FCMAT

FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM

Fiscal Alert

April 2020

Effective Cash Management During Uncertain Times

Background

You have heard the phrase, "cash is king." Private industry has long understood the importance of this concept. Governmental entities and especially California schools began to fully appreciate the importance of effective cash forecasting and management strategies during the Great Recession when state cash receipts fell dramatically, resulting in the deferral of cash payments to local educational agencies (LEAs). During the economic recovery of the past eight years, the focus on cash has understandably lost a bit of its luster. However, during periods of economic distress, cash is a "third rail" issue, and LEAs must enhance their planning and monitoring around cash issues weekly.

This Fiscal Alert addresses the impact of the ongoing COVID-19 pandemic on LEAs cash resources for the current and subsequent fiscal year. This alert is for all LEAs, including county superintendents serving in their financial oversight role. During these rapidly changing, unprecedented times, it is critical for LEAs to begin analyzing and planning for various scenarios that will adversely impact cash flow and avoid cash shortfalls.

During the Great Recession a significant decline in state tax revenues prompted numerous apportionment deferrals that caused LEA cash fluctuations and resulted in extensive local borrowing. Similar deferrals will be one of the first tools the state uses to stabilize its own cash flow and to control in what year Proposition 98 appropriations are attributed. Cash deferrals are more favorable to LEAs than actual reductions in state funding but require LEAs to maintain accurate cash flow projections and to develop multiple cash flow scenarios to deal with the impact of the deferrals when they occur.

The May Revision may address short-term state plans and determine whether cash deferrals are part of those plans, especially for June 2020. However, the May Revision, and likely the June adopted budget, will not provide definitive answers about budget and associated apportionment plans, necessitating the need for LEAs to wait until a revised state budget is adopted in August/September to receive a more complete funding plan for the 2020-21 fiscal year. Use the time now, before the May Revision, to analyze and plan for various current year and budget year cash scenarios for your LEA. Cash deferrals could come as soon as June 2020, with a deferral of the June principal apportionment to early July. Ensuring the availability of adequate cash reserves is a vital function for all LEAs.

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Budget vs. Cash Flow

Budgets and cash flow projections are equally important but vary in their nature, data and analysis. The term "budget" means that funds are devoted to a purpose and/or entity, while "cash" means that funds are paid and readily available for use. Cash flow projections are built from budget data with apportionment schedules and payment terms on compensation and purchases taken into consideration. LEA budgets are a set of annual data with a focus on June 30. Cash flow is presented in shorter periods of time, typically monthly, but weekly and daily in some cases depending on circumstances. Budgets and cash flow are equalized with year-end accruals. Significant variances in cash flow actuals to projections generally serve as the first indicator of fiscal distress. Deficit cash positions determine the timing and amounts of the need for alternative liquidity (see below). The general fund, which is the focus of most LEA budgets, is only one of the district's funds. Cash is transferable and may be commingled; therefore, LEAs need to project and analyze all funds.

Relevant Issues

Cash Flow Analysis and Planning

Following best practices under normal circumstances LEAs should update cash flow projections monthly and not only at periodic reporting periods. At a minimum, cash projections should be prepared extending through the current and into the subsequent fiscal year. In periods of economic distress and funding uncertainties, the frequency and depth of cash flow projections and analysis should be increased.

Using recently completed second interim cash flow projections as the starting point, update the projections with February and March actuals, and build in necessary changes in the forecast for April, May and June, considering the new realities affecting the LEA. Do not limit the analysis and monitoring to the general fund, expand to cover all funds; Reviewing cash positions across all funds is essential to proper analysis.

Considerations regarding cash receipts must look beyond state apportionments for LCFF. To a lesser degree of impact, cash flow analysis must include:

- Property taxes – April is a significant month for property tax receipts. Monitor and analyze apportionments from the county auditor/controller and treasurer/tax collector against the existing cash flow projections. Most California counties operate under the Teeter Plan for tax collection apportionments to local agencies, in which the tax levy is apportioned without regard to delinquencies, shielding local agencies from the impacts of late and nonpayments. County offices of education and districts should consult frequently with their county auditor/controller and treasurer/tax collector to understand cash flow expectations and adjust cash flow projections accordingly.
- Local cash receipts from a variety of sources are also adversely affected, including:
  - Parent-paid nutrition programs, childcare programs, and transportation programs.

    - Facility leases and use of facilities fees
- Lottery sales are impacted from the stay-at-home orders. While new lottery revenue forecasts for third and fourth quarters have not been released, cash flows should assume a decreased third quarter payment (and fourth quarter accrual).

