



**Special Investigation No. 2008-03  
City of Richmond Cash Flow Management  
March – September 2007**

**Prepared by:  
CITY AUDITOR  
Richmond, Virginia**

**Submitted to:  
The Honorable Members of City Council**

**October 18, 2007  
Revised October 29, 2007**

October 29, 2007 <sup>1</sup>

The Honorable Ellen Robertson  
The City Council Finance Committee Chair  
City of Richmond, VA

Dear Mrs. Robertson,

Re: Report on the City's Cash Flow Management

***Background and Objectives:***

On March 14, 2007, the City's Finance Department began to withhold a portion of funding required to pay the Richmond Public Schools' (RPS) non-payroll related expenditures. Since then, RPS has complained about fiscal difficulties suffered as a result of the City's actions. Subsequently, RPS has unsuccessfully attempted to pursue legal remedies to correct the situation.

On September 20, 2007, during the Finance Committee meeting, the City Auditor was directed to evaluate the City's cash flow management practices and its impact on RPS. Specifically, the objectives of the evaluation were to verify:

1. If the City withholds funds either due to lack of availability of cash for paying the RPS expenditures or for the purposes of better cash management of the City's funds
2. If the RPS is managing its cash flow to request payments only for the expenditure due to be paid at an appropriate time

***What prompted withholding of funds?***

Several reasons were given by the Finance Department for its actions related to withholding RPS funding.

1. The City is likely to experience a cash shortfall during certain parts of the year; therefore cash management is used to avoid a cash shortfall. The withholding was implemented to conserve the cash.
2. There is a general perception that RPS operations are inefficient. The audit report issued by the City Auditor's office in June 2007 confirmed the perception by identifying opportunities for improvements. Subsequently, the City Administration attempted to hire an outside consulting firm to audit certain issues at RPS. When these efforts were not successful, the Administration began to withhold funds due to lack of their assurance of efficiency in RPS operations.
3. City Finance Department argued their inability to confirm RPS' exercising prudence in expending cash. The Chief Financial Officer (CFO) recently

indicated that being given the ability to access the RPS' financial information system would provide him needed information and assurance in order to fund their requests in full.

***What is Cash Flow?***

Cash flow simply means receipt and payment of cash. Cash receipts and payments are not synonymous with revenues and expenditures respectively. For example, money borrowed by the City does not represent an income and principal portion of debt paid does not represent expenditure.

***What does cash flow management mean?***

Managing cash flow involves controlling the timing of the payment of cash. Generally, by holding money longer through deferring payments within negotiated terms, the organization may be able to either invest the cash to generate interest income or defer borrowing to reduce finance charges. On the contrary, deferring payments beyond negotiated terms could result in adverse impact on credit and late payment charges.

***Methodology:***

This was not an audit in accordance with Generally Accepted Government Auditing Standards (GAGAS); however, during the course of our work, we reviewed supporting documents and conducted other appropriate tests using the Standards wherever possible. We believe that our analysis provides a reasonable basis for our conclusions and our recommendations.<sup>1</sup>

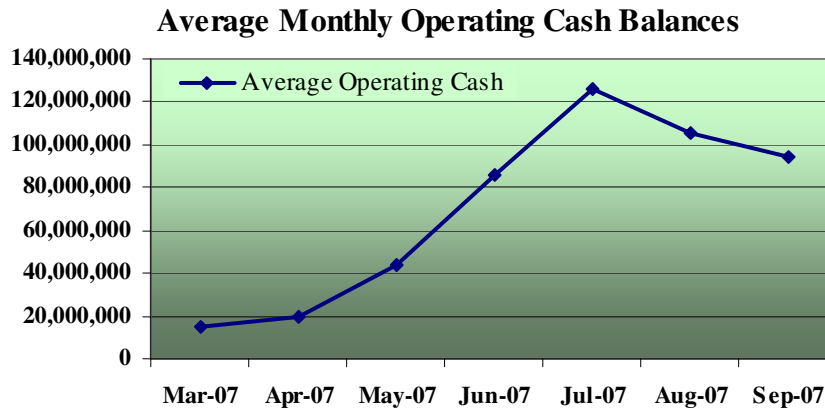
- Performed high-level financial analysis of City of Richmond's statement of assets and statement of activities from FY 2003
- FY 2006 and RPS's statements of activities for FYs 2003 through 2006
- Reviewed articles on credit ratings by outside agencies on the City's 2006 RAN and G.O. Bonds and credit rating reports to obtain background information on City's perceived creditworthiness
- Obtained background information from City's Finance Department on main operating accounts and a general understanding of cash inflows and outflows
- Reviewed revenue and expense patterns from data supplied from RPS and the City's Finance Department
- Reviewed cash flow operating chart and related bank statements
- Reviewed Richmond City Council minutes from March through September 2007
- Selected a random sample of RPS checks and related invoice support to compare invoice due dates and check dates
- Reviewed recent court transcripts regarding RPS and City Administration case over City's right to withhold funds

<sup>1</sup> Revised for the inclusion of GAGAS statement

**Findings:**

**Cash Shortage:**

- Review of the City’s operating cash flow data indicated that the City had adequate cash to meet its and RPS’ obligations.



