



BEST PRACTICE

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

Background. Cash flow forecasting 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 optimization of funds as well as insure sufficient liquidity. Cash flow forecasting can determine what dollar amount of the portfolio needs to remain liquid to meet disbursement obligations, generally within a six-month period. Also, it can identify core funds, or those funds available for longer-term investing. For instance, cash flow forecasts can help identify reasonable maximum and weighted average maturities of investments. 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. Forecasting should be done organization-wide. 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 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.
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.
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. The frequency of such updates is determined by the volatility of revenues and expenditures.

References

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