



Office of the City Auditor

**Report to the City Council
City of San José**

**INDIRECT COST
ALLOCATION: IMPROVED
PROCEDURES AND BETTER
COMMUNICATION NEEDED**

**Report 13-10
November 2013**

November 14, 2013

Honorable Mayor and Members
Of the City Council
200 East Santa Clara Street
San José, CA 95113

Indirect Cost Allocation: Improved Procedures and Better Communication Needed

The City of San José provides a variety of direct services to the public, such as policing, utility services, and building permitting. The City also performs supporting activities to aid departments in their service delivery. These support service costs, also referred to as overhead or indirect costs, include such things as department-level administration and central services like payroll, computer support, and facility maintenance. Cost allocation is the process to estimate the overhead associated with City services so that the City can set fees appropriately and give management an accurate picture of the true cost of its activities.

The Finance Department (Finance) prepares the annual City-wide Cost Allocation Plan. The plan allocates overhead costs to the City's direct services, and calculates an overhead rate as a percentage of direct labor costs associated with specific services. This rate is then used to calculate fees for specific services and potential reimbursements from special funds. This ensures that the General Fund is reimbursed for central service activities that serve enterprise or special funds, such as utility funds, and others. For fee-based programs, central service costs are only recaptured to the extent that fees are set to be cost recovery and are collected for individual services.

The objective of this audit was to review and evaluate the City's fiscal year (FY) 2013-14 City-wide overhead plan for appropriateness and accuracy.

Finding 1: Finance Should More Clearly Define Indirect Costs. The City's FY 2013-14 overhead plan included \$120 million of central service costs which were deemed to be overhead. These costs are associated with various direct services and thus allocated to departments to set fees or to reimburse the General Fund from special or enterprise funds. There were an additional \$39 million of central service costs that were judged to not support other departments, and as such were not included in the plan as overhead. However, it is unclear why some central service costs were considered to be overhead and others were not. It also appears that decisions about whether certain costs should be included as overhead have not been consistent over time. To ensure the appropriate and consistent classification of central service costs, Finance should update its procedures to more clearly define indirect costs that should be included in the plan. It also should review and revise its lists of allocated and unallocated costs.

Finding 2: Finance Should Review and Update Its Cost Allocation Methodology. To determine the full cost of City services, Finance allocates indirect costs by means of allocation bases that are intended to relate the support activity performed to the services received by other departments. These allocation bases include such things as the size of department budgets, total full-time equivalent (FTE) employees by department, and more specific workload data that approximates the services provided to other departments. To ensure that allocation bases reflect actual workload and take into account organizational changes, Finance should improve its communications with central service departments and revise allocation bases. Finance should also improve how it allocates overhead to capital projects, review the Equipment Usage and Building Occupancy cost pools to ensure costs are consistently and accurately allocated, and reorder the central service department allocation sequence.

Finding 3: Finance's Procedures and Resources Should Be Enhanced. Finance relies heavily on Excel spreadsheets to calculate overhead – preparing at least 150 worksheets that contain many different calculations, analyses, and other information important to the overhead calculations. To improve the consistency and accuracy of these spreadsheets, we recommend Finance establish a process for reviewing critical data entry areas and key calculations. Finance should also document the rate calculation methodologies contained in these worksheets. Finance also uses old overhead software that has limited functionality, does not allow importing data from Excel files (necessitating an extensive manual data entry exercise), and only provides limited reports. We recommend Finance switch to a newer software application. Finally, Finance's cost allocation process may also improve with additional staffing as only 0.5 FTE is currently assigned to preparing the City's overhead plans.

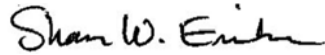
Finding 4: The Overhead Rate Calculation Can Be More Transparent. The current overhead plan is difficult to comprehend and is not documented in a clearly understandable format. Additionally, cost allocation information is not well communicated to City staff, leading to confusion about how overhead is calculated and how overhead rates should be applied. Other jurisdictions make their plans easier to understand and explain by including descriptive information about cost allocations. Finance should include such information and routinely explain rates to City departments. Explaining overhead to departments is particularly important when there are service delivery changes that might affect the application of overhead.

Appendices. Following the conclusion of the report are seven appendices that provide further detail about cost allocation in the City of San José. Appendix A diagrams the two-step methodology used to allocate costs. Appendix B lists the central services included in the overhead plan, along with the total costs for each service and the base used to allocate the service. Appendix C shows the components of overhead and rate calculations for line departments, including utility and capital funds. Appendix D compares the percent of central services allocated to line departments and funds. Appendix E provides examples of how overhead is applied to fees and special funds. Appendix F shows five-year trends of overhead rates by each core service within a department. Appendix G has an example of the five-year trend of overhead components for one sample department (Police).

We would like to thank the Finance Department; the Budget Office; the departments of Airport; Environmental Services; Human Resources; Information Technology; Planning, Building & Code Enforcement; Police; Public Works; and the City Attorney's Office for their time and insight during the audit process.

This report includes 13 recommendations to improve Finance's cost allocation process. We will present this report at the November 21, 2013 meeting of the Public Safety, Finance, and Strategic Support Committee. The Administration has reviewed this report and its response is shown on the yellow pages.

Respectfully submitted,



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Glossary

Allocation base: The criterion used to allocate indirect costs. It serves as an estimate of the indirect services provided to a department. For example, the number of full-time equivalent employees is used to allocate payroll costs.

Central service: Services provided centrally by the City to departments and funds. The costs of these services are primarily allocated through the indirect cost allocation plan or directly billed. Departments that primarily provide central services are referred to as central service departments; their costs are allocated through the cost allocation plan.

Cost allocation: The process by which costs for services are tied to the departments, funds, or programs that are receiving those services. Indirect cost allocation is specific to the allocation of costs that are linked to multiple City services. Cost allocation is used to estimate the full cost of services provided by the City, but does not necessarily involve the transfer of funds.

Cost pool: A set of costs that must be allocated. This can be a division, a department, or an inter-departmental program. In San José's overhead plan, cost pools are generally either individual departments or costs that do not relate to a specific department, such as City-Wide Expenses.

Direct bill: A specific charge to an enterprise or special fund for services provided by General Fund department staff or resources.

Indirect cost: Costs that are linked to multiple services. For example, the costs budgeted for the Human Resources Department are indirect costs because they support City employees across all departments instead of just one specific service to the public. Indirect costs are colloquially referred to as "overhead." Only those costs that are related to services provided to City departments or funds are considered indirect costs.

Line department/fund (also called receiving department): A department or fund that provides direct services to the public that is allocated overhead (i.e. receives overhead) through the cost allocation plan from central service departments.

Overhead plan (also called plan or cost allocation plan): The documentation that records the indirect central service cost allocations made to departments and funds. In this report, the term overhead plan or plan refers to the FY 2013-14 City-wide Cost Allocation Plan.

Overhead rate (also called indirect cost rate): A ratio of indirect costs to direct labor costs (expressed as a percentage). In San José, overhead rates are calculated by adding a core service's central service cost allocations, departmental strategic support costs, and departmental non-personal costs and dividing the sum by the direct labor costs for the core service. A second set of rates is calculated using the same method but excluding non-personal costs.

Unallocated central service costs: Costs of central services that are not allocated to departments through the cost allocation plan. These costs typically fall into one of two categories. First, the costs are for direct services to the public (such as processing business licenses), and thus do not fit the description of an indirect cost as they do not support services provided to other City departments or funds. Second, the costs are recovered in another way (e.g. costs that are charged separately outside of the plan) and thus do not need to be recovered through indirect cost allocation.

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Introduction

In accordance with the City Auditor's Fiscal Year (FY) 2013-14 Work Plan, we have completed an audit of the Finance Department's calculation of overhead cost allocations and rates. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We limited our work to those areas specified in the "Audit Objective, Scope and Methodology" section of this report.

The Office of the City Auditor thanks the management and staff from the Finance Department; the Budget Office; the departments of Airport; Environmental Services; Human Resources; Information Technology; Planning, Building & Code Enforcement; Police; Public Works; and the City Attorney's Office for giving their time, information, insight, and cooperation during the audit process.

Background

The City provides a variety of services to the public, including police and fire protection, environmental and utility services, transportation and aviation services, libraries and community centers, and community and economic development. These services are provided by the Police and Fire Departments; the Environmental Services Department; the Airport; and various other departments which directly serve the public.

To provide these services, the City also performs supporting activities to aid departments in their service delivery. These activities, the cost of which is colloquially referred to as overhead, include such things as payroll provided by the Finance Department (Finance), computer support provided by the Information Technology Department (IT), and facility maintenance provided by Public Works.

