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Free cash is a revenue source that results from the calculation, as of July 1, of a community's remaining, unrestricted funds from its operations of the previous fiscal year based on the balance sheet as of June 30. It typically includes actual receipts in excess of revenue estimates and unspent amounts in departmental budget line items for the year just ended, plus unexpended free cash from the previous year. Free cash is offset by property tax receivables and certain deficits, and as a result, can be a negative number.

Cities and towns generally use free cash to support current-year operations or to provide a revenue source for the ensuing year's budget. However, free cash is not available for use until after the accountant, auditor, or comptroller submits a prior-year balance sheet to the Division of Local Services (DLS) and the Director of Accounts certifies the free cash. The DLS certification protects communities from relying on free cash that might not materialize due to inaccurate local estimates.

The Technical Assistance Bureau (TAB) recommends that communities understand the role free cash plays in sustaining a strong credit rating and encourages them to adopt policies on its use. Under sound financial policies, a community strives to generate free cash in an amount equal to three to five percent of its annual budget. This goal helps deter free cash from being depleted in any particular year, which enables the following year's calculation to begin with a positive balance. To do this, the community would orchestrate conservative revenue projections and departmental appropriations to produce excess income and departmental turn backs.

As a nonrecurring revenue source, free cash should be restricted to paying one-time expenditures, funding capital projects, or replenishing other reserves. When a community incorporates free cash into revenue source projections for next-year operational expenses, it is prudent to place a percentage restriction on the total free cash to be used.

Overall, TAB recommends that communities adopt a free cash policy that avoids supplementing current-year departmental operations. By eliminating the expectation of additional resources later in the fiscal year to backfill budgets, department heads will produce more accurate and realistic annual appropriation requests.

Any free cash use requires an appropriation approved by the city council on the mayor's recommendation or by town council or by town meeting but only after DLS has certified the free cash total. The same rules apply to DLS's certification of retained earnings, which is the enterprise fund equivalent of free cash.