Where is that crystal ball?
The basics of revenue and expenditure forecasting

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Major themes:

• Forecasting is about seeing the “big picture” (i.e. developing strategy, as opposed to tactics)

• Fiscal turbulence impacts all communities (large/small; wealthy/not-so-wealthy)

• Incremental vs. multi-year approach (structural deficits, managing expectations, and why it matters)
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 2½
- 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 ongoing 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 anatomy of a forecast...

• The revenue side

• The expenditure side (and, don’t forget about capital!)

• Plan for monitoring/adjustments
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

• (Ordinarily) 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

October 24, 2009
MMA – Association of Town Finance Committees
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
How quarterly projections tie into multiyear 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
“Forecasting” and “planning” are not the same thing

- Forecasting is an ongoing part of planning
- For planning purposes, simply projecting revenue and expenses for multiple years is insufficient
- Deficits are an inevitable part of your forecast, but they should not be part of your financial plan
Wellesley’s “Planning Maxims”

1. Focus on environmental changes; set priorities based on level of financial risk

2. Gain buy-in for your strategy

3. Simplify

4. Create a dashboard

5. Emphasize the need for accountability
Helpful resources:

• MMA and other organizations (ICMA, GFOA, etc.)

• Department of Revenue – Division of Local Services

• Your professional staff