

City of Portland Overhead Model Review

FINAL REPORT
DECEMBER 2004

December 3, 2004

Mr. Don Carlson
Office of Management and Finance
City of Portland
1120 Southwest Fifth Avenue
Portland, Oregon 97204

**Transmittal of Final Report:
City of Portland – 2004 Overhead Model Review**

Dear Mr. Carlson:

FCS Group Incorporated is pleased to present this final report to the City of Portland, describing our findings and recommendations related to the Overhead Model Review we conducted from September through November 2004.

This project provided the City with an objective, technical review of its existing practices in allocating general overhead costs to City funds. The purpose of this external review was to evaluate the City's methods for allocating costs and recommend means for improving cost recovery, equity, stability, process, and cross-departmental interactions.

In general we found:

- In many aspects, the City of Portland has exceeded its comparable peer cities, specifically in seeking an extensive set of equitable allocations between bureaus and in formalizing stakeholder communication and involvement.
- Areas for improvement include: minimizing substantial annual cost burden shifts between bureaus, providing for the predictability of annual charges, formalizing the rationale for allocating costs, simplifying process and improving planning time, and enhancing internal communication by elevating overhead allocation decision-making to a policy level.

We have provided a series of recommendations, across eight topics, which address these areas of improvement. These recommendations have been designed building on the positive work completed by City staff over the last 15 years since overhead practices were last reviewed. A checklist of these recommendations is included as the final chapter in this report.

It has been a pleasure working with you and other City staff and stakeholders on this project, and we appreciate the candidness and accessibility of all involved. We are happy to be of service to the City and are available to discuss questions or issues raised by any interested party regarding our recommendations.

Sincerely,

FCS GROUP INCORPORATED

Jeanette Hahn
Project Manager

Tracey P. Dunlap
Principal

City of Portland Overhead Model Review

FINAL REPORT
Issued December 2004

Prepared by



FCS Group Incorporated

PROJECT TEAM

Tracey Dunlap, Principal in Charge • Jeanette Hahn, Project Manager
Peter Moy, Technical Advisor • Beth Jacobs, Financial Analyst

OFFICES AND CONTACT INFORMATION

Home Office

8201 164th Avenue Northeast, Suite 300 • Redmond, Washington 98052
(425) 867-1802 • Fax (425) 867-1937

Bay Area Office

50 California Street, Suite 1500 • San Francisco, California 94111
(415) 277-5905

www.fcsgroup.com

TABLE OF CONTENTS

Introduction	1
Study Objectives	1
Qualifications of the Reviewer	4
Definitions	5
Basic Principles of Cost Allocation.....	6
Existing Practices	9
General Fund Overhead Model	9
Indirect Cost Model.....	17
Comparable Practices	21
Scope of Benchmarking Survey.....	21
Survey Responses	23
Positive Elements	25
General Fund Overhead Model	25
Indirect Cost Model.....	26
Areas of Improvement	29
Stability.....	29
Predictability	30
Allocable Costs.....	30
Process	31
Communication	31
Indirect Cost Model.....	32
Recommendations	33
1. Combat Instability in Annual Charges	33
2. Simplify Cost Centers	34
3. Streamline Annual Process	35
4. Remodel Stakeholder Involvement Process	36
5. Enhance Communication.....	36
6. Establish Formal Policies.....	37
7. Scrutinize Interagency Agreement Pricing Structures	38
8. Other Recommendations and Commentary	39
Conclusions	43
Response to Project Goals	43
Conclusion	44
Checklist of Recommendations	45
Appendices	
Narrative of Responses to Benchmarking Survey.....	Appendix A
Presentation Packet of Summary Findings, October 2004.....	Appendix B

INTRODUCTION

The purpose of this chapter is to describe the origination, primary goals, and scope of work for the Overhead Model Review; discuss the qualifications of the Project Team to provide an expert technical review; and define terminology used throughout this final report. This chapter also provides perspective on the basic principles of overhead cost allocation, as applied by the Project Team in performing this review.

Study Objectives

Origination

In August 2004, the City of Portland (City), Office of Management and Finance (OMF), issued a Request for Proposals (RFP) for qualified firms to provide a technical review of the City's overhead models. These models include the City's federally approved indirect cost allocation plan and the General Fund overhead model. The City selected FCS Group, Incorporated (FCSG) to conduct this review and to deliver preliminary findings for this work by the end of October 2004.

From our discussions with City staff, we learned that the desire for an external review of the City's cost allocation methods stems from several perspectives. First, OMF acknowledges that the existing models have evolved over time and have not undergone extensive review for their achievement of "clarity, equity, stability, consistency, and simplicity," as stated by the RFP. The last known review and framing of the overhead models took place 15 years ago, in 1989.

Secondly, the City's operating bureaus, which pay these charges, have communicated concern over several specific aspects of the overhead models, including the types of costs included as overhead and the measures by which they are allocated. Fundamentally, these bureaus are also concerned about the stability of the charges over time.

While OMF initiated this study as a part of its budget goals, there are stakeholders in the process Citywide, and this study sought to incorporate feedback from multiple perspectives and consider the impacts of our recommendations on those concerned parties.

Project Goals

OMF – specifically, Financial Planning in the Bureau of Financial Services – is currently responsible for managing the overhead models. The preliminary findings of this technical review of those models was required to be complete by October 25, 2004, to allow City staff members the ability to consider and integrate the findings and recommendations into the next update of the overhead models. The next update should start in December 2004 for the 2005/2006 fiscal year, which begins on July 1, 2005.

As identified by the City, the primary goals and desired outcomes of this review were to identify recommendations for improvements to the overhead models that:

- Reflect best practices of methods used by comparable cities;
- Enhance equity and stability experienced by City operating bureaus which pay these charges and City service bureaus which depend on the revenue from these charges; and
- Allow flexibility in adapting to evolving policies and procedures directed by the City Council and the bureaus.

The City's RFP identified specific questions that needed to be answered during this review:

- Are there revisions that can be made which would simplify the overhead models, improving comprehension, equity, and stability?
- Which overhead services should be funded through cost allocation and which should be handled through interagency agreements and direct billing? Is there decision-making criteria that exists or can be developed for future management of this issue?
- Who should be responsible for managing overhead cost allocation, including development of the models, acquisition of information needed to maintain the models, facilitation of communication with City stakeholders, and recommendation of final charges?
- How should large, one-time expenditures be processed through the overhead models?
- Are the allocation measures currently used appropriate, are there others that would better achieve the stated goals of cost allocation, and are the current sources of this data sufficient?

Representatives from the City's operating bureaus, whose budgets are subject to these overhead charges, communicated the following concerns:

- The stability of annual charges, both in the budget and the true-up adjustments;
- The appropriateness of costs included as allocable overhead; and
- The appropriateness of existing allocation methods used to distribute cost burden.

Based on our prior experience in developing and reviewing cost allocation plans, FCSG set the following questions and goals for our technical review, the answers to which helped frame our conclusions and recommendations:

- Are the costs allocated through the City's overhead models real and current?

- Do the costs represent services provided as a part of operating the “business” of government at the City?
- Are the allocation measures used to distribute those costs real and current?
- Do those allocation measures reasonably link to the level of service and/or benefit received, or at a minimum, represent a mutually acceptable means for apportioning cost recovery?
- Are the results of the plan explainable to internal City stakeholders, bureau directors, and their constituents?
- Is the City’s process feasible to complete thoroughly on a regular basis and acceptable to the planning needs of those most impacted by its results?
- Do the overhead models provide sufficient cost recovery of allowable overhead costs through federal program reimbursement, compliant with OMB Circular A-87 guidelines?

Scope of Work

OMF maintains two cost allocation models: a General Fund Overhead Model and an Indirect Cost Model. In addition to allocating overhead costs, the City also imposes direct charges, which stem from interagency agreements. These three mechanisms represent the primary forms of overhead cost recovery.

The General Fund Overhead Model (referred to as the “overhead model”) allocates City-wide service costs, which are not covered under an interagency agreement, to operating programs. Interagency agreements govern the level of service and, subsequently, the internal charges imposed directly on an operating program from a service program. The Indirect Cost Model calculates, through cost allocation, the allowed rate of overhead that can be charged to and reimbursed from federally-funded programs (e.g., grant-funded programs) or other programs requiring a compliant plan, subject to the constraints of each individual application.

In our scope of work for this review, FCSG committed to the following tasks for reviewing the City’s cost allocation and recovery practices:

- *Data collection:* The Project Team met with City staff and stakeholders to gather information and obtain a general understanding of the requirements, annual process, and impacts of overhead cost allocation. FCSG met with individuals from the service bureaus who are tasked with gathering information that drives the models, those who are responsible for updating the calculations, those who depend on the income from overhead charges, and those who oversee the annual process, including advisory committee members. The Project Team also met with directors and finance managers

from the operating bureaus who pay overhead charges, in order to understand the policy-level perspective of those who must plan around and pass-through the results of the overhead charges to their own customers, in the form of rates and fees.

- *Technical review:* FCSG conducted a review of the cost allocation models, examining the computations, validating consistency between cited costs and measures and source documents, and identifying any areas for improvement or necessary corrections. Based on this technical review, examination of documentation, and discussions with City stakeholders, the Project Team identified core issues that should be addressed, and we crafted a series of recommendations to achieve the objectives originally identified by the City.
- *Benchmarking:* Based on key issues identified by City staff, in addition to our own observations, the Project Team developed a list of topics for inquiry to comparable cities selected by Portland. FCSG then made contact with the appropriate representatives of these agencies and documented survey findings.
- *Presentation:* FCSG developed a summary-level presentation packet describing our overall observations and recommendations and presented those materials to representatives from OMF and internal stakeholders, including the City's Overhead Committee. (That presentation packet is included as Appendix B to this report.)
- *Documentation:* Finally, the Project Team prepared this report documenting the complete findings and recommendations of the review. The purpose of this report is to provide a reference for City staff who are tasked with implementing revisions to the overhead allocation process.

For this project, FCSG conducted a detailed review of the City's overhead and indirect cost models and practices. While we examined the types of services which depend on interagency agreements for cost recovery, we did not conduct a detailed review of those independent rate calculations, cost allocations, and/or direct-billing arrangements. Furthermore, this project did not include a performance audit or efficiency review, which would study and question the relationship between levels of service provided and costs incurred. In other words, the "size" of overhead cost pools was not evaluated within the charter of this project.

Qualifications of the Reviewer

Since 1988, FCSG has been serving Western United States clients in the public sector across three substantive consulting areas: general government resource management (including indirect cost allocation), utility rate and financial analysis, and management studies. Many of the underlying principles of our approach to indirect cost allocation stem from the experience of our 20-member staff across these fields of study, providing fee and

funding consulting services for most municipal activities. Through our work with over 250 public sector clients in over 1,100 projects, we understand the general government perspective (the need and justification for recovering service costs), but we also have direct experience with the application of overhead costs through rates and fees in operating areas, such as utilities and development review.

The members of our Project Team are active leaders in the area of indirect cost consulting services, called upon by professional associations such as the Washington Finance Officers Association and the Oregon Municipal Finance Officers Association to teach classes on overhead allocation and recovery.

In the past five years, FCSG has performed technical reviews and/or developed indirect cost allocation plans for the following agencies with similar issues and needs as Portland:

- Clackamas County, Oregon
- City of Seattle, Washington
- City of Coeur d'Alene, Idaho
- City of Canby, Oregon
- City of Othello, Washington
- City of Shelton, Washington
- City of Richland, Washington
- Columbia County, Oregon
- City of Puyallup, Washington
- City of Forest Grove, Oregon
- City of Redmond, Washington
- City of Kirkland, Washington
- City of Brisbane, California
- City of Mercer Island, Washington

Definitions

The following terms are used throughout this report:

- *Overhead and General Overhead:* Central support service and general government costs, typically found in the General Fund, which are allocated through the City's General Fund Overhead Model. Examples of these costs include accounting, legal, financial planning, and the City Council.
- *Indirect Cost:* Allowable central support service costs which are identified in the City's federally-compliant Indirect Cost Model, which follows the guidelines of OMB Circular A-87. With required exceptions, such as the City Council, these costs stem from the same functions as the General Fund Overhead Model.
- *Direct Charge:* A cost that is assessed directly to a bureau, typically through an interagency agreement. These support costs, which may or may not originate from bureaus also included in the General Fund Overhead Model, are excluded from the general cost allocations. A short list of example areas which are directly charged in whole or in part includes human resources, legal, and purchasing.

- *Program Area:* A specific area of activity or function within a bureau or division. As an example, Accounting (itself a division of OMF), has several program areas, including payroll, accounts payable, etc.
- *Support Service or Overhead Bureau/Program Area:* A department providing central support services or general governmental functions. Examples overhead bureaus include the City Auditor, the City Attorney, OMF Accounting, etc.
- *Operating Bureau/Program Area:* A department providing service directly to the public or other distinct customer base and which is supported by central services, regardless of whether or not they are assessed overhead charges. (This includes internal service funds, which are charged for overhead services.) Examples of operating bureaus include Police, Environmental Services, Water, Transportation, Fleet, etc.
- *Paying Bureau:* An operating department which is assessed a charge for overhead services based on the cost allocation models.

Basic Principles of Cost Allocation

Overhead cost allocation plans must balance two sometimes competing viewpoints. With respect to cost recovery, the basic perspective of a city's General Fund is that:

- Central services are provided and funded with general city resources (e.g., taxes) that directly support the delivery of the city's primary public service functions.
- General city resources should not subsidize activities which serve distinct customers and have alternative cost recovery mechanisms available (e.g., fee revenues), unless city policy explicitly authorizes subsidy.
- Compensation should be made to the General Fund for those overhead or support services provided to city enterprise funds or other operating functions with dedicated, controllable revenue sources.

