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Cash Balance –
Can It Take the ***Stress***?

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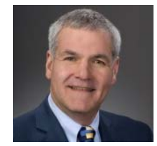

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It is natural to assess any organization's financial condition by looking at cash on hand, or cash balance. Cash balance is an indicator, but a more important financial analysis is the school district's revenue compared to spending. If spending exceeds income then the only financial assurance is that the cash balance will run out – sooner or later.

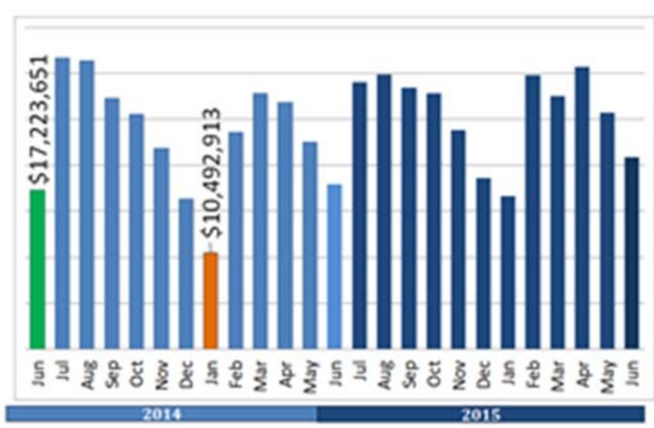
What is the significance of cash on hand? Cash balance is the primary defense against financial stress caused by unexpected or unusual events. Just like at home it is wise to have some dollars in the bank. You never know when that kiddo will call from college and the car is "beyond repair."

Just like for each household, the amount of savings to keep can be different for each school district. This article will discuss three key areas relevant to all districts:

1. Establishing cash flow estimates when all is going well
2. Defining your district's actual cash balance needs under *STRESS*
3. Using benchmarks to guide cash balance goals and policy

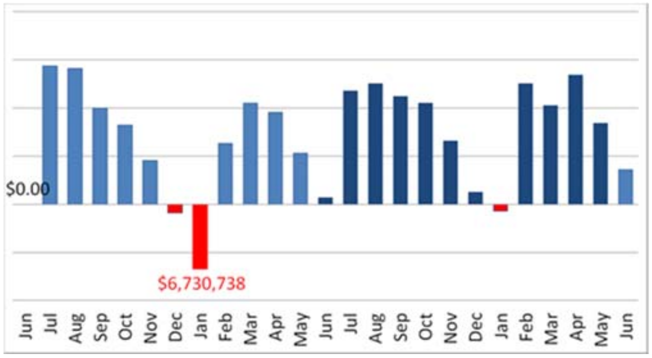
Typical Income and Expense Monthly Cash Flow

At Public Finance Resources (PFR) we believe that monthly estimates of income and expenses are essential to reliable financial forecasting. The graph below is an example of a district's monthly cash flow balance resulting from its monthly income and expense estimates. The bars represent the "ebb and flow" of the district's monthly cash balance after starting fiscal year 2014 with $17,223,651 in the bank. Peaks and valleys develop with a drop of almost $7 million from the starting balance to the lowest. What caused the peak in July? You probably guessed it – local property tax collections. Cash balances grow at the start of the two-month tax collection cycle and then cash declines in the post-collection months. Still, this district has adequate cash balance every month. And June's 2014 ending balance is higher than at the start of the fiscal year. This tells us that the district is adding (income exceeds expenses) to its year-over-year ending cash balance.



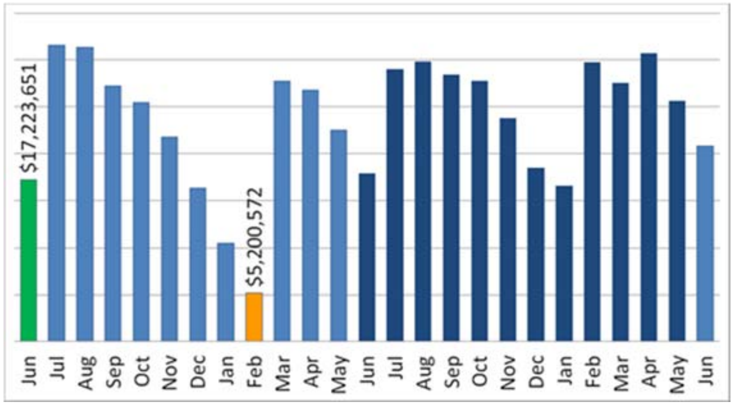
Cash Balance Performance Stress Testing

With the monthly cash flow estimates prepared the district is now ready to see how its monthly cash balance would respond to certain stress indicators. For example, what would happen if the district had started with zero cash at the beginning of fiscal year 2014? The picture isn't pretty as the graph to the right shows.



