



RIVERSIDE PUBLIC UTILITIES

Board Memorandum

BOARD OF PUBLIC UTILITIES

DATE: FEBRUARY 26, 2024

SUBJECT: COST ALLOCATION PLAN UPDATE

ISSUE:

Receive a report on the City of Riverside Cost Allocation Plan.

RECOMMENDATION:

That the Board of Public Utilities receive and file a report on the City of Riverside's Cost Allocation Plan.

BACKGROUND:

On June 21, 2022, the City Council adopted Resolution No. 23866 approving the Fiscal Year (FY) 2022-2024 Biennial Budget. Prior to the second year of the biennium, the City initiated a review and update of the FY 2023/24 adopted budget. An update to the second year of an adopted biennial budget is necessary to ensure the City is proactive and responsive to financial and operational changes. On June 27, 2023, the City Council adopted Resolution No. 24010 approving the amendments to the Fiscal Year 2023/24 Budget.

On May 8, 2023, the Board of Public Utilities received proposed amendments to Riverside Public Utilities' (RPU) FY 2023/24 budget. During the discussion, the allocation of General Fund internal support costs to RPU funds was addressed. There are several categories and methods of cost allocation employed in City finances which impact RPU finances, including:

- Citywide cost allocation plan: Charges from the City's General Fund internal service departments to recipient funds.
- Direct charge of positions: Positions housed in other funds are dedicated, either in full or in part, to RPU support, and the proportional cost of each position is directly charged to RPU funds.
- Utilization Charges: Utilization charges represent actual expenses incurred by departments, such as an engineer's time on capital projects. These charges are recorded as they occur.

This report focuses on the Citywide cost allocation plan, its purpose, and its impact on RPU funds.

DISCUSSION:

What is a Cost Allocation Plan?

A Cost Allocation Plan (CAP) is a structured financial strategy and framework used by organizations, both public and private, to distribute and assign various costs and expenses across different departments, units, or services within the organization. The primary purpose of a CAP is to accurately allocate overhead and indirect costs to specific cost centers or programs, ensuring that the costs are fairly and proportionally distributed based on their utilization by various internal stakeholders or departments. In the complex landscape of municipal finance, where diverse departments and funds coexist, cost allocation becomes an indispensable mechanism to fairly attribute shared costs and allocate resources judiciously. Through the application of a CAP, organizations can achieve cost transparency, allocate resources efficiently, and make informed financial decisions while promoting accountability and fairness in cost sharing.

Cost Allocation Practice in Municipalities

In municipalities, cost allocation is employed to systematically distribute shared costs among various departments and funds. It is a strategic method designed to ensure fairness, transparency, and efficiency in the utilization of resources, as well as the appropriate pricing of City services. The significance of cost allocation lies in its ability to provide a clear and equitable framework for attributing common expenses, fostering optimal resource management within the municipal structure.

At its core, cost allocation involves the identification and apportionment of indirect costs, such as administrative and support services, to specific departments and funds. This practice is essential for municipal finance as it allows for a more accurate representation of the costs associated with each functional area.

The Government Finance Officers Association (GFOA) underscores the significance of cost allocation in its best practices for financial management. GFOA guidance acknowledges cost allocation as a vital tool for municipalities to demonstrate prudent financial management and adherence to regulations. GFOA emphasizes the importance of comprehensive and consistently applied cost allocation plans, ensuring that costs are appropriately distributed across programs and activities, contributing to effective financial practices at the municipal level.

The cost to governments to track every expense and directly attribute each cost to each function would exceed the benefits. Indirect cost allocation is an accounting function by which estimates are made to distribute indirect costs to programs or functions, in order to approximate their full cost. Certain important management objectives (measuring the cost of government services, establishing fees and charges, charging back the cost of internal services to departments/agencies, fully utilizing restricted funds, and requesting reimbursements under federal and state grants, when allowed) can be served by allocating indirect costs. – GFOA

2 CFR 200.416 in the U.S. Code of Federal Regulations provides specific guidance on cost allocation plans for municipalities that receive federal funding. It emphasizes the necessity of documenting the allocation of indirect costs and ensuring that such costs are distributed based

on a logical and consistent method. This federal regulation plays a crucial role in guiding municipalities to develop cost allocation plans that meet federal standards and facilitate compliance with grant requirements.