Regarding cash payments, most LEAs are experiencing unplanned, extraordinary expenditures including:

- The shift to distance learning including procuring technology and network access devices
- Maintaining salaries and in some cases increasing compensation for disaster service workers
- Accounting for interfund cash lending or deficit absorption in the general fund to cover cafeteria fund and childcare program deficits

LEAs should also consider delaying any nonessential payments and discretionary purchases to preserve available cash for critical operational functions. Savings should also be accounted for, including utilities, fuel, some contracted services, and other variables related to the physical operations of campuses (using summer months as an example).

If the cash flow projection for the LEA shows negative for any period (month, week, or day), corrective action must be taken to ensure sufficient cash resources are made available to eliminate this negative position. In some counties, county treasurers automatically provide safeguards by allowing short-term negative cash balances in one fund if they are offset by other LEA funds. You should clearly understand how your county treasurer functions when it comes to LEA cash balances. If corrective action is required, it may include the use of alternative liquidity resources and adjustments to expenditure plans, or a combination of both.

Alternative Liquidity

Alternative liquidity is a fancy term for the identification of available cash resources outside of the LEA's general fund. Therefore, expanding the cash projections and monitoring across all funds is essential. LEAs should immediately begin to prepare alternative liquidity schedules that show the projected cash flow and cash balance for each fund by month, and in some cases by week. Alternative liquidity analyses should also look beyond the district's funds on deposit in the county treasury and determine what short-term borrowing options exist for cash flow and working capital needs.

Regarding interfund borrowing, LEAs should analyze the various forms of alternative liquidity against the provisions of Education Code Section 42603. Borrowing from other funds to satisfy temporary shortfalls in operating cash is common practice among California school districts. With increasing uncertainty about the state apportionment plans, districts should refresh their knowledge on proper interfund borrowing. Now is the time to prepare temporary borrowing resolutions for your board of education to consider for approval. This authorization will enable LEA business officials to quickly access the cash resources in other funds by temporarily transferring those resources to where they are needed. A best practice is to adopt a resolution at the start of each fiscal year to authorize interfund borrowing throughout the year; but if such authorization does not currently exist through June 30, 2020, a resolution should be prepared now for the current year.

Education Code Section 42603 allows temporary borrowing between funds, stating the following:

> The governing board of any school district may direct that moneys held in any fund or account may be temporarily transferred to another fund or account of the district for payment of obligations. The transfer shall be accounted for as temporary borrowing between funds or accounts and shall not be available for appropriation or be considered income to the borrowing fund or account. Amounts transferred shall be repaid either in the same fiscal year, or in the following fiscal year if the transfer takes place within the final 120 calendar days of a fiscal year. Borrowing shall occur only when the fund or account receiving the money will earn sufficient income, during the current fiscal year, to repay the amount transferred. No more than 75 percent of the maximum of moneys held in any fund or account during a current fiscal year may be transferred.

LEAs need to be mindful of the interfund borrowing repayment requirements specified in code. Failure to repay a lending fund in accordance with the statutory provisions can damage the trust of the district's stakeholders and should be identified as a deficiency in the district's annual audit report.

The Education Code does not limit interfund borrowing authority to particular funds and includes no specific exclusions for funds holding restricted dollars. Borrowing from bond proceeds is not advisable and, in some cases depending on bond official statement offering documents, may be inappropriate. This includes the potential loss of tax-exempt status for the bonds, the loss of the direct subsidy payments, possible disclosure violations, and other legal considerations that should be avoided. FCMAT recommends that districts utilize the other options available to mitigate a temporary cash shortage instead of using bond proceeds. This coincides with guidance outlined in a previous Fiscal Alert as well as in an advisory published by the California Debt and Investment Advisory Commission (CDIAC). Also see FCMAT Fiscal Alert Interfund Borrowing Using Bond Proceeds (https://www.fcmat.org/PublicationsReports/FCMAT_Fiscal_Alert-Interfund_Borrowing_Using_Bond_Procees-10-1-19.pdf). Ultimately the decision to borrow from bond proceeds should be made locally after consultation with the LEA's bond counsel.

As mentioned, alternative liquidity is not limited to interfund borrowing but includes other options available to districts in need of temporary cash as follows:

1. Tax and Revenue Anticipation Notes (TRANs)

   Another common method to mitigate a cash shortfall is a TRANs, a short-term note that may be issued by the district or the county board of supervisors on its behalf and secured by anticipated tax revenues to be collected in the same fiscal year. TRANs funds, sometimes held in a "proceeds" account, may be used for any purpose, including current expenses, capital expenditures, repayment of indebtedness and working capital. Many districts access TRANs through pooled TRANs such as through their county office of education or a related organization. There is usually a minimum of 90 days lead time to complete a TRANs transaction and pay cost of issuance fees for attorney, financial advisor, underwriter, and other professional assistance.

