

3/16/89

Introduced by: Gary Grant

Proposed No. 89-188

MOTION NO. **7516**

A MOTION approving a cash reserves requirement plan for the division of human services in the department of human resources.

WHEREAS, the King County executive and King County council are committed to development and implementation of prudent financial policies for all funds maintained by the county, and

WHEREAS, Ordinance 8802, Section 59, requires the executive to establish the cash reserve needs of the human services division, and

WHEREAS, Ordinance 8802, Section 59, requires the executive to submit a plan to achieve and maintain an adequate cash reserve in the division of human services.

NOW, THEREFORE BE IT MOVED by the Council of King County:

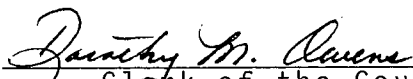
The attached human services division cash reserves requirement plan is hereby approved and adopted.

PASSED this 15th day of May, 1989.

KING COUNTY COUNCIL
KING COUNTY, WASHINGTON


Chairman

ATTEST:


Clerk of the Council

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RESPONSE TO COUNCIL PROVISIO
HUMAN SERVICES DIVISION
CASH RESERVE REQUIREMENTS

89 - 188

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The King County Council included the following proviso in Section 59 of ordinance 8802. "A review of division cash reserve needs and a plan to achieve and maintain an adequate cash reserve shall be submitted to the Council by March 1, 1989 for review and approval."

Human Services Division staff have prepared the following paper to respond to this proviso; included is a preliminary recommendation for cash reserve amounts for both Fund 107 and Fund 112, and a plan to develop final cash reserve recommendations after close out of Fiscal Year 1989.

I. DEFINITIONS

Following are definitions of terms which will be used throughout this discussion.

A. Fund Balance:

For a given period of time, e.g., year, biennium, etc., fund balance is defined as the excess of assets over liabilities including all accrued assets and liabilities. In Fund 107, the fund balance is distributed to Mental Health, Developmental Disabilities, Aging, and Administration. Involuntary Treatment Services (ITS) owns all of the Fund 112 Fund Balance.

Formal tracking of fund balance and distribution to programs and administration began in 1983. A financial review was conducted to establish the correct amount of fund balance, to analyze cash flow needs, and to recommend distribution to programs. The result was a recommended cash reserve amount, which was allocated to Administration, and a distribution of the remainder to Human Services Division (HSD) programs to be used as discretionary funds. Since 1983, the fund balance has both increased and decreased within each program as well as within each fund.

Fund balance decreases as a result of expenditures exceeding revenue; conversely, fund balance increases when revenue exceeds expenditures. The rules governing the growth of each program's fund balance are different and are outlined below:

Administration: As mentioned above, Administration was assigned a fund balance to act as a reserve for cash flow purposes for both Fund 107 and Fund 112. Since Administration is not a revenue producer, it cannot automatically increase its fund balance by underexpending available revenues. Once the administrative fund balance is spent, it cannot be recreated unless a special assessment is made of each of the revenue-generating programs.

FUND BALANCE: MINIMUM RESERVE REQUIREMENTS
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Mental Health & Developmental Disabilities: Each of these programs can add to fund balance by underexpending designated millage revenue. These programs cannot add to their fund balance by underexpending state revenue since, in almost all cases, the state pays only for actual incurred expense.

Involuntary Treatment Services (ITS): This program, like Mental Health (MH) and Developmental Disabilities (DD), can only bill the state for actual costs minus the maintenance of effort contribution. Unlike MH and DD, ITS does not receive a source of revenue which can be "underexpended" and thus added to fund balance. The total amount billed during the biennium must be no greater than the total actual expenses incurred during the biennium minus the County "maintenance of effort" contribution.

The ITS program has had a long standing fund balance because the state allowed ITS to retain an amount identified in the 1983 Fund Balance review project. Once spent, ITS will not be able to regenerate a fund balance that spans more than one biennium unless given permission by the state.