Following intensive research and inquiry with external subject matter experts, the City made a strategic decision not to pursue the maintenance of a federally compliant CAP, primarily due to the stringent guidelines imposed by the Federal Government. The decision to forgo a federally compliant CAP is rooted in several considerations, including the allocation of internal resources, the complexities associated with the federal approval process, and the challenges posed by the ongoing maintenance of such a plan. Furthermore, in certain circumstances, the allocation of overhead costs to a grant reduces the grant funding available for the core purpose of the grant. Alternatively, federal guidelines allow grant recipients to charge administrative costs of 10% to the grant without the requirement to maintain a federally compliant CAP. This option was determined to be the most cost effective for the City.

Benefits of a Cost Allocation Plan

A well-implemented CAP offers a multitude of advantages to a municipality, serving as a strategic tool that enhances service efficiency, financial transparency, and informed decision-making. The CAP ensures equitable resource distribution by allocating shared costs based on objective criteria. This prevents any single department or fund from shouldering an undue burden, fostering fairness in the allocation of resources. Other benefits of a CAP include:

Efficiency: A CAP allows for the consolidation of administrative support services, eliminating the duplication of efforts and resources. A shared infrastructure promotes cost efficiency by reducing redundant expenses across multiple functions. Furthermore, centralized administrative support can be adjusted and adapted more easily to accommodate shifts in priorities, organizational structure, or external factors.

Specialized Expertise and Focus on Core Functions: Centralized administrative functions enable the City to pool specialized expertise in areas such as human resources and, finance, and information technology. This concentration of skills enhances the quality and effectiveness of the City's internal support services. Each recipient department can focus on its core activities without the burden of managing a full internal administrative infrastructure. This allows departments to concentrate on their primary missions and goals, leading to increased productivity and effectiveness in each City department.

Standardization and Risk Management: A centralized administrative support structure facilitates standardization of processes and procedures across the City. Consistent practices enhance efficiency, reduce errors, and contribute to a more cohesive and well-managed administrative framework. A centralized administrative structure also enhances the City's ability to manage compliance and mitigate risks. Uniform policies and procedures can be implemented, reducing the likelihood of non-compliance and improving risk management practices.

Cost of Services: The allocation of internal support service costs to recipient departments and funds provides transparency into the cost of services for each recipient function or department. This is achieved by systematically attributing internal support costs through objective and relevant allocation methodologies. Neglecting to consider indirect costs could result in underestimating the expenses associated with delivering a service, thereby impeding effective budgeting and decision-making processes.

Developing the Cost Allocation Plan

A well-structured Cost Allocation Plan (CAP) is essential for municipalities seeking to ensure fairness, transparency, and efficiency in the distribution of shared costs. The City applies an internal culture of continuous improvement to the CAP, which culminated in a 2021 review of the City's CAP by an independent consultant. For several years prior to 2018, the cost allocation plan was prepared by a consultant on behalf of the City. With the development of the FY 2018-2020 biennial budget, the City initiated the in-house development of the CAP, marking a significant shift from its previous reliance on an external consultant for this task. This move transferred the responsibility for the development, creation, and maintenance of the CAP to City staff while also establishing a mechanism for continuous improvement. The transition not only underscored the CAP's importance but also paved the way for its ongoing evolution, with City staff proactively cultivating industry connections and conducting research to ensure that the CAP remains aligned with industry-wide best practices throughout each budget cycle.

Identifying Allocable Costs

Allocable costs are expenses that can be reasonably and directly attributed to a specific project, activity, or function within an organization. These costs are typically incurred by Internal Service Departments for the benefit of another department or fund, and they should be allocated based on a reasonable and consistent methodology.

Internal Service Departments (ISDs) are departments that exclusively serve other City departments without catering to any external customers. For example, the Human Resources Department offers services such as staffing, recruitment, and training for all City departments. The costs of these services are allocated across other City departments based on specific measurable units.

Allocable costs can include both direct and indirect costs. Software charges as direct costs, allocated on the basis of user licenses assigned to personnel in City departments and funds. Indirect costs in the City's CAP encompass ISD operating costs that are not traceable to a specific department or fund. In other words, the efforts of the ISD benefit the City organization as a whole; labor and overhead costs are not tracked and charged on an hourly basis due to the impractical nature of such an effort.

In 2019, in-depth research into the operations and responsibilities of Economic Development Division in the Community and Economic Development Department revealed that the majority of their clientele were external. As a result, this division did not qualify for allocation within the CAP and was removed from the CAP with the FY 2020/21 annual budget.