On the other hand, the perspective of a city's enterprise funds (e.g., utilities) and other payers of overhead costs (e.g., internal service funds and other operating funds) is that:

- User fees and rates should be based on actual costs incurred to provide services, and in some cases, those fees and rates are legally or contractually obligated to that standard.
- In some cases, rates and charges must remain competitive or at least consistent with comparable practices; therefore, sensitivity to costs, especially overhead, is even greater.

- The ability to plan for and manage department costs on a long-term basis is necessary for strategic rate setting, especially in those functions with substantial capital investment programs.

When working with overhead charges, it is important to establish the appropriate expectations for the outcome. Chiefly, and by definition, cost allocation is an estimate, and the results of an overhead allocation plan can be debatable because of that. If costs could be directly charged accurately and efficiently, cost allocation plans would not be as common as they are currently among municipalities. However, most central support services are difficult to “price”. Unit costs for incremental service are problematic to quantify, and even if a unit cost could be calculated, administering the pricing structure would be cumbersome, if not prohibitively costly. So long as involved parties can agree on the rationale for and limitations of cost allocation, it is more effective to presume that there is overall benefit in having central support services and then determine a reasonable way to apportion the cost burden for that general benefit citywide.

In prior decades, cost allocation plans emerged as very simple calculations: Overhead costs for a city were totaled and either distributed using a single allocation factor or expressed as a rate (e.g., percent of salary/wage costs), both of which achieve the same effect through a simple process. However, with the evolution of technology and the growing sophistication of stakeholders, both internal and external to the organization, cost allocation became more complex – specifically to enhance achieved or perceived equity in overhead charges. Multiple overhead cost centers to which different allocation factors are assigned has become the industry standard.

Despite this trend toward increased detail in cost allocation, adding complexity should be considered carefully. Too much detail could complicate regular updates, and for the added maintenance burden, may not yield the benefit desired, in terms of the level of accuracy achieved. In the end, so long as costs are allocated, there will always be room for debate.

Finally, we have found that the current climate in government calls for a diligent process of involvement and communication with cost allocation stakeholders. This can be best accomplished through a formal committee of affected departments or a commitment to a series of regular meetings during annual allocation updates. Any forum for stakeholder involvement should include balanced representation from service providers and beneficiaries. The purpose of formal communication channels is to foster ongoing and open discussion targeting a consistent understanding of allocation methods, cost recovery objectives, and service levels. Establishing expectations in cost allocation, or revisiting city-specific policies or objectives in cost recovery, are important regular components of any communication process.

This page is intentionally left blank.

EXISTING PRACTICES

The purpose of this chapter is to summarize the City's existing practices related to overhead allocation and cost recovery, specifically, the analytical tools used to calculate overhead charges, the program areas affected, data sources, implementation, and communication.

The City maintains two central analytical models, which are used to allocate and calculate overhead charges and indirect cost rates, described below. These models define the level of cost recovery for central support services provided by bureaus in the General Fund. The City also recovers support service costs through interagency agreements, which have not been examined in depth in this study, except as they interact with the City's general overhead allocations.

The City's existing cost allocation practices have been in place for at least 15 years, with technical modifications made periodically throughout that time. The last substantive review of cost allocation practices were documented in the *General Fund Overhead Committee Report* issued August 7, 1989. That study evaluated the mechanics of overhead calculations, modified specific allocation factors, questioned specific cost centers, and recommended procedures targeting improved equity in allocation.

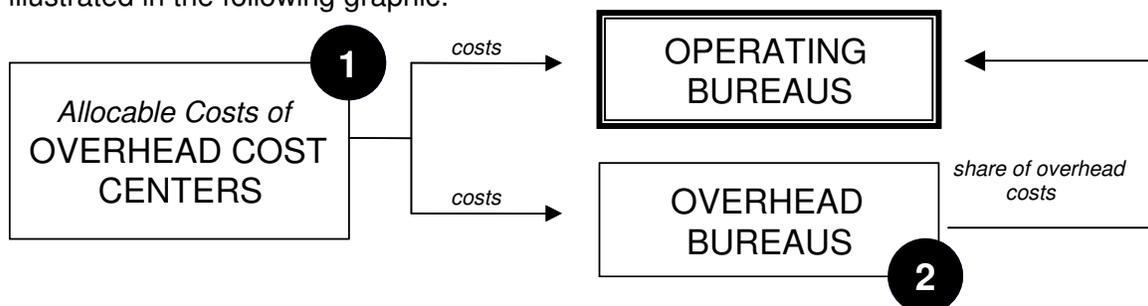
(Please note that this report, as a default, refers primarily to the General Fund Overhead Model, as it is one of the City's primary means of cost recovery for the General Fund and is of greatest interest to internal stakeholders. Most of our commentary and recommendations are targeted at the General Fund Overhead Model and associated practices, although specific descriptions and observations on the Indirect Cost Model are included, as warranted.)

General Fund Overhead Model

Analytical Methods

The City's General Fund Overhead Model is contained in one spreadsheet based analysis. Calculations to derive allocation factors from data sets are maintained in a separate workbook. Summaries and related analyses are developed in separate spreadsheets.

The analysis follows what is referred to in the industry as a "two-step" allocation method, illustrated in the following graphic:



In the first step of this method, all overhead costs are allocated to all bureaus, both operating and overhead. This recognizes that overhead bureaus receive central support service costs, too. (For example, Payroll provides paychecks to staff in the City Attorney's Office.) In the second step of this method, cost allocated to overhead bureaus in the first step, are distributed to operating bureaus. (For example, the City Attorney's share of central support services is allocated to operating bureaus.)

The purpose of this two-step method is to recognize the sometimes disproportionate support service that can be provided within overhead bureaus. For example, the City Auditor's Office may use a relatively high level of service from an Accounting program. Through a two-step method, operating bureaus which use a higher level of the City Auditor's Office will also receive that Office's costs from Accounting to the same degree. This method can provide a more complete portrayal and equitable distribution of cost.

Bureaus and Program Areas Allocated

In its current General Fund Overhead Model, the City distributes 21 cost centers through 27 discrete allocations. The costs for each allocated program area are readily accessible by querying in the City's financial/budgeting system; no separate analyses are conducted to identify functional components of bureaus.

Of \$22.1 million in overhead costs identified for Fiscal Year 2004/2005, the adopted budget targets recovery of \$13.3 million from non-General Fund bureaus and funds, or 59.96% of the total. Exhibit A on page 13 shows the allocated cost centers for Fiscal Year 2004/2005 and their percentage of total overhead costs. With 11 distinct program areas, OMF represents the largest umbrella of allocated overhead costs, at over 50% of the total. The City Council represents the second largest share of costs at 17% of the total.

Operating Bureaus and Funds Supported

The General Fund Overhead Model distributes overhead costs Citywide and considers assessment of overhead charges to 49 of 88 separately accounted for bureaus and funds. Of those 49 bureaus and funds, 12 reimburse the General Fund for nearly 54% of identified central support services costs. Transportation, Environmental Services, and Water represent the three largest contributors of overhead cost recovery to the General Fund in Fiscal Year 2004/2005. A complete listing of these operating bureaus and funds which are assessed overhead charges, including their share of allocated overhead costs, is shown in Exhibit B on page 14.

It is important to note that the overhead model allocates costs completely, Citywide. Even though the City does not charge certain bureaus for allocated overhead – specifically those budgeted in the General Fund – its analytical method calculates an equitable share of support costs for those programs. In fact, while they are not charged directly, the City

shows those bureaus' share of overhead in its budget document, in order to portray the full cost service. In practice, though, no transaction takes place.

Allocation Measures Used

The General Fund Overhead Model uses 17 different allocation factors for 27 separate allocations of overhead program areas. These allocation methods are summarized in Exhibit C on page 15.

The City uses a diverse blend of data sets for distributing costs, including factors traditionally employed throughout the industry, such as number of employees or full-time-equivalents (FTEs), budgeted expenditures, and staff hours (both tracked and estimated). However, the City has also tapped volumetric data recorded by other City systems, as a means of applying more transaction- or usage-based metrics as cost allocation methods. This is a practice many cities aspire to, and one that Portland has implemented extensively, using data such as the number of transactions in the General Ledger, the number of journal entries, and the number of telephone calls, to name just a few.

All of the data sets used as allocation factors are readily available and are updated on a regular basis in the overhead model. OMF Financial Planning is able to generate reports from City systems displaying each department's share of a particular measure, or is able to receive data sets which are created by staff in bureaus, such as the City Attorney's Office (estimated staff time) and Purchasing (a functional analysis using multiple metrics). In some cases, such as the use of budgeted expenditures as an allocation factor, OMF staff follows a series of steps to adjust the data set, in accordance with strategies set with the Overhead Committee which are intended to achieve higher degrees of equity. In this particular case, budgeted expenditures are adjusted to reduce the share of capital- or debt-only funds, which might not received a level of support service commensurate with their level of expenditure.

Cost Data Used

Charges are set each fiscal year according to spending "targets" as established by the City Economist during the annual budget process. Overhead charges are typically based on 99% of these expenditure targets. Targets are issued throughout the budget process and finalized in April prior to the start of the next fiscal year.

Targeted costs are off-set by estimated internal revenues, to identify an allocable overhead cost pool for each program area. Internal revenues include those resources received through the separate interagency agreement process. This step avoids doubly allocating overhead costs for support service bureaus which recover costs through both the general allocation and direct, agreement-based charges. Essentially, only those costs which are not recovered through interagency agreements are allocated as general overhead.

Because the City sets and imposes general overhead charges based on budgeted costs, it uses an annual true-up process to adjust for actual incurred costs and activity levels. This true-up adjustment results in either a charge or a rebate to each individual operating bureau or fund, depending on whether the budgeted costs were under- or over-realized. The true-up charge or rebate is imposed on the operating bureaus at the time it is calculated.

Annual Implementation Process

OMF is charged with the responsibility for managing and maintaining the overhead allocation process. The Financial Planning division is responsible for the preparation of the overhead models, collection and validation of data sets, and communication with internal City stakeholders. OMF estimates that the Financial Planning staff member currently assigned the bulk of the analytical effort for overhead allocation may spend up to 20% of his annual time on this project.

The City uses an advisory body to support OMF in its development of overhead allocations. This group is referred to as the Overhead Committee, and is comprised of financial analysts from those operating bureaus who reimburse the General Fund for overhead costs allocated to them through this process. The Overhead Committee, in place since 1989, has been a long-standing component of the City's cost allocation process, and it has served historically as a "steering" body. This means that the feedback and consensus-based direction derived through Committee meetings has highly influenced, if not at times directed, the evolution of cost allocation. The Overhead Committee, its interaction with OMF financial analysts, and their individual reports to management in their own bureaus, has served as the primary venue of dialogue on General Fund cost allocation at the City.

A complete cycle of the annual overhead allocation process is listed below:

- *August through September:* OMF collects data sets which will be used as allocation factors in the overhead model.
- *December through March:* In support of the City annual budget process, OMF develops at least two iterations of the overhead model, following the development of City budget "targets." The results of each iteration are distributed to affected City bureaus. Meetings are held with the Overhead Committee to review, discuss, and modify analytical results.
- *April:* OMF develops the final iteration of the overhead model, calculating the charges to be incorporated into the budget to be effective July 1st.
- *July:* Operating bureaus begin to be assessed for their allocated overhead, based on the adopted budget.
- *August through September:* OMF runs a version of the overhead model, using actual cost and allocation factors from the prior completed fiscal year, to calculate the true-up

adjustment required. True-up charges and credits are issued to operating bureaus upon completion.

EXHIBIT A
Allocated Overhead Bureaus & Program Areas, Fiscal Year 2004/2005
(Including Percent of Allocated Overhead Costs)

Service Bureaus	Allocated Program Areas	% of Total
Office of the City Attorney	Total Bureau	8.9%
Office of the City Auditor	Auditor	5.1%
	Audit Services	4.5%
	Records Management	1.6%
	Direct Allocations	5.1%
	Subtotal: Office of the City Auditor	16.4%
City Council	Total Bureau	17.0%
Office of Management and Finance	Purchasing	15.6%
	Financial Services Administration	6.2%
	Financial Planning	6.5%
	Grants	0.9%
	Accounting Administration/Technical Accounting	8.7%
	Accounts Receivable	0.0%
	Accounting Customer Relations	0.5%
	Accounting Quality Assurance	2.7%
	Accounts Payable	4.1%
	Payroll	4.8%
	Accounting Processing	0.0%
	Subtotal: Office of Management and Finance	50.1%
Bureau of Planning	Comprehensive Planning/Governmental Coordination	1.0%
Office of Neighborhood Involvement	Information & Referral	0.8%
Office of Emergency Management	Total Bureau	5.0%
Special Appropriations	City Council	0.9%
Grand Total: All Service Bureaus Allocated		100.0%

EXHIBIT B
Operating Bureaus & Funds Allocated Overhead, Fiscal Year 2004/2005
(Including Percent of Allocated Overhead Costs Received)

Operating Bureaus	% of Total
various General Fund & Other Non-Paying Funds*	40.04%
112 Transportation Operating	12.15%
151 Environmental Services Operating	11.24%
153 Water Bureau Operating	7.81%
704 Facilities Services	5.01%
116 Planning and Development Fund (OPDR)	4.16%
705 Fleet Services Operating	3.93%
707 Communications Services Operating	2.01%
711 Information Technology Fund (BIT)	1.90%
706 Printing/Distribution Services	1.63%
115 Emergency Communication (BOEC)	1.62%
252 PDC	1.24%
701 Health Insurance	1.20%
709 Workers' Compensation	0.96%
708 Insurance & Claims	0.90%
157 Solid Waste Management	0.76%
154 Golf Operations	0.59%
505 Parks Construction Fund	0.55%
159 Parking Facilities Operating	0.49%
651 Fire & Police Disability & Retirement (FPD&R)	0.46%
501 Fire Bureau Facilities GO Bond Construction	0.42%
152 Hydro	0.26%
502 LID Construction	0.26%
156 PIR Operating	0.13%
160 Spectator Facilities Operating	0.13%
120 Mt. Hood Cable Regulatory Commission	0.06%
118 Public Safety Capital	0.05%
201 Convention & Tourism	0.03%
161 Environmental Remediation	0.02%
various All Other Paying Bureaus/Funds	0.00%
Grand Total: All Operating Bureaus	100.00%

* These bureaus and funds are not assessed overhead charges; the remaining bureaus and funds on this list are charged based on the results of the model.

