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Managing Cash in Reimbursable Environments

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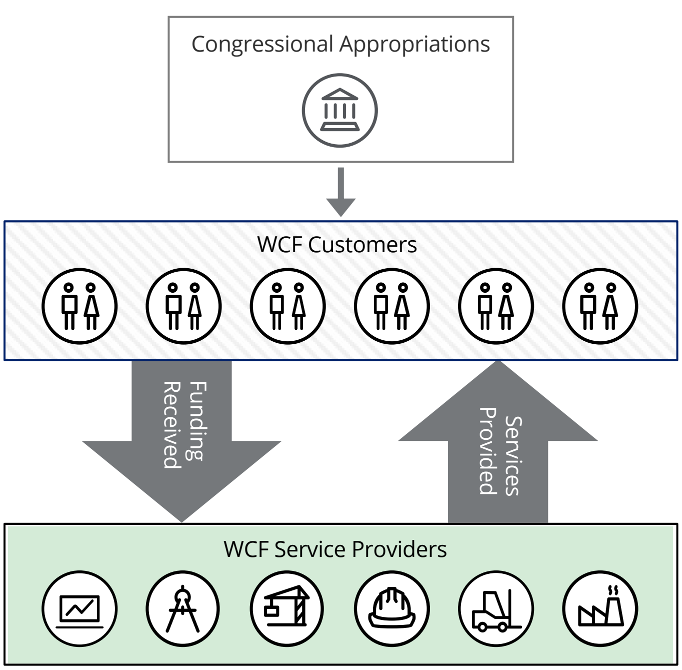
Introduction

Financial and budgetary constraints placed on federal agencies can make it challenging to optimize the allocation of resources to the mission. With federal agencies looking to do more with their budgets, C-Suite Leadership (i.e., CFO, COO, CIO) can consider leveraging alternative funding models. This article provides an overview of operating within a reimbursable environment, including Working Capital Funds (WCF), and highlights the flexibility, functions, and benefits to managing cash flows and reserves within organizations with congressional approval for such a model.

Overview of Reimbursable Environments

Within a reimbursable environment, federal agencies can focus on cost recovery where operating expenses are recovered through the collection of funding (or revenues) from internal and/ or external customers. As a result, the organization potentially benefits from more flexibility, agility, and scalability to align its resources with mission needs. **The graphic** below paints a picture of this concept in the context of a revolving fund or WCF, where collections from customers are estimated to cover the full cost of operations and services provided. This gives an organization the ability to finance continuing operations and invest in infrastructure across fiscal years.

How Does A WCF Work?



Monitoring and Managing Cash Flows Out (Expense)

Within a WCF Model, the federal agency's shared service component(s) are fully funded through collections received from customers. The organization charges customers for the full cost of doing business, both goods and services provided (direct costs) and requirements not directly attributable to the goods and services provided (indirect costs) through indirect rates. By relying on customer-driven funding, WCF organizations operate more like a "business" than those within the normal appropriated environment. Unlike the Appropriated Model, funding received from customers is converted to no-year funds, which means that there is no authorization expiration date for unused funding. It is important to note, **in order for a WCF to become fully operational including the benefit of no-year funding, congressional approval and legislative authority must be obtained.**

When establishing and optimizing a WCF, many organizations become "cost conscious" with a better understanding of the actual cost of doing business and awareness of cash flows out. As in the commercial or private sector, it is important to truly understand the impact of operations on financials, analyze drivers behind fluctuations in expenses, monitor operating costs, leverage financial insight or awareness, identify opportunities to better control or cut costs, drive data-based decision to more efficiently manage the organization, and maintain consistent cost recovery through the use of strategic levers. **It is critical to know all costs across the organization, top down, left right, all the way through to the services provided, and customers supported. This understanding is critical for cash management.**

WCF leaders and administrators view cash as a key metric and measurement of the organization's health and solvency. Cash management provides key stakeholders insight into critical financial measures, to include costs, revenues, net income, and assets/liabilities. Understanding the dynamics of cash outflows driven by operational expenses across the fund, allows for the ability to maintain operations and invest in infrastructure and future capabilities. Effective management of cash creates confidence in the financial health of an organization.

