

## **SELECTBOARD'S FIVE-POINT FINANCIAL REVIEW**

### ***WHAT YOUR MONTHLY FINANCIAL STATEMENTS SHOULD TELL YOU***

Most decisions that a governing body will make throughout the budget year rely on a clear understanding of the municipality's financial position. Whether you are making spending decisions or allocating resources, proper financial reporting is the basis for solid management strategy. Up-to-date and accurate financial statements, both balance sheets and budget-to-actual comparisons, are **essential** and should be provided on a monthly basis.

Monthly reports allow management to be proactive, to make budget decisions that allow the municipality to end the year in the black. If the annual audit or annual report is the only financial document available to you, there will be no time to react to potential problems such as over-expenditures or revenues that do not meet original projections. This is reactive management and reflects a governing body with little control over its finances. Here are some guidelines to help Vermont selectboards avoid this situation. With regular reports in hand, there are five key things to look for:

#### **🔔 Budget-to-Actual Performance**

Carefully review all budget reports. You should be approving balanced budgets (projected revenues should equal projected expenditures) at your annual meeting unless you have to cover prior year deficits. Material over-expenditures should be explained to your satisfaction and provisions made to under-spend in other line items that contain surpluses.

On the revenue side, determine if year-to-date actuals are on target and ask for projections to the end of the fiscal year. If you anticipate an overall revenue shortfall, you will have a couple of choices: make it up on the expenditure side or be prepared to ask voters to fund a deficit the following year. At year-end you should examine historical data, comparing budget performance for the fiscal year just ended with at least the prior four years. A five-year trend analysis will give you a good sense of how well you are managing your budgets. Look at both revenues and expenditures: how close were you to what you budgeted? If you find that you are consistently overestimating revenues or underestimating expenditures, then you should plan to tighten up projections when you are preparing a budget for the next fiscal year. The important thing to remember is to always look back before looking ahead to determine if you are on course. Examining trends is crucial to good budget management.

#### **🔔 Tax Collections**

Property taxes in Vermont make up around 90% or more of the budget in many towns. Therefore, projecting what you will collect during the fiscal year, in current and delinquent taxes, will determine whether or not you will meet your budget projections. You should know what is owed at prior year-end, as well as at any given time during the current budget year. You should also have a good sense of what percentage of current taxes billed are usually collected every year and how much of the delinquent taxes receivable might be collected. Without this information, you cannot make reasonable tax revenue projections at budget time or during the course of the year.

Again, trend analysis is useful here. Comparing the percentage of billing collected over the past five years will be helpful in making projections. When you get halfway through the budget year, ask for an analysis of tax collections and determine if you will be able to meet your tax revenue budget.

#### **🔔 Unanticipated Expenditures**

Be on the lookout for circumstances that could result in unanticipated expenditures. Legal costs and large equipment failures are good examples. Although they are unexpected, when you are aware of them they should be taken into account in the budget projections. Immediately identify any surpluses in other line items that can be tapped to cover the overage and make provisions in the reporting to ensure that those surpluses will not be used for any other purpose.

#### **🔔 Cash Flow**

This is an area frequently overlooked. Cash flow, as opposed to revenue and expenditure flows, is a measure of actual cash moving in and out of the checking account. This includes transfers of funds, as well as revenues and expenditures that have hit the checking account.

Some towns must borrow in anticipation of taxes during certain times of the year because they do not have enough cash to cover operating expenses until taxes start flowing in. A monthly cash flow analysis shows all receipts and disbursements throughout the year, indicating the months where you have a shortfall and need to borrow money. The months you have a surplus give you extra cash for investing. This analysis is useful for planning both short-term borrowing needs as well as investing strategy and should be done at the beginning of each fiscal year and, if at all possible, updated throughout the year along with the normal monthly reporting.

### **Projected Fund Balance**

Using your revenue and expenditure projections to fiscal year-end, you should be able to determine what your fund balance will be, assuming projections hold. Fund balance is what is left over when you subtract all your liabilities from your assets. It includes your surplus or deficit from current year operations added to the prior year's fund balance. It consists of any reserved funds such as investment in capital assets, as well as reserves set aside for specific purposes, and, last but not least, unreserved funds, those that are left over to be returned to the taxpayers or carried over into the new budget year. Your balance sheet should break out your fund balance into reserved and unreserved.

Fund balance is important! You should know where you stand at year-end because the unreserved fund balance will be carried into the new year and factored into your tax calculations unless you are maintaining a balance as a cushion.

Once again, trend analysis is a must. Compare unreserved fund balances over the last five years to see how stable your equity has remained. Ideally, you should have a **positive** fund balance every year. A deficit should always be retired the following year by raising taxes for that purpose. Frequent deficits or a steadily declining fund balance can indicate poor budget management.

Following these guidelines should give you a clearer picture of your finances. Don't be afraid to ask questions. Be sure that you are able to explain any variances in your budget or financial statements that could raise questions in the taxpayers' minds. Your town finances should never be a mystery to you or the taxpayers!

*- Michael Gilbar, Director, VLCT Administrative Services*

*VLCT News*, April 2004