Direct Versus Indirect Costs

It is important for the City to understand the full cost of the services it provides, so that it can set fees appropriately and give management an accurate picture of the true cost of its activities. To calculate the full cost of a public service, both direct and indirect costs need to be counted. Generally, one can distinguish between direct and indirect costs as follows.

Indirect Cost Allocation

- Direct costs can be linked to a specific service to the public. For example, one service the City provides is Police response. The costs budgeted for Police response would be direct costs.
- Indirect costs (or overhead), on the other hand, are linked to multiple services. For example, the Human Resources Department (HR) supports City employees across all departments, instead of providing one specific service to the public. Indirect costs can also be within a department, such as costs for Police departmental administration that support multiple services: Police response, investigations, permitting, etc.

To illustrate, the full cost for the City to issue a permit to a taxicab driver includes the salaries and benefits of Police Department staff whose time is directly associated with processing the application and issuing the permit as well as the indirect costs supporting the process. These indirect costs include the costs of management and support staff in the Police Department, Finance’s costs of payroll processing for the above employees, building custodial costs, electricity, IT support, and others. Exhibit I describes the full cost equation for this example.

Exhibit I: Example Full Cost Calculation for a Taxicab Driver Permit

<i>Full Cost</i>	=	<i>Direct Cost</i>	+	<i>Indirect Cost (colloquially “overhead”)</i>
<i>Full cost of issuing a taxicab driver permit</i>	=	<i>Employees’ time (salary and benefits) to receive application, conduct criminal background check, review drug test, administer a test of traffic laws, issue permit</i>	+	<i>Share of management and support staff costs in the Police Department; plus a share of City central service costs that support these employees’ time issuing this permit (e.g. Finance payroll processing, building custodial costs, electricity, IT support)</i>

Source: Auditor analysis

For the example above, the full cost of the permit includes the direct cost of program staff within the Police Department, indirect costs from supporting activities from other City departments, and indirect costs related to supporting activities within the Police Department. This full cost can be used to calculate the appropriate fee for a taxicab driver permit. Although the full cost of the permit includes costs of activities outside of the Police Department; the Police Department’s annual operating budget does not include those costs. They remain in the annual budgets of those respective departments.

Indirect Cost Allocation

It is usually difficult to measure indirect costs (or overhead) associated with a specific service because, as noted above, they are linked to multiple services. Indirect cost allocation is a process to estimate the indirect costs associated with

each service. Instead of attempting to measure indirect costs exactly, they are “allocated” to a service based on an estimate.

The San José City Council’s *Operating Budget and Capital Improvement Program Policy*¹ states: “All overhead costs shall be allocated to the appropriate program within the limits of local, State and federal laws.” The goals of allocating overhead costs are twofold:

1. Calculating the full cost of City services for fee setting purposes
2. Reimbursing the General Fund for indirect costs which serve enterprise or special funds

For some departments or funds, the cost allocation process is solely designed to determine the full cost of a specific service for fee setting purposes and does not involve a transfer of funds between departments.² Only when overhead is charged to enterprise or special funds to reimburse the General Fund for central service costs is there an actual transfer of funds.

Finance’s Accounting Division is responsible for preparing the City’s Cost Allocation Plan, also called the overhead plan (plan). This plan is a document that shows the results of the allocation of overhead costs to departments and funds. Finance’s *Indirect Cost Allocation Plan Procedure Manual* describes the purpose of the plan as follows:

To identify and account for general fund and other indirect cost related to central service programs that benefit all city departments. The rates developed will be used to calculate estimates for inclusion in the applicable adopted operating and capital budgets and the annually adopted schedules of fees and charges.

The procedures describe the general process for allocating costs and identify the following departments and programs as indirect costs:

- City buildings’ usage
- City equipment and vehicle usage
- City-wide Programs
- Building leases
- City Manager
- Emergency Services
- Independent Police Auditor

¹ Council Policy I-18.

² Departments may also seek reimbursements for indirect costs from federal or other grants. The City has a separate Grant Overhead Plan which allocates costs based on federal rules on allowable reimbursable costs.

- Mayor & City Council
- Finance
- Information Technology
- City Attorney
- City Clerk
- City Auditor
- Human Resources
- General Services³

These departments and programs are referred to as “central services;” their costs allocated in the FY 2013-14 plan totaled \$120 million. These costs are based on the FY 2012-13 adopted budget.⁴ For comparison, the General Fund operating budget for FY 2012-13 was \$967 million. See Appendix B for a detailed description of San José’s indirect costs included in the plan.

In the fall of each year, Finance requests and collects workload data from central service departments and cost data from the Budget Office. The data is used to estimate the levels of service provided by central service departments to other departments and serve as a basis for allocating costs. For example, Finance might use square feet occupied as an estimator for the costs of building maintenance and electricity for individual departments. In this example, square footage is called the “allocation base” for maintenance costs.

Finance then compiles the data in various spreadsheets, making adjustments and reclassifications as necessary, and enters it into proprietary software that calculates the actual allocations. The software uses a two-step methodology, as diagrammed in Appendix A, for allocating the indirect costs.

1. The software first allocates central service department costs to all City departments, including other central service departments, based on the levels of service estimates as described above.
2. The software then allocates the costs that central service departments received in the first step. Central service departments allocate their

³ The Department of General Services was consolidated into Public Works in 2010-11, but Finance continues to treat General Services separately as a central service.

⁴ It should be noted that departments providing direct services to the public may be charged for central services in multiple ways: (a) costs which are allocated to line departments through the overhead plan as described above, (b) costs paid directly by enterprise or special funds (which are included in the plan as direct bills to offset costs otherwise allocated to them), (c) costs paid out of special funds are in some cases deemed unallocated costs in the plan (e.g., HR costs paid out of the benefit funds), and (d) direct charges by Public Works which are not included in the plan in any way (these relate to work provided by facilities management staff to departments that are paid for out of departmental non-personal budgets). (e) other separate charges, for example City Hall debt service or the HR/Payroll System Upgrade were allocated and charged separately.

costs to other central service departments ranked below them in a set order and to departments providing direct services (called “line departments”). Once a central service department has allocated its costs in this step, it no longer receives allocations from other central service departments below them in the order. This process ends when the final central service department has allocated its remaining costs (and thus, all overhead in the plan has been allocated to line departments providing direct services or special funds).

This calculation produces a dollar amount of indirect costs for each line department or special fund. The dollar amount is used to calculate an overhead rate which is used by departments in setting fees (see next section on the calculation of the overhead rates) and reimbursements from special funds. See Appendix C for complete departmental allocation details.

These allocations are documented in the overhead plan, which includes each central service’s indirect costs, a short description of the allocation bases for each central service, and overhead amounts allocated to each line department.

It should be noted that in addition to the City-wide overhead plan, which is the subject of this audit, Finance produces two other plans. One is specific to Airport costs and the other is guided by federal regulations for reimbursements from grants. The City-wide overhead plan, referred to in this report simply as the overhead plan, documents the rates that departments use to calculate fees and reimbursements around the City.⁵

Calculation of Overhead Rates

From the overhead amounts for line departments identified in the plan, Finance calculates overhead rates (expressed as percentages) and issues a table of rates every January for the following fiscal year.

Overhead rate calculations have three components, the first two of which make up what is broadly called overhead:

1. The cost of central services allocated to departments or funds through the overhead plan.

⁵ The three overhead plans which Finance produces annually are (1) the City-wide Cost Allocation Plan (overhead plan), (2) the Airport Overhead Plan, and (3) the Grant Overhead Plan. Additionally, the Finance Department uses an outside vendor to prepare a Public Works plan. Rates produced by different plans are used for different purposes. For example, departments use rates from the Grant Plan when they seek reimbursements from federal grants. The plans are generally similar in methodology. The City-wide Plan uses prior-year adopted budget figures and generally two-years-prior workload measures. The Airport and Grant Plans are to exclude costs that are disallowed under federal guidelines, use two-years-prior actual expenditures and two-years-prior workload measures. For this audit, we focused on the City-wide overhead plan, referred to simply as the overhead plan, as noted in the Audit Objective, Scope and Methodology section.

Indirect Cost Allocation

2. The cost of departmental administrative activities, which includes departmental strategic support staff and non-personal costs.
3. The cost of direct labor for department programs, which is based on staff salaries.

It is important to note that in addition to the costs allocated to line departments in the plan, a line department's own administrative activities (as performed by staff in the department's strategic support core service) are included in the overhead amount and factored into the rate calculation. In some cases, the costs of these departmental administrative activities are greater than central service costs allocated through the overhead plan.

