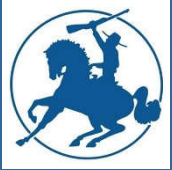


**RANCHO MURIETA
COMMUNITY SERVICES DISTRICT**



BOARD OF DIRECTORS | APRIL 15, 2020

CENTRAL SERVICES FULL COST ALLOCATION PLAN

Presentation of Draft Consultant Report

ClearSource Financial Consulting

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PURPOSE OF COST ALLOCATION (1 OF 2)

What is a Central Services Full Cost Allocation Plan?

- ➔ A rational method to distribute costs which support multiple activities within an agency
- ➔ Typically focused on central services and general government costs (“indirect” costs)

Why are Indirect Costs Allocated?

- ➔ Incurred for common or joint purposes
- ➔ Benefit more than one final cost objective
- ➔ Cannot be readily identified with a particular final cost objective without effort disproportionate to the results achieved



PURPOSE OF COST ALLOCATION (2 OF 2)

How is a Full Cost Allocation Plan Used at RMCSD?

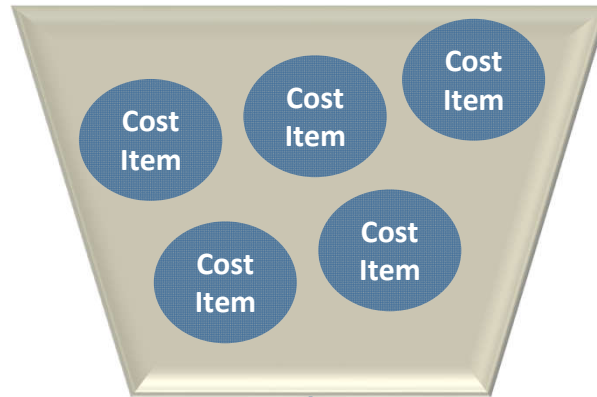
- ➔ Sets internal transfers to the General Fund to pay for centralized indirect costs not already directly budgeted or billed in direct service funds
 - Can be applied in multiple forms of cost recovery, such as user fees and utility rates
 - Can be applied to direct charges of labor to projects or other forms of negotiated cost recovery or cost-sharing
- ➔ A tool supporting financial management processes
 - Informs annual budget
 - Supports annual audit and reflects audited results
 - Can be influenced and validated by periodic review of staff timekeeping data



INDIRECT COST ALLOCATION

Indirect Cost Pool

A cost traced to multiple service functions, typically a central service, general governmental, or administrative function. Not reasonably direct-billed.



Expense categories, such as labor, materials, supplies, and services.

Allocation Base

The data set used as the basis for distributing indirect cost pools to benefitted units.



Benefitted Units or "Direct Services"

Organizational departments/programs that represent the mission of the entity: the final service product.



SCOPE OF CONSULTANT REVIEW

- ⇒ Review prevailing practices
- ⇒ Compare to industry guidance and practices
- ⇒ Recommend allocation methods and develop a sustainable model to implement those methods on an annual basis
- ⇒ Produce findings that can be implemented in budgeting and cost recovery (e.g., user fees, utility rates)
- ⇒ Comment and recommend associated budget management practices, including application of labor time tracking



PREVAILING ALLOCATED COSTS

Beneficiary Fund	Expenditure Account / Description			Total Allocations in FY19-20 Budget	FY19-20 <u>Distribution</u> of Total Charges
	4099	4999	5999		
	Admin Employee Services Allocation	Admin Services Allocation	Admin Operating Exp Allocation		
200 Water	\$ 428,341	\$ 157,752	\$ 46,021	\$ 632,115	39%
250 Sewer	\$ 327,037	\$ 120,443	\$ 35,137	\$ 482,617	30%
260 Drainage	\$ 67,169	\$ 24,737	\$ 7,217	\$ 99,123	6%
400 Solid Waste	\$ 55,057	\$ 20,277	\$ 5,915	\$ 81,249	5%
500 Security	\$ 223,530	\$ 82,323	\$ 24,016	\$ 329,870	20%
Grand Total	\$ 1,101,134	\$ 405,532	\$ 118,307	\$ 1,624,973	100%

Note this distribution of total charges for subsequent comparison to proposed Cost Allocation Plan.