Therefore, the lack of cash cannot be a reason for the actions taken by the City’s Finance Department to withhold RPS funding. During the analysis, however, the auditors noticed that this measure was made applicable only to RPS. None of the other agencies or City departments were subjected to cash conservation.

- More than 40% the City’s revenues are received at the end of the year. This creates significant cash available at the end of a fiscal year but creates cash shortages during the year. In the past, the City has borrowed by issuing revenue anticipation notes (RANs) to meet the anticipated shortages mainly due to payments for debt and natural gas procurement. The CFO argued that proper management of cash would reduce the cash borrowings by the City. During FY 2007, the City Council authorized the Finance Department to issue RANs up to \$100 million. Of this, the Finance Department issued \$65 million in revenue anticipation notes, leaving \$35 million spare capacity to meet unanticipated cash demand.

Auditors examined whether the idle borrowed cash results in an unnecessary burden on the City. Audit tests identified that the City pays approximately 3.5% per annum on the 2006 RANs. However, idle cash is deposited in short-term investments, which earn about 5.3% per annum. This earned income lowers the City’s interest cost. This demonstrates that the City is not at a significant disadvantage.

## *The City's Cash Flow Management*

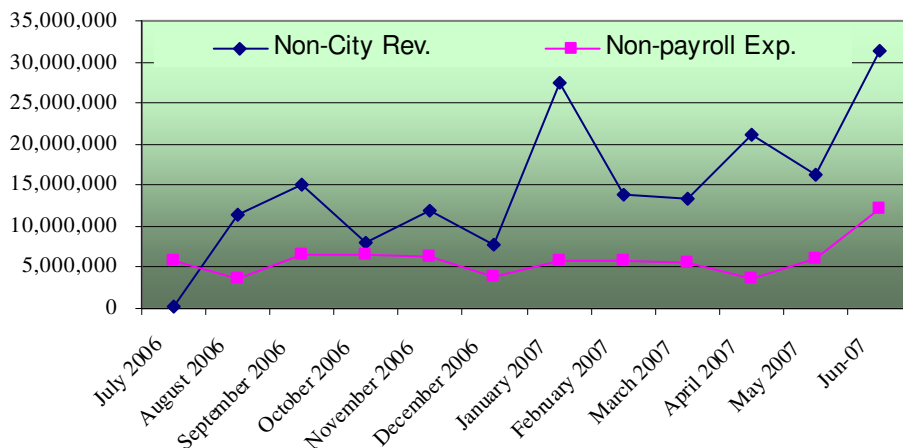
- The City of Richmond presently enjoys strong bond ratings on its debt instruments. Credit analyses include evaluations of City economic trends, past performance and liquidity, and projected cash flows. Therefore, the City's bond rating is not a driving factor for improving the City's cash flow management.
- Financial analysis of CAFR information indicates consistent strong liquidity which suggests the City's ability to meet all current obligations in a timely manner. Additional effort to improve the City's liquidity is not critical.
- The City Administration is concerned about operational efficiencies of the School Division. In an attempt to compel RPS to improve its efficiencies, the City Administration began to withhold a percentage of funds requested by RPS for non-payroll related disbursement effective March 14, 2007.

Auditors found this method to be ineffective for the purpose as the City is required to provide total funding equal to the annual appropriations and funds received from other entities for RPS use. Deferring cash payments may cause inconvenience to RPS staff. However, as long as the Finance Department is required to pay the entire budget appropriation to RPS, this method will not be able to force efficiencies in RPS operations. An arbitrary withholding of funds could result in late fees and finance charges, which can increase the funding needs.

During the period from March through June 2007, the City earned net interest (interest earned on investments less potential interest payment on borrowings) on all the deferrals of RPS requests of only about \$17,000, which represents a negligible return of 0.046% on \$37 million disbursements for the period March 14, 2007 through June 30, 2007. This indicates that the action was just "symbolic" and did not help the City's cash flow management.