The City's allocable ISDs or divisions with the ISDs, are listed in the following table:

Table 1 - Allocable Internal Service Departments or Divisions

Department/Division	
Mayor	City Council
City Manager	City Clerk
City Attorney	Human Resources
General Services	Finance
Innovation & Technology	CEDD – Property Services
Non-Dept – City Occupancy	Non-Dept – Employee Parking

Divisions within ISDs that serve external customers are excluded from the CAP. These include:

- City Manager – Community Police Review Commission
- City Clerk – Passport Services
- Finance – Business Tax & User Fees

Direct charges are also excluded from the CAP. These include:

- Software costs accounted for in the Innovation & Technology Department are excluded from the CAP. Those costs are directly allocated to departments on the basis of user licenses assigned to personnel in City departments and fund.
- Personnel assigned to specific departments are direct charged and excluded from the CAP. For example, the cost HR personnel that works solely on RPU recruitments is charged directly to RPU.

Identifying Recipient Departments and Funds

Departments and funds recipient from allocations are generally easily identified through the allocation bases used to allocate costs. For example, Human Resources functions with full-time equivalent positions (FTEs) are allocated only to those departments and funds that have personnel.

The City utilizes standardized cost-allocation software employing an iterative step-down methodology, which acknowledges that ISDs provide services to one another. As an illustration, the Human Resources Department extends support services not only to other ISDs but also to all departments with personnel, warranting an allocation of Human Resources costs for both sets of recipient departments. Following this initial allocation, the full cost of an ISD is exhibited, and subsequently fully allocated to other departments and funds.

Obtaining Identifiable and Reliable Metrics

Allocation bases serve as the criteria for distributing costs among departments. These can be quantitative measures such as the number of employees, or square footage, or other metrics that fairly represent the service provided. Best practices dictate the necessity of a defensible methodology combined with reliable metrics; these principles are crucial for the fair and efficient distribution of costs across the City. The bases selected should provide an objective measure of the benefit provided to other departments and funds.

With the development of each CAP, Finance Department staff collaborates with representatives from each ISD to reassess existing allocation bases and identify opportunities for new, more applicable methods. For example, if new software becomes available to track allocable activities more accurately, it is explored for its potential benefits in enhancing the precision and reliability of allocation metrics. By staying adaptable and open to incorporating advancements in data tracking and allocation methodologies, the City aims to refine its CAP, ensuring that each year brings a more accurate and efficient allocation process.

The following table lists the allocation metrics used in the City's CAP. During CAP development, City staff meet with various departments to understand their functions and collectively determine an appropriate approach. Subsequently, measurable and reliable metrics are selected, emphasizing the reliability and availability of data to ensure their suitability for the CAP's

methodology. It is essential to note that all selected metrics and evaluations adhere to best practices and align with guidance provided by leading public governance organizations in the industry.

Table 2 - CAP Allocation Bases

Department	Section/Function	Allocation Basis
Mayor	Legislative Support	Number of Agenda Items by Section
	Citywide Support	Net Expenditures by Section
City Council	Legislative Support	Number of Agenda Items by Section
	Citywide Support	Net Expenditures by Section
City Manager	Public Relations	Net Expenditures by Section
	General Citywide Support	Number of FTEs per Department
	Intergovernmental Relations	Number of Agenda Items by Section
City Clerk	Records Management	Invoices by Section
	Elections	Net Expenditures by Section
	Legislative Support	Number of Agenda Items by Section
City Attorney	Direct Support	Attorney Working Hours by Section
Human Resources	HR Citywide	Number of FTEs per Department
General Services	Building Maintenance	Net Expenditures by Section
	Publishing	Invoiced amounts of Print Shop Charges
	Property Management	Total support hours
	Citywide Capital Projects	Number of Capital Projects Managed by GS
Finance	Purchasing	Number of Purchase Orders by Section
	Administration	Net Expenditures by Section
	Treasury and Debt	Net Expenditures by Section
	Accounting	Total Accounting Transactions by Section
	Budget	Net Expenditures by Section
	Payroll	Number of FTEs per Department
Innovation and Technology	Client Service and Cybersecurity Support	Number of FTEs per Department
	Software Maintenance - Citywide Support	Number of FTEs per Department
	IT General Citywide Support	Number of FTEs per Department
Citywide Property Services	Property Services Support	Property Services Support by Hours
Building	City Hall Depreciation	FY City Hall Occupancy
City Occupancy	City Hall Occupancy Support	Dept/Section Occupancy by Sq Footage
Employee Parking	ND Parking	Parking Spaces by Section