A decorative graphic on the left side of the slide consists of a dark blue triangle pointing right, a light blue triangle pointing left, and a horizontal orange line. The text is centered horizontally and partially overlaps the orange line.

FUNDAMENTALS OF COST ALLOCATION



CRITICAL DISCUSSIONS IN DEVELOPING A PLAN (1 OF 3)

What Indirect Cost Pools Should be Allocated?

- ➔ General Fund 100
 - Management
 - Administrative Services
 - Financial Services
 - Customer Service
 - Information Technology
 - Legal Services
 - Human Resources
 - Risk Management

Where do these functions originate?

- ➔ These functions are developed inside the Cost Allocation Plan based on analysis of time spent by labor positions and line-item expenditures.
- ➔ These are not functional distinctions made in the District's budget. (They could be informed by revised timekeeping categories.)
- ➔ Functional expression of General Fund costs enables nuance in cost allocation. Direct service funds may utilize these types of central services to different degrees.



CRITICAL DISCUSSIONS IN DEVELOPING A PLAN (2 OF 3)

What Direct Services Should Receive Allocations?

- ⇒ Water Fund 200
- ⇒ Sewer Fund 250
- ⇒ Drainage Fund 260
- ⇒ Solid Waste Fund 400
- ⇒ Security Fund 500

These are the direct services of the District.

- ⇒ Costs borne in the General Fund exist to support the provision of these core areas of business.
- ⇒ Direct services should fully carry their share of indirect costs as a necessary “cost of service”



CRITICAL DISCUSSIONS IN DEVELOPING A PLAN (2 OF 2)

How Should Indirect Services be Allocated?

- ➔ Ideal methods are:
 - Applied reasonably and consistently across the organization
 - Supported by accurately developed and current data
 - Appropriate to costs distributed
 - Reflective of a reasonable measure of benefits provided
 - Able to achieve consensus on fair and equitable methods of distributing costs

What Fiscal Year Serves as the Basis for Expenses?

- ➔ Prior year actual and audited (e.g., Fiscal Year 2018-19)



CONSIDERATIONS IN ALLOCATION

The Technique of Cost Allocation

- ⇒ Used for services of broad benefit agency-wide
- ⇒ Costs otherwise directly attributable to services are typically **budgeted or billed** in those departments/funds
- ⇒ Industry guidelines emphasize **reason** in both analytical decisions and **scale of effort**

*Highly
developed
at RMCS.*

The Impacts of Cost Allocation

- ⇒ Decisions consider downstream impacts where cost allocation results are applied
 - Cost of service and proportionality ethics in user fees and utility rates, for example



ANALYTICAL DECISIONS



BASIC STEPS IN ALLOCATION

Develop Essential Inputs

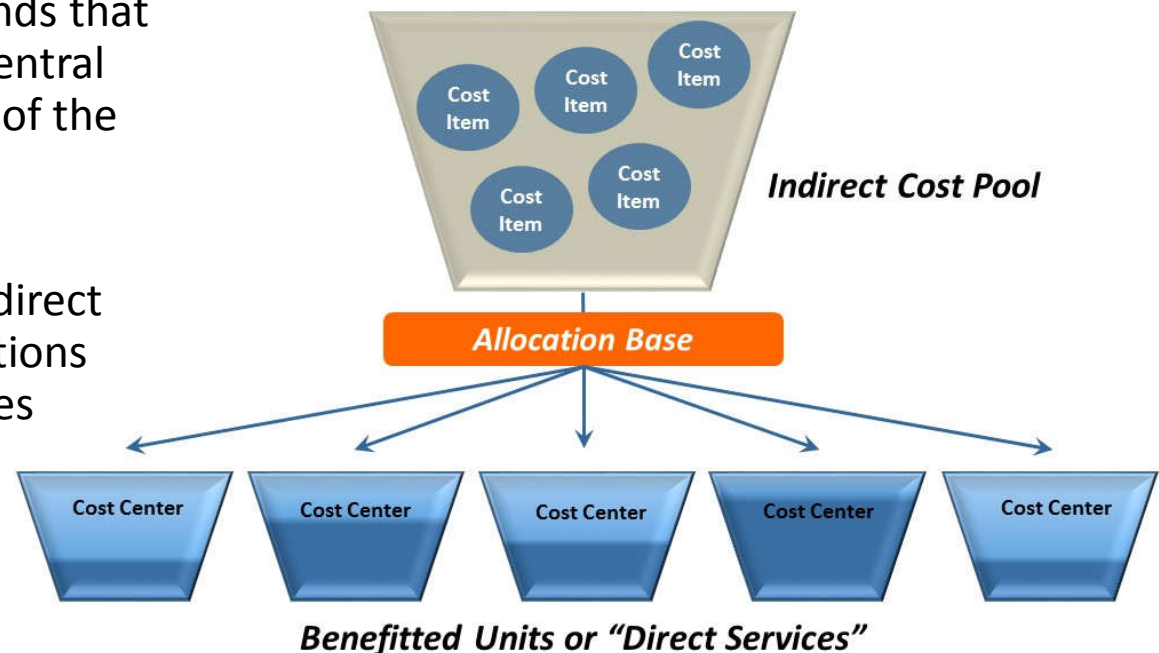
- ➔ Identify pools of indirect service costs appropriate for allocation
- ➔ Assign a basis for allocation
- ➔ Identify organizations/funds that receive or benefit from central service (“direct” services of the District)