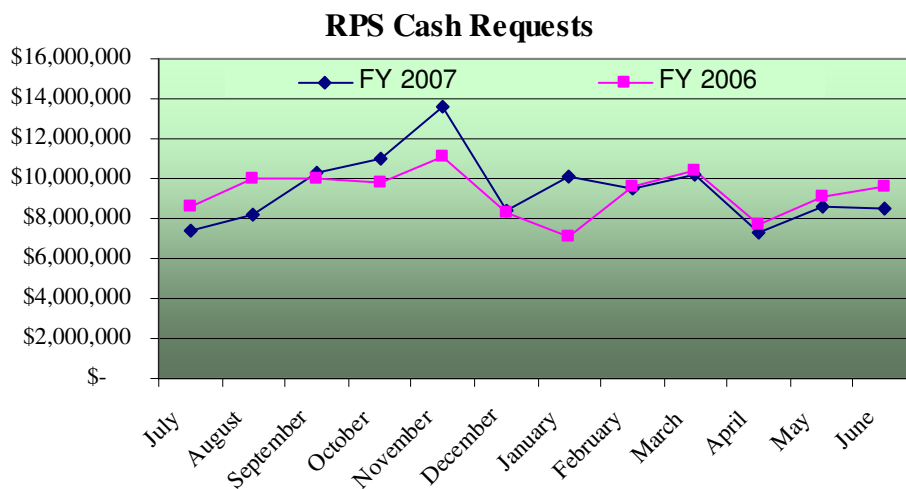
- For FY07, the City received the revenues of about \$178 million annually from State and Federal governments on behalf of RPS. This funding can only be used for RPS. Audit analysis indicated that during the FY 2007, beginning March 2007, there was adequate funding from these sources to pay non-payroll related RPS obligations.

**Non-City Revenue and Monthly Operating Expenditure for RPS**



Source: RPS Finance Department (unaudited)

- The cash requirements of RPS have not changed much during FY 2006 and FY 2007 as depicted in the following graph:



Source: RPS Finance Department (unaudited)

Based on the above information, the City Finance Department should have anticipated paying for RPS operating expenditures over FY 2007 in accordance with RPS’ normal expenditure pattern. There appears to be no abnormal demand by RPS during the period beginning March 2007.

***CFO’s Fiduciary Duty***

The CFO claimed that he has a fiduciary duty to manage the City’s finances including cash for both the City and RPS. He expressed that, unlike other City departments, he is not able to access RPS’ financial system to assess appropriateness of its cash

management practices. He indicated that due to unavailability of pertinent information he opted to withhold funding. However, the CFO did not meet with RPS personnel to express his concerns and need for specific information. Without such communication, the RPS personnel did not have an opportunity to provide adequate information to resolve the issue.

### ***Impact of Withholding Funds on RPS***

The RPS Finance Department was unable to demonstrate any tangible adverse impact on RPS operations due to the City Finance Department actions. According to the information available to the auditors, no vendors have terminated their business relationships with RPS. Any lack of availability of product or services has not impacted its core mission adversely.

### ***RPS Cash Flow Management:***

#### ***Payments before due date***

The scope of RPS' cash flow management is limited because all revenues are received by the City and all disbursements are made when approved. Therefore, the only thing RPS personnel can do to manage its cash flow prudently is to pay RPS bills only when they are due.

Audit identified that RPS does not attempt to manage its cash flow. RPS pays its bills as soon as they are received by the RPS Finance Department regardless of when they are due. Audit tests identified that in a representative sample, about 43% (\$308,726.76 out of \$719,473.68) of all payments made were paid prior to due date. The City's Finance Department appears to have a valid concern related to lack of management of cash by RPS personnel. This issue can also be illustrated with the timeliness of one request for a significant payment: RPS submitted a funding request for about \$2.1 million payable to Virginia Retirement System 12 days prior to the due date. The City's Finance Department appropriately held this payment until the day before it was due. The City earned interest of about \$3,000 from the float.

#### ***Proactive Actions***

Based on the information available, RPS does not appear have a policy to negotiate payment terms favorable to the City's cash flow patterns. Deferring cash payments could help the City to use the available cash most effectively. Alternatively, negotiating discounts for early payments could reduce RPS' costs and cash requirements.

#### ***Conclusion***

The City's Finance Department does not appear to have sufficient reason to withhold funding from RPS. However, RPS has not suffered an adverse impact from the City's actions. The RPS personnel need to manage cash by paying invoices only when they are due and by negotiating beneficial payment terms. Lack of communication has resulted in mistrust between the City and RPS staff. There appears to be a need for the City and RPS staff to negotiate satisfactory terms for funding RPS non-payroll expenditures.

Preferably, these negotiations need to be done in presence of an independent, intermediary party and terms need to be documented in writing.

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City Auditor