Rates are calculated by dividing the overhead amount by the department's direct labor costs, as demonstrated in the formula below.

$$\text{Overhead Rate} = \frac{\text{Cost allocation from City central services} + \text{Department's administrative costs}}{\text{Department's direct labor costs}}$$

Changes to any of these three components in the above formula will affect a department's overhead rate. Because direct labor costs are a critical piece of the overhead rate calculation, any staffing changes in a department will likely affect the overhead rate. If the only component that changes is the direct labor costs due to staffing reductions, then the overhead rate will increase.

When calculating fees or reimbursements, overhead rates usually are multiplied by the labor costs related to the activity. The resulting overhead amount is then used to calculate the full cost of a service for fee setting purposes or to reimburse the General Fund for services benefiting special funds. See Appendix E for four such examples.

Continuing the example from the taxicab permitting process earlier, Exhibit 2 shows an example of a rate calculation for the Police Department's Regulatory Services core service. This service had an overhead rate of 56.19 percent for FY 2013-14, meaning that \$0.56 of overhead is associated with one dollar of salary.

**Exhibit 2: Example Overhead Rate Calculation for the
Police Department's Regulatory Services
Core Service**

Cost of City Central Services Allocated Within the Overhead Plan		To: Regulatory Services
from	City-Wide Programs	\$210,658
	City Attorney	\$48,260
	General Services	\$35,447
	Building Occupancy	\$32,129
	Information Technology	\$29,564
	Human Resources	\$29,455
	City Manager	\$26,592
	Building Leases	\$24,126
	Equipment Usage	\$18,519
	Mayor & City Council	\$16,727
	Finance	\$16,650
	Independent Police Auditor	\$15,338
	City Auditor	\$4,777
	City Clerk	\$3,773
	Emergency Services	\$854
A	Sub-total	\$512,871
Departmental Indirect Costs		
B	Non-Personal costs	\$226,612
C	Strategic Support	\$426,396
Total Overhead Amount		
D	A+B+C	\$1,165,879
Departmental Direct Labor Costs		
E		\$2,074,908
Overhead Rate		
D/E	Divide Overhead by Direct Labor	56.19%

Source: Finance Department's City-wide FY 2013-14 Cost Allocation Plan, NGCS II Schedule G, and Finance rate sheet.

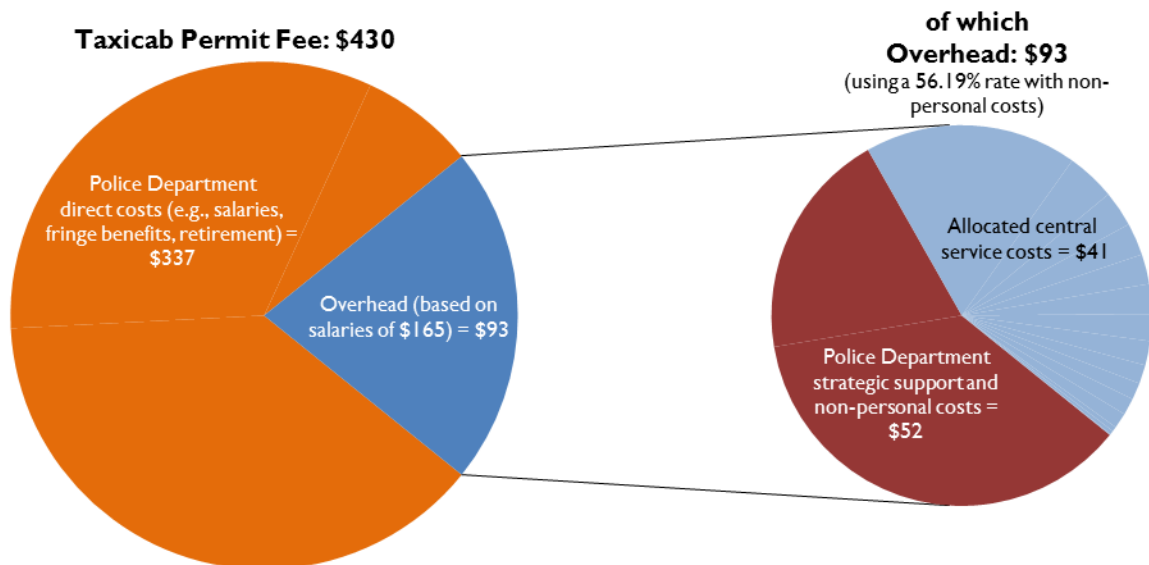
See Appendix C for rate calculations for all departments.

Costs of City central services do not add exactly to line A due to rounding within the NGCS II software.

This method of calculating overhead rates is used across all City departments. The rate calculation for utility funds and capital projects involves a blending of several different department overhead allocations. For more detail, see Appendix C.

Once the overhead rate is calculated, line department staff use these rates to set fees to recover the costs of that service.⁶ Exhibit 3 shows how overhead is factored into the fee calculation of a taxicab permit based on the rate calculated in Exhibit 2 above. See Appendix E for more detail on this permit fee as well as further examples of the cost components of other fees.

Exhibit 3: Example Breakdown of the Components of a Taxicab Permit Fee



Source: Auditor analysis of Police fee calculation, the City-wide Cost Allocation plan, and Finance-prepared overhead rate sheet

See Appendix E for other more detail and other examples.

Overhead Rates Over Time

Generally, the City has seen overhead rates fluctuate over the last few years. Exhibit 4 shows the City's overall overhead rate over the last five years, calculated by dividing indirect costs (from both central services and within departments) by direct labor costs.

⁶ Some fee-related programs are intended to be 100 percent cost recovery; others are intended to be less than full cost recovery.

Exhibit 4: City Overhead, 5-Year History (\$millions)

	FY 09-10	FY 10-11	FY 11-12	FY 12-13	FY 13-14	5-year change
Allocated costs from City central services	\$100.7	\$108.6	\$100.4	\$99.5	\$100.1	-0.54%
Indirect costs within line departments	\$95.9	\$88.3	\$88.0	\$82.8	\$86.1	-10.25%
Total overhead allocated	\$196.6	\$196.9	\$188.4	\$182.3	\$186.2	-5.28%
Line departments' direct labor	\$420.9	\$426.8	\$383.5	\$335.8	\$344.0	-18.27%
Rate (divide overhead by direct labor)	46.7%	46.1%	49.1%	54.3%	54.1%	7.4%

Source: Auditor analysis of Finance's City-wide Cost Allocation Plans and rate tables. FY 2009-10 through FY 2012-13 unaudited

Note: Includes data for almost all line departments and funds; excludes data for the Airport, capital projects, and utility funds.

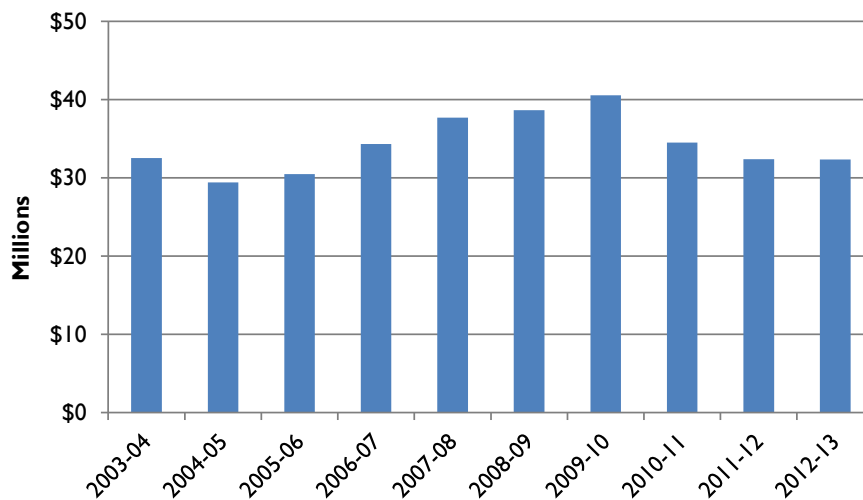
Overhead rates for core services within a department fluctuate as well. For example, Planning, Building, and Code Enforcement's overhead rate for development services rose from 26 percent in FY 2009-10 to 39 percent in FY 2011-12. For FY 2013-14, it is 35 percent. The Police Department's overhead rate for Response to Calls for Service has fluctuated between 48 and 57 percent over the last five years. See Appendix F for five-year trends of all overhead rates.

Reimbursements to the General Fund from Enterprise and Special Funds

Once rates are calculated, they are used in several ways across the City. For General Fund programs and departments, the rates are used to set fees or recover costs from grants. For programs that do not calculate fees or use grant funding, it is possible that their overhead rates are not used.