EXHIBIT C
Allocation Factors by Program Area, Fiscal Year 2004/2005

Service Bureaus	Allocated Program Areas	Allocation Factor
Office of the City Attorney	Total Bureau	Estimated Staff Time, Expressed as FTEs
Office of the City Auditor	Auditor	Number of Council Items
	50% of Audit Services	Work Hours by Fund/Bureau
	50% of Audit Services	Number of Employees on Payroll
	Records Management	Cost per Unit of Work
City Council	Direct Allocations	Specific/Assigned Allocation
	37% of Total Bureau	Number of Council Items
	20% of Total Bureau	Number of Employees on Payroll
	20% of Total Bureau	Adjusted Budget
Office of Management and Finance	23% of Total Bureau	Equal Shares
	Purchasing	Derived Allocation by Function & Volume/Activity
	Financial Services Administration	Adjusted Budget
	Financial Planning	Adjusted Budget
	Grants	Grants Transactions
	Accounting Administration/Technical Accounting	Number of Transactions in GL Module
	Accounts Receivable	Number of Invoices Issued
	Accounting Customer Relations	Number of Employees on Payroll
	50% of Accounting Quality Assurance	Number of Vendor Invoices Paid
	50% of Accounting Quality Assurance	Number of Transactions in AP Module
	50% of Accounts Payable	Number of Vendor Invoices Paid
	50% of Accounts Payable	Number of Transactions in AP Module
Payroll	Number of Employees on Payroll	
Accounting Processing	Number of Journal Entries	
Bureau of Planning	Comprehensive Planning/Governmental Coordination	Adjusted Budget
Office of Neighborhood Involvement	Information & Referral	Number of Telephone Calls
Office of Emergency Management	Total Bureau	Adjusted Budget
Special Appropriations	City Council	As City Council

Indirect Cost Model

The City of Portland currently maintains an indirect cost plan compliant with the federal Office of Management and Budget Circular A-87 (OMB A-87). While the City's Overhead Model plays a key role in the budgeting process and affects the actual amounts allocated to operating bureaus, the A-87 plan is used specifically for the purpose of establishing overhead rates that can be used to gain reimbursement of costs from federally funded programs (i.e., grants) and other programs that require the use of an A-87 method. While the formal federal approval process is often not performed, an A-87 compliant indirect cost plan must be prepared and available prior to applying for cost reimbursement of indirect services by a federal award.

On an annual basis, staff in OMF – traditionally grants specialists – develop the formal documentation encompassing the A-87 plan. The City's plan includes an introduction of the Indirect Cost Rate Proposal, methodology used in the plan, and Schedules A through N as defined and required by the Circular. While the results are not applied as widely as the City's General Fund Overhead Model, the documentation developed for this Indirect Cost Plan is far more extensive. That said, the costs and allocation factors used in the Indirect Cost Plan are nearly identical to the City's General Fund Overhead Model, deviating only as required by the A-87 guidelines.

Indirect Cost Methodology

The City has classified each of its departments or bureaus as direct or indirect based on their function and allowability per Circular A-87. Indirect cost centers identified in the plan provide support services to other areas of the City. However, certain indirect cost centers are charged directly to the departments that use their services as opposed to being allocated as overhead as are the remaining indirect cost centers. Direct cost centers are defined as those which provide a service directly to the public.

Indirect costs refer to the cost of providing the basic service of government, or overhead costs required to support the departments that provide direct services to the agency's constituents. OMB A-87 requires that the costs included as overhead be reasonable and “[do] not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost” (Section C.2).

The City uses two primary methods to distribute its indirect, or overhead costs: directly charging departments for services provided and indirect cost allocation. The directly billed departments in the plan perform an internal service function and therefore lend themselves to this method of allocation. The following indirect cost centers are directly billed: Bureau of General Services, Printing/Distribution, Communication Services, Fleet Services, Facilities Services, Bureau of Technology Services, Bureau of Risk Management, Insurance and Claims, and Workers' Compensation. Clearly identifying these internal direct charges is an

important step in the A-87 process, demonstrating that overhead costs are not double-counted.

Outside of these directly billed functions, the City allocates certain indirect cost centers as overhead, according to A-87 guidelines. The allocated indirect cost centers are not internal service funds (like their directly-billed counterparts), but simply other departments within the General Fund that perform overhead functions. Circular A-87 describes indirect costs as those which are “(a) incurred for a common or joint purpose benefiting more than one cost objective, and (b) not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved” (Section F.1).

Within each overhead bureau, there are often several program areas, which increase the equity with which indirect bureaus performing multiple functions can be allocated. In the A-87 plan, the City has applied the same program area distinctions and cost allocation factors that have been derived with the Overhead Committee and applied in the General Fund Overhead Model.

The direct cost centers are those recipients of the costs allocated from both directly billed and indirectly allocated overhead bureaus. Due to the guidelines set by Circular A-87, certain cost centers considered to be “direct” in this plan differ from the operating bureaus in the General Fund Overhead Model. For example, the federal guidelines stipulate that legislative costs may not be considered indirect costs and distributed as overhead, while in the General Fund Overhead Model, the costs of the City Council are indeed recovered as central support costs. (This is one of the primary reasons for maintaining two separate overhead allocation plans: to ensure that internal cost recovery, which is not bound by specific external regulation, is optimized.)

The direct cost centers, or operating bureaus, used by the City in its A-87 compliant indirect cost plan are as follows: Bureau of Police, Bureau of Fire, Bureau of Parks, Bureau of Environmental Services, Office of Transportation, Bureau of Water Works, City Council, Office of Cable and Franchise Management, Bureau of Licenses, Office of Neighborhood Involvement, Bureau of Planning, Bureau of Development Services, Bureau of Housing and Community Development, Portland International Raceway, Golf Operations, Bureau of Emergency Communication, Bureau of Hydroelectric Power, and the Office of Sustainable Development. In the indirect cost plan, all of these bureaus receive a portion of the Citywide indirect cost allocation, for purposes of setting overhead rates by bureau, as prescribed in the Circular.

An overhead rate is used to charge indirect costs within a governmental unit to federal awards or other programs requiring this process. The rate is used to distribute a proportionate amount of indirect costs, and the City has elected to base its rate on the total amount of direct costs in any given bureau. Unlike in the City’s General Fund Overhead

Model, large or one-time expenses, such as capital projects, must be excluded. For setting an overhead rate, Section B.4 of Attachment E to OMB Circular A-87 defines the basis of that rate as *‘the accumulated direct costs (normally either total direct salaries and wages or total direct costs exclusive to any extraordinary or distorting expenditures) used to distribute indirect costs to individual Federal awards. The direct cost based selected should result in each award bearing a fair share of the indirect costs in reasonable relation to the benefits received from the costs.’*

The City’s calculated A-87 indirect cost rates differ by bureau and, in some cases, there are multiple rates applied within a bureau; it is not a uniform Citywide indirect cost rate. Because of the different service delivery methods and funding sources for each department or bureau, the City determined that using a multiple allocation base methodology would be more appropriate than using a simplified methodology to calculate the City’s indirect cost rates. According to the City’s Indirect Cost Rate Proposal, net direct costs *“include allowable personnel costs (inclusive of fringe benefits) and costs of materials and services (both internal and external)”* net of one-time capital costs.

Finally, the City also computes a carry-forward adjustment for its A-87 plan. Because costs processed in the Indirect Cost Model are based on the current year budget, federal guidelines require a true-up process and subsequently, with the results of that true-up be applied in the next year’s computed rates.

Application of Indirect Cost Rates

As is the case with many municipalities in today’s governmental operational climate, the City is somewhat limited in how it can apply the results of its A-87 compliant indirect cost plan. Chiefly, in order to recover overhead costs from grant-funded programs, those costs must be included in the original application for the award. Secondly, due to resource constraints at all levels of government, many grant programs have begun capping indirect cost recovery at pre-determined levels, most often far less than the municipality’s calculated overhead rate. Recovering overhead costs has often become a negotiation rather than a demonstration of cost; the calculated overhead rate then becomes the maximum a city can hope to recover. In many cases, municipalities simply use precious grant monies to fund as much of their programmatic costs as possible, leaving these Citywide indirect costs to be absorbed from non-grant resources.

It is difficult to quantify the level of indirect costs actually recovered by the City through funding programs requiring an A-87 approach. That said, the resulting overhead rates are indeed applied by several operating bureaus, Transportation being one of the primary users of the results. In order to effectively apply its overhead rate, Transportation develops its own internal analyses to derive variations of the rate that fit the needs of its unique applications.

This page is intentionally left blank.

COMPARABLE PRACTICES

The purpose of this chapter is to describe the results of a benchmarking survey, conducted by FCSG, to determine specific practices related to overhead cost allocation as performed by cities considered peers by Portland.

Scope of Benchmarking Survey

Objective

The intent of the benchmarking survey is to determine the “best practices” of the overhead cost allocation and recovery methods used by other cities. While cost allocation methods are often unique to each individual agency, it is relevant to examine the practices of others to gauge whether or not Portland’s approach is within the bounds of other cities.

Benchmarking can also provide ideas for resolving areas in question, when applying the experience of another city often carries weight with disagreeing parties.

FCSG has developed an assessment of the City’s overhead allocation methods from a perspective balancing industry standards, common sense, legal and/or institutional requirements where applicable (e.g., federal reimbursement using A-87 rules), and our professional experience with other communities in the Pacific Northwest. It is our belief that benchmarking to peer cities is a valuable part of examining one’s practices. However, it is important to remember that the City of Portland is a unique organization, and any changes desired which are inspired by the practices of another city should first be considered for their applicability, practicality, and consistency with Portland’s own organization and objectives.

Cities

The following cities were selected by OMF, with concurrence from City stakeholders, as agencies to which overhead allocation methodologies were compared:

- Austin, Texas
- Cincinnati, Ohio
- Charlotte, North Carolina
- Denver, Colorado
- Kansas City, Missouri
- Phoenix, Arizona
- Sacramento, California
- Seattle, Washington

These cities were selected due to their comparable size (population) to Portland. Several of these cities were included as comparative entities in the City of Portland’s recent *Service Efforts and Accomplishments* reports. Unfortunately, during the timeframe for this study, we

were only able to acquire responses from five of the eight targeted cities: Austin, Cincinnati, Charlotte, Denver, and Seattle.¹

Key Areas of Inquiry

Based on City staff input and our own needs in compiling comparative information, FCSG developed the following list of questions for each city regarding overhead cost allocation:

1. Which service costs are processed through an allocation of overhead, and which are charged directly through internal service arrangements?
2. What are the types of allocation measures used? How many are used? Are they updated periodically?
3. Is a true-up process used? Or is overhead allocated based on actual figures with a lag period? If a true-up or adjustment process is used, how many adjustments are allowed?
4. How does the update of overhead allocations fit in with the budget process?
5. Who is responsible for the overhead allocation computation and process?
6. Are indirect costs charged to grants?
7. How is the General Fund's share of overhead shown and/or treated in the budget?
8. How involved are internal stakeholders in the development of overhead charges? Is a formal committee used? If so, it is advisory or steering in nature, and what is the make-up of the committee (operating departments only or both operating and service) and the individual participants (analysts/technical versus managers/policy)?
9. If a federal indirect cost plan is used, on what is the resulting overhead rate based (e.g., a percent of direct program costs? a percent of salaries? something else)?
10. How stable are resulting charges? What, if anything, is used to combat or cope with any instability of annual allocations?
11. Is anything done to deal with actual or perceived duplication of support services? For example, if an operating department relies on its own purchasing function, how does that relate back to allocated costs from a centralized purchasing department?
12. If estimated time (as opposed to tracked time) is used anywhere as an allocation factor, do any credibility or equity problems arise?

¹ *Austin*: Joseph Gonzalez, Controller's Office, (512) 974-3338; *Cincinnati*: Linda Weigand, Finance Department, (513) 352-6144; *Charlotte*: Mike Nail, Budget Office, and Lee Madden, Treasurer, (704) 336-5013; *Denver*: Tom Migaki, Budget & Management Office, (720) 913-5500; and *Seattle*: Carolyn Iblings, Finance Department, (206) 684-5211.

13. Are any formal policies or criteria in place that guide what can and cannot be included and allocated as general overhead? If policies are in place, who sets them (e.g., City Attorney's office, City Council, departments)?
14. Are "general government" costs included in the allocation of overhead (e.g., City Council, emergency management, campaign finance reform, etc.)?
15. How does the City manage the issue of the "size" of the allocated cost pools? In other words, do departments who pay overhead charges have the ability to scrutinize the costs of and levels of service provided by overhead departments?

