Cash Flow Management

A QUICK REFERENCE GUIDE FOR ELECTED OFFICIALS AND STAFF

AUDAX AT FIDELIS

QUEENSLAND TREASURY CORPORATION

This booklet is a quick reference guide to help you to:

- understand the principles of good cash flow management
- understand the benefits of cash flow forecasting, and
- become familiar with the tools that QTC has available to assist Local Governments with cash flow management.

Governance

It is a common misconception that as long as a company is profitable or a local government is reporting an operating surplus, then the business is sound. Past corporate collapses, however, have confirmed that this is not true. A company (or local government) can certainly fail when it is still profitable, no matter its size. This reinforces the saying **'Cash is King'!**

One of the most important fiduciary duties of a Company Director is to ensure that the organisation does not trade if insolvent. In fact, Directors are potentially subject to severe penalties, including civil penalties and criminal charges, if this is found to be the case.

Ensuring that an organisation is solvent is not just an important task for leaders of publicly listed companies. It is equally important for local government leaders (ie, elected officials and senior staff).

One of the most important considerations in running a business—or a local government—is to ensure that there is adequate cash flow to meet all short term obligations.

Cash flow management

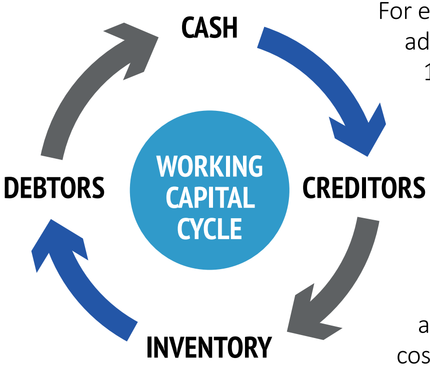
Cash flow management is about putting in place strategies to ensure that there is enough cash in the business to operate on a day-to-day basis without facing a liquidity crisis.

The diagram to the right represents the typical 'working capital cycle' for a commercial business. This is the length of time taken to use the business' cash holdings to create goods or services for sale and to receive the sales proceeds (ie, cash).

Management of cash flow within the local government context follows the same cycle, although with more focus on the delivery of services, rather than turnover of inventory.

Good cash flow management is achieved by managing cash resources effectively. This can include:

- ensuring that council maintains a balanced operating result
- ensuring that payments are received on time to control debtors
- taking available credit on purchases
- managing and financing capital projects correctly, and
- managing risk.



Why an operating surplus and cash are not the same thing

Generating an operating surplus and having cash in the bank are not the same thing, although they are related to some extent. A local government may be generating an operating surplus, but still experience cash flow problems (or vice versa). Only when both profitability and liquidity are properly managed will financial sustainability be achieved.

The operating result measures the revenue earned, and expenses that accrue over a particular period. The amounts allocated to the period in question depend on the accounting principle of matching revenues earned with expenses incurred. For example, insurance is normally paid a year in advance. The expense is accrued evenly over the 12 months of the policy, and may relate to two different financial years.

Calculation of the operating result also involves several non-cash items. The most obvious non-cash expense is depreciation. This expense will not impact the local government's cash holdings. In accounting terms, depreciation represents the systematic allocation of the depreciable amount (upfront cost) of a fixed asset over its useful life. The impact on the local government's cash balance occurs at the time of purchase.

Cash management practices

There are several options available to a local government to improve the management of cash. These include:

1. Monitor cash flow actively

An improvement in cash management starts with building an accurate cash flow estimate and monitoring actual receipts and disbursements.

2. Accelerate collection of receipts

More frequent and timely billing can assist with liquidity management (eg, issuing rates notices quarterly instead of half-yearly). Where possible, take advantage of automation through technologies, such as online banking.