However, the City does use overhead rates for reimbursements from special funds to the General Fund for central services provided to non-General Fund activities, including ratepayer-funded utility services, Airport services, and others. Over the past ten years, these reimbursements have averaged \$34 million annually, reaching a high of \$41 million in FY 2009-10. Overhead reimbursements have ranged from 3.5 percent to 4.8 percent of the overall General Fund budget. Exhibit 5 shows the reimbursements the City has received for the cost of providing services to non-General Fund activities.

**Exhibit 5: Overhead Reimbursements to the General Fund,
10-Year History**



Source: Auditor Analysis of City of San José Adopted Budgets and Annual Reports

Effect of Outsourcing on Overhead

Outsourcing a City program to an external contractor changes the type of central services provided to that program. As a result, the type of costs tied to the program will also change. As long as the program continues to use City central services, it will be tied to certain central service costs. If a program has fewer City staff, then it will require fewer central services such as payroll. However, it may still generate overhead for services provided by other City functions (such as accounts payable, budget, attorney services, or audit work).

For example, since 2004, the management of the City’s Convention and Cultural Facilities has been outsourced to Team San Jose, Inc., a non-profit corporation. This outsourcing has affected the type of central service costs allocated to the City’s Convention and Cultural Affairs Fund (Fund 536).⁷ Though the number of City staff has been decreased, Fund 536 (and thus Team San Jose) is still included in the plan as it still utilizes central services. It no longer is allocated payroll costs; however, it now is allocated City Auditor costs associated with the City’s annual performance audit. See Appendix C for Fund 536’s cost allocation details.

Outsourcing may also change the method by which overhead is charged. Following the example above, when the City funded positions in Fund 536, overhead was calculated by multiplying the overhead rate by direct labor costs in the fund. Because Fund 536 no longer pays for City employees, in FY 2013-14,

⁷ The Convention and Cultural Affairs Fund (Fund 536) accounts for the revenues and expenditures related to the City’s Convention and Cultural Facilities.

the fund was charged the lump sum of \$753,416 as calculated by the plan (see Appendix C). This amount will be reimbursed to the General Fund by Fund 536.

On a smaller scale, these effects will be similar when a program within a department or division is outsourced. The effect will be seen in the overhead rate for the core service in which the program had been budgeted. If the program continues to use City services, the department will be allocated central service costs. In addition, contract costs for outsourced services in a department's non-personal budget will be factored into overhead amounts and rates.⁸ See Appendix B for a full listing of the data used to calculate central service costs in the City.

Audit Objective, Scope, and Methodology

The objective of our audit was to review and evaluate the City of San José's FY 2013-14 City-wide Cost Allocation Plan for appropriateness and accuracy. We sought to understand the purpose, development, and components of the City-wide Cost Allocation Plan through interviews, reviews of documentation, and reviews of data utilized during the plan's development. These include:

- Interviews with management and staff from Finance; the Budget Office; the Airport; the Environmental Services Department; Human Resources; Information Technology; the Department of Planning, Building, and Code Enforcement; the Police Department; and Public Works.
- Review of Council Policy I-18, *Operating Budget and Capital Improvement Program Policy*.
- Review of Title 2 of the Code of Federal Regulations, Part 225, *Cost Principles for State, Local and Indian Tribal Governments* (Office of Management and Budget Circular A-87), the California State Controller's *Handbook of Cost Plan Procedures for California Counties*, and a U.S. Department of Health and Human Services' *Implementation Guide for Office of Management and Budget Circular A-87*.
- Review of Finance's *Indirect Cost Allocation Plan Procedure Manual* and the FY 2013-14 City-wide Cost Allocation Plan.
- Reconciled a sample of allocated costs to Finance's supporting worksheets and departmental source documents such as workload data provided by central service departments. We also reconciled a sample of departmental workload data to source documents.

⁸ A number of central service functions are allocated based on data that is not affected by a full-time equivalent (FTE) count. Many functions are allocated based on actual workload or the size of a department's budget, both of which would capture the services provided to an outsourced function. For example, costs related to the Mayor and City Council and the City Manager's services are allocated based on the size of a department's (or fund's) budget, which would include the non-personal cost of a contract.

- To evaluate the effectiveness and accuracy of the proprietary software that Finance used in making its calculations, we traced a sample of costs through Finance's worksheets and the software. We also spoke with a vendor's representative to understand the functionality of the currently used and alternative software products.
- Benchmarked the City's plan, method, and software use by reviewing plans and interviewing staff from other jurisdictions who are involved with their agency's overhead plans, including Alameda County; Atlanta, GA; Fresno (City); Long Beach; Los Angeles (City); Palo Alto; Sacramento (City); Sacramento County, San Diego County, San Francisco, San Mateo County, and Santa Clara County. We reviewed the plan and method of allocating costs but did not compare final overhead rates as such rates may not be comparable across jurisdictions due to differences in calculation and organizational structure.
- Reviewed best practices literature including *Cost Analysis and Activity-Based Costing for Government*, R. Gregory Michel, Government Finance Officers Association (GFOA), 2004 and the GFOA's Best Practice *Documentation of Accounting Policies and Procedures*.

We limited our review to the FY 2013-14 City-wide Cost Allocation Plan.⁹ We did not audit the budget data provided by the Budget Office, the sources and databases for departmental workload data, and the uses of overhead rates.

⁹ As described in earlier, the Finance Department produces three overhead plans. We did not audit the Airport or Grant Plans, or the Public Works plan that is prepared by an outside vendor. The Airport Plan is audited annually, and furthermore, subject to regulation by the Federal Aviation Administration (FAA). The Grant Plan is audited annually as part of the City's Single Audit of federal grants. The 2010-11 Grant Plan was approved in June 2013 by the U.S. Department of Housing and Urban Development (HUD). As noted in HUD's approval/agreement, the City is required to submit true-up calculations to account for any under/over recovery of indirect costs based on the rates applied in fiscal year 2010-11.

Finding I Finance Should More Clearly Define Indirect Costs

Summary

The City's FY 2013-14 overhead plan included \$120 million of central service costs which were deemed to be overhead. These costs are associated with various direct services and thus allocated to departments to set fees or to reimburse the General Fund from special or enterprise funds. There were an additional \$39 million of central service costs that were judged to not support other departments, and as such were not included in the plan as overhead. However, it is unclear why some central service costs were considered to be overhead and others were not. It also appears that decisions about whether certain costs should be included as overhead have not been consistent over time. To ensure the appropriate and consistent classification of central service costs, Finance should update its procedures to more clearly define indirect costs that should be included in the plan. It should also review and revise its lists of allocated and unallocated costs.

The Purpose of the Overhead Rate Calculation Is to Recapture Indirect, Central Service Costs

The City provides a variety of services directly to the public through various line departments, including the Police and Fire departments, the Department of Transportation, the Library Department, and others. It also has a number of central service departments which support those direct services. These support activities include such things as payroll provided by the Finance Department, computer support provided by IT, and facility maintenance provided by Public Works.

As noted in the Background, the purpose of the overhead plan is to identify these support functions and allocate their costs across the City's services based on an estimate of the level of support provided to those services. The goals of the overhead plan are twofold:

1. Calculating the full cost of City services for fee setting purposes
2. Reimbursing the General Fund for the cost of providing central services to enterprise or special funds

Although some special funds reimburse the General Fund directly or in a lump sum, many central service costs are only recaptured to the extent that fees are set to be cost-recovery¹⁰ and are collected for individual services. For example, the amount of overhead costs recaptured through the residential building permit fee is a function of the fees being set to be fully cost recovery (including overhead), and the actual level of permitting activity in a given year. Overhead is not paid directly out of the Planning, Building, and Code Enforcement Department's annual budget.

The plan groups central service costs by "cost pool." Cost pools within the plan are simply a set of costs which support other services. This can be a division, department, or some other cost which may not directly relate to an individual department. Examples of this last type of cost pool are the Building Occupancy and Equipment Usage cost pools meant to allocate a portion of the cost of buildings and equipment to departments that use them.

\$120 Million of Central Service Costs Is Treated as Overhead

Central service costs are treated in three different ways within the overhead plan.