Survey Responses

Highlights

We have included the detailed responses to the areas of inquiry described above as Appendix A of this report. Those comments can be compared directly with Portland's existing practices, documented in the prior chapter, as well as the observations and recommendations identified by the Project Team in later chapters of this report.

While the participating cities responded with differing levels of candidness, we can summarize the following highlights, relevant to our ultimate recommendations for Portland:

- Four of the five responding cities (Austin, Charlotte, Cincinnati, and Denver) impose overhead charges on a lagged basis, using actual costs and usage data from a prior period to establish future charges. Similar to Portland, Seattle, imposes overhead charges based on its biennial budget, conducting a true-up adjustment once every two years. However, Seattle applies its true-up by carrying forward any surcharge or rebate to the following year's overhead charge.
- Four of the five cities (Austin, Cincinnati, Denver, and Seattle) do not use formal advisory or steering committees, but will convene meetings if specific issues are raised. In addition, Seattle will also send out, to affected departments, documentation describing charges and services. Only Charlotte, like Portland, uses a steering committee of financial analysts, but its committee meets only once yearly and has experienced very little discussion activity.
- None of the cities described issues with the stability of their overhead charges on the magnitude that Portland has experienced. In most of the comparable cities, the allocation factors are what we consider traditionally stable factors, and the cities sometimes chose those factors specifically to prevent instability or complication in the process.

- Three of the five cities (Austin, Charlotte, and Denver) have experienced, as of yet unresolved, problems of perceived duplication and payment of services, such as Purchasing, due to the concurrent use of overhead allocations and direct charges or the concurrent use of centralized and decentralized like services.
- All of the cities use estimated staff time as an allocation factor for some cost centers, and they have not experienced any problems or disagreement with this approach.
- Only Seattle has adopted fiscal policies governing cost allocation. Of the five responding cities, Seattle's overhead allocation practices seem most comparable in scale and complexity to Portland; from our discussions with the remaining cities, we suspect their practices are simpler.

POSITIVE ELEMENTS

This chapter describes elements of the City's existing overhead cost allocation practices which we consider to be positive, meaning that they meet any or all of the following objectives:

- Target equity in cost recovery.
- Promote stable financial impacts from year to year.
- Are both consistent with industry practices and/or legal requirements and mutually acceptable to operating and service bureaus.
- Are consistent with or relate to the practices of the City's peer agencies

General Fund Overhead Model

In general, we view favorably the City's overall practices and tools employed for overhead cost allocation. Specifically, we call out the following areas:

- *Technical Review:* Upon reviewing the technical model, supporting spreadsheets, and data files used for the General Fund Overhead Model, we find no material mathematical errors. Cost allocations are complete; although a common pitfall of allocation models, especially ones that manage a large number of cost centers and receivers, we find no over- or under-counting of allocated costs.
- *Consistent Application of Methods:* Furthermore, the technical model operates as defined in available documentation associated with and distributed Citywide in support of the allocation plans. With minor exceptions, the City consistently applies stated cost centers, program area distributions, and allocation factors as published in the technical analyses.
- *Simple Application:* The models have been designed to handle costs and allocation factors simply, which aids not only a regular updating process, but also, auditing. The staff members responsible for directing the annual process follow fairly clear steps and have sustained readily accessible and thorough documentation describing analytical and information needs. This is an achievement, given the number of cost centers and allocation factors maintained in the plan, as well as the multiple iterations and advisory processes undertaken each year.
- *Allocable Costs:* The significant cost centers allocated in the General Fund Overhead Model are indeed central service functions which support the business activities of government. With a few exceptions noted in the next chapter, most of these cost centers match those traditionally defined in overhead allocation plans developed by peer

cities. Furthermore, the overall proportion of overhead costs recovered from paying bureaus – roughly 60% of total – is consistent with our experience with other municipalities. (In other words, the City does not appear to be targeting excessive recovery of General Fund costs from non-General Fund bureaus.)

- *Allocation Factors:* In response to payee concerns, the data sets chosen as allocation factors in the City's General Fund Overhead Model have evolved over time to attempt fair linkage to service levels. That said, as discussed in the next chapter, sometimes aggressive pursuit of equity can lead to other areas of concerns, including stability of annual charges. However, the City has actively responded to equity concerns and its use of a breadth of data sets to augment its cost allocation practices. In our experience with other municipalities, this type of data acquisition and application in overhead allocation is often a work-in-progress, rather than standard practice.
- *Stakeholder Process:* For more than 15 years, the City has used a formal stakeholder process to provide open communication on overhead costs and allocation methods. The City accomplishes this through the facilitation of its Overhead Committee. Going beyond the practices of its peers, the City has managed its cost allocation process with consensus-based collaboration, using the Overhead Committee as a steering body with apparent ownership of the end results. While individual Committee members may desire further or faster changes, such work will eventually take place over time. These Committee members should be proud of the product of their time and effort, and the City as a whole should be satisfied that its General Fund cost recovery is a sound product of cross-discipline teamwork.

Indirect Cost Model

Overall, the City's Indirect Cost Model and documented plan presents no material compliance issues with OMB Circular A-87 guidelines for federal reimbursement. Specifically, we note the following:

- *A-87 Compliance:* The City's Indirect Cost Plan follows the Circular's prescribed sequence for the narrative and the allocation calculations. Indirect and direct cost centers have been appropriately determined and unallowable costs excluded.
- *Thorough Narratives:* The Indirect Cost Plan includes concise yet thorough text that describes both the mission of each department as well as the services that they provide. Descriptions contained in the plan articulate the indirect manner in which listed cost centers serve direct bureaus and provide the appropriate budgetary identification codes to facilitate tracing figures back to the original budget document.
- *Fair and Reasonable Allocation Factors:* Circular A-87 and related documents suggest that agencies can use a wide breadth of allocation factors to distribute costs of overhead

departments: “*Any method of distribution can be used which will produce an equitable distribution of cost* (Implementation Guide for Office of Management and Budget Circular A-87”, Attachment C, 4.6.2).” The City has chosen factors specifically targeting equity and that do not seem to impose an undue burden of data maintenance on the concerned bureaus.

- *Basis of the Overhead Rate:* The City uses total direct costs as the basis for calculating its overhead rate. This method of using total direct costs, net of distorting items like capital expenditures, can produce more stable results than using other factors, such as salaries and wages, as the basis for the rate, depending on the circumstances of the individual program.
- *Orderly Working Papers:* Organized and complete working papers are the foundation of accuracy in any indirect cost plan. Circular A-87 requires that “*documentation used as a basis for claiming costs under the federal awards must be retained for audit* (Attachment C, G.5).” The City maintains Excel spreadsheets and records whose format is uniform for each department and that appear to be refined and updated each year.

This page is intentionally left blank.

AREAS OF IMPROVEMENT

This chapter describes our observations on areas in which the City should consider altering its practices to improve the overhead allocation process and products. These areas of improvement serve as the general basis with which we formed our recommendations, described in the next chapter. Our observations documented in the following sections focus primarily on the General Fund Overhead Model; a specific section discussing the Indirect Cost Model is also included.

Stability

After years of pursuing equity in overhead charges, it is our observation that the City's most pressing objective in revising its overhead practices is to promote stability in annual charges: moderating annual shifts in cost burden between paying bureaus. The example cited most often during the Project Team's discussion with City staff was the nearly \$400,000 true-up charge calculated for and imposed on the Bureau of Facilities Services, linked primarily to a shift in its share of Purchasing costs. This true-up charge represents over 35% of the Bureau's currently budgeted total overhead allocation.

There are substantial swings in some cost centers from year to year, primarily due to allocation factors that are linked heavily to usage. Naturally unstable allocation factors include those associated with volume, transactions, and staff hours. These types of factors are currently used to distribute costs for the City Auditor, Purchasing, and Accounting, several of the most contentious allocated cost centers – debated primarily because of the magnitude of annual shifts as well as the ease with which those factors can be manipulated to avoid overhead charges. (Although not investigated in-depth but discussed anecdotally, perceived manipulation is another side-effect of these types of factors: bureaus individually revise their practices to diminish their share of a particular support service, causing other bureaus to pick up a larger cost burden.)

It should be noted that in the case of Purchasing, some instability is due to what is considered Council-directed discretionary revenues, which is used to off-set allocated costs. While the allocation factors used for Purchasing represent the most talked about area of stakeholder concern, we have reviewed in detail the separate analysis performed by Purchasing to determine its allocation factors and find no material flaw or inconsistency. However, the feedback from stakeholders is valid, and the total costs allocated for Purchasing may be the core problem. From Fiscal Year 2003 to 2004, discretionary revenues off-setting allocable costs increased \$420,000; therefore allocated overhead costs decreased \$215,000. In the following year, discretionary revenue decreased \$298,000, and coupled with inflationary level increases in department costs, allocated overhead costs increased \$560,000. Regardless of allocation methodology, paying bureaus would feel a huge shift in their share.

Predictability

The City's "real-time" approach to calculating and imposing overhead charges leaves little room for paying bureaus to plan for changes in costs and adjust their revenue sources accordingly or manage their reserves as necessary. The historical instability of charges has led to substantial changes in allocated overhead from year to year, experienced both in the budgeting process and the true-up adjustment.

Additionally, there may be a need for the City to expand or formalize educational sessions that may offer the opportunity for management in paying bureaus to learn about and discuss forthcoming changes in overhead cost centers. These sessions could include discussion of staffing needs, service levels, legal requirements, and Council mandates that affect existing and future costs. Currently, outside of several focused reviews offered by divisions within OMF, the Overhead Committee – chartered to review analytical allocation methods and results – wrestles with their self-advocacy focus to verify programmatic costs without the appropriate forum or organizational position to engage in an effective discussion. That said, we will acknowledge that any initiation, reconfiguration, or expansion of cross-departmental communication forums does require consistent and comprehensive two-way interest to be successful and worthwhile (i.e., both support service and paying bureaus have to want it).

Allocable Costs

We believe it is important, and it is industry practice, to confine general allocations to costs related to central support services or business activities. The City has included several cost centers which, from an industry perspective, have not traditionally been considered support services allocated through an overhead recovery plan. An example of this is the City's Comprehensive Planning function, for which roughly \$126,000, or 62% of its total costs, is targeted for recovery through overhead charges in Fiscal Year 2004/2005. Inclusion of such costs is a matter of City policy.

Furthermore, related to communication, it appears that costs for central support services are not well understood by paying bureaus. Much of the City's existing practices related to overhead allocation – primarily the Overhead Committee – focuses almost strictly on the detailed allocations, or the technique, rather than causes of costs and service levels. (Refer to the observation in the prior section.) There is also concern that as the City Council develops or mandates new programs, that the general overhead allocation is viewed as a default funding mechanism.

Finally, the City's use of both interagency agreements and general overhead allocation has introduced complexities, including perceived (and possibly actual) duplication and/or over-charging of services. Interagency agreements, established between individual bureaus, identify the level of service to be provided and the corresponding direct charges that will be

imposed for those services. These agreements are negotiated separately from the General Fund Overhead allocation process, but in some cases, encompass support service bureaus that are included in the allocation process. This happens when individual bureaus “buy” incremental service from a central support function, as often happens in the Purchasing cost center. There is a general presumption among stakeholders that the more these side arrangements are made, the more disproportionate the remaining general allocations become. On the opposite side, those purchasing the incremental service may be concerned that they are unfairly being assessed a general allocation of costs while paying directly for the same service. Overall, it’s a complicated issue that should be explored, and notably, is one experienced by peer cities who responded to our benchmarking survey.

Process

There appears to be room in the City’s practices to simplify the process by easing the annual burden of maintaining the cost allocation models, as well as accommodating the planning needs of affected bureaus. First, the annual development and management of overhead allocations seems cumbersome. No fewer than four iterations of the overhead models are generated during the course of a year: three during the development of the budget and one during the true-up process.

Secondly, development of the charges is prospective, based on budget, which means that overhead costs are being identified and distributed at the same time that affected departments are developing their own budgets and the General Fund concurrently needs to establish its revenue base. Budgets are constantly adjusted during this period based on revised overhead figures. The Overhead Committee is convened multiple times during this exercise.

Finally, when the true-up adjustment is calculated, it is applied immediately, providing little time for planning, especially for bureaus who owe additional funds due to actual cost and usage data. This practice presumes that these bureaus have capacity in their existing revenue streams to accommodate the added cost or that they have set aside additional reserves in the event of increased overhead. Given the high degree of historical instability in overhead charges, both presumptions are unlikely.

Communication

Finally, we encourage the City to elevate the discussion of overhead to management levels to foster discussion of policy implications and service levels. Currently, there are limited forums for dialogue on the impacts on overhead costs of evolving City practices, City Council mandates, and legal requirements. The Overhead Committee is chartered to focus primarily on cost and data detail in the allocations themselves, and bureau management appears to rarely be involved in the more global impacts of cost allocation.

Furthermore, the purpose and use of the Overhead Committee should be examined. With a “steering” charter, the Committee should have diverse perspectives from both paying and overhead representation. Additionally, OMF, as the party responsible for managing cost allocation and recovery of overhead costs according to City objectives, does not have a strong policy-oriented role on the Committee. In the past, without a chairperson, consensus or conclusions of the Committee have relied on self-governance among Committee members. While we observed an admirable amount of devil’s advocacy among Committee discussion in order to consider broader City objectives, it should be recognized that each Committee member ultimately represents (and should be allowed to solely represent) his or her own bureau’s interests and that sometimes their own interests will conflict with those of another Committee member.