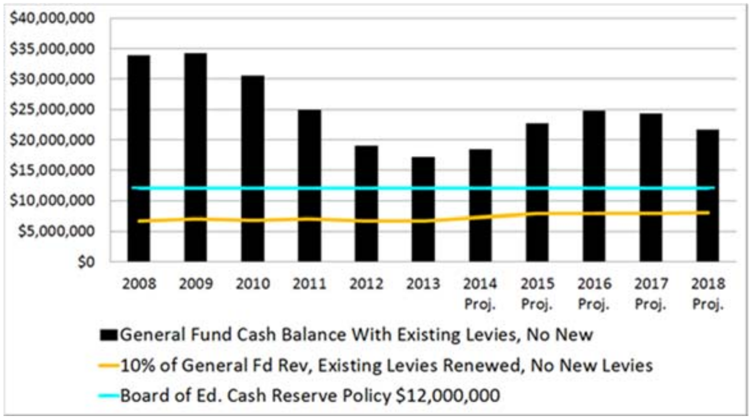
Without any cash on hand at the start of the fiscal year the district would experience negative cash flow in multiple months with the largest negative balance in January, 2014. This stress test tells the district that a starting balance of $6,730,738 is needed to avoid borrowing. Having no cash in the bank is stressful enough, what about other financial stresses?

For example, how would a delay in local property tax collections of 30 days impact the district's monthly cash balance? The delay in collecting tax revenue further stresses the previously modeled low cash balance of the year, and creates a new "lower" balance of $5,200,572 in February, 2014. In this case the district's starting cash balance of $17,223,651 is adequate to confront this financial stress factor. More of the balance is consumed to confront the financial distress of delayed local tax collections.



Establishing a Credible Reserve and External Benchmarking

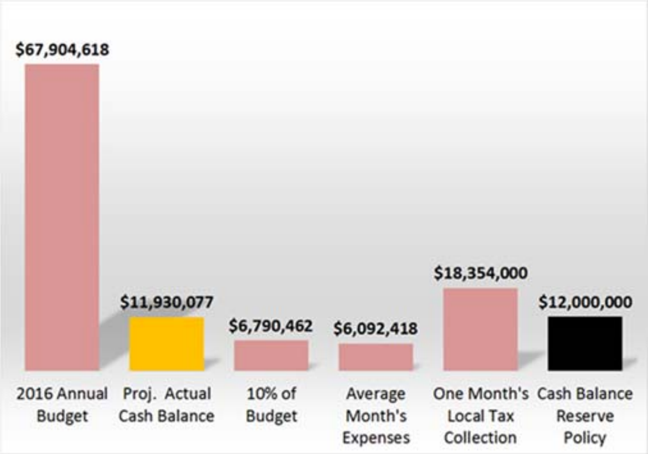
If a delay of property tax collections was the district's financial stress concern, then a starting cash balance of about $12,000,000 ($17,223,651 - $5,200,572) is sufficient to "weather the storm."



The district can compare their established cash balance goal to an external benchmark. For example, a debt rating agency may consider the district's cash balance as a percentage of revenue or expenditures. In this case, a 10% of general fund revenue is modeled in the graph next to the district's $12 million cash balance reserve policy.

Conclusion

A credible year-end cash balance policy is one that is understood by your district's stakeholders, and at the same time meets credible internal and external benchmarks. This graph provides multiple benchmarks for the district to consider when determining a cash balance reserve. Not all of these will be important to each district.



Invest time now to establish your district's cash balance needs against your specific benchmarks. As a result you will experience clarity when explaining your cash on hand, your stability/stress benchmarks, and also why you can or cannot make certain expenditures with one-time cash on hand.

Remember, a goal is to have cash on hand to confront reasonable financial stress so that the district does not have to take out a loan to pay its bills.

Great news for the over 200 clients using PFR's forecasting software – these tools will be re-emphasized in this year's update seminars. Please register early. www.PFRCFO.com/seminars