- \$120 million in central service costs which support other City programs are deemed to be overhead and allocated to those programs. These central service costs include such items as payroll services, utilities in City buildings, Budget Office services, City Attorney services, and others.
- \$39 million of central service costs are not allocated to other City services because they are deemed to be for direct services to the public (i.e., they are not support functions for other City programs). For example, the cost of elections (City Clerk's Office) is not allocated to other City services within the overhead plan. In addition, other costs are not allocated because they are charged to departments through other means (e.g., Human Resources' costs related to employee benefits are charged separately).¹¹
- \$11 million in direct bills, which account for instances where enterprise or special funds pay for budgeted central service costs. These costs are entered into the plan to offset allocated costs to ensure that those funds are not double charged for services. For example, the FY 2012-13 budget for the Integrated Waste Management Fund (IWM) included \$3 million for IT services. This amount was included in the overhead plan as a direct bill to offset any IT costs which would be allocated to IWM for supporting activities.

¹⁰ Some fee-related programs are intended to be 100 percent cost recovery; others are intended to be less than cost recovery.

¹¹ Although these costs are "unallocated," they are included in the overhead plan so that they absorb an appropriate relative share of departmental administrative costs or allocated costs from other central service programs.

Exhibit 6 shows total central service costs in the FY 2013-14 overhead plan broken down by the above designations. See Appendix B for more detail on individual central service department programs and their costs.

Exhibit 6: Central Service Costs in the FY 2013-14 City-Wide Overhead Plan (\$millions)

Cost Pool	Included as Overhead	Unallocated (not included as overhead)	Direct Billed
City-Wide Programs	\$32.6	-	-
Building Occupancy	\$4.3	\$24.2	-
General Services	\$14.7	-	\$2.6
Information Technology	\$12.8	\$0.8	\$3.6
Finance	\$6.2	\$6.6	\$2.2
City Attorney	\$12.6	-	\$2.0
City Manager	\$10.7	\$0.1	\$0.3
Mayor and City Council	\$8.0	\$3.0	-
Human Resources	\$4.7	\$2.9	\$0.6
Equipment Usage	\$6.9	-	-
City Auditor	\$2.1	-	-
City Clerk	\$1.1	\$1.0	-
Building Leases	\$1.8	-	-
Independent Police Auditor	\$1.1	-	-
Emergency Services	\$0.2	\$0.4	-
Total	\$119.8	\$39.0	\$11.3

Source: Auditor Analysis of the FY 2013-14 City-Wide Cost Allocation Plan.

As is shown in Exhibit 6, City-Wide Programs was the largest cost pool in the plan. The majority of the \$33 million in these costs were related to workers' compensation claims and sick leave payments (\$17 million and \$6 million, respectively).

Finance Procedures Do Not Provide Clear Guidance on What Costs Should Be Considered Overhead

As noted above, the plan is designed to allocate central service costs that support the delivery of City services. Finance has developed procedures to help staff identify and account for those costs. Unfortunately, the procedures only provide broad guidance on what central service programs are, simply defining them as those "activities that indirectly benefit all departments across the organization." However, the procedures do not provide specific guidance on how to determine whether a program indirectly benefits other departments or should be considered as providing services directly to the public.

The procedures also do not provide clear guidance on how to determine whether costs within individual cost pools should be deemed overhead or not. For example, for the City-Wide Programs cost pool, the procedures state only that staff should "review budgeted programs and classify eligible cost." There is not specific guidance on how staff is to classify budgeted City-Wide Expenses,

which include such things as the costs for workers' compensation claims, general liability insurance, property tax administration, and others.

Similarly, the procedures identify service yards, communication buildings, and other direct use buildings as those buildings which should be included in the plan's Building Occupancy cost pool. However, the procedures do not clearly define what an "other direct use building" is. As such, there is no specific guidance on how staff is to classify the costs for such buildings as the City's libraries, community centers, and other buildings related to fee-generating programs.

In practice, it is up to Finance staff to make individual decisions regarding whether central service program costs should be allocated or not allocated within the plan. In some cases, Finance worked with central service program staff to help determine what costs should be allocated in the plan and what costs should not. In other instances, it is not clear whether that communication had occurred. Also, in many cases the rationale for why certain costs were considered overhead and others were not was not documented.

Central Service Costs May Not Have Been Treated Consistently

Because of the broad guidance and the lack of documentation, it is unclear why certain central service program costs are deemed to be associated with service to other departments and included in the overhead plan, and others are not. Examples include:

- The Building Occupancy cost pool is meant to spread the historical cost of City facilities over time and across associated departments (defined as a "usage allowance"). For example, the FY 2013-14 plan allocated \$500,000 to the Library Department in usage allowances for various library buildings.

As noted earlier, the procedures simply state that the buildings included in the allocation include service yards, communication buildings, and other direct use buildings. It is not clear how staff has determined what a "direct use building" is and it appears that determination has been inconsistent over time. For example, while \$500,000 in library building costs were included in the plan, \$2.9 million in costs related to other library buildings were not.

Also, despite some library building costs being allocated in the plan, there were no usage allowances allocated as overhead for community centers or other Parks, Recreation, and Neighborhood Services' facilities (totaling \$4.9 million), nor for Animal Shelter facilities (usage allowances totaling \$300,000). Again, there was no explanation for why these costs have not been allocated in the plan.¹²

¹² The usage allowances for City Hall and the employee parking lot are not allocated as overhead as it is City policy to charge the annual debt service separately on a fund basis.

To be clear, these choices do not affect individual department budgets; however, they do affect how the City determines the full cost of individual services for fee calculations.

- Most central service departments, including the City Manager, City Clerk, and Emergency Services, provide multiple services. The Finance Department splits their costs between those which are for services to other departments (overhead) and direct services to the public (costs unallocated in the plan). In these and other instances, the rationale is not documented for why certain costs are deemed public services and others are deemed to provide services to other City departments.
- The City-Wide Expenses section in the budget includes activities that relate to more than one department or are not directly associated with ongoing departmental activities. As described earlier, Finance procedures only state that staff “review budgeted programs and classify eligible cost.” According to Finance, they communicate with the Budget Office to help determine whether costs should be allocated in the plan. However, budgeted City-Wide Expenses in the City’s Adopted Budget contain a multitude of program costs, only some of which are allocated as overhead in the plan. There is little, if any, documentation for why some City-Wide Expenses are deemed overhead and others are not.

Documenting Decisions Ensures Costs Are Consistently Treated Over Time

As noted previously, the rationale for decisions about whether costs should be allocated in the plan as overhead or not was in many cases not documented. Documenting decisions provides staff with the history and reasoning necessary to appropriately and consistently treat costs over time. The California State Controller’s Office, in its *Handbook of Cost Plan Procedures for California Counties* stresses this point, stating:

Costs and credits should be treated properly and consistently. Any decisions or interpretations and the supporting rationale should be thoroughly documented. A clear, comprehensible, and complete audit trail must be maintained, linking the cost plan with all of the information used in its preparation.

Documenting decisions is especially important to maintain consistency during periods when there is staff turnover, which has been the case within Finance (at least nine different individuals have prepared or supervised the preparation of the plan since 2007).

Recommendation #1: To ensure that central service costs are treated appropriately and consistently, the Finance Department should update its procedures to more clearly define what costs should and should not be allocated within the Cost Allocation Plan. Specifically, the procedures should:

- **Provide guidance on how to determine whether a central service department, a City-Wide program, or an individual central service program provides services to the public versus to another City department**
- **More clearly define what a “direct use building” is in determining allocated costs within the building occupancy cost pool**
- **Require that staff document decisions regarding whether costs should be deemed allocable or unallocable in accordance with the above**

Recommendation #2: To conform to the updated procedures (as outlined in Recommendation 1) in the FY 2014-15 Cost Allocation Plan, the Finance Department should review and revise its lists of:

- **Allocated and unallocated central service costs**
- **City-Wide Expenses**
- **Direct use buildings**

Finding 2 Finance Should Review and Update Its Cost Allocation Methodology

Summary

To determine the full cost of City services, Finance allocates indirect costs by means of allocation bases that are intended to relate the support activity performed to the services received by other departments. These allocation bases include such things as the size of department budgets, total full-time equivalent employees by department, and more specific workload data that approximates the services provided to other departments. To ensure that allocation bases reflect actual workload and take into account organizational changes, Finance should improve its communications with central service departments and revise allocation bases. Finance should also improve how it allocates overhead to capital projects, review the Equipment Usage and Building Occupancy cost pools to ensure costs are consistently and accurately allocated, and reorder the central service department allocation sequence.

Allocation Bases Need to Be Periodically Reviewed and Updated

The methodology Finance utilizes to allocate indirect costs is by means of “allocation bases,” or a set of criteria used to allocate indirect services provided to departments. For example, the allocation base used to allocate the cost of Finance’s payroll function across all services is the number of full-time equivalent employees in each department.