Indirect Cost Model

- *Mechanical Error in Spreadsheet:* There is a minor error in a cell that appears on page 15 of the City’s Indirect Cost Plan. The unallowable expenditures noted (in this case, Capital Outlay) in Schedules B and C, dealing with the Bureau of Police, do not balance. Fixing this calculation should be simple, and the correction will not materially change the plan (the adjusted rate for the Bureau of Police would still be within the one-one hundredth of a percent).
- *Substantiation of Allocation Method for City Attorney:* While OMB A-87 and related documents offer leeway in selecting an allocation basis, the preference is that an agency be able to provide quantitative substantiation of the chosen allocation base. The City currently distributes the costs of its City Attorney based on the estimated number of employees dedicated to each operating bureau (derived through time estimates). In order to avoid any possible A-87 compliance issues with regards to the Attorney’s allocation, the City may want to consider an alternative allocation factor or request that staff in that Office begin keeping timesheets to provide a more precise basis for allocation. Timekeeping need not be in increments of one-tenth of an hour, as is the standard for attorneys in private practice, but estimates by the half-hour could yield adequate substantiation for this cost pool’s allocation.

RECOMMENDATIONS

The purpose of this section is to describe our recommendations for enhancing the City's overhead cost allocation and recovery practices. These recommendations assume the following basic principles are universally accepted:

- OMF maintains a strong role in directing and maintaining the practices necessary to achieve the City's cost recovery objectives, including overhead cost allocation.
- The Overhead Committee is used as the collaborative forum with which to discuss and establish allocation strategies and mechanics and review annual updates.
- The City continues and bureaus accept the goal of centralizing Citywide support services and governance activities.
- There is general acceptance that central support service and governance activities provide benefit Citywide.

1. Combat Instability in Annual Charges

We recommend that the City revise several of its allocation factors following three general approaches described below. While OMF should be tasked with the responsibility for making the final decision on these issues, identification of key cost centers to work on and discussion of alternative factors should be worked through the Overhead Committee.

- First, OMF should select more stable allocation factors for highly variable or historically contentious cost centers. In general, relatively stable allocation factors include budgeted expenditures, full-time equivalents (e.g., number of employees), operating revenues, labor costs, and generally any other statistic that reflects the size, financial or otherwise, of a department.

The purpose of this task is to apportion general benefit and associated cost burden for program areas, rather than attempting to achieve a high degree of equity in exchange for greater instability. A good start to tackling this would be to review with the Overhead Committee each cost center that has a transaction-, volume-, or hours-based allocation factor, to determine whether or not there is a need to change the existing factor. Compiling historically allocated costs and charting annual variances may be useful in supporting this discussion.

For example, a cost center we recommend using to initiate this process is the City Auditor's Office. This program area is currently allocated using a combination of allocation factors, including actual cost per unit of work, actual work hours by fund or bureau, and actual number of Council items. Two of these factors vary substantially from year to year, depending on where the Auditor's Office determines work should take

place. Given that over the course of time, this program area serves every bureau in the City, it could be assigned a general allocation factor, such as bureau budgets (e.g., each bureau/fund's own budgeted expenditures in a given fiscal year). Using "budget" as an allocation factor is a very stable basis over time, as the level of expenditure and relationship of it between departments does not vary greatly from year to year. In Fiscal Year 2004/2005, using the array of usage-based factors, the General Fund targets to recover 55% of City Auditor costs from paying bureaus. Using budget as an allocation factor would recover 58% of those costs and introduce a pattern of annual stability for paying bureaus.

- Secondly, OMF should incorporate a rolling history for allocation factors that remain linked to actual usage data. For example, we have reviewed the separate analysis used to determine allocation factors for Purchasing, and while we find no error or inconsistency with industry practices, we agree that the derived factors will be volatile from year to year. We recommend continuing with the current allocation basis for Purchasing, but calculate a minimum three-year rolling average to smooth out spikes in allocated costs caused by changes in usage.
- Finally, the use of estimated staff time in deriving allocation factors for several cost centers has created contention in past discussions of overhead. Currently, estimated staff time is used to allocate costs for the City Attorney's Office, and it is used as part of the derivation for allocation factors in Purchasing. If time estimates continue to be a source of concern for stakeholders, we recommend initiating a short-term self-reported time-study in these functions to validate estimates. Staff time estimates can prove to be an effective means to apportion costs, but only when the credibility of the estimates is not questioned repeatedly. A short-term, summary-level time study can resolve the issue. Over the course of 10 to 12 weeks, staff could simply fill out a brief timesheet that asks only for a percentage of total time worked in any given week across City departments. (Or in the case of Purchasing, time could be reported across the 12 identified functions of service.) The compiled results could then be used as the basis for allocating costs in the next run of the overhead model.

2. Simplify Cost Centers

Within Accounting, the City Auditor's Office, and the City Council, several program areas have their costs broken down based on out-of-date, negotiated percentages, and then these seemingly unsubstantiated cost pools are allocated based on different factors. For example, in Accounting, the Quality Assurance program area is split in half, as is the Accounts Payable program area. The City Council has its total costs broken into four cost pools using the following percentages: 37%, 20%, 20%, and 23%.

Given that these breakdowns are aged and do not link to a functional or accounting distinction within the program area, we recommend consolidating each program area and selecting one allocation factor from existing data sets that represents an acceptable means for apportioning benefit and recovering costs. This consolidation would decrease the number of separate program area allocations from 27 to 19 or 20, depending on whether or not the City Auditor's Office is further consolidated according to Recommendation #1.

If a higher degree of functional detail is desired by stakeholders in the City Council cost center, an alternative idea would be to allocate a portion of the costs according to each individual Commissioner and the bureaus that they oversee. (Commissioner-specific allocations could be accomplished using a simple factor, such as budgeted expenditures.)

3. Streamline Annual Process

We recommend that the City streamline its annual cost allocation process to improve predictability of charges, as well as ease the burden on staff who are involved. There are three options for streamlining:

- A. *Charge overhead based on only one allocation factor.* Under this approach, the City would identify all budgeted overhead costs and allocate the total according to one data set, with no true-up factor applied for actual costs. For example, if budgeted expenditures by bureau/fund were selected as the lone allocation factor, in Fiscal Year 2004/2005, the General Fund would recover 58.51% in overhead costs. This can be directly compared to the adopted rate of recovery for the same fiscal year of 59.96%, achieved through the current series of 27 separate cost center allocations.

This method is clearly very simple – a regression, in fact, to out-of-date industry practices. However, the overall rate of recovery achieved by the General Fund is strikingly close to current practice. This type of approach does not explicitly target equity between departments, but it would simplify and stabilize yearly allocations. It also yields very little, if no, risk to the General Fund.

- B. *Charge overhead on a lagged basis.* Under this approach, the City would budget for and impose overhead charges based on its existing allocation methods, but using the last known year of actual costs and allocation data. This approach would eliminate the iterations involved during the budget process, as well as the true-up adjustment. (The overhead model would be run once annually.) It would also afford paying bureaus the time to plan for future changes in overhead charges. The major implication of this approach is that the General Fund would have to accommodate any increases in overhead bureau costs, as off-setting revenue for those costs in the form of allocated overhead charges, would be based on prior year costs. Over the past three years, the average annual change in revenue to the General Fund from allocated overhead charges was \$1.2 million.

C. *Charge overhead according to budget with a carry-forward true-up adjustment.* Under this approach, the City would continue to calculate overhead allocations based on budgeted costs, but it would make the subsequent true-up adjustment a carry-forward charge or credit in the following year's allocation. This approach keeps the General Fund's budgeted cost recovery consistent in timing with existing practice, but unlike current procedure, provides paying bureaus the opportunity to plan for the true-up impact. The General Fund would have to accommodate any true-up costs that are not collected immediately, but the risk is only if the budgeted charges are less than actual costs. Over the past three years, the General Fund has actually issued an overall average annual true-up credit of roughly \$220,000. In this approach, we would also recommend that the City attempt to run its overhead model only once during the budget process, to avoid iterations and the downstream impacts of them.

Option A, while producing an overall recovery result noticeably close to the existing overall rate through simple means, does not provide sufficient attention to the need for interdepartmental equity. While Option B is directly comparable to the practices of other cities, we recommend that the City attempt Option C as a transition to streamlining its annual allocation process.

4. Remodel Stakeholder Involvement Process

We recommend that the City continue its facilitation of the Overhead Committee, including its existing participants and its historical "steering" charter, for purposes of evaluating cost allocation methods, directing revisions, and analytical results on an annual basis. However, we recommend enhancing this body to include a facilitator from OMF who would chair the Committee; oversee the development of either majority-based decisions, if not consensus; manage the scope of the Committee's charter; administer the compilation or coordination of information that assists Committee discussions; and ensure implementation of Committee decisions. This OMF chairperson would serve on the Committee in addition to the OMF staff member who is responsible for maintaining the analytical cost allocation models.

Furthermore, given that the Committee, as a steering body, develops recommendations and direction for annual cost allocations, we recommend that the City add permanent participants on the Committee who represent the General Fund (or overhead) perspective. This will enable each Committee member to represent his or her own individual interests while retaining a balanced body for effective decision-making.

5. Enhance Communication

We recommend that the City establish a budget and service-level review committee composed of director and/or management representatives from paying bureaus. The intent of this process is to provide a formal opportunity for directors and/or managers of overhead

functions to describe their operations, the services provided, mandates they must fulfill, and impacts on budgeted costs. Accordingly, paying functions would have the opportunity in these sessions to discuss with their management peers the levels of service provided and impacts on allocated shares of overhead costs.

This type of review does not have to be a cumbersome process, nor a gross consumption of time. The City could set a target of having this committee review two to three overhead cost centers each year in one- to two-hour meetings each. In fact, this recommendation stems directly from our observation of the work OMF and several of its divisions are already doing to provide focused reviews for stakeholders of its services.

This type of process accomplishes multiple objectives. First, it removes the discussion of cost and service level from the Overhead Committee, which should be chartered specifically to review and discuss allocation strategies and review analytical work products. Secondly, it elevates discussion of service levels and cost impacts to a management topic, where policy implications and greater City goals can be considered and action, as necessary, can be initiated.

6. Establish Formal Policies

We recommend that the City consider establishment of formal policies which can be used to guide cost allocation, analytical review, and the evolution and addition of Citywide services. In this respect, Portland would be following the lead of Seattle, the one city in our benchmarking effort whose practices seemed most in line with Portland.

In establishing policies or cost allocation criteria, the City should consider adding an element of formality or enforceability by bringing them to the City Council for adoption. In crafting policies, we recommend that OMF take the lead, using the Overhead Committee for brainstorming, and involving the City Attorney, who has expressed opinions on allocable costs and practices in the past, at the request of City utilities.

The types of policies we recommend developing include the following topics:

- *General Objective in Overhead Cost Allocation:* This type of statement should identify the City's primary goal in allocating and recovering overhead costs.
- *Inclusion of Central Support Service Costs:* This policy should define "central support services," which typically encompass those activities which provide the business and administrative functions of a municipality. We consider these the "traditional" costs of support, including administration, financial services, personnel management, and legal services. Furthermore, this policy may prescribe that these cost centers be allocated based on either a method that serves as a proxy measuring usage or a method that distributes general benefit Citywide.

- *Including of Governance Costs:* This policy should define governance activities which are less business-oriented and have more to do with the unique attributes of providing public service within a governmental structure. These cost centers typically include legislative bodies and citywide and regional coordination and involvement. This policy should prescribe that these cost centers be allocated following either a measure that distributes general benefit Citywide or an alternative, Council-directed cost recovery method.
- *Criteria for Selecting Allocation Factors:* It may be prudent for these policies to establish criteria to assist OMF and the Overhead Committee in selecting new, or revising established, allocation methods. This type of criteria may provide guidelines for ranking potential allocation factors in terms of (in rank order) their stability, tracked and auditable data source, and linkage to service levels .
- *Technical Procedures:* Within the cost allocation analysis and annual process, to the extent that special exceptions or adjustments are made, or specific calculations are required, these policies may need to provide the direction and rationale formalizing such procedures. These policies may prescribe the rationale for charging allocated costs to specific bureaus and funds and not others, the cost basis of the charges (e.g., actual or budget), any true-up procedure and timing of it, schedules for requesting and receiving data, and annual timeline.
- *Advisory Practices:* Finally, it will be important for the City to provide a formal charter for the Overhead Committee, describing membership and chairmanship, responsibilities, role, scope of review, and timing of meetings. To the extent other advisory or stakeholder involvement procedures are implemented, establishing a policy describing the purpose and procedures of those forums is also advisable.

While we were unable to obtain any existing policies related to overhead cost allocation in this review, we did review a report we obtained during our prior work with the City of Portland, which may serve as a good foundation for crafting policies: *The Cost of Service Guidelines*, issued December 1992. This document provides an effective discussion of cost of service techniques and cost recovery objectives. Also, the *General Fund Overhead Committee Report* issued August 7, 1989, provides good language that could serve as the basis for drafting fiscal policies. Finally, the City of Seattle adopts formal policies on a regular basis, which could also serve as a reference point for Portland.

