Forecasting Revenues and Expenditures:
Integrating Best Practices into Your Community’s Financial Plan

Presented by:
Christopher J. Ketchen, Division of Local Services

What I hope you will learn...

• The need to manage expectations in an environment of “structural deficits”

• The implications of which approach you take toward budgeting

• Help with forecasting is available through the Division of Local Services
What is “structural balance/deficit”

Structural balance – program cost growth equals revenue growth

Structural deficit – currently in balance but recurring revenues do not cover recurring expenses

Why is structural balance so elusive?

- Uncontrollable costs
- Constraints of Proposition 2
- Variable state aid
- Lack of financial planning
The traditional approach to budgeting:

• Balanced only for one year

• Line items in budget are changed incrementally year-after-year

• Often results in level service, level funded, or funding cuts

The case against the traditional approach

• Revenue and expenditures: no consideration for on-going relationship

• This year’s surplus – or balanced budget – can very quickly spiral into next year’s deficit
Multi-year budget planning

• Addresses future shortfalls (structural deficit) identified through forecasting

• Focuses on departments/programs (not line items)

• Calculates approximate funding for planned service levels

Why forecast?

• To manage expectations and gain consensus around assumptions

• To help enhance fiscal stability/enable corrective action

• To quantify financial impact of policy decisions
Key points to understand about forecasting before you start...

- In the beginning, forecasts almost always involve deficits
- Multi-year forecasts are the only way to identify trends
- Integrating timing of capital spending is crucial

The revenue side: taxes, state aid and local receipts

- Develop revenue inventory
- Analyze impact of rate changes or changes in economic conditions
- Craft reasonable assumptions for out-years
The revenue side (continued): use of available funds

- Avoid using one-time revenue for ongoing expenses

- What are one-time revenues?
  - Stabilization: yes
  - Overlay Surplus: yes
  - Free Cash: it depends – let’s discuss…

Where does free cash come from?

START WITH: Undesignated/Unreserved Fund Balance
MINUS: Accounts Receivable
PLUS: Credit balance in Deferred Revenue
MINUS: Debit balances in other funds
MINUS: Overspent appropriations
MINUS: Prepaid Items
MINUS: Amounts appropriated from free cash
PLUS: 60 day collections from date of mailing, net refunds, if tax bills issued after May 1st
PLUS: Late Payments
In other words...

START WITH: Last year’s free cash
MINUS: Appropriations from free cash
PLUS: Excess revenue (or minus for deficit)
PLUS: Budget turn-backs
(or minus overspending X2)

The expenditure side: personnel

• Quantify year-over-year salary obligations
  – Use contractual agreements for relevant employees
  – Make assumptions on non-contract employees
  – Estimate ongoing program/staffing needs
The expenditure side (continued): expenses and capital

- Estimate non-salary departmental expenses

- Make reasonable assumptions on healthcare, other benefits and shared costs (some historical data available through DLS)

- Insert estimated costs of capital plan

“Forecasting” and “planning” are not the same thing

- Forecasting is an ongoing part of planning

- For planning: simply projecting revenue and expenses for multiple years is insufficient

- Deficits are illegal and have no place in your financial plan
How quarterly projections tie into multi-year planning...

- Quarterly projections help to identify financial opportunities (same process as multi-year planning on a smaller scale, giving you the best possible data)

- Quarterly projections are not the same thing as year-to-date budget reports

Our Forecasting Tool and Best Practices are here to help:

www.mass.gov/dls

click on “Financial Management Assistance”