To calculate the allocation bases, Finance utilizes data from Budget Office Automated Budget System (ABS) reports and central service department-provided workload data. Finance has intended to establish an allocation base for all central service costs that relates the activity performed to the services received by other departments. The purpose of this (as described in the Background section of this report) is to determine the full cost of the City’s services for fee setting purposes, or to reimburse the General Fund for services provided to enterprise or special funds.

Finance uses a wide variety of allocation bases. The most prominent bases, by prevalence and by the amount of allocated overhead, are departmental budget size, number of full-time equivalent employees, and direct cost (i.e., functions that are directly associated with specific departments or funds). Other bases may be specialized and unique to a specific central service program and based on data that approximates the workload of that program.

See Appendix B for a complete list of central service department functions and their allocation bases.

Some Allocation Bases Do Not Reflect Actual Workload

Each year, Finance requests assistance from central service departments to calculate the City's overhead rates. It does this through individual memoranda to departments, asking for workload data for their services. For example, in the memo to the Human Resources Department (HR), Finance requests data on the costs of prior year workers' compensation claims by department. This information is then used as the allocation base in the overhead plan to allocate HR's costs to administer the workers' compensation program.

According to central service departments, although they provide data as requested, they generally do not meet or communicate with Finance further about how their data is used or the appropriateness of their allocation bases. In addition, they may not review the overhead plan once it is completed.

Because of the lack of ongoing communication between central service program staff who are most familiar with their work and Finance staff who prepare the overhead plan, there are instances where costs in the plan have allocation bases which do not reflect the actual workload of the program. For example, despite providing accounting services for both the Sewer Service & Use Charge Fund and the San José/Santa Clara Treatment Plant Operating Fund, all of Finance's associated accounting costs (totaling \$462,000) are allocated to the Sewer Service & Use Charge Fund only. Similarly, the costs of accounting services associated with the City's Facility and Maintenance Districts (totaling \$168,000) are allocated to all City departments based on the size of each department's budget rather than to the districts themselves.

There are also instances where the allocation base for individual costs within the City-Wide Programs cost pool may need to be updated. For example, the cost of auditing the City's Comprehensive Annual Financial Report (CAFR) is allocated to departments based on the number of audit hours associated with City Auditor-prepared performance audits (which are unrelated to the preparation of the CAFR). According to Finance, they communicate with the Budget Office to identify City-Wide costs; however, it is unclear how much the Budget Office is included in the discussion of how to allocate such costs.

Some Allocation Bases Have Not Been Updated to Account for Organizational Changes

Finance's procedures also call for central service programs to be reviewed each year to ensure that any organizational changes are accurately reflected in the overhead plan. As such, the memoranda Finance sends to central service departments for updated workload data also ask that departments contact Finance if they have questions or suggestions for improving service level measurements. Despite this, there have been instances where organizational changes have not been accounted for in the overhead plan.

For example, prior to the dissolution of the City's Redevelopment Agency (RDA) in 2012, a quarter of the Mayor and City Council's costs were allocated to the RDA. The methodology did not change upon the RDA's dissolution, and a quarter of the Mayor and City Council's costs were allocated to the Successor Agency to the Redevelopment Agency (SARA) in the FY 2013-14 overhead plan, even though the workload has likely been reduced. Similarly, facility management costs totaling \$4.1 million have been allocated based on the workload of former in-house custodial staff (a service which was outsourced in FY 2010-11) rather than the current workload of facility management staff.

Better Communication Between Finance and Central Service Departments Should Alleviate Problems

Regular communication between central service department staff and the Finance Department about overhead cost allocations could help ensure that allocation bases accurately reflect the service provided. In San Mateo County, department financial officers are briefed yearly about the overhead process during a routine meeting. The briefing includes information about the overhead plan, the methodology used to allocate costs, the regulations the plan must follow, and the purpose of cost allocation. Additionally, department staff is informed of the timeline of the overhead plan preparation and are given specific details about departmental allocations. This meeting takes place after the request for department data is made and before the data is due, such that County staff have the opportunity to ask questions if necessary.

Recommendation #3: Before the Cost Allocation Plan is developed, the Finance Department should meet annually with central service departments, and the Budget Office, to review the allocation bases of their programs to ensure costs are appropriately allocated and identify any significant changes in departmental workloads. This review should include the allocation bases for City-Wide Expenses. Any changes resulting from the above should be documented and Finance Department's procedures should be updated accordingly.

Recommendation #4: As part of its review of the FY 2014-15 Cost Allocation Plan, the Finance Department should review and revise the allocation bases to better reflect workload. This revision should include the Mayor and City Council's allocation to the Successor Agency, the allocation of Public Works' facility management costs, the allocation of Finance costs for utility fund accounting, and any other bases that are identified.

Finance Can Improve How It Allocates Overhead to Capital Projects

Finance calculates a separate capital overhead rate to recoup central service costs related to personnel who are working on capital projects. Finance identifies departmental staff charged to capital funds and determines their share of overhead of their respective department. The actual capital rate is a weighted average of the overhead rates of individual departments with capital program staff. See Appendix C for detail on the capital rate calculation.

The capital overhead rate is applied on a bi-weekly basis against labor costs charged to capital projects. For example, if City staff charges one hour of their time to a particular capital project, overhead is calculated as a percentage of the cost of that hour of time and charged to that capital project. This rate is utilized for capital projects delivered by the Department of Public Works, the Environmental Services Department, and others.

The capital rate for FY 2013-14 is 46.7 percent, up from 39.9 percent from the prior year. Based on budgeted labor costs of about \$26 million, \$12 million in overhead costs may be charged to capital projects in FY 2013-14.¹³

The Capital Overhead Rate May Not Fully Capture All Associated Central Service Program Costs

As noted previously, a prominent allocation base utilized in the overhead plan is the size of departmental budgets, the rationale being that the larger a department, the more central services it is likely to utilize.¹⁴ Because of concerns that the capital overhead rate is not fully capturing a proportionate share of central service costs (in particular those related to oversight from the City Manager's Office and the Mayor and City Council), Finance includes both operating and capital budgets in its calculation of a department (or fund's) budget for overhead allocation purposes.

However, including capital budgets in this way has had the effect of increasing allocations of City Manager and other costs to some special *operating* funds and not specifically to capital projects. For example, the capital budget for the City's sanitary sewer system was included in the Sewer Service & Use Charge operating fund's budget calculation, increasing the cost of overhead to that fund and not to specific sanitary sewer capital projects. As such, individual capital projects may not be reflecting the full cost of the services provided to them.

¹³ Actual overhead reimbursements are calculated based on staff activity charged to capital projects.

¹⁴ In total, \$21.8 million in costs were allocated based on the size of department budgets in the FY 2013-14 plan. The most prominent of these costs were a portion of the City Manager's costs (\$7.6 million) and the Mayor and City Council costs (\$5.5 million).

Finance Should Explore Alternative Methods to Allocate Overhead to Capital Projects

For some central service programs, Finance applies a service ratio to estimate workload and allocate costs. For example, the City Clerk's costs are split between allocated overhead and direct public service on a 60/40 ratio based on an estimate of the City Clerk's workload. Similarly, the Mayor and City Council's costs have been split between overhead to City departments and funds, overhead to the former RDA, and public service on a 50/25/25 ratio. A similar service ratio could be utilized to allocate a portion of the costs of the City Manager's Office and the Mayor and City Council to the capital program. Such costs would then be included in the capital overhead rate calculation.

The benefit of charging overhead in this manner (rather than through a departmental or fund rate) is that overhead will be charged directly to capital projects and capital projects' funds, and be based on actual activity during a specific project's completion. It would also avoid allocating capital-related overhead to special operating funds (such as the Sewer Service & Use Charge operating fund example described above).

Additionally, Finance does not treat rebudgets consistently in its calculation of the department budget size allocation base. Finance backs out *operating* rebudgets from this calculation. However, *capital* rebudgets are not backed out. Rebudgets are unspent or unencumbered prior-year funds which are reauthorized for the same purpose as previously approved (carried over), usually as a result of delayed program implementation. Finance should back out capital rebudgets similar to operating rebudgets.

Recommendation #5: To improve how it allocates overhead to capital projects, the Finance Department should:

- **Utilize a workload estimate or other appropriate alternative allocation methodology to account for City Manager, Mayor and City Council, and other central service costs related to capital programs**
- **Back out capital rebudgets from the calculation of the department budget size allocation base**

Equipment Usage and Building Occupancy Cost Pools Should Be Reviewed to Ensure Costs Are Consistently and Accurately Allocated

As described in Finding 1, the overhead plan includes Equipment Usage and Building Occupancy cost pools meant to allocate a portion of the cost of equipment and buildings to departments that use them. The purpose of this is to ensure that the calculation of the full cost of a City service includes the cost of the buildings and equipment necessary to deliver the service.