7. Scrutinize Interagency Agreement Pricing Structures

We recommend that the City examine its methods for pricing services governed by interagency agreements. There are bureaus, such as Purchasing, for which direct charges through interagency agreements are collected, in addition to general costs allocated as a part of the General Fund Overhead Model. In carving off incremental costs for recovery

through a direct charge (e.g., a dedicated staff position), the remaining costs allocated from that bureau (such as supervision) may be disproportionately high. The effect is that paying bureaus who do not have separate interagency agreements may, over time, pay more for their share of services, since other bureaus pay through direct charges that may not be reflective of the full cost of service.

We recommend that the City attempt to standardize pricing formulas used for interagency agreements. An analytical structure could be developed that would establish the full cost of service, to ensure that the share of costs paid by operating bureaus, whether through general cost allocation or direct, agreement-based charges, is proportional and fair.

As a related issue, it should be noted that the City does not have to establish direct charges in order to have agreements between bureaus which prescribe levels of service to be achieved. For example, Human Resources has negotiated interagency agreements, and therefore, directly charges all of its costs through that mechanism. However, those direct charges are simply the product of an allocation and could easily be consolidated as part of the General Fund Overhead Model, avoiding the separate transactions, while still preserving the level of service agreements in place. As another example, the City could still establish interagency agreements for special levels of service provided by Purchasing, yet process recovery of all of Purchasing's costs through the General Fund Overhead Model and avoid the issue described above.

8. Other Recommendations and Commentary

Other Recommendations

Through the course of this study, we have identified several other, more minor, areas for improvement:

- Most of the instability felt through the allocation of Purchasing costs is due to the City Council's appropriation of "discretionary revenue," which is used to off-set departmental costs eligible for allocation through the General Fund Overhead Model. We recommend that OMF explore the source of this appropriation and determine a course of action that might help to stabilize the allocable cost pool used to set overhead charges.
- As another simplification of process, we recommend that the City alter its current use of "budgeted expenditures" as an allocation factor, to simply use the last recorded set of actual expenditures by bureau. (Please note that the term "budget" is used loosely in overhead plans; it can refer to budgeted expenditures or actual expenditures, but as an allocation factor, it is intended to reference a department's level of spending, be it projected or historical.) This change should not detract much from the general proportionality between departments achieved in allocation, but will yield more global benefits to the process, primarily in easing the timing of OMF workload during the update

of the overhead model. We find the existing set of adjustments made to expenditures – performed mainly to adjust capital and debt funds for allocation purposes – reasonable and consistent with industry practices, and the current procedure should remain as is.

- Implementing some of the recommendations listed in this chapter may have substantial one-time impacts, while gaining stability in the years following. Upon calculating overhead allocations under any of these new procedures, the City may want to consider phasing in the results over a period of two to three years, depending on City needs and stakeholder feedback. This practice is consistent with our experiences in other cities where large, one-time shifts were made to correct or change practices.
- Some stakeholder concern was raised about the consistency of the cost centers used in the overhead models to actual bureau functions. (OMF Accounting was cited as one example.) As this evaluation was outside the charter of this study, the City may want to verify that its cost accounting systems, from which cost centers are derived in the overhead models, are reflective of the current organizational structure of the bureaus.
- The Transportation Bureau, as a frequent user of the overhead rate established in the Indirect Cost Model, has experienced difficulty, or at least a cumbersome process, in applying the rate to all of its programs, primarily due to the direct-cost basis of the rate. The City may need to consider conducting some analytical work to assist the Bureau in establishing a more effective means for recovering the full cost of service across its programs.
- Finally, we recommend that the City consider developing a component of its General Fund Overhead Model that maintains history over time, specifically regarding allocation factors. This could be accomplished by simply generating several stock summaries and charts in separate worksheets within the model, which could assist not only OMF staff, but also the Overhead Committee, in evaluating changes in the overhead charges over time. Incorporating this evaluation of annual changes in the presentation of updated overhead charges may enhance and streamline communication.

Response to Specific Questions

In the first chapter of this report, we provided a list of specific questions the City identified at the start of this review. Below, we have listed direct answers:

- *Are there revisions that can be made which would simplify the overhead models, improving comprehension, equity, and stability?*

Most of the recommendations listed in this chapter, such as #1, directly address these core issues. Primarily, we find that stability is the chief concern among stakeholders, a problem whose most accessible solutions, described earlier, run contrary to the theme of increasing equity as pursued in the past 15 years. As it works to implement revisions to

its overhead allocation practices, the City must work to carefully balance these competing needs. Working decisions through a collaborative communication process will be a requirement for a successful transition.

- *Which overhead services should be funded through cost allocation and which should be handled through interagency agreements and direct billing? Is there decision-making criteria that exists or can be developed for future management of this issue?*

This is an issue that will have to continue to be considered on a case by case basis. However, we can say that the City of Portland is using interagency agreements and direct billing for more functions that we have experienced with other municipalities. Certainly the results of our benchmarking survey indicate that direct-billing is confined to costs traditionally borne in an internal service fund, such as fleet, insurance, technology, etc. Our recommendations listed earlier in this chapter, such as #7, were formed to resolve some of the specific problems the City has been facing, primarily the dual use of direct charges and cost allocation for bureaus such as Purchasing.

With respect to its interagency agreements, the City should be principally focused on ensuring that negotiated direct charges are reflective of the full cost of providing the service, not just the incremental cost of staff and incidentals. Furthermore, the City should recognize that it does not need to direct bill costs in order to have interagency agreements prescribing levels of service; the same service agreements can be in place, even for cost centers which are allocated within the General Fund Overhead Model.

- *Who should be responsible for managing overhead cost allocation, including development of the models, acquisition of information needed to maintain the models, facilitation of communication with City stakeholders, and recommendation of final charges?*

OMF Financial Planning should be responsible for managing the full array of overhead allocation practices. This is consistent with its charter, as well as the practices of other municipalities.

- *How should large, one-time expenditures be processed through the overhead models?*

There is no uniform answer to this question, as each one-time expenditure is different. First of all, there will always be some level of one-time expenditure in bureau costs, which should be a part of the overhead allocation. For large, unique costs, such as systems acquisitions or facility expansion, we find that amortizing the cost over a reasonable period of time is the best way to incorporate it into the allocation plan. This means that ultimate cost recovery is delayed, but the stability achieved usually outweighs that concern. If a large expenditure can be specifically attributed to the needs of one or few bureaus (e.g., a utility billing system), the City should simply directly

charge the cost and keep it out of the overhead allocation model. (Please note that capital outlay are not allowed in the City's A-87 compliant Indirect Cost Model.)

- *Are the allocation measures currently used appropriate, are there others that would better achieve the stated goals of cost allocation, and are the current sources of this data sufficient?*

In general, we have no concerns with the City's chosen allocation factors and data sources, other than the fact that some of the heavily volume- and transaction-based factors are creating the greater problem of instability. Our recommendations listed earlier in this chapter, such as #1, provide specific recommendations for revisions. Other than that issue, many of the City's allocation factors are consistent with industry practices.

CONCLUSIONS

This chapter recaps the findings and recommendations of this review, as related to the project goals described in the Introduction and Study Objectives listed at the beginning of this final report.

Response to Project Goals

The desired outcome the City identified for this review was to generate recommendations for improvements to the overhead models that achieved the following goals:

- *Reflect best practices of methods used by comparable cities.*

The recommendations described in this report focus primarily on simplifying practices to achieve stability and predictability of the overhead charges, as well as enhancing existing communication channels to elevate overhead cost recovery to a more policy-oriented level. In most areas of cost allocation, the City of Portland has exceeded the practices of peer cities, including pursuit of equity and establishment of a formal stakeholder review process. These are areas worthy of recognition. The recommendations to address identified areas of improvement will not place Portland out of bounds with industry trends.

- *Enhance equity and stability felt by City operating bureaus which pay these charges and City service bureaus which depend on the revenue from these charges.*

The most significant recommendations of this study involve the delicate balance between equity and stability: two competing goals. From this perspective, the City will have to proceed on the major theme that central support services provide overall general benefit Citywide and that eventually, over time, all bureaus are served. From this foundation, the City can explore implementation of more stable allocation factors that apportion benefit, as opposed to attempting to mirror the incremental and real-time purchase of service on demand.

- *Allow flexibility in adapting to evolving policies and procedures directed by the City Council and the bureaus.*

None of the recommendations described in this report constrain the City in responding to change, but they do attempt to place more formality on cost allocation. The establishment of policies that reflect general City goals protects both the General Fund and the paying bureaus' perspectives. It defines the reasons for overhead cost recovery and the methods by which certain governmental activities should be considered. In effect, they set the expectation from which dialogue can take place effectively. Furthermore, the City has already established a practice by which its cost allocation

practices can evolve to change: It convenes a committee of stakeholders, within which, strategies can be developed in response. In effect, the City's existing open-forum practices, enhanced by the recommendations of this study, do not allow the City's cost allocation practices to go stale.

Conclusion

Cost allocation, by definition, is an estimate. Establishing this expectation is one of the most fundamental components of a successful overhead allocation plan. Many cities can become bogged down in attempts to accurately price their central support services for internal consumption, leading to a "slippery slope" that either jeopardizes full cost recovery or pits departments against one another, as exceptions and adjustments ultimately have to be made. Sometimes, going back to basics is the best way to move forward.

In this particular case, Portland has been progressive in its cost allocation, years ahead of the practices of many of its peer and neighboring cities. The City uses a diverse set of allocation factors targeting equity between bureaus, and it has successfully sustained a formal stakeholder committee process. It is accomplishing tasks in its cost allocation process that remain merely goals for many others.

However, this also means that Portland experiments with its practices, sometimes creating outcomes contrary to its overall goals. While we find that the City's cost allocation practices are well established and have become an institutional process, we also find room for improvement in the following key areas:

- *Targeting stability*: minimizing cost burden shifts between bureaus.
- *Supporting predictability*: providing time for prudent planning and response to costs, as well as understanding the evolution of support services and governance activities
- *Solidifying allocable costs*: establishing or reviving formal policies that confine general allocations to central support services and governance activities.
- *Simplifying process*: easing the annual workload for determining cost allocations while improving bureau planning for costs.
- *Enhancing internal communication*: elevating discussion of overhead allocation to include policy implications and interaction with bureau and/or City goals.

The recommendations described in this report directly respond to these needs. Furthermore, they are designed to take advantage of the positive, collaborative work already completed by City staff, over the 15 years since the last comprehensive report on overhead practices.

Checklist of Recommendations

The following is a brief checklist of the recommendations described in detail in the previous chapter:

1. Increase the stability of annual charges by:
 - Replacing heavily transaction- and/or volume-based allocation factors with more stable metrics, such as bureau expenditures.
 - Where transaction- and/or volume-based allocation metrics are desired, incorporate a minimum three-year rolling average to smooth out annual variances.
 - Consider initiating short-term, summary-level time studies in areas where estimated staff time is used to allocate costs and questioned regularly.
2. Simplify cost centers, including the use of multiple allocation factors for single cost pools.
3. Streamline the annual process by calculating overhead allocations once during the budget process and imposing the true-up adjustment as a carry-forward in the following year's charge.
4. Remodel the stakeholder involvement process by adding a facilitator from OMF to the existing Overhead Committee, and adding to that steering committee representatives from overhead bureaus.
5. Enhance communication by forming bureau director and/or manager level review committees of overhead functions, providing a forum for policy-oriented discussion of services provided, mandates to fulfill, and impacts on bureau costs and general allocations.
6. Establish formal policies to guide the annual development of cost allocations, as well as the support the ongoing evolution of general cost recovery needs Citywide.
7. Scrutinize interagency agreement pricing structures to ensure that the full cost of service is charged for any incremental services provided outside the general overhead allocation plan.

(Several other minor recommendations and response to specific City questions are listed in the Recommendations chapter of this report.)

APPENDIX A

Narrative of Responses to Benchmarking Survey

Survey Responses

1. Interagency Costs (Direct Charges) versus Overhead Allocation

At the City of **Austin**, the “Support Services Fund” is separate from the General Fund, and includes all departments that the City allocates as overhead. The Support Services Fund includes Management Services (the City Manager and his team), the Public Information Officer, Legal Department, Human Resources, the City Auditor, and Financial Services (which includes the Budget Office, the Controller, and the Treasurer). Some purchasing staff is dedicated directly to the Electric Utility and are charged directly in the plan, as opposed to following the allocation factor used for the Purchasing function as a whole.

The City of **Cincinnati** directly charges departments including Printing, Central Stores, Telecom, technology services, and Fleet. Other more traditional central support services are allocated as overhead.

The City of **Charlotte** allocates most traditional City-wide support services functions. It directly charges fleet and risk management costs based on use; contracted print shop services are also charged directly based on use; and phone expenses are paid directly from each department’s own budget.

The City of **Denver** uses a mix of direct charges and allocation; their practice is to directly charge through as much as possible and they have, in the past, tried to direct charge most of the traditional functions. However, they have recently initiated a study with a consulting firm to revise their cost allocation approach. They will probably always allocate functions like the budget office, attorney, and mayor.

At the City of **Seattle**, certain components of Fleet, Facilities, Space Planning (a component of Technical Services), and particular components of the Personnel Department are directly charged. The rest of the City’s Central Service Departments are distributed based on allocation factors. In special instances, all departments could potentially be directly charged in an instance where a large, one-time expenditure or situation is involved. For example, if City Attorney employees are directly assigned to a department-specific case. (Refer to the example provided in question #2.)

2. Allocation Factors

The City of **Austin** updates allocation factors on an annual basis. A number of allocation factors are used, all of which are well within the industry standards. Factors include time estimates (Legal Department), City-wide expenditures, FTEs, square feet (Building Services), number of transactions processed (Accounts Payable), and hours of service provided. No unusual factors are used to allocate costs.