Aging: The Aging Program can add to its fund balance only as long as Finance continues to transfer the original budgeted amount of Cx to Fund 107 without regard to underexpenditure. This is an artifact of the Aging Program (a Cx agency) being included as a minority partner in a non-Cx fund (Fund 107). For the past few years, the Budget Office has assumed that the prior year Aging fund balance would be used to support the current year Aging Program and has allocated Cx accordingly. Thus, while Mental Health and Developmental Disabilities can, in theory, have an ever-growing fund balance, the Aging Program's fund balance is planned to be spent each year.

B. State Advance

The State Department of Social and Health Services (DSHS) provides each County with a cash advance at the start of each biennium for use as working capital. This advance, or working capital, is intended to "float" our operations between payments from DSHS. The advance is calculated as 1/12th (or 2 months) of the biennial contract amount. It is deposited as cash and carried on the books as a liability ("debit cash and credit liability").

In theory, DSHS could terminate the state advance contract and demand repayment of the advance within 60 days. This is not, however, very likely.

At the start of each new biennium, DSHS adds to the advance an amount in proportion to the increase in the biennial contract award. Conversely, if the new biennial award is less than the previous award, DSHS would request a repayment of the advance in proportion to the decreased biennial award.

C. Cash Flow

The term "cash flow" is used to describe the revenue and expenditure cycle. One goal of HSD's fiscal operations is to accommodate the revenue and expenditure cycle without running out of cash. This means that each Fund must always have on hand sufficient cash to meet current liabilities, i.e., payroll, contractor payments, etc. If current disbursements exceed available cash, the fund shows a negative cash balance. This is very nearly always caused by the flow of revenue not keeping pace with expenditures due to time lags in the billing/reimbursement process (for state funds) or the timing of collection of taxes (millage).

D. Interfund Loan

In the event that HSD achieves a negative cash balance, the Finance Office automatically executes an Interfund Loan. This is a loan of cash from another county fund, although cash is never actually transferred between funds. Interest is paid daily on this loan which is calculated to be the exact value each day of the negative balance.

II. NEED FOR CASH BALANCE

Fund 107 and Fund 112 each have two needs for cash:

- ° sufficient cash or working capital, to maintain a positive balance while accommodating the difference between the expenditure and revenue cycles and,
- ° sufficient fund balance, a reserve, to 1) use in case of emergency, 2) fund short term programs that are of primary interest to the County, and are not eligible for state reimbursement, and 3) provide the ability to operate two programs at once to "transition" persons from one program to another.

These two needs are discussed in turn.

A. Working Capital: Discussion

How much working capital is required for each fund? In order to answer this question, the cash flow for each fund must be examined. Table 1 models the 1988 cash flow for Fund 107 and Table 2 models the 1988 cash flow for Fund 112. The purpose of these models is to show the effect of the delay between expenditure and receipt of revenue and the extent to which the state advance provides sufficient "cushion" to maintain a positive cash balance.

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Expenditures were reduced by the amount of fund balance that was planned to be spent during 1988 in order to provide a clearer picture.

Specifically, each table was constructed and is to be read as follows:

- Cash Required - represents expenditures which have been distributed across the year in 12 equal amounts with the last period being the "13th month."
- Cash Provided - represents revenues which have been distributed across the year in proportion to when they are received, e.g., state revenue is received in April for expenditures made in February, millage receipts cluster around the property tax payment periods for April and October.
- Monthly Difference - represents the difference between expenditures made during the month and revenues received during the same month, e.g., in April, Fund 107 expended \$1,652,000 and received \$1,849,000; a net addition in cash of \$197,000.
- Ending Balance - adds to the current month all previous month's ending balances, e.g., the ending balance for March (\$3,073,000) is added to the April monthly difference of \$197,000 which results in an April ending cash balance of (\$2,876,000).
- State Advance - represents the value of the state advance. For Fund 107 the state advance is \$2,703,000; it is not additive across all months shown as it only represents the cash available each month to offset any negative ending balance.
- Adjusted Ending Balance - represents the amount of cash remaining after state advance is applied to the ending balance, e.g., the ending balance for April is (\$2,876,000) and after applying the cash provided by the state advance, there is still a negative cash balance, in April, of (\$173,000). This negative cash balance would have to be offset by a working capital reserve amount of at least \$173,000 in order for Fund 107 to avoid an Interfund Loan.