The costs allocated in the plan equal 6.67 percent of the historical cost of vehicles and equipment and 2 percent of the historical cost of buildings (based on expected lives of 15 and 50 years, respectively). The costs allocated in the plan total \$6.9 million in Equipment Usage costs and \$4.3 million in Building Occupancy costs.

The Cost of Grant-Funded Buildings and Equipment Should Be Treated Consistently

Within the Building Occupancy cost pool, Finance has identified \$7 million of building assets which were funded through grants. The usage allowance of these assets, totaling \$146,000, is not deemed to be overhead and as such is not allocated to departments to calculate overhead rates.

The City has also purchased equipment through grant funding. For example, in FY 2011-12 the Fire Department purchased nearly \$100,000 in equipment through an Urban Area Security Initiative grant. In contrast to the grant-funded buildings, the usage allowance of this equipment was included in the overhead rate calculation.

We believe that grant-funded assets should be treated consistently across the Building Occupancy and Equipment Usage cost pools.

Vehicles and Equipment Included in Department Non-Personal Budgets Should Be Treated Consistently

As described in the Background, overhead rates take into account both allocated overhead from the overhead plan and individual department strategic support and non-personal costs. The Equipment Usage cost pool includes many vehicles and pieces of equipment purchased out of individual departments' non-personal budgets. To account for this, Finance backs out vehicle replacement costs from the non-personal budget portion of the rate calculation so that such costs are not included twice (once as allocated overhead and a second time in the department's non-personal budget).

However, equipment costs do not appear to be backed out of the calculation in the same manner. For example, computer equipment purchased by one department totaling about \$18,000 appears to be generating a usage allowance

but had not been backed out of the department's non-personal budget in a similar manner as the vehicle purchases. We believe vehicles and equipment purchases should be treated in a consistent manner.

Vehicles and Equipment Schedule Used to Calculate Usage Allowance Does Not Reconcile with Finance's Fixed Asset Accounting System

To calculate annual equipment usage costs, Finance maintains a spreadsheet with the historical cost of assets by department. Each year it is updated to include new vehicles and equipment and exclude assets which were retired or disposed of during the year. The total historical cost of the assets included (\$104 million) matches the amount reported in the City's Comprehensive Annual Financial Report (CAFR).

However, it appears that errors have occurred over time as the individual departmental asset list used in the overhead plan does not reconcile to the departmental list included in Finance's fixed asset accounting system. For example, the overhead plan's backup worksheet shows \$14 million in vehicles and equipment for the Police Department (generating \$933,000 in usage costs), whereas the fixed asset accounting system reports \$25 million in total vehicles and equipment for the Police Department. Such discrepancies exist across nearly all departments.

Because of the discrepancies, Finance should review and standardize its fixed asset listings. As Public Works' fleet management division also maintains an asset inventory, Finance should also work with Public Works to ensure the correct department is allocated equipment usage costs in the overhead plan.

Usage Allowances May be Allocated for Buildings and Equipment Whose Costs Have Been Fully Allocated in Past Years

The usage allowance is meant to allocate the historical cost of an asset to associated departments over time. Thus, no more equipment usage costs should be allocated once the full cost has been captured through the year-to-year overhead plans. For buildings, based on a 2 percent usage allowance, this would mean that any asset over 50 years old should not be generating a usage allowance. However, about \$65,000 in usage allowances were generated for buildings older than 50 years (in one instance, the building was more than 100 years old).

Based on a 6.67 percent usage allowance, the historical cost of vehicles and equipment would be recaptured over 15 years. It appears that this cost pool may also include assets whose historical cost has been fully allocated in prior years as well.

Recommendation #6: To ensure that vehicle and equipment costs in the Equipment Usage cost pool are consistently and accurately allocated, the Finance Department should:

- Treat grant-funded vehicles and equipment as unallocated costs (similar to how grant-funded building assets are treated in the Building Occupancy cost pool)
- Treat vehicles and equipment purchased through departmental non-personal budgets consistently
- Review and standardize the vehicle and equipment fixed asset schedules in the Cost Allocation Plan
- Remove any assets which are more than 15 years old and whose historical cost has been recaptured in past Cost Allocation Plans

Recommendation #7: To ensure that Building Occupancy costs are accurately and appropriately allocated, the Finance Department should remove any assets more than 50 years old and whose historical cost has been recaptured in past Cost Allocation Plans.

Finance Should Reorder the Central Service Department Allocation Sequence

As described in the Background, the overhead plan utilizes a two-step method of allocating central service costs. The first allocates all central service costs to all other departments, including other central service departments. The second step is a series of allocations, whereby the remaining central service costs are allocated down to other departments (or closed out) in a designated order. The close-out order of the central service departments is as follows (and correlates with the order of departmental codes assigned in the City's Financial Management System (FMS)).¹⁵

1. City Manager
2. Emergency Services
3. Independent Police Auditor
4. Mayor and City Council
5. Finance
6. Information Technology
7. City Attorney
8. City Clerk

¹⁵ Unlike central service departments, the Building Occupancy, Equipment Usage, City-Wide Programs, and Building Leases cost pools are not allocated overhead costs and are completely closed out after the first step.

9. City Auditor
10. Human Resources
11. General Services

Once a central service department has allocated its remaining costs in this step, it no longer receives allocations from central service departments below it in the designated allocation order (i.e., costs flow downward through the order in the second step, but do not flow upward). For example, in the second step, City Manager costs are allocated to Human Resources, but Human Resources' costs are not allocated to the City Manager or any of the departments above it in the close-out process. See Appendix A for a graphical illustration of the allocation process.

According to City Council Policy I-18, central service costs are to be allocated down "in priority order" to the departments and funds receiving their services. The GFOA has written that the allocation order is important in estimating indirect costs, and may significantly affect the outcome of cost allocation. The GFOA further writes that usually central service departments that serve the most departments are allocated first while (central service) departments that receive the most services are allocated last.

In response to our question about the effect of the allocation order on overhead rates, Finance ran a limited test scenario that reordered a few of the central service departments. For most of the line departments, there was minimal impact. However, one line department's overhead rate changed by 1.5 percentage points. That was the case even with such a minimal change to the allocation order.

To provide for more precise estimates of indirect costs, Finance should reorder the allocation sequence of central service departments in the overhead plan such that central service departments that serve the most departments are at the beginning of the allocation order and those that serve the fewest are at the end.

Recommendation #8: To align the Cost Allocation Plan with City Council Policy I-18 and to provide for estimates of indirect costs that better reflect workload, the Finance Department should reorder the central service departments in the Cost Allocation Plan such that central service departments that serve the most central service departments (in terms of numbers and dollars) are at the beginning of the allocation order, and those that serve the fewest are at the end.

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Finding 3 Finance’s Procedures and Resources Should Be Enhanced

Summary

Finance relies heavily on Excel spreadsheets to calculate overhead – preparing at least 150 worksheets that contain many different calculations, analyses, and other information important to the overhead calculations. To ensure the consistency and accuracy of these spreadsheets, we recommend Finance establish a process for reviewing critical data entry areas and key calculations. Finance should also document the rate calculation methodologies contained in these worksheets. Finance also uses old overhead software that has limited functionality, does not allow importing data from Excel files (necessitating an extensive manual data entry exercise), and only provides limited reports. We recommend Finance switch to a newer software application. Finally, Finance’s cost allocation process may also improve with additional staffing as only 0.5 FTE is currently assigned to preparing the City’s overhead plans.

Overhead Calculations Rely Heavily on Multiple Excel Spreadsheets

Finance makes extensive use of Excel spreadsheets in its cost allocation calculations, preparing at least 150 different worksheets in the course of calculating FY 2013-14 overhead rates. These spreadsheets contain a multitude of data from various sources and contain many different calculations, analyses, and other information important to the overhead process.

The spreadsheets serve many different purposes, but two critical uses – described in more detail below – are accounting for direct bill credits (which, if omitted, lead to departments being double-billed) and calculating overhead rates for utility funds, capital funds, and paid absence rates. Finance also uses the spreadsheets to store workload and budget data, make intermediate calculations (such as distributing costs across a department’s services), compile data for entry into the overhead software (NGCS II), and for other purposes.

Direct Bills Contained Multiple Data Entry Errors

Finance identifies direct bills¹⁶ through data from the Budget Office’s Automated Budget System (ABS). Finance summarizes these costs (\$11 million for FY 2013-14) in an Excel worksheet and then enters them, as appropriate, in the NGCS II software as a direct bill credit.