3. Optimise timing of disbursements

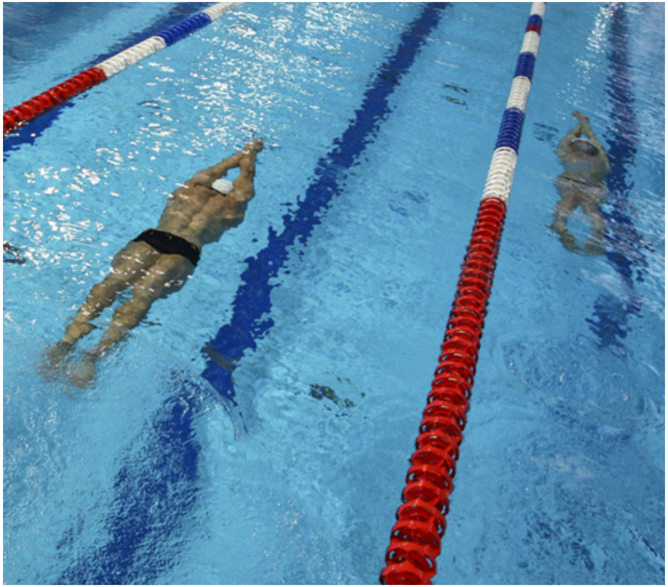
Generally, the longer that cash can be held prior to disbursement, the more interest it will accrue. Take advantage of discount periods where available, and ensure all payments are made before penalty charges are imposed.

4. Maximise interest earning on cash holdings

Ensure any surplus cash does not sit idle. If earmarked for future use, invest it appropriately until required. QTC's Surplus Cash Framework can assist to determine the most appropriate use for surplus cash.

5. Ensure infrastructure assets are funded appropriately

A council can fund infrastructure assets through various sources. These can include cash holdings, subsidies and grants, and borrowings.



Appropriate funding of infrastructure assets

Once a council has made a decision to invest in new infrastructure or renew existing assets, it is important to consider the various options to finance the project.

Typically these include:

- cash (ie, existing cash holding or funding from operations) debt
- grants and subsidies (when available), or
- a combination of some, or all, of the above.

It may be appropriate to fund some long-life assets that generate cash flow (ie, water, sewerage, waste) through the use of debt, thereby spreading the cost of these assets over their useful life, rather than through the use of short-term liquid funds (eg, cash).

Funding a new asset from existing cash holdings can also raise issues of inter-generational equity by creating a situation where existing users (ie, current ratepayers) are effectively funding assets that will be used by, and create benefit for, future generations. The use of debt finance for a long-term asset can help match the burden of paying for the asset with the likely users of that asset by spreading the cost of that asset over time.

A local government may choose to put aside cash reserves (ie, through internally restricting cash) to fund the future renewal of particular infrastructure. By ensuring that the planned future expenditure on these assets (as driven by asset management plans) is linked to the long-term financial forecast, the local government is best able to determine the most appropriate funding mix for its capital projects, and that proposed debt holdings are sustainable.

Cash flow monitoring tool

Councils can improve cash flow management through effective working capital management and detailed cash flow forecasting.

An accurate forecast will predict the ability of the council to create the cash necessary to support core operations and fund capital projects. It will indicate any cash flow gaps (ie, periods when cash outflows exceed cash inflows), and periods when external funding sources (ie, debt or grant funding) will be required. Those periods when external funding is required are likely to occur when Council is embarking on major capital works.

While a local government's core financial system is likely to have a module available to assist with cash flow management, an alternative solution that is simple to implement is a QTC Excel-based template. It is available to local governments for free download from the QTC website.

The tool is able to:

- compare current forecast to previous versions
- forecast by week, fortnight or month
- calculate interest earned on cash balances automatically, and
- provide a dashboard of key metrics for reporting purposes.

