RECOMMENDED PRACTICE

Use of Cash Flow Forecasts in Operations (2005) (CASH)

Background. Cash flow forecasting is an estimate of receipts and disbursements during a given period. When used as a cash management guide, this tool can lead to the optimization of funds as well as insuring sufficient liquidity is present to meet liabilities. Cash forecasting is distinct from governmental accounting and budgeting in that the forecast is done with intent to measure the organization's ability to meet needs in light of resources with the ultimate goal of negating the need for any short-term borrowing and to avoid the liquidation of any long-term securities (investments). When done on an organizational level, spending patterns can be coordinated to mitigate any potential shortfalls and balance the flow of funds..

Recommendation.

1.) Forecasting cash flow must be done on an organizational level. All operating departments need to be involved in developing reasonable expectations of planned expenditures. This is to insure all possible outflows of resources are measured, and if needed, prioritized.

2.) The prioritization of expenditures is a function of the organization's goals. Fixed items (payroll, insurance, debt service, etc.) may need priority of cash demand over discretionary expenditures that may not be as fixed cyclically, nor organizationally dependent.

3.) Forecast time frames need to accurately reflect the receipts of the organization.

4.) Use historical data to measure activity of 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.

5.) A forecast for receipts should include cash, maturities, and short-term investments. Cash includes currency on hand and demand deposits. Short-term investments have low transactions costs, but should be viewed as emergency cash bridges. Maturities include all items held in investments, which may become mature during the forecast time frame.

6.) A forecast for disbursements should recognize the organization's priorities in light of statutory regulations on prompt payment.

7.) Cash forecasters should recognize the items and controls that influence the organization's float, and develop strategies that favor the collection of receipts as soon as possible, and the delay of disbursements as long as possible.

8.) Forecasts should include room for error. This tolerance should be organizationally determined.

References

- Mikesell, John. (1999). *Fiscal Administration. Analysis and Applications for the Public Sector.* Boston: Harcourt Brace & Company.
- Greifer, Nicholas (Ed). (2004). *Banking Relations.* Chicago, IL. Government Finance Officers Association.
- *Recommended Budget Practice* – Appropriate Level of Unreserved Fund Balance in the General Fund (2002).

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