It appears that the City of **Cincinnati** allocates all overhead costs according to departmental payroll as a percentage of City-wide payroll; this sole data set is updated annually.

The City of **Charlotte** uses a variety of allocation bases. It updates some allocation factors annually, but others that require more effort to obtain, such as estimated staff time, are revised every other year. The choice of the initial allocation factor was discussed and decided with a process involving both budget and overhead department staff. Overhead departments are strongly encouraged to retain the same allocation factor unless there is a material change of circumstances within the department.

The City of **Denver** updates allocation factors on an annual basis. Allocation factors include items such as FTEs, square footage, and estimated time. They do not use budgeted expenditures by department as an allocation factor.

The City of **Seattle** uses a wide variety of allocation factors, including estimation of effort. (The FCSG Project Team can provide the City of Portland with a complete copy of the Seattle's documentation upon request.) The methodology is only examined once every two years (i.e. changing an allocation factor). The City Attorney's Department does keep track of their staff hours spent on each City department; the department costs are allocated based on the total hours spent for each department, with the exception of several "memorandums of agreement" outside of the cost allocation plan, when attorneys are being directly charged due to a specific function or lawsuit. The Mayor's office is allocated based on staff-time estimates. IT ("Applications") and Purchasing also estimate time or keep track of actual hours. The Finance Department is allocated based on staff time, with the Administrative function (the Director and immediate staff) spread as a weighted average of all other staff time.

Purchasing used to be allocated based purely on the number of contracts, until departments protested that the purely numerical count did not reflect the varying degrees of complexity in different contracts. The change to different allocation factors was developed after meeting with both operating departments and the Purchasing Department to arrive at a more equitable factor. Also, the Contracting allocation factor used to be "the number of open working days on a contract;" however, since some contracts may be open without work being done, customers wanted to move towards using estimated time as an allocation factor. The director of the Contracting group did not think that estimated time was the most equitable method of cost allocation, so the department moved towards a hybrid factor: 50% based on dollar value of the contract, and 50% based on the number of contracts.

3. True-Up Process

The City of **Austin** has attempted to true-up their allocation plan, but there is a two year lag. For example, Fiscal Year 2003 actual costs were used to prepare the Fiscal Year 2005 plan. The City views this as one of the more difficult cost allocation issues it faces.

The City of **Cincinnati** calculates indirect cost charges in the current year budget based on the prior year's actual indirect costs.

The City of **Charlotte**'s allocation of overhead is lagged two years. For example, the City uses the actual costs from the prior year to develop the next year's budget

The City of **Denver** runs its allocation model on a lagged basis, using actual costs and data from the prior fiscal year, and charging those amounts in the year following their expenditure.

The City of **Seattle** makes an adjustment to true up the costs at the end of every two-year budget cycle. This adjustment can be either a rebate or a surcharge, depending on the level of actual costs to what was originally charged, and the adjustment is assessed as a carry-forward on the next overhead charge.

4. Interaction with the Budget Process

The City of **Austin** updates overhead allocations during the budget season using lagged costs. In the event of a significant reorganization that would have a material effect on the plan, the City attempts to modify as necessary.

The City of **Cincinnati** typically completes its indirect cost plan immediately after the budget process.

The City of **Charlotte** operates on a fiscal year basis, with year-end at June 30. The allocation process begins on September 15 with a memo being sent to each overhead department requesting that the prior year's allocation factors be examined and updated as necessary before October 15. As described above, the charges incorporated into the developing budget are based on historical costs.

The City of **Denver** operates on a calendar year budget. In the budget process, they simply use a placeholder for the overhead charge, using prior year activity and an incremental adjustment for inflation. Overhead costs are actually charged to departments on a lagged basis.

The City of **Seattle**'s plan is completed in August, the eighth month of the fiscal year (a two-year period following a calendar year basis). The City Council adopts the allocation factors in the first year of a biennium, and endorses the second year. The indirect cost plan developed in August is delivered to Accounting in January, to initiate the actual charges.

5. Responsibility

At the City of **Austin**, the Controller's Office is responsible for updating the Support Services Cost Allocation Plan.

The City of **Cincinnati**'s Finance Department is responsible for both cost allocation plans used by the City. The City's overhead model was developed in-house and a proprietary software program is used for the A-87 plan.

At the City of **Charlotte**, currently, the Budget Office is responsible for the overhead allocation. However, responsibility for the indirect cost allocation plan updates has changed hands frequently in the past.

The City of **Denver**'s overhead recovery and allocation practices are the responsibility of its Budget and Management Office.

At the City of **Seattle**, the Assistant Director of Finance maintains the overhead model, while staff in the Accounting Department are in charge of the A-87 compliant model.

6. Reimbursement from Grants

The City of **Austin** charges indirect costs to grant-funded programs and an A-87 plan is used. The A-87 plan goes by the name "Full Cost Plan" as opposed to the "Support Services Cost Allocation Plan."

The City of **Cincinnati** uses an A-87 compliant cost allocation plan to charge relevant indirect costs to grant-funded programs. The rate from this software program is used only for its sewer district and technology services, which are operated jointly with the County. All other eligible City departments and funds are charged using the rate from the City's in-house indirect cost model.

While departments at the City of **Charlotte** that are applying for grants use the overhead rates calculated by the City's overhead plan, no A-87 compliant plan exists.

The City of **Denver** is currently investigating charging overhead to grant-funded areas. They may develop a federal A-87 plan, but they don't currently maintain one. They currently use a variety of overhead rates for various programs. When grant-funded programs are charged for General Fund overhead, they are most interested in ensuring that service is received.

The City of **Seattle** charges indirect costs to grant-funded programs, and an A-87 plan is maintained for that purpose. The separate overhead model functions as the City's primary indirect cost allocation plan for all purposes except for federal grant reimbursement.

7. General Fund Share of Overhead

The City of **Austin**'s General Fund is primarily a public (e.g. direct) services fund, so no costs are allocated from this fund. The City does not show any overhead allocated to these services in its budget.

The City of **Cincinnati** does not typically charge indirect costs to departments within the General Fund, nor does it show any such cost for General Fund departments in its budget.

The City of **Charlotte** does not show allocated overhead to General Fund departments in its budget.

The City of **Denver** calculates General Fund departments' share of overhead costs, but they do not show that figure in their budget.

The City of **Seattle** does not show General Fund department's share of General Fund overhead in its budget.

8. Stakeholder Involvement

At the City of **Austin**, managerial level staff from each involved department are consulted to ensure that the best allocation methodology is utilized. There is only a little feedback each year and not much negotiation, as the departments are now used to this process. There is no formal advisory or steering committee process.

The City of **Cincinnati's** cost allocation plan is updated each year by analyst level staff. Internal stakeholders are not involved in this process, nor are any committees formed with the intent of discussing plan updates.

At the City of **Charlotte**, internal stakeholders are not very involved in the cost allocation process. Should a situation arise where they determine that more relevant factors should be used in the allocation, a discussion meeting will be held. A steering committee of analysts meets each year regarding the plan, although there typically is no disagreement or much change from prior years.

The City of **Denver** does not use a formal committee process. They will sometimes meet with their enterprise funds (e.g., airport, wastewater, golf course, etc.) to discuss overhead. From an anecdotal perspective, there does not seem to be much contention in the allocation process; however if questions are raised, they will scrutinize their allocation practices and may revise. Their Airport Fund is the most vocal and typically monitors and analyzes allocations to a greater detail than others.

At the City of **Seattle**, overhead departments receive annual requests to update their allocation factors. In the event of material changes that involve multiple departments, concerned parties meet and discuss options and potential alterations to the plan or methodology. Outside of this practice, no formal advisory committee process is used.

9. Federal Indirect Cost Rate

The City of **Austin** bases its federal indirect cost rate on the percent of direct salaries versus total salaries.

The City of **Cincinnati**'s A-87 proprietary plan bases the indirect cost rates on the ratio of direct to indirect program costs.

The City of **Charlotte** does not use an OMB Circular A-87 compliant plan.

The City of **Denver** does not currently use a federally-approved indirect cost rate.

10. Stability of Overhead Charges

At the City of **Austin**, unless there is a significant reorganization in a particular year, the Full Cost Plan is usually very stable. However, due to carry forwards, the federal A-87 plan is not as stable, in their experience.

At the City of **Cincinnati**, charges resulting from both plans have proved to be fairly stable. While certain departments, typically utilities, will request to see the plan updates each year and have the Finance Department explain any changes, the Finance Department doesn't believe that any particular cost pools are being scrutinized.

The City of **Charlotte**'s charges for indirect costs have been very stable over the past three to four years. Due to revenue challenges, the only fluctuations have been inflation adjustments for salaries.

The City of **Denver** does not experience any major swings in their allocations, primarily due to the allocation factors selected. The City has historically targeted simplicity in selecting its allocation factors. Overall, the resulting overhead charges have increased moderately over time.

The City of **Seattle**'s overhead charges have proven to be fairly stable, though some problems with instability have occurred with the federal A-87 plan. In the overhead model, the allocation factors the City chose typically will not fluctuate to the point where the change becomes material; these factors have been developed with stability in mind. One exception situation to the experienced stability is large capital expenditures on technology purchases. However, these purchases are treated as a separate allocation to distinguish these specific one-time costs from the general overhead charge.

Departments are aware of the fact that, in some cases, their overhead costs will increase if they use more services. However, because there is a lag in payment of actual costs based on actual usage due to the carry-forward of the true-up adjustment, the departments know they will eventually see their charges increase. Sometimes certain factors have caused spikes in overhead charges, but the City has typically been able to sufficiently explain the rationale. An example of this occurred when allocations to the utilities increased because the cashiers in the treasury started to accept credit cards.

11. Duplication of Services

At the City of **Austin**, in many instances, departments have the internal capability to process purchase orders. Central purchasing costs are still allocated, though, with the exception of the Electric Utility. Several members of the purchasing staff are dedicated exclusively to the Electric Utility and thus directly charged. Thus far, no issue of or problem with duplication has been raised.

The issue of duplication of payment for support services has never been raised at the City of **Cincinnati**.

Duplication of support services is an issue with which the City of **Charlotte** continuously struggles. The City's Aviation departments employs its own purchasing staff, but is still allocated a share of the City-wide purchasing function as a portion of the overhead charge. While Aviation would prefer not to pay this charge, they recognize the fact that excluding or reducing their portion of the City-wide allocation will then place an unfair burden on the smaller departments. Although not warmly welcomed, Aviation accepts the charge as a cost of doing business and being a part of the City as a whole. The City has not made any revisions to its practices to address this issue.

The City of **Denver** experiences problems with potential duplication of services and charges (e.g., police/workers compensation). It is an issue that has just recently arisen, and they are currently investigating it.

By and large, this issues has not been a problem at the City of **Seattle**. Seattle City Light once hired its own purchasing staff, and physically located those utility-funded resources within the general purchasing department of the City. No complaints have been received about any perceived inequity in resulting Citywide Purchasing allocations.

12. Estimated Staff Time as an Allocation Basis

The City of **Austin** has not had any issues with equity when time estimates are used. There is a general understanding that in some cases, estimates of time are the best allocation factor. In some cases, "Actual Hours of Service Provided" is used as a factor, and time is tracked to the half-hour.

The City of **Cincinnati** does not use estimated staff time as an allocation factor.

The City of **Charlotte** has not experienced any equity issues when using time estimation. They have determined that timekeeping is the most telling metric for certain departments, such as the Budget Office and Legal Services. The attorneys do maintain records of their time, while the Budget Office costs are allocated based on time estimates.

The City of **Denver** uses estimated staff time as a factor in allocating certain costs (e.g., a portion of the budget office, attorney, and auditor). The use of estimated time has not caused any problems nor created contention among departments.

The City of **Seattle** uses estimated time for multiple cost centers in its allocation plan. Thus far, no problems have occurred with this methodology. In general though, when questions are raised, meetings will be held to remedy the situation.

13. Formal Policies Guiding Cost Allocation

The City of **Austin** has no formal policies in place regarding its cost allocation plans.

The City of **Cincinnati** does not have any policies related to overhead costs.

The City of **Charlotte** does not have any formal policies regarding indirect cost allocation.

The City of **Denver** has no formal policies guiding overhead allocation; there has been no need to develop them. They try to keep things as simple as possible – examining the benefits of adding complexity (e.g., What do you achieve, and is it worth it?).

The City of **Seattle** has established formal policies guiding overhead cost allocation. (The Project Team has obtained these policies and provided a copy to Portland.) These policies, and the indirect cost allocation plan itself are adopted by the City Council during each budget biennium.

14. Inclusion of General Government Costs

The City of **Austin** allocates traditional central service functions, including the City Manager and the Mayor and Council. It does not allocate Emergency Management as overhead.

The City of **Cincinnati** includes Council costs in its in-house overhead model. Emergency management is still considered a direct service, and is not allocated to any other department as a charge. There are no other non-traditional central support cost centers included.

The City of **Charlotte** does not allocate any general government costs, such as Mayor and City Council. Allocated services appear to be confined to traditional support service functions.

The City of **Denver**'s overhead allocation and recovery practices include city council and mayor costs and is confined to mostly traditional government support service functions.

The City of **Seattle** allocates traditional central support service functions and general government functions such as the City Council. It also assigns portions of cost for several non-traditional functions based on a "memorandum of agreement" format, which is a specific arrangement that identifies the rationale for assigning cost recovery of more governance related functions (as opposed to central support). For example, through its indirect cost

plan, the City recovers costs for a portion of its emergency management function that serves as a communications hub linking the whole city (including coordination of enterprise-funded emergency activity). Other emergency management portions (such as specific areas funded by the Department of Homeland Security and Emergency Preparation) are not considered to be overhead; departments or funds requiring these particular services maintain them in-house. The City also allocates a regional coordination function within its Planning department, also following a “memorandum of agreement” approach, versus blanket cost allocation.