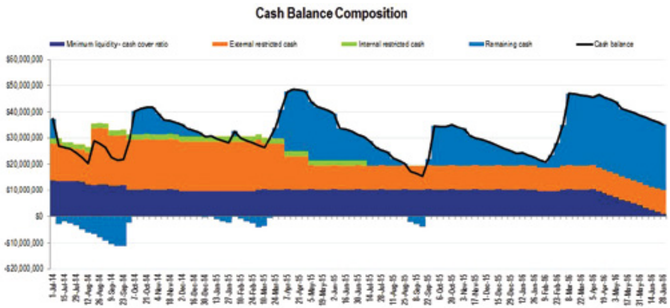
	Actual		Forecast							
	17-Mar-15	24-Mar-15	31-Mar-15	7-Apr-15	14-Apr-15	21-Apr-15	28-Apr-15	5-May-15	12-May-15	19-May-15
Cashflows by type										
Net operating	2,938,520	4,941,224	7,499,454	12,209,809	1,221,022	121,884	121,577	-78,731	117,498	-437,465
Net capital	-50,000	-450,000	-450,000	-5,450,000	-300,000	-450,000	-450,000	-3,950,000	-300,000	-300,000
Net financing	-	-	-	-	-	-	-	-	-1,710,000	-
Total	2,888,520	4,491,224	7,049,454	5,759,809	921,022	-328,116	-328,423	-4,028,731	-1,892,502	-737,465
Operating cashflows										
Cash receipts	3,688,520	5,691,224	8,249,454	13,159,809	1,971,022	871,884	871,577	871,269	867,498	312,535
Cash outgoings	-750,000	-750,000	-750,000	-950,000	-750,000	-750,000	-750,000	-950,000	-750,000	-750,000
Net operating cashflows	2,938,520	4,941,224	7,499,454	12,209,809	1,221,022	121,884	121,577	-78,731	117,498	-437,465
Capital cashflows										
NDRRA	-	-	-	-	-	-	-	-	-	-
New STP	-	-150,000	-150,000	-5,150,000	-	-150,000	-150,000	-3,650,000	-	-
Project 3	-	-	-	-	-	-	-	-	-	-
Project 4	-	-	-	-	-	-	-	-	-	-
Other	-50,000	-300,000	-300,000	-300,000	-300,000	-300,000	-300,000	-300,000	-300,000	-300,000
Net capital investing cashflows	-50,000	-450,000	-450,000	-5,450,000	-300,000	-450,000	-450,000	-3,950,000	-300,000	-300,000
Financing cashflows										
Proceeds from borrowings	-	-	-	-	-	-	-	-	-	-
Scheduled DSPs	-	-	-	-	-	-	-	-	-1,710,000	-
Additional principal repayments	-	-	-	-	-	-	-	-	-	-
Net financing cashflows	-	-	-	-	-	-	-	-	-1,710,000	-
Closing cash balance	**29,358,557**	**33,849,781**	**40,899,235**	**47,659,045**	**48,580,066**	**48,251,950**	**47,923,526**	**43,894,796**	**42,002,293**	**41,264,828**
Cash Balance Composition										
Minimum liquidity - cash cover ratio	10,350,000	10,350,000	10,350,000	10,550,000	10,350,000	10,350,000	10,350,000	10,550,000	10,350,000	10,350,000
External restricted cash	17,500,000	17,500,000	17,500,000	12,500,000	12,500,000	12,500,000	12,500,000	9,000,000	9,000,000	9,000,000
Internal restricted cash	2,800,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Remaining cash	491,443	3,999,781	11,049,235	22,609,045	23,730,066	23,401,950	23,073,526	22,344,796	20,652,293	19,914,828
Closing cash balance	29,358,557	33,849,781	40,899,235	47,659,045	48,580,066	48,251,950	47,923,526	43,894,796	42,002,293	41,264,828

How to develop your forecast

History is often the best indicator of what will happen in the future. A local government can develop its cash flow forecast from existing information already in the business. This includes information such as the time period normally observed to receive payments (following the issue of rates notices), seasonal variations in operating expenses (eg, parks maintenance may increase during summer months or the wet season), and the timing of common operating items (eg, payment of insurance premiums, receipt of financial assistance grants). Additional adjustments will need to be made for new operational and capital items, and the price increases that occur over time due to inflation and other factors.

Scenario analysis

Once the cash flow forecast is complete, it is important to run some 'what if' scenarios to measure how reactive your operating cash flows are to changes in events, such as increases in operating or capital expenses etc. Scenario analysis of this nature will reveal how quickly a local government may run out of cash should any of these events occur.