B. Working Capital: Findings

FUND 107

The adjusted Ending Balance column on Table 1 shows a range of from \$2,706,000 ending cash in January to (\$370,000) ending cash in March. Obviously the state advance does not provide sufficient cash, by itself, to accommodate HSD's cash flow. One of the major reasons that it is not sufficient is that it covers only state revenue, and only the amount of revenue estimated at the beginning of the biennium. The state advance does not cover millage or any local revenues; it also does not cover new revenues added to the County/State contract during the biennium.

As can be seen from Table 1, the cyclical variance in ending cash balance is due, in large part, to the pattern of millage revenue. Millage is generally expended on a 1/12th basis; it is received, however, in clusters around the April and October tax payment times. As millage increases in amount, as it has routinely each year, a greater strain will be placed on the cash flow of Fund 107.

The current fund balance amount required to insure that Fund 107 would not need an Interfund Loan is \$370,000.

FUND 112

The adjusted Ending Balance column on Table 2 shows a range of from \$342,000 ending cash in January to (\$135,000) ending cash in July. Thus, \$135,000 of working capital would be needed to alleviate the need for an Interfund Loan for Fund 112 for July. The variance would have been more uniform from month to month if the \$103,000 contribution from Fund 107 had not occurred entirely in August.

COMBINED FUNDS

As mentioned earlier, the current amount assigned to Administrative Fund Balance is considered to be the cash reserve for both Funds 107 and 112 combined. We demonstrated above that if each Fund had to provide its own cash reserve amount, the total would be approximately \$495,000. If, however, we add the "adjusted Ending Balance" for each month from Table 1 to the same figures in Table 2 we can arrive at an estimate of the cash reserve needed if we continue to consider Fund 107 as the "host" for both of the funds' cash reserve amounts.

Ten of the thirteen "months" evaluated would require cash reserves in excess of the state advance; the distribution, in order of amount of reserve required, follows:

470.6	March
408.7	September
282.2 - 304	April, July, August
184.7 - 220.3	June, October, December
116 - 118.9	May, November

From this analysis, the maximum combined cash reserve amount required would be \$470,000 (occurs in March). With the exception of September, the remainder of the amounts are far below what is required for March.

C. Working Capital: Recommendations

- ° Fund 107 should remain as the "host" for both Fund 107 and Fund 112 working capital reserve amounts since this combination results in less cash required as reserve.

- ° The combined amount of working capital reserve estimated above, \$470,000, should be considered preliminary until
 - the amounts can be reevaluated using actual receipts and expenditures for 1989 in place of the "model" on which this analysis is based. Actual receipts for previous years (with the exception of millage) were not used in this analysis since a routine system of billing, accrual and deposit to specific revenue accounts was only initiated at the start of the second quarter of 1988. It is possible that the recommended working capital reserve could be less than that which resulted from this study if actual history, based on a timely billing and accrual system, could be used;
 - the start of the new biennium (89-91) which will provide an adjustment to the state advance which should include an additional advance amount for the amendments that occurred during this current biennium as well as for any increases in funding. This adjusted advance might decrease the additional amount required for working capital.
- ° The estimated ending 1988 Administrative Fund Balance of approximately \$405,000 should be placed in a working capital reserve account (in ARMS this account 27416-"Designated for Working Capital") to separate this from Fund Balance which is often viewed as a "slush" fund which should be used up prior to seeking new funds. The funds remaining as fund balance could be allocated entirely to programs for use as "emergency" or discretionary funds.

The amount retained for working capital will be moved to the "Designated for Working Capital" account at the time of the 1988 year end close and after the review of 1988 ending fund balance which will be conducted by Human Services Division Fiscal/Planning staff.

- ° Further expenditure of Administrative Fund Balance should not be planned since the 1988 estimated Ending Fund Balance is \$65,000 below the preliminary amount recommended by this study.
- ° An assessment to increase the working capital reserve should not yet be made to the Mental Health, Developmental Disabilities and Involuntary Treatment Programs for the following reasons:
 - Each program will close 1988 with more fund balance than was originally projected which assists HSD to meet cash reserve requirements.
 - All three state programs are in a transition or budget balancing mode and should be allowed as complete a use of discretionary fund balance as possible to minimize the impact on services to program participants.