Some allocation bases render the City's CAP non-compliant with federal guidelines established for grant recipients. For example, federal guidelines do not allow the allocation of the City Attorney's contracted litigation costs, nor do they allow an allocation basis of attorney hours worked per division. As such, many cities use FTE as an allocation basis for a federally compliant CAP. However, adopting this methodology would over-allocate to certain funds, such as Electric and Water, which have a combined total of 633 FTE, and under-allocate to other funds, such as the Worker's Compensation Trust Fund, which has 5 FTE. This illustrates the importance of scrutiny, validation, and formulation in the selection of allocation bases.

CAP Step-Down Methodology

Within the City's standardized cost-allocation software (*Allocate*, by e-Civis), the step-down methodology employs a systematic approach to allocate costs that recognizes the intricate relationships between various departments and funds. Importantly, the step-down methodology distinguishes between internal service departments and user departments. Service departments, which provide essential support services, are allocated their costs first. The costs are then 'stepped down' to user departments based on allocation metrics. This cascading process enhances accuracy by acknowledging the nuances of service utilization and the dynamic nature of internal relationships.

The following figures depict the step-down methodology. First, the ISDs are allocated to all recipients, ISDs and non-ISDs alike (*Figure 1 - Allocation of ISDs to All Recipients*). This is an iterative process in the cost allocation software that results in the total cost of service for all ISDs. Ultimately, the total costs of the ISDs are allocated to non-ISDs (*Figure 2 - Final Allocation of ISD Total Costs to Non-ISDs*).