15. Level of Cost and Service

In order to educate stakeholders and field questions they may have, the City of **Austin** makes an effort to meet with its larger departments and review cost pools and variances, and discuss the reasons for change from prior years. The indirect cost plan is not distributed internally unless a specific request is made.

Affected departments at the City of **Cincinnati** have never asked about the relationship of services provided to the level of indirect costs being charged; therefore, no process in place for addressing any concerns.

At the City of **Charlotte**, if the methodology of the cost allocation plan is ever questioned, the Budget Office schedules a meeting and reviews in detail the logic behind the development of overhead charges with the concerned party. The City has never needed to take additional follow-up steps after such a review.

The City of **Denver**'s operating departments have sometimes raised questions about the amount of costs in overhead departments. When questions are raised, staff will investigate and respond with rationale for programs and staffing; however there is no formal process for discussing and scrutinizing program services, costs, or efficiency.

The City of **Seattle** provides a text summary in the overhead plan that lists the services allocated and the services departments are supposed to be receiving. Historically, if departments needed further explanation, then meetings would be held. However, if a drastic change in service level or cost is known or imminent, departments affected through overhead allocations are to be notified of the change. For example, if many attorneys are hired due to a specific case, Finance staff will notify the affected department to make them aware of the implications.

APPENDIX B

Presentation Packet of Summary Findings, October 2004



City of Portland Overhead Model Review

Summary of Consultant Findings *Issued October 25, 2004*

FCS GROUP, INC.

8201 - 164th Ave NE • Suite 300 • Redmond, WA 98052 • (425) 867-1802 • www.fcsgroup.com

Topics

- **Background**
 - Project objectives and process, and existing practices
- **Basic Principles**
- **Review**
 - Technical review, positive elements of existing practices, and areas of improvement
- **Recommendations**
- **Comparable Practices**
- **Next Steps**

Project Objectives

- Provide a substantive review of existing overhead cost recovery practices
- Identify improvements which:
 - Enhance equity and stability
 - Reflect practices of the industry and comparable cities
 - Allow flexibility in adapting to changing procedures and policies at the City

Background

Consultant Process

- Review overhead models and background documentation
- Meet with City staff:
 - Representatives from overhead functions
 - Representatives from paying bureaus
 - Overhead Committee
- Survey comparable cities
- Document recommendations

Existing Practices

- Three methods of overhead cost recovery:
 - “Interagency Agreements” – Direct agreements between bureaus identifying the level of service provided and corresponding direct charges for service
 - “Overhead Model” – Allocates General Fund support services costs which are not covered under Interagency Agreements
 - “Indirect Cost Model” – Determines an overhead rate compliant with federal requirements for use in grant-funded functions

Overhead Allocation Process

- **Managed by OMF Financial Planning**
- **Allocations are developed consistent with the timing of the annual budget and through several iterations**
- **Overhead Committee, made of paying functions, steers the process and influences resulting allocations**
- **Charges are based on budgeted costs, and one-time adjustments are made after year-end to reflect actual costs**

FCS Group, Inc. 7

Basic Principles

The General Fund Perspective

- **Services are provided that support the direct delivery of the City's core public service functions**
- **General governmental resources should not subsidize activities which serve distinct customers, and have alternative cost recovery mechanisms available, unless directed by policy to subsidize**
- **Compensation should be made to the General Fund for those overhead services provided to City enterprise funds and other operating functions with dedicated revenue sources**

The Enterprise Perspective *

- **In most cases, user fees and rates legally must be based on the costs incurred to provide service**
- **In some cases, rates and charges must remain competitive, therefore, sensitivity to cost, especially overhead, is even greater**
- **Long-term planning and management of utility costs is necessary for strategic rate setting**

* Utilities, internal service funds, and other operating functions which pay overhead

Foundation

- **By definition, cost allocation is an estimate and the results can be debatable**
- **Strive for a reasonable way to recover costs**
- **Look for substantiation and common sense in cost allocation practices**

Substantiation

- **Are the allocated costs real and current?**
- **Do the allocated costs relate to the “business of government?”**
- **Are cost allocation measures real and current?**
- **Do the measures by which costs are allocated:**
 - **Reasonably link to the level of service and/or benefit received, or**
 - **Represent an acceptable means for apportioning cost burden?**

Common Sense

- Does the plan make sense to those responsible for its implementation and upkeep?
- Does the plan make sense to those directly impacted by its results?
- Can the results be explained to internal stakeholders?
To their constituents?
- Is the process by which the plan is updated:
 - Feasible to complete thoroughly on a regular basis?
 - Acceptable to those who must plan around and defend its results?

Review

Technical Review

- **No mathematical errors found**
 - Allocations are complete; costs are not over- or under-counted
- **Models operate as defined in City-published summaries of practices**
 - Cost centers, distributions, and allocation methods are consistently applied
- **Indirect Cost Model:**
 - Compliant with Circular A-87 requirements
 - Minor calculation correction in one area, but no material impact

Positive Elements

- **General**
 - The models have been built to handle costs simply, making them easier to audit and update on a regular basis
- **Allocable Costs**
 - The significant cost centers allocated are centralized service functions which support the business activities of government

Positive Elements (continued)

➤ Allocation Methods

- Allocation factors have evolved over time to attempt a linkage to service levels, which has responded to payee concerns
 - However, sometimes aggressive “equity” can lead to instability (see next section)

➤ Process

- Formal stakeholder process through the Overhead Committee to provide open communication on allocation methods

Areas of Improvement

- **Stability:** minimizing cost burden shifts between bureaus
- **Predictability:** providing time for planning and response
- **Allocable costs:** confining general allocations to costs related to central support or business activities
- **Simplifying process:** easing annual burden and improving bureau planning
- **Enhancing communication:** elevating discussion of policy implications and service levels

Stability

- **There are substantial swings in some cost centers from year to year**
 - **Primarily due to allocation methods linked heavily to usage, such as volume, hours, etc.**
 - **Auditor's Office, Purchasing, Accounting**
 - **In the case of Purchasing, some instability due to Council-directed discretionary revenue which offsets allocated costs**

Predictability

- **Instability leads to substantial changes in annual charges**
- **Timing of the calculation and implementation of charges leaves little room for planning in paying bureaus**
 - **In line with budget development**
 - **True-up adjustments are assessed at the time of calculation**
- **Opportunity for paying bureaus to learn about and discuss changes in overhead cost centers is limited (e.g., staffing, service levels, legal requirements, Council mandates)**

Allocable Costs

- **Costs centers that are not traditionally considered support services have been included as overhead**
 - **Example: Comprehensive Planning function**
- **Costs in support services are not well understood by paying bureaus**
 - **Formal communication channels focus almost strictly on detailed allocations**

Simplifying Process

- **Annual development of allocations is complicated**
 - **Three iterations during budget development**
 - **One true-up adjustment**
- **Development is prospective, based on budget, yielding an overall true-up credit most of the time**
- **Each iteration causes complications in paying bureaus**
 - **Adjusting proposed budgets**
 - **Responding to true-up adjustments without time to plan**

Enhancing Communication

- **Limited forums for a dialogue on the impacts of evolving City practices on costs**
 - **Overhead Committee is primarily focused on cost and data detail in allocations**
 - **Bureau management is rarely involved in more global impacts**
- **With a “steering” charter, committee needs diverse perspectives from both paying and overhead representation**
- **OMF does not have a strong, policy-oriented role on the committee**
 - **Consensus or conclusions rely on self-governance among committee members with sometimes conflicting interests**

Recommendations

1. Combat Instability in Annual Charges

- **Change allocation factors in the following ways:**
 - A. **Select more stable allocation factors; exchange equity for stability and apportion general benefit/cost burden instead of annual usage**
 - Ex: Auditor – use budgeted expenditures rather than actual work?
 - Types of “stable” factors – budget, FTEs, etc.
 - B. **Incorporate rolling history into allocation factors that remain linked to volatile data on actual usage**
 - Ex: Purchasing – apply a three- to five-year average to composite percentages
 - C. **Initiate a time-study for functions currently using estimated time as a basis for apportioning costs**
 - City Attorney, Purchasing

2. Simplify Cost Center Allocations Which Have Arbitrary Functional Breakdowns

- **Within Accounting, Auditor’s Office, and City Council, program cost pools are split based on out-of-date negotiated percentages and then allocated using different factors**
- **Choose one factor from existing data sets for each budgeted program area that represents an acceptable means for apportioning benefit and cost recovery**

3. Streamline Annual Process to Improve Predictability and Ease Workload

- **Streamline through one of three proposed options:**
 - A. **Charge overhead based on budget only**
 - B. **Charge overhead on a lagged basis – budget for and impose charges based on last known year of actual costs and allocation data**
 - C. **Charge overhead using budgeted costs, but calculate once during the budget process as an estimate and make the true-up adjustment a “carry-forward” component in next year’s allocation**
 - **Don’t impose a true-up without time for bureaus to plan**

3. Streamline Annual Process to Improve Predictability and Ease Workload (cont.)

- **Implications of streamlined options:**
 - A. **Very simple and little risk to the General Fund**
 - B. **For annual budgeting, the General Fund will have to accommodate increases in overhead costs, as off-setting revenue from charges will be based on prior year costs**
 - C. **The General Fund will have to accommodate the true-up that isn’t charged immediately**
 - **Risk is only if the budgeted charges were less than actual costs, which has not happened often in the past**

4. Remodel Current Stakeholder Involvement to Improve Communication and Consistency

- **Retain Overhead Committee, existing participants, and historical charter (e.g., “steering” in nature; evaluation of allocations)**
- **Add a facilitator from OMF to chair the committee and oversee consensus-based implementation**
- **Add permanent participants who represent the General Fund (or overhead) perspective**

5. Enhance Stakeholder Process by Adding Management and/or Policy Review

- **Expand “focused reviews” that OMF is already conducting for its functions to include other support service cost centers**
- **Set up a budget and service-level review committee composed of director/management representatives from paying bureaus**
 - **Review 2-3 overhead cost centers each year**
 - **Allows overhead functions to describe their operations, services provided, mandates, impacts on budgeted costs**
 - **Allows paying functions to discuss levels of service and impacts on allocated shares of overhead**
 - **Facilitates a policy-level discussion, rather than analytical**

6. Establish Formal Criteria or Policies Which Guide Cost Allocation

- **Provides a policy umbrella over analytical review and decision-making in Overhead Committee:**
 - **Distinguish between central support services that are allocated based on usage/benefit and governance activities that are allocated by policy**
 - **Define criteria for selecting allocation factors**
 - **Establish priorities in selection, such as stability (highest), tracked/auditable data (medium), linkage to service (lowest)**
- **Involve the City Attorney and OMF in setting policies**
- **Policies should be adopted by Council as a part of the budget to be enforceable**

7. Scrutinize “Pricing” of Interagency Agreements to Avoid Over-Burdening the General Allocation

- **For bureaus which have both interagency agreements and are allocated, are the incremental side agreements truly “full cost?”**
 - **By carving off incremental costs (e.g., a staff position) to directly bill, remaining allocated costs to remaining bureaus may be disproportionately high**
- **Standardize interagency agreement pricing formulas**
 - **Should relate to the “full cost” in all cases**

8. Other Recommendations

- **Direct charging through interagency agreements is not a requirement of having “level of service” agreements.**
 - **Traditional central service functions, like Human Resources, could be allocated as General Fund overhead, yet a service agreement could still be made, if the parties want it**
- **Discretionary revenue appropriated to Purchasing fluctuates greatly, resulting in significant swings to Purchasing allocations. Can the Council stabilize this discretionary revenue?**

Comparable Practices

Comparable Practices

- **8 comparable cities**
 - **Responsive: Austin, Cincinnati, Charlotte, Denver, and Seattle**
 - **Waiting for key individual: Kansas City and Phoenix**
 - **Unresponsive to requests: Sacramento**
- **15 areas of inquiry**
 - **Full responses to each question will be included in the final report**

Survey Highlights

- **Austin, Charlotte, Cincinnati, and Denver all impose overhead charges on a lagged basis**
 - **Seattle uses a biennial budget estimate with a true-up adjustment that is carried forward to the next budget**
- **Austin, Cincinnati, and Denver do not have formal advisory/steering committees but will convene meetings if specific issues are raised**
 - **Seattle does not have a formal committee but sends out documentation describing charges and services and will have joint meetings as needed**
 - **Charlotte uses a steering committee of financial analysts once a year but there is little to no disagreement**

Survey Highlights (continued)

- None of the respondents described problems with stability – most of their allocation factors are (and in some cases specifically chose to be) stable
- Austin, Charlotte, and Denver have experienced (unresolved) problems of perceived duplication and payment of services, such as Purchasing, due to the concurrent use of overhead allocation and interagency agreements
- Cincinnati, Charlotte, Denver, and Seattle do not experience problems in using staff time estimates as an allocation factor
 - Austin will only use tracked time (to the half-hour)
- Only Seattle has adopted fiscal policies governing cost allocation

Next Steps

Next Steps in Project

- ✦ Review summary of findings in detail with OMF and internal stakeholders – Nov. 10th
- ✦ Issue draft report to OMF detailing findings, recommendations and impacts
 - ✦ Finalize report upon staff feedback
- ✦ Report to City Council (?)