Monitoring and Managing Cash Flows In (Revenue)

WCFs have a multitude of strategic options (or levers to pull) to influence their cash balances. These options provide the organization with flexibility in recovering costs and planning for the future. As a WCF grows and evolves, leadership can consider utilizing any of the strategic options listed below:

- **Strategic Pricing**: The primary process that a WCF organization uses to take a strategic look at the next fiscal year (and out years), recover forecasted operating costs, sustain operations, and raise cash levels by charging customers for goods and services; enabling an organization to set prices to break even over time.

- **Rate of Disbursement**: Value that measures the average amount of expenditures during a given period; allowing an organization to position itself to meet any expenditure obligations, while maintaining appropriate cash balances.
- **Range of Operation**: Value that shows the difference between the highest and lowest expected cash levels; organizations can utilize this measure to better understand historical fluctuations in cash balances and liquidity.
- **Reserves Held for Future Requirements**: Cash that is set aside or fenced off for specific investments and requirements expected to be disbursed in future years, such as investments or recapitalization (e.g., replacement of existing critical capital assets to maintain core infrastructure over time).
- **Contingency Planning**: Cash that is set aside for fenced off for a well-considered risk mitigation plan that addresses seasonal volatility, external market forces, extenuating circumstances, emergencies, and other unknown variables; the final consideration when determining cash levels.

WCFs should leverage any/all cash management options to manage cash balances within established policies and guidelines. Continuous analysis and financial reporting of cash balances is needed to ensure that healthy cash levels and liquidity are maintained to avoid the risk of insolvency or lapses in service.

Optimizing Available Cash Balances and Reserves

Within a WCF, cash generated from the sale of goods and services sustains operations and provides the ability to make investments in anticipated future business needs. Most funds within the government have guidelines, rules, and regulations that outline the upper and lower limits for cash balances. Cash is often measured in the number of Days of Available Cash, which is calculated by subtracting assets from liabilities, investment funds, and recapitalization funds, then divided by 360 days. WCFs monitor and manage this cash as a key measurement of the health and solvency of a fund.

$$\textbf{Days of available cash} = \frac{\textbf{Assets} - (\textbf{Liabilities} + \textbf{Investments} + \textbf{Recap})}{\textbf{360 days}}$$

Administering a WCF comes with additional fiscal responsibility and stewardship. Federal agencies conduct detailed data analyses to drive financial awareness, transparency, accountability, and insight into required cash balances throughout the fiscal year of execution, while keeping sights set on the fund's goal of breaking even. A deep understanding of cost and consumption/demand will further assist organizations in staying ahead of the curve, while also complying with cash balance regulations. WCF administrators and program managers have a variety of other options for understanding their cash balances, in addition to Days of Available Cash:

- **Quick Ratio:** A financial ratio widely used in the commercial or private sector that measures liquidity detailing the organization's ability to pay its debts over a 12-month period.
- **Statement of Cash Flows:** A financial model widely used in the commercial or private sector that demonstrates how cash entered and exited an entity during a given period based on balance sheet; reduction in working capital flows directly to overall cash available for repaying current operational expenses and investing in future capabilities.

Federal CFOs, WCF administrators, and program managers can leverage the latest data on cash balances, collections, and disbursements to manage cash efficiently and effectively throughout the fiscal year. **Cash balances and reserves should be closely monitored and checked regularly to understand how the business is operating and proactively identify key trends, gaps, risks, or opportunities for future planning purposes**.

