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The Good and the Bad: LAO Examines State's Cash Management

The state of California's budgetary and cash situations are currently very strong. In anticipation of the next recession, the Legislative Analyst's Office (LAO) has prepared an examination of the state's cash management activities during good and bad times, with a focus on the state's General Fund.

Background

Just as with local educational agencies (LEAs), the state's budget and cash flow are different concepts but very closely related. The budget is an estimate of the revenues, expenditures, and fund balance for the entire year, but cash comes in and goes out on a daily basis. On a given day, if there are more cash receipts than disbursements, a cash surplus is generated. If the opposite occurs, a cash deficit is generated. These surpluses and deficits occur on the natural all year long. The key is in managing the overall trend of the operating cash balance throughout the year.

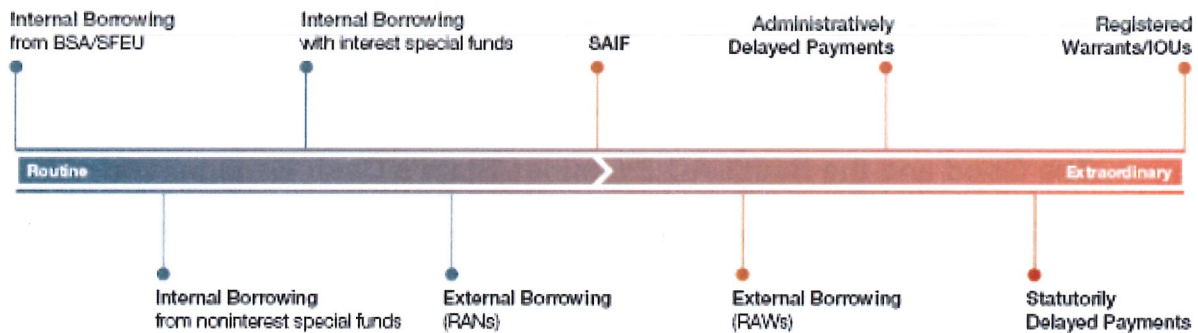
In the state's case, just as with LEAs, cash disbursements are spread more evenly throughout the year than revenues. For example, paychecks for state employees, apportionments to LEAs, and Medi-Cal payments are issued all year long. On the revenue side, the state's cash collections are concentrated more toward the end of the fiscal year. This is because personal income tax is the most significant source of revenues for the General Fund, and this tax is primarily collected in December, January, April, and June as these are the months with key income tax filing deadlines. Therein lies the challenge. During tough economic times, disbursements outpace receipts through the first part of each fiscal year, which requires a significant cash cushion.

Cash Management Options

The State Controller's Office (SCO) is responsible for managing the state's cash flow, and in order to accomplish this has several tools at its disposal, ranging from the routine to the extraordinary:

Figure 4

Cash Management Options



BSA = Budget Stabilization Account; SFEU = Special Fund for Economic Uncertainties; RANs = revenue anticipation notes; SAIF = State Agency Investment Fund; and RAWs = revenue anticipation warrants.

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In the figure above, the external borrowing options indicate the issuance of municipal bonds in the form of revenue anticipation notes (RANs), which are for borrowing within the fiscal year, and revenue anticipation warrants (RAWs), which are for borrowing across fiscal years. Moving toward the more extraordinary measures on the right side of the figure, the options involve delaying payments, such as the deferrals of apportionments to schools and community colleges implemented during the Great Recession, and issuing registered warrants for the state's obligations. In fact, during the Great Recession the state had depleted its internal borrowing capacity, and the frozen credit market made it impossible to borrow using RANs and RAWs, which caused some of the extraordinary measures that were implemented at the time.

Today and Beyond

The state's current cash situation is entirely different from that of the Great Recession. For example, issuing RANs was routine almost every year for decades, but no RANs have been issued since 2014 because the state has been able to rely on internal borrowing for cash purposes. In fact, the resources available for internal borrowing are currently at an all-time high, as the state has been increasing its reserves in its General Fund and in other funds. Given this scenario, the Legislature recently approved measures to allow the state to borrow from the state's cash balance for specific uses:

- Senate Bill (SB) 84 (Chapter 50/2017) authorized borrowing \$6 million to make a one-time supplemental payment to the California Public Employees' Retirement System to reduce the state's contributions required for state employee pensions
- Assembly Bill (AB) 1054 (Chapter 79/2019) created a fund to help cover the costs of wildfire liabilities of investor-owned utilities

When the next recession occurs, the LAO's report warns that, once again, cash received on the revenue side will be lower than budgeted. The state estimates its revenues at a time when it does not know whether a recession will occur or if a recession has already begun—nor does the state know how deep the recession will be. For example, in January 2008 the state's cash projections for the 2008–09 fiscal year were \$15 billion higher than actual receipts. The LAO warns that this dynamic will occur again, to some degree, in a future recession.

At the same time, internal sources for borrowing cash will decrease because budget reserves in the General Fund will decrease due to lower revenues. Also, the cash in other funds will decrease because of reduced revenues or increased expenditures in those funds due to the recession. The state will likely be looking to external sources such as RANs and RAWs for cash borrowing once again.

Given that the Legislature has recently authorized, through SB 84 and AB 1054, borrowing from the state's cash reserves for specific purposes, the LAO advises caution when considering any additional borrowing of this type—it can reduce cash reserves at a time that would compromise the state's ability to weather a recession.

Conclusions

The cash flow of LEAs are similar to that of the state in many ways. Most LEAs are issuing paychecks and paying vendors steadily all year long, but cash from some significant sources could arrive later than the disbursements—particularly for those LEAs that rely more heavily on local property tax revenues than on state aid. History tells us that the state's financial woes always roll downhill to LEAs, so adequate levels of local budgetary and cash reserves are critical for financial planning and staying solvent—through the ups and downs of the economy and state revenues.

To read the LAO report in detail, go [here](#).

— *Robert McEntire and Sheila G. Vickers*

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