Perform the Analysis

- ➔ Allocate indirect costs to direct services following proportions found in the selected bases

Identify the Outcomes

- ➔ Derive annual shares by organization/fund
- ➔ Derive indirect rates





ALLOCATION BASES

Metrics Used for Allocating Costs are Ideally:

- ➔ Based on readily available information
- ➔ Not created solely for the purpose of cost allocation
- ➔ Data sets which can be easily maintained to reflect current or recent conditions
- ➔ Able to yield an outcome that:
 - Reasonably reflects service or benefit received, or
 - Represents an acceptable proportionality between benefitting funds
- ➔ Able to avoid large swings from year to year unless underlying organizational change has occurred and would warrant such swings



ALLOCATION BASES USED IN THE PROPOSED PLAN

- ➔ **Gross Operating Expenses**
Total expenditures in the fund net of capital, debt service, depreciation, and financing uses
- ➔ **Modified Operating Expenses**
Gross Operating Expenses net of large contractual costs, pass-through items, and distorting or extraordinary expenses
- ➔ **Wages Expense**
Labor costs recorded to each department/fund
- ➔ **Sales Revenue**
Billed revenue by fund

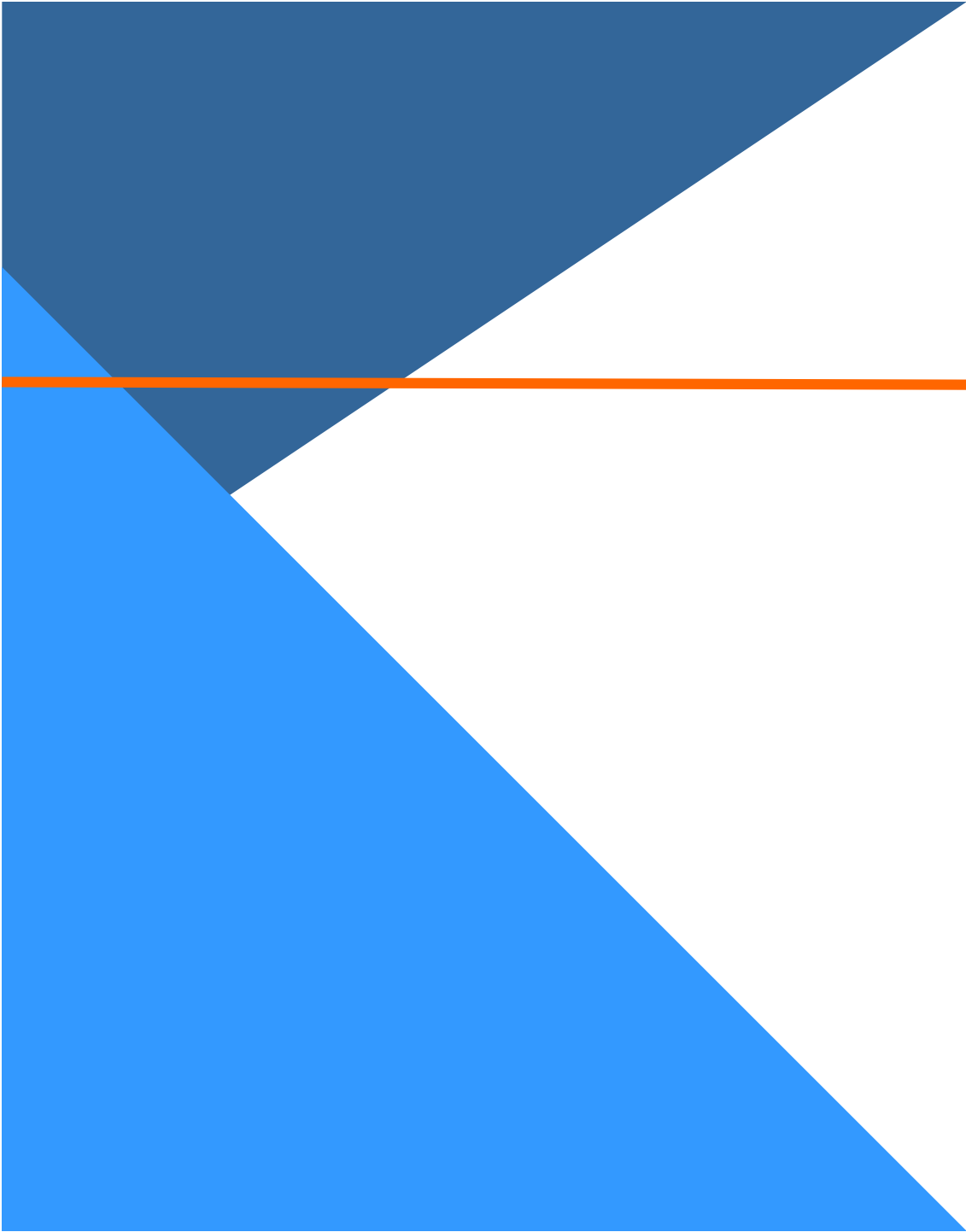


INDIRECT COST POOLS AND ALLOCATION BASES

ALLOCABLE INDIRECT COST POOLS

Central Services Department / Indirect Cost Pool	Allocable Indirect Cost	Allocation Basis
General Fund 100:		
Management Services	\$ 242,832	Modified Operating Expenses
Administrative Services	\$ 369,717	Modified Operating Expenses