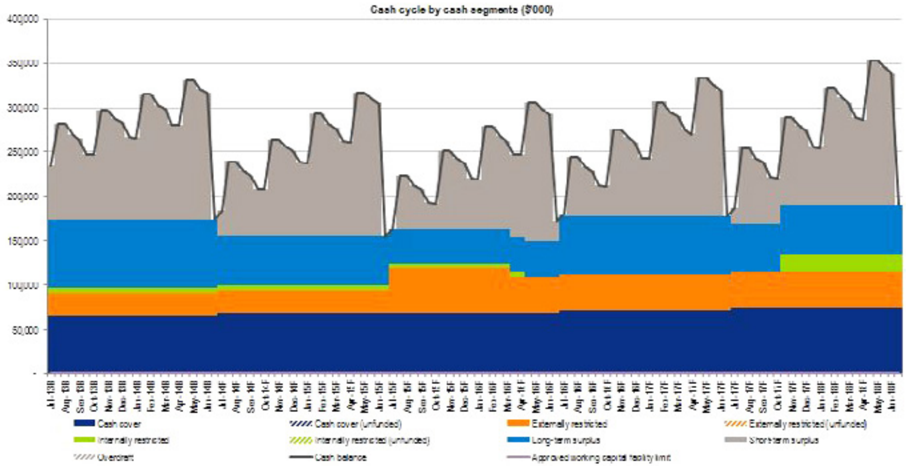


Local Government Forecasting Model

QTC's Local Government Forecasting Model (LGFM v3.0) is available for local governments to assist with preparing long-term financial forecasts. The model has been updated to include some major enhancements, including the ability to forecast the timing of cash flows with increased accuracy, and to:

- schedule operating revenue and expense items to be received either annually, semi-annually, quarterly or monthly
- have flexibility in defining the days receivable (payable) to individual revenue and expense items if required, and
- specify separate dates relating to cash spend and commissioning for capital expenditure items.

For further details on LGFM v3.0, please refer to QTC's website (www.qtc.com.au).



Surplus Cash Framework

QTC has developed a Surplus Cash Framework to assist clients to make the best use of their surplus cash, taking into account their liquidity requirements, investment objectives, and appetite for interest rate and credit risk.

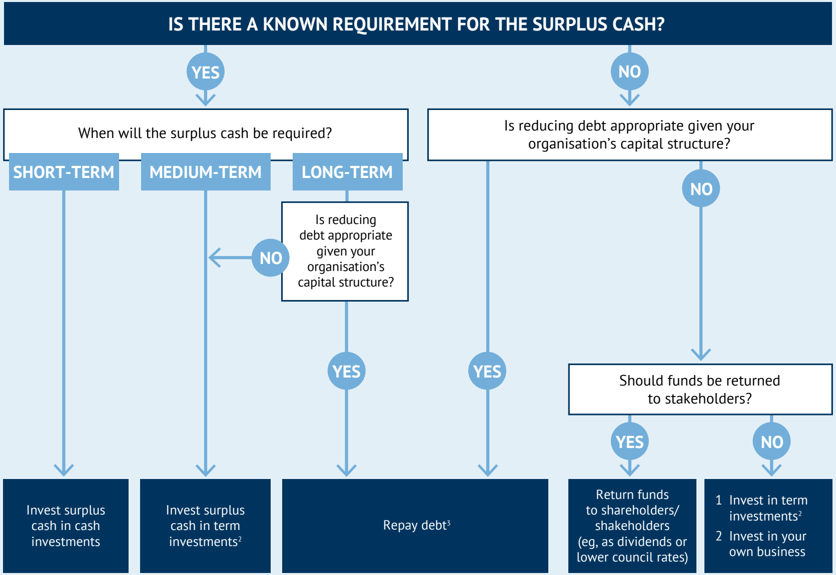
Once a local government has a robust process in place to forecast its cash flow requirements and has identified that surplus cash is available, QTC's Surplus Cash Framework provides a structured decision-making process to determine the most appropriate use for these funds. Options include:

- invest the cash for a fixed period of time
- reduce debt
- return funds to stakeholders in the form of reduced rates and charges, and
- invest in your business through capital projects

Further information on the Surplus Cash Framework is available on the QTC website.

SURPLUS CASH

Surplus cash is the cash balance that is in excess of operating cash requirements.



2 Term investments include fixed-rate deposits (longer than six months), enhanced cash funds, bond funds and asset-backed securities
3 QTC's terms and conditions should be reviewed if considering this option

QTC provides training courses on many aspects of financial management tailored to your council. These courses are facilitated by highly qualified professionals with extensive experience working with local governments and can assist you to take the first step on this important journey.

Councils interested in learning more about QTC's financial management training options can contact QTC on 07 3842 4600 or through your QTC Client Account Manager.

QUEENSLAND TREASURY CORPORATION

GPO Box 1096
Brisbane Q Australia 4001

Telephone: +61 7 3842 4600
Facsimile: +61 7 3221 4122

www.clients.qtc.com.au