011) (TIM)

Background. A cash flow forecast is an estimate of cash receipts and cash disbursements (together, cash transactions) during a given period. When used as a cash management guide, it can lead to the optimized use of funds as well as insure sufficient liquidity. When used for investment purposes it also helps identify maximum maturity limits, and weighted average maturity limits that establish potential benchmarks.

Cash flow forecasting can determine what dollar amount of the portfolio needs to remain liquid to meet disbursement obligations, generally on a monthly basis. Also, it can identify core funds, or those funds available for longer-term investing which allows a longer maximum maturity. For instance, cash flow forecasts can help identify reasonable maximum maturity and a weighted average maturity for safety and liquidity in the portfolio. Cash flow forecasting is distinct from governmental accounting and budgeting. It is a forecast to measure the organization's ability to meet liquidity needs. The ultimate goal of this forecast is to mitigate the need for short-term borrowing or liquidation of securities (investments) before maturity. Cash forecasting should take into consideration all organization-wide portfolios and funds. This allows spending patterns to be coordinated to mitigate potential shortfalls and balance the flow of funds.

Recommendation. The Government Finance Officers Association (GFOA) recommends that state and local governments take into account the following considerations when undertaking cash flow forecasting:

1. All operating departments should be involved in developing reasonable expectations of timing and amounts of planned expenditures. This ensures all possible outflows of resources are measured, and if needed, prioritized. Forecast time frames should accurately reflect the cash transactions of the organization.

2. The organization's goals should drive the prioritization of expenditures. Further, fixed items such as payroll, employee benefits, insurance, and debt service should have priority of cash demand over discretionary expenditures.

3. Historical data should be used to measure activity of a cyclical nature, both for receipts and disbursements. A well-established base of financial activity predicated on historical data enables the cash forecaster to anticipate disbursements and receipts. This activity should be verified by the operating department for its likely recurrence. Analytical software can be used to maintain historical data and provide an enhanced ability to forecast future liquidity needs. Analytical software can also enhance the organization's ability to perform statistical analysis to compare the forecast to actual activity. Dependent upon the use of the information, the 80-20 Rule can be used to maintain information and reduce gathering and maintenance efforts.

4. A forecast for receipts should include expected inflows and investment maturities. Inflows include payments such as property taxes, utility payments, and user fees. Maturities include all items held in investments that will mature during the forecast time frame.

5. A forecast for disbursements should include regular expenditures such as payroll and recognize non-repetitive expenditures. Historical data can assist in forecasting disbursements.

6. Cash flow forecasts should be used to recognize the items and controls that influence the organization's cash position. Organizations should develop strategies to implement effective and efficient cash management

techniques such as collecting receipts as soon as possible and managing disbursements judiciously.

7. Forecasts should be made conservatively. Fluctuations may occur in both receipts and disbursements for a variety of reasons. The level of precision required in a forecast or tolerance for variance should be determined at the organizational level and not on an ad hoc basis.

8. Forecasts should be updated on a regular basis, for example, monthly. The frequency of such updates is determined by the volatility of revenues and expenditures. Daily monitoring and recording of actual revenues and expenditures by major categories can greatly enhance the organization's ability to prepare timely updates to the cash flow forecast..

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