Financial Services	\$ 351,987	Modified Operating Expenses
Customer Service	\$ 84,409	Sales Revenue
Information Technology	\$ 137,395	Wages Expense
Legal Services	\$ 71,086	Modified Operating Expenses
Human Resources	\$ 63,312	Wages Expense
Risk Management	\$ 152,366	Modified Operating Expenses
Total Central Services Allocated in this Plan	\$ 1,473,103	<i>FY 18-19 Expenditure Basis</i>

Example: Departments with greater labor costs receive a larger allocation of Human Resources.



OUTCOMES



RESULTING SHARES OF ALLOCATED CENTRAL SERVICES

SHARE OF ALLOCATED INDIRECT COSTS

Fund	Distribution in Proposed Plan	Distribution of 2019-20 Charges	Increase (Decrease)
200 Water	37%	39%	-1.7%
250 Sewer	25%	30%	-4.9%
260 Drainage	4%	6%	-1.9%
400 Solid Waste	2%	5%	-3.0%
500 Security	32%	20%	11.5%

*Findings in the ClearSource plan.
Driven by the allocation of actual FY 18-19 costs.*

Compare to current charges imposed in FY 19-20.

Note the resulting shifts in cost burden proposed for FY 20-21.



IMPACT OF CHANGE TO ALLOCATED SHARES

COMPARE INTERFUND CHARGE RESULTS, PROPOSED PLAN TO CURRENT BUDGET

Fund	Recalibrated Interfund Charge Using FY 19-20 Costs	Compare to: FY 2019-20 Budgeted Charge	Increase (Decrease)
200 Water	\$ 605,147	\$ 632,115	\$ (26,968)
250 Sewer	\$ 402,961	\$ 482,617	\$ (79,656)
260 Drainage	\$ 67,903	\$ 99,123	\$ (31,220)
400 Solid Waste	\$ 32,230	\$ 81,249	\$ (49,018)
500 Security	\$ 516,733	\$ 329,870	\$ 186,863
Total Transfers to the General Fund	\$ 1,624,973	\$ 1,624,973	\$ -