Strategic Opportunities

Operate Like a Business

Federal agencies that adopt WCFs can fund operations through cash inflows from operations, unlike the standard Appropriated Model that relies solely on direct congressional appropriations. For this reason, WCFs are the governmental entities that most closely operate like a "business." As a result, WCF entities can operate with more autonomy through a variety of benefits, including but not limited to:

- **Budget Flexibility**: A WCF Model can open doors and provide access to additional sources of funding. Revenues are treated as no-year funds, offering administrators and program managers additional flexibility when making business and financial decisions in the short- and long-term.
- **Flexible Pricing**: A WCF operates differently than that of traditional congressional appropriation guidelines with the flexibility to conduct cost assessments and set strategic pricing points aimed at recovering the full cost of operations; flexible pricing options allow WCFs to adapt to ever-changing market conditions and to address any unintended profi ts or losses.
- **Financial Transparency and Fiscal Accountability**: Establishing a WCF can strengthen financial transparency and fiscal accountability, as well as support auditability goals by encouraging a review of business and financial systems, processes, and procedures; sound financial management and fiscal stewardship is critical to maintain the viability of a WCF Model.

- **Efficient Management**: Since customers must now pay for the goods and services that they consume, a WCF Model incentivizes customers to consume only what is necessary to support their mission needs and reduce excess; effective WCF governance process also puts pressure on WCF service providers to cut or control costs, while stressing efficiency at both ends of service delivery can help drive an organization to deliver real cost savings.
- **Continuity of Operations**: With no-year funds and available cash on hand, WCFs benefit from less risk to continuity of operations during adverse events.
- **Agility to Flex to Customer Demand**: As customer-centric entities, WCFs also benefit from more agility to flex and meet evolving mission requirements, programmatic needs, or surge/ support in emergency response activities, as well as more incentive to align services to customer demand.

Invest Funds into Operations

Adoption of reimbursable operating models offers agencies the chance to increase their overall efficiency. Federal agencies that control costs and realize efficiencies or economies of scale in their service delivery can drive savings for customers and redirect available funding towards critical mission needs. Cash collected within a WCF converts to no-year funds, removing the fund tenure limit that appropriated budgets face. As a result, federal agencies can use revenues collected and cash generated to fund and sustain their operations, as well as make investments into anticipated business needs. An example of this could be a government organization using its cash reserves to make investments in its IT infrastructure, to stand up a new shared service and improve the critical IT support services provided by the organization to its customers in the long-term without relying on appropriations.

Sustain into the Future with Recapitalization

integral to cash management is planning for future high dollar investments to fund and improve operations and critical infrastructure. Through strategic pricing, federal agencies can plan, budget, cost, price, and collect recapitalization and investment dollars to sustain operations into the future. An example of this could be a government organization using its cash reserves to fund the major replacement or recap of its real property (e.g., government headquarters building), the space which its customers physically occupy. Recapitalization dollars are used to replace capital assets that have exceeded their useful life, to include, Plant, Property, and Equipment (PP&E), and Internal Use Software (IUS). This can minimize disruption of operations for any long-lead equipment purchases or developments. Federal agencies can depreciate/amortize the cost of their capital assets, defined as assets with a value over $50,000, and IUS over the course of their accounting useful life. Once the asset/IUS reaches the end of its accounting useful life (or operational useful life), it can be replaced using the revenues collected over time and cash reserves designated for recapitalization.

Proactive planning of recapitalization purchases allows organizations the flexibility to incrementally collect funding for large investments over time.

Cash Is Key

Cash on hand is key to the agility and flexibility associated with the WCF Model, especially when navigating times of financial and budgetary constraints. It offers the opportunity to truly maintain momentum, sustain operations, invest in the organization, and proactively plan for future recapitalization, as a direct result of recovering the full cost of doing “business.” An ongoing ambition and dedication to optimizing working capital supports maximization of free cash flow, while protecting against potential risk that could threaten future liquidity or fund solvency. Insufficient funds can lead to negative impacts to the mission and its customers, as well as potential material weaknesses and auditability issues. Excessive funds can quickly lead to customer pushback, inefficient use of funds, and unwanted financial scrutiny. **Striking the optimal balance is imperative to successfully managing cash flows in a reimbursable environment**.

Find out more

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