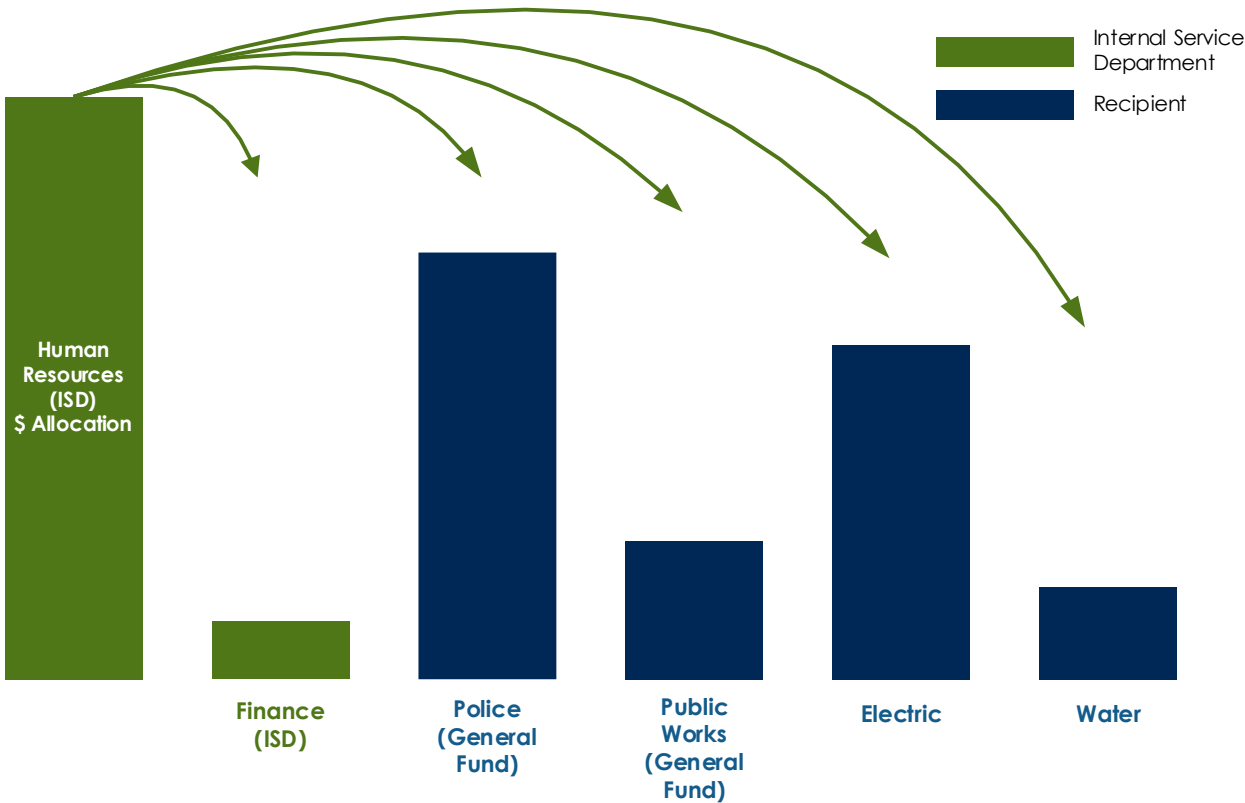


Figure 1 - Allocation of ISDs to All Recipients

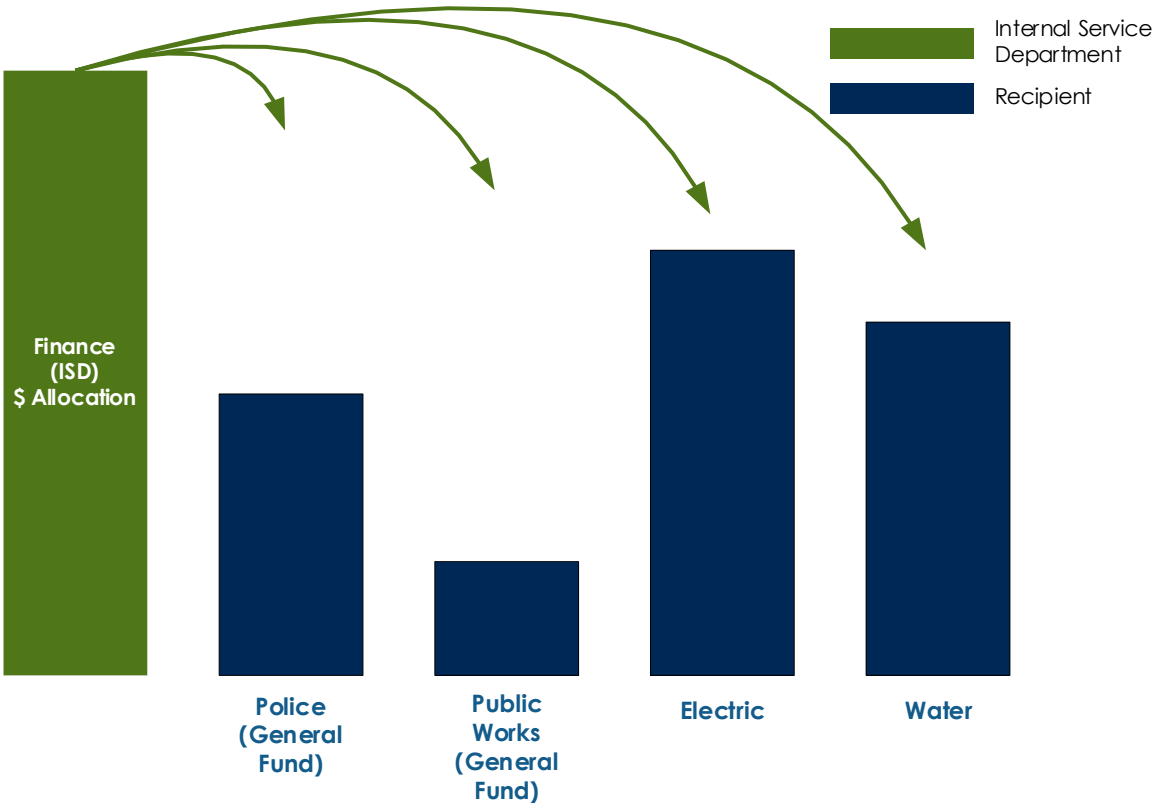


Figure 2 - Final Allocation of ISD Total Costs to Non-ISDs

Public Access to the CAP

The cost allocation software produces a user-friendly PDF version of the cost allocation plan (Attachment 1). The PDF versions of the City's cost allocation plans are accessible on the City's website at <https://riversideca.gov/finance/budget.asp>.