- ➔ To assist illustration of impacts in the change of allocated costs, **the above outcomes assume equal General Fund costs between the two years fiscal years**



EXAMPLE INTERFUND CHARGES FOR FY 2020-21

COMPARE INTERFUND CHARGE RESULTS, PROPOSED PLAN TO CURRENT BUDGET

Fund	Proposed Interfund Charge for FY 2020-21	Compare to: FY 2019-20 Budgeted Charge	Increase (Decrease)
200 Water	\$ 620,161	\$ 632,115	\$ (11,954)
250 Sewer	\$ 412,958	\$ 482,617	\$ (69,659)
260 Drainage	\$ 69,588	\$ 99,123	\$ (29,536)
400 Solid Waste	\$ 33,030	\$ 81,249	\$ (48,219)
500 Security	\$ 529,553	\$ 329,870	\$ 199,684
Total Transfers to the General Fund	\$ 1,665,290	\$ 1,624,973	\$ 40,317

- ⇒ **Applies the proposed General Fund budget for FY 2020-21**, as of March 26, 2020
- ⇒ Interfund charges are applicable in the basis for rates and fees to reflect full cost of direct services provided
- ⇒ Interfund charges are additive to all other directly budgeted costs in direct service funds
- ⇒ Property tax allocation may need to be revised among direct service funds to accommodate the change in interfund charges and capacity of primary revenue streams



INDIRECT COST RATES

- ➔ Indirect Cost Rates are an alternate outcome of the Cost Allocation Plan
- ➔ Applicable to direct expenditures in each fund or to salary expense for any labor charged to special projects

INDIRECT COST RATES		
Fund	Rate per Dollar of Salary	Rate per Dollar of Direct Expenditure
200 Water	101%	31%
250 Sewer	107%	30%
260 Drainage	83%	34%
400 Solid Waste	0%	4%
500 Security	79%	34%
Composite for All Direct Services	79%	23%

[a] Due to current practices for recording labor to each fund, the composite rate can be sufficient.

[b] Direct expenditure excludes capital, debt service, depreciation, and financing uses. The rate specific for each fund is recommended if utilized.



OVERALL FINDINGS (1 OF 2)

- The District has used and maintains a current cost allocation method supporting its annual practices. **Enterprise funds appropriately receive charges for recovery of General Fund costs**, representing their share of District-wide central services.
- The proposed Cost Allocation Plan methodology uses prior year actual expenditures from FY 2018-19 to derive distributive shares of central services costs. This **expenditure basis complies with audit findings**.
- The proposed methodology **examines indirect costs functionally** and applies readily accessible and replicable data sets to distribute central overhead costs to the District's direct community services.
- ClearSource recommends **applying the distributive result** of the Cost Allocation Plan to prospective General Fund costs in FY 2020-21 to **sustain full cost recovery within the same time period**.



OVERALL FINDINGS (2 OF 2)

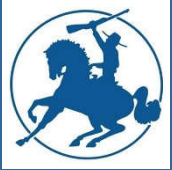
- ➔ ClearSource finds an **overall shift in cost burden to Security**. Capacity in underlying revenue sources should be examined before relying on these results. General **tax revenue may need to be reallocated** accordingly from previous levels.
- ➔ The District will be able to **own and use the Cost Allocation Plan** model in subsequent years to sustain this approach.
- ➔ The Cost Allocation Plan should **reduce administrative burden while yielding reasonable results** to direct services.
- ➔ The District's **timekeeping** for administrative personnel can be used periodically to **compare to and/or validate** Cost Allocation Plan outcomes.
- ➔ Interfund charges for allocated central services can be **applied once per fiscal year**, at the District's discretion, in line with the Plan. Many agencies choose to perform this at fiscal year end.



RECOMMENDATIONS AND NEXT STEPS

- ➔ Consider applicability of methodology and outcomes
- ➔ Consider ramification to enterprise funds and the feasibility of applying cost burdens in their underlying revenue sources (e.g., fees/rates, tax allocation)
- ➔ Apply distributive results to current year or budget year General Fund costs (as appropriate)
- ➔ Receive final consultant report linked to prospective budget year information and associated recommendations
- ➔ Adopt FY 2020-21 budget with revised interfund charges to recover central services costs allocated in the plan

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CENTRAL SERVICES FULL COST ALLOCATION PLAN

DISCUSSION & QUESTIONS

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