- Alternatives should be sought to reduce the cash reserve required for the month of March, e.g., bill the state for estimated January services or a portion of estimated January services at the end of January instead of waiting until the end of February to bill for actual services. According to the analysis presented above such an action would result in the current administrative Fund Balance amount being adequate for working capital purposes.
- A subsequent analysis will be performed at year end 1989 which takes into account the routine system of billing and revenue accrual, the new biennial contract, and the adjusted state advance. This might produce a reduced working capital amount or, if not, the programs will be better able to schedule payment of an assessment to increase working capital reserve after they have completed transition from the 87-89 biennium to the 89-91 biennium.
- In the worst case, which is extremely unlikely in 1989, if the only Fund Balance left to Fund 107 and Fund 112 was the administrative Fund Balance, HSD would be at risk for a \$65,000 interfund loan for some part of the month of March. This would result in an interest charge of less than \$900 (assumes 15% annual rate paid daily for the entire month).

D. Discretionary Fund Balance: Discussion

As has been shown, developing a recommendation for the amount of working capital needed for a given fund is somewhat "scientific". Arriving at an amount to reserve as discretionary fund balance is not as concrete a process. The discussion will begin by recalling some of the "discretionary" uses made of fund balance in the last few years.

- ° Mental Health Jail Diversion Project: this project is of great interest to the County. While it may be eligible for state funds, the project would have to be modified, if funded totally by state funds, so as to be responsive to state mandated priorities. This change in focus would render the project less responsive to the specific needs of King County in regards to jail population reduction.
- ° Involuntary Treatment Services Funding Crisis: fund balance is being used to extend the date of possible cuts. The extra time provided by the fund balance allows ITS to move closer to the new biennium before cuts are instituted. It is possible that additional funds may be provided in the new biennium which will preclude the need for cuts.

- Developmental Disabilities Transition Program: Fund balance is used to "start up" new programs (with higher priority outcomes than existing programs) so that they will be 100% ready to accept transfers of persons from the existing programs.

In addition to the types of situations illustrated by the above examples, fund balance might also be used to fund a program or an agency during a transition from full funding to a reduced level due to cuts in state revenue, changes in program direction, or cancellation of an agency contract. The prime consideration in this instance is to provide for an orderly transition of the persons served by the program into new programs.

The amount of fund balance allocated to the examples given above ranges from less than 1% (\$88,500) of the annual program budget to 3.5% (\$300,000) of the annual program budget. Estimation of the amounts needed to cover the emergency transition of persons from closed programs or agencies is suggested below.

- Two months funding for the largest program provided.

DD: Specialized Industries	\$137,333; 1.6% of the annual budget
MH: Basic Comm. Support & Treatment	\$664,351; 6.4% of the annual budget

- Two months funding for the largest agency contract.

DD: Northwest Center	\$122,333; 1.5% of the annual budget
MH: Harborview	\$292,608; 2.8% of the annual budget

The amount of discretionary fund balance suggested by all of the possibilities given above ranges from 1% to 6.4% of the annual budget. Three of the possibilities are below 2%.

E. Discretionary Fund Balance: Recommendations

Mental Health and Developmental Disabilities should strive to maintain a discretionary fund balance of from 1% to 2% for use in an emergency or for use for a high priority project for which state funds are not applicable or immediately available. This issue will be considered by each of the program Boards, and staffs as they develop their 1989-91 biennial spending plans.

- While fund balance for the MH and DD programs will increase and decrease, from year to year, care should be taken to enter each new biennium with as close to the desirable discretionary fund balance level as can be achieved. This will provide some protection against changes in program funding due to legislative appropriation and/or DSHS allocation.

- A discretionary fund balance level is not recommended for the Aging Program since, as already mentioned, the Aging Program does not have the ability to purposefully "grow" or maintain a fund balance.
- A discretionary fund balance level is not recommended for ITS since it is also not able to increase a cross-biennium fund balance once the current fund balance is exhausted. The current fund balance maintained by ITS should be spent only in an emergency, since it cannot be regenerated.