FY 2023/24 Cost Allocation Plan

The current year's cost allocation plan resulted in a 58% (\$33.60 million) allocation of ISD costs to General Fund departments, as illustrated in the following table. For fully allocated departments, such as the Mayor's Office, the impact of the step-down methodology is readily observed: The *Charges from ISD's* column represents ISD allocations to the Mayor from other ISD departments, such as Human Resources, Finance, and Innovation & Technology. This resulted in a total cost for the Mayor Department of approximately \$1.16 million, as depicted in the *Charges to Recipients* column. This column displays a negative amount, reflecting the full allocation of the Mayor's costs to recipient departments and funds.

Table 3 - General Fund CAP Impacts

General Fund Departments	Charges From ISDs	Charges to Recipients
Mayor	\$ 221,170	\$ (1,155,021)
City Council	449,434	(2,087,833)
City Manager	999,233	(6,467,270)
City Clerk	297,909	(2,147,529)
Office of the City Attorney	1,196,712	(6,673,816)
Human Resources	1,055,715	(5,289,154)
General Services	880,794	(6,046,820)
Finance	1,671,884	(8,697,104)
Innovation and Technology	1,453,912	(14,659,948)
Housing & Human Services	125,204	
Community Development	3,905,435	(1,062,502)
Police	9,772,109	
Fire	4,372,194	
Public Works	3,221,114	
Library	1,073,899	
Parks, Recreation & Comm Svcs	2,595,614	
Museum of Riverside	254,939	
Non-Departmental	51,414	(3,416,727)
Total	\$ 33,598,685	\$ (57,703,724)

The total amount of \$57.70 million in allocable charges identified in ISDs are allocated to recipient funds and departments using the allocation basis listed in *Table 2 - CAP Allocation Bases*. An example allocation can be observed in *Table 3 - City Attorney Allocation Metrics Comparison*.

With 58% of ISD costs allocated to General Fund departments as illustrated in *Table 4 - General Fund CAP Impacts*, the remaining 42% is allocated to other City funds and departments. The fund-level impacts of the FY 2023/24 CAP are displayed in *Table 5 - FY 2023/24 CAP Results by Fund* and illustrated in *Figure 3 - FY 2023/24 CAP Results by Fund*.

Table 4 - FY 2023/24 CAP Results by Fund

Fund	Charges From ISDs	% Share of Allocation
101 - General Fund	\$ 33,598,685	58%
170 - Development	156,386	0%
280 - Housing Authority	548,662	1%
410 - Storm Drain	20,657	0%
411 - Special Capital Improvement	54,543	0%
420 - Measure Z Capital Projects	90,420	0%
510 - Electric	9,736,228	17%
511 - Electric-Public Benefit Progs	149,329	0%
520 - Water	3,875,424	7%
521 - Water Conservation	13,576	0%
530 - Airport	200,336	0%
540 - Refuse	1,273,129	2%
550 - Sewer	2,593,661	4%
560 - Special Transit	613,821	1%
570 - Public Parking	366,301	1%
610 - Workers' Compensation Trust	793,160	1%
620 - Unemployment Insurance	3,429	0%
630 - Liability Insurance Trust	2,732,461	5%
640 - Central Stores	115,019	0%
650 - Central Garage	768,497	1%
Total	\$ 57,703,725	100%