2. County Superintendent of Schools (Education Code sections 42621 and 42622)

   A district may borrow from the county superintendent of schools with the approval of the county board of education. Funds loaned by the county superintendent are subject to availability of excess funds held by the county superintendent. Funds must be repaid within the same fiscal year. (EC 42621)

   Similar provisions exist for county superintendent of schools to make a conditional apportionment to a district or charter school that may be paid back to the county superintendent in the subsequent fiscal year. (EC 42622)

3. County Treasurer

   The California Constitution, Article XVI, Section 6, states the following:

   > …the treasurer of any city, county, or city and county shall have power and the duty to make such temporary transfers from the funds in custody as may be necessary to provide funds for meeting the obligations incurred for maintenance purposes by any city, county, city and county, district, or other political subdivision whose funds are in custody and are paid out solely through the treasurer's office. Such temporary transfer of funds to any political subdivision shall be made only upon resolution adopted by the governing body of the city, county, or city and county directing the treasurer of such city, county, or city and county to make such temporary transfer. Such temporary transfer of funds to any political subdivision shall not exceed 85 percent of the anticipated revenues accruing to such political subdivision, shall not be made prior to the first day of the fiscal year nor after the last Monday in April of the current fiscal year, and shall be replaced from the revenues accruing to such political subdivision before any other obligation of such political subdivision is met from such revenue.

   To borrow from the county treasurer, the district must submit a resolution to the county board of supervisors requesting a loan. Following the board's approval, the county treasurer's office disburses to the district an amount not to exceed 85% of the amount of money accruing to the district during the current fiscal year. Repayment of the advance is made from tax revenues accruing to the district later in the fiscal year.

Cash Monitoring

Cash should always be monitored routinely and in-depth. The best practice is to monitor cash flow projections against actuals monthly. However, in rapidly changing environments, it is highly recommended and not unusual to expand that monitoring to real time for planned receipts and high dollar expenditures. In times of uncertainty, at a minimum, monitoring should occur weekly. The goal of the increased surveillance is to ensure you do not incur a shortfall or fall below a preestablished balance for working capital needs.

Reserves as components of the fund balance are not necessarily equivalent to cash holdings but may be backed by other assets. During uncertain times, it is essential to ensure that all reserves are supported by equivalent cash balances. During the previous period of economic distress it was not uncommon for LEAs to have adequate fund balance reserves, but as a result of both inter-year and intra-year cash deferrals from the state, only a small portion of the reserves were backed by cash balances at any given time. This limited the usefulness of the reserves for an emergency or unforeseen circumstance.

In most cases, the link between LEAs and county treasurers (who serve as the LEA's treasurer) is through the county superintendent. In a fiscally uncertain environment, it is essential to maintain regular communication and strengthen relationships with the county treasurer. County superintendents should ensure that property taxes, state apportionments, interest income, and other cash resources are recorded timely to school district accounts. In addition, timely reconciliations, including clearing accounts, are important in ensuring the accuracy of all incoming and outgoing cash. County superintendents serve a vital role for the LEAs regarding cash flow monitoring.

Conclusion

The accuracy and reasonableness of preparing cash flow projections through the subsequent fiscal year depends on both apportionment schedules and budget assumptions. At a minimum, each budget scenario prepared should have at least one cash flow projection (all funds). However, apportionment considerations can and will be adjusted without regard to budget assumptions and will necessitate more than one cash flow projection scenario for each budget scenario. For example, a budget scenario with a zero cost of living adjustment for 2020-21 will necessitate at least two cash flow scenarios; one with a June deferral to July and one without. The June deferral, if following past accounting practice, will not adversely affect revenues, only cash receipts.

Remember that an emergency appropriation for districts (e.g., a state takeover of an LEA's governance) is triggered by insufficient cash flow to meet payroll at a given time. The trigger is influenced by budget deficits but is based on cash flow projections. Despite the challenges with cash flow during the Great Recession, LEAs managed their cash flow adequately and avoided the need for state intervention.

Cash oversight is always an important LEA responsibility, and it is especially heightened during this difficult and uncertain economic time. We recommend LEAs dedicate sufficient resources to regular and accurate monitoring of cash availability to ensure critical functions can continue without interruption. Yes, cash is king. But also remember, cash shows no mercy if you run out.