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TABLE 1
 1988 CASH FLOW MODEL: FUND 107
 (Dollars shown in thousands)

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	13TH MO.	TOTAL
CASH REQUIRED	0.0	1,652.6	1,652.6	1,652.6	1,652.6	1,652.6	1,652.6	1,652.6	1,652.6	1,652.6	1,652.6	1,652.6	1,652.6	119,831.0
CASH PROVIDED														
Mental Health				853.6	853.6	853.6	853.6	853.6	853.6	853.6	853.6	853.6	853.6	2,561.6
Devel. Disab.				634.0	634.0	634.0	634.0	634.0	634.0	634.0	634.0	634.0	634.0	7,609.0
Millage	3.0	16.0	28.0	301.0	277.0	5.0	8.0	9.0	5.0	301.0	218.0	15.0	0.0	1,186.0
Current Expense		121.0	60.0	61.0	60.0	61.0	60.0	61.0	60.0	61.0	60.0	61.0	0.0	726.0
ITS Overhead						25.0						25.0	0.0	50.0
City of Sex.			4.0			4.0						4.0	0.0	16.0
TOTAL PROVIDED	3.0	137.0	92.0	1,849.6	1,824.6	1,582.6	1,555.6	1,557.6	1,556.6	1,849.6	1,765.6	1,592.6	4,464.6	119,831.0
MONTHLY DIFFERENCE	3.0	(1,515.6)	(1,560.6)	197.0	172.0	(70.0)	197.0	(75.0)	196.0	177.0	113.0	(60.0)	2,812.0	0.0
ENDING BALANCE	3.0	(1,512.6)	(3,073.2)	(2,876.2)	(2,704.1)	(2,774.1)	(2,871.1)	(2,766.1)	(3,062.1)	(2,865.0)	(2,752.0)	(2,812.0)	0.0	0.0
STATE ADVANCE	2,703.0	2,703.0	2,703.0	2,703.0	2,703.0	2,703.0	2,703.0	2,703.0	2,703.0	2,703.0	2,703.0	2,703.0	2,703.0	2,703.0
ADJUSTED ENDING BALANCE	2,706.0	1,170.4	(370.2)	(173.1)	(1.1)	(71.1)	(168.1)	(263.1)	(357.1)	(162.0)	(49.0)	(109.0)	2,703.0	0.0

TABLE 2

1980 CASH FLOW MODEL: FUND 112
(Dollars shown in thousands)

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	13TH MO.	TOTAL
CASH REQUIRED	0.0	267.7	267.7	267.7	267.7	267.7	267.7	267.7	267.7	267.7	267.7	267.7	268.3	3,213.0
CASH PROVIDED														
DSHS Contract	0.0	0.0	0.0	228.0	228.0	228.0	228.0	228.0	228.0	228.0	228.0	228.0	686.0	2,798.0
Maint. of Effort	0.0	62.0	31.0	31.0	31.0	31.0	31.0	31.0	31.0	31.0	31.0	31.0	0.0	372.0
Cont. from PH	0.0	0.0	0.0	0.0	0.0	0.0	0.0	103.0	0.0	0.0	0.0	0.0	0.0	103.0
TOTAL PROVIDED	0.0	62.0	31.0	259.0	259.0	259.0	259.0	362.0	259.0	259.0	259.0	259.0	686.0	3,213.0
MONTHLY DIFFERENCE	0.0	(205.7)	(236.7)	(8.7)	(8.7)	(8.7)	(8.7)	94.3	(8.7)	(8.7)	(8.7)	(8.7)	417.7	0.0
ENDING BALANCE	0.0	(205.7)	(442.4)	(451.1)	(459.8)	(468.5)	(477.2)	(362.9)	(391.6)	(400.3)	(409.0)	(417.7)	0	0.0
STATE ADVANCE	342.0	342.0	342.0	342.0	342.0	342.0	342.0	342.0	342.0	342.0	342.0	342.0	342.0	342.0
ADJUSTED ENDING BALANCE	342.0	136.3	(100.4)	(109.1)	(117.8)	(126.5)	(135.2)	(140.9)	(149.6)	(158.3)	(167.0)	(175.7)	342.0	342.0

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