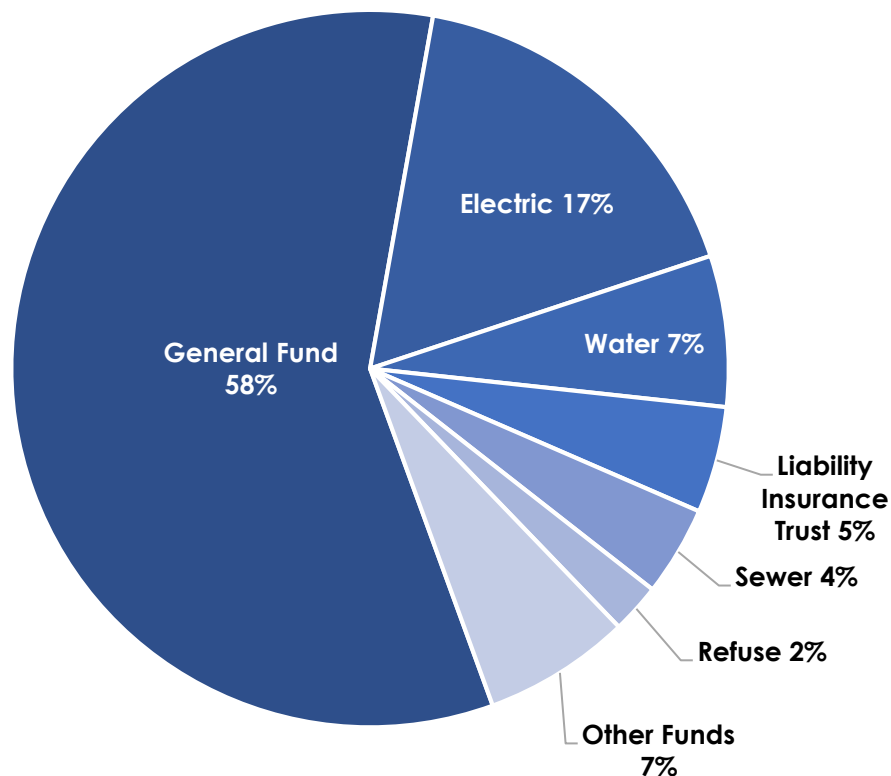


Figure 3 - FY 2023/24 CAP Results by Fund

Impact of FY 2023/24 Positions Added to ISDs

When a fully allocable position is added to an ISD, the position cost will be allocated to recipients through the CAP along with the rest of the respective ISD's costs. The fiscal impact of the position to recipients will be similar the allocation percentages illustrated in *Table 5 - FY 2023/24 CAP Results by Fund* and *Figure 3 - FY 2023/24 CAP Results by Fund*, with immaterial variations resulting from unique allocation metrics in the various ISDs.

In the amended FY 2023/24 budget adopted by the City Council on June 27, 2023, included the addition of 14.75 FTE in ISDs to accommodate increased workloads. The FTE increase resulted in additional allocable costs of \$2,152,698. Because each ISD is allocated to recipients using a unique allocation basis, the exact fiscal impact to RPU of the added positions cannot be determined; the fiscal impact is embedded within the full ISD costs entered into and allocated by the CAP software. However, based on the percentage allocations displayed in *Table 5 - FY 2023/24 CAP Results by Fund*, the estimated fiscal impact to RPU funds is as follows:

Table 5 - Estimated Fiscal Impact by Fund of ISD Positions added in FY 2023/24

Fund	% Share of Allocation	Estimated Fiscal Impact
General Fund	58%	\$ 1,248,565
Electric	17%	365,958
Water	7%	150,689
Liability Insurance Trust	5%	107,635
Sewer	4%	86,108
Refuse	2%	43,054
Other Funds	7%	150,689
Total	100%	\$ 2,152,698

STRATEGIC PLAN ALIGNMENT:

This report and the CAP process aligns with the High Performing Government strategic priority, specifically goals 5.2 and 5.3:

- 5.2. Utilize technology, data, and process improvement strategies to increase efficiencies, guide decision making, and ensure services are accessible and distributed equitably throughout all geographic areas of the City.
- 5.3. Enhance communication and collaboration with community members to improve transparency, build public trust, and encourage shared decision-making.

This item aligns with each of the five Cross-Cutting Threads as follows:

1. **Community Trust** – The CAP is a fair, well-documented process that is aligned with industry best practices. It reflects the City's dedication to sound policy and the use of reliable information for the greater public good.
2. **Equity** – The reliance on standardized cost-allocation software and the engagement of leading public governance organizations in the industry during annual review of the City's

CAP ensure that CAP practices are aligned with industry standards, reflecting the City's commitment to equitable resource allocation.

3. **Fiscal Responsibility** – Staff's continuous evaluation, improvement, and alignment of the CAP with industry best practices demonstrate dedication to fair and accurate distribution of allocable costs and pricing of services.
4. **Innovation** – Staff's dedication to continuous improvement and conformity with industry-wide best practices demonstrates innovation in meeting the City's changing needs.
5. **Sustainability & Resiliency** – The CAP allows for a transparent and fair method of cost allocation to various departments, which, in turn, helps to ensure accurate pricing of public services. By accurately pricing public services through the CAP, the City ensures the needs of the present are met without compromising the needs of the future.

FISCAL IMPACT:

There is no fiscal impact associated with this report.

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availability of funds: Kristie Thomas, Finance Director/Assistant Chief Financial Officer
Approved by: Rafael Guzman, Assistant City Manager
Approved as to form: Phaedra Norton, City Attorney

Attachments:

1. FY 2023/24 Cost Allocation Plan
2. Presentation