¹⁶ On some occasions, an enterprise fund or special fund pays directly (called a “direct bill”) for central services which are normally funded by the General Fund. For example, the Sewer Service and Use Charge (SSUC) Fund directly paid for \$0.5 million in City Attorney costs in FY 2012-13. When Finance includes the Attorney costs as a central service in the overhead calculations, it has to offset the allocation from Attorney to the SSUC Fund by \$0.5 million – it has to credit the SSUC Fund for the direct bill. Otherwise, the SSUC Fund would be paying twice for these services.

Because of data entry or other errors, it appears not all direct bills were accounted for correctly in the FY 2013-14 plan. Errors included:

- One direct bill totaling \$419,000 paid by the Sewer Service and Use Charge Fund was entered incorrectly to offset costs from the Water Utility Fund.
- \$239,000 in direct bills identified by Finance from the ABS reports were not entered into NGCS II to offset allocated costs. These included \$175,000 in City Attorney costs paid by the Workforce Investment Act Fund and \$64,000 in IT costs paid by the San José/Santa Clara Treatment Plant Operating Fund.
- \$106,000 in direct bills related to City Auditor costs paid by various utility funds were not identified by Finance in their review of the ABS reports and as such were not entered into NGCS II to offset allocated costs.
- \$564,000 in direct bills which Finance deemed related to unallocated programs and did not enter into the plan. There was no explanation in the Finance workpapers to explain this reasoning. \$498,000 of these costs related to IT costs paid through the Sewer Service and Use Charge Fund and \$66,000 related to Human Resources costs paid through the Vehicle Maintenance and Operations Fund.

In some of the cases above, Finance could have identified and remedied the errors by a more thorough review of the plan or its worksheets. For example, a review of the plan's detail pages could have found the \$419,000 direct bill entered on the wrong line because that fund had been allocated zero costs. Unfortunately, given limited resources, these errors were missed.

Utility and Capital Overhead Rates, and Paid Absence Rates Require Improved Documentation and Review

Finance also relies on Excel spreadsheets to calculate overhead rates for utility and capital funds, as well as for determining paid absence rates. These calculations have a major impact on ratepayers and City operations – utility ratepayers ultimately paid \$16.0 million in overhead in FY 2012-13.

Finance's Spreadsheet Calculations Contain Inconsistencies

Finance annually calculates overhead rates for the City's utility services, including recycling and garbage services, sanitary sewers, storm sewers, wastewater treatment, and potable water delivery. These overhead rates are eventually factored into customers' utility bills. Finance also calculates a capital overhead rate to capture overhead for City employees working on capital projects and a paid absence rate to capture the cost of City employee's vacation, sick, and

holiday leaves.¹⁷ These rates cannot be calculated with NGCS II alone because they involve multiple steps and data sources. Appendix C shows the rates and rate calculations.

These rate calculations contained several inconsistencies, but it was unclear whether these were data entry errors or intentional adjustments as supporting documentation to explain the rationale behind them was lacking. For example:

- The utility and capital rate worksheets included some cost figures that were inconsistent with their data sources
- The paid absence rate for “all other departments” may have been mislabeled or miscalculated¹⁸

Finance’s procedures manual does not describe the purpose, methodology, or formula for calculating utility rates and the capital rate. For example, it does not specify the weighted average method currently used and also does not address what costs should be included or excluded. Furthermore, it appears Finance staff simply used the previous year’s spreadsheets as templates to replicate the calculations with updated data. Thus, any potential inconsistencies and omissions could persist into the future.

It also appears that line departments affected by these utility and capital rates may have an unclear understanding of the calculation methodology. If Finance documented and communicated its methodology, it could improve transparency and understanding of these calculations in other departments (also see Finding 4).

Additional Review Can Prevent Errors and Eliminate Potential Inconsistencies

Because of the heavy reliance on the large number of complex spreadsheets to track direct bills, calculate utility and capital rates, and compile and analyze data, there is a risk that errors will persist unless there is a more rigorous review process. For example, if Finance had reviewed the critical worksheets and key calculations noted above more closely, it likely could have discovered and remedied many of these issues.

¹⁷ The paid absence rate is applied to an hourly staff time calculation; for example, the Police Department estimated that 3.65 staff hours were needed to process a taxi driver permit. The fee for a taxi driver permit included the staff salaries of those 3.65 hours, plus paid absence costs of 19 percent of salaries for the cost of vacation, sick, and holiday leave associated with the direct 3.65 hours. To be exact, paid absence rates capture the costs of vacation, sick, executive, holiday, personal, administrative, funeral, jury, military, and witness leave.

¹⁸ Finance calculated separate rates for the Police Department, the Fire Department, and “All Other Departments.” It appears that the paid absence rate for all other departments actually included payroll data from *all* departments, *including* Police and Fire. It is unclear if this was intentional or mislabeled. Moreover, Finance’s Excel formulas backed out compensated time off and disability leave from the denominator, but not the numerator. Finance’s calculations also did not take into account some pay codes such as paid time off (PTO), premium pays, or overtime. It was unclear if these inclusions and exclusions were intentional.

Finance's procedures, however, do not specifically address quality control or supervisory review. The procedures also do not differentiate roles for management and staff. Given the vast scope of the calculations and data entry, Finance should place emphasis on reviewing (1) direct bills because of the risk of double-billing enterprise and special funds, (2) the utility and capital rate calculations because of the high dollar impact to rate payers and special funds, and (3) other areas it deems critical or where it deems there is risk of error. It should also specify timelines for such a review, for example immediately after data entry into NGCS II and before finalizing rates.

Recommendation #9: To improve the accuracy of its indirect cost allocation calculations and ensure the previously identified errors do not reoccur, Finance should:

- **Establish a review process of critical data entry areas and key calculations. These should include direct bills from enterprise and special funds; utility, capital, and paid absence rate calculations; and other data entry or calculations which Finance deems critical or where there is a high risk of material error. Finance should also update its procedures to specify management and staff roles and timelines for such reviews.**
- **Document its methodologies and purposes for calculating utility overhead rates, the capital overhead rate, and paid absence rates. It should also document reasons for any adjustments made.**

Finance Uses Outdated and Inefficient Software

Finance uses a software application called *New Griffith Cost System II (NGCS II)* that calculates the dollar allocations from central service departments to line departments, using the allocation bases described in Finding 2. Since this involves repeated, lengthy calculations (see Appendix A), it is not easy to manually compute in Excel. It appears that NGCS II makes computations that are arithmetically accurate.¹⁹

As it was developed in the early 1990s, NGCS II has limited functionality and is outdated compared to newer software. It only runs on the DOS operating system and the software vendor Maximus no longer provides support or updates. Thus Finance today already is exposed to risk of NGCS II failing or becoming

¹⁹ Accurate computations notwithstanding, one part of NGCS II cannot handle numbers exceeding \$99,999,999. This necessitated a side calculation for the Police Department's "Respond to Calls for Service" core service whose direct labor costs were \$103 million. Another idiosyncrasy is that NGCS II calculates fractions to four decimals, but only displays three, with the rounding difference being absorbed into the last line-item.

incompatible and it will have to phase out its use of NGCS II sooner or later, by choice or by necessity.²⁰

NGCS II Requires Data Entry by Hand which Creates Potential for Errors

NGCS II requires large amounts of manual data entry. In a major data entry exercise, multiple Finance staff typed in by hand about 1,100 data points, which were mainly the costs for each central service, allocation units for each central service department, and direct bill credits. Finance staff estimated this data entry exercise required at least two days to enter all the data for the FY 2013-14 overhead calculations.²¹ NGCS II does not allow Finance staff to import data from an Excel spreadsheet. Exhibit 6 shows a screenshot of a data entry screen in NGCS II.

Exhibit 7: NGCS II Data Entry Screen

Expense Maintenance for 30 - City-Wide Programs								
Expense Item Name	Codes	32554544	G & A	Pers	Benef	Support	Sv	Aud & CPA
	1	2		-1-		-2-		-3-
SALARIES & WAGES			0	0	0	0	0	0
FRINGE BENEFITS			0	0	0	0	0	0
211 Call Center			0	0	0	0	0	0
ARRA of 2009 Admin		75000	0	0	0	75000	0	0
Audit/CPA Free Use		35210	0	0	0	0	0	35210
Annual Audit		220000	0	0	0	0	0	0
Bey Bud Cuts Org Im		0	0	0	0	0	0	0
Banking Services		1150250	0	0	0	1150250	0	0
Bond Project Audits		54000	0	0	0	54000	0	0
City Audit Perf Aud		0	0	0	0	0	0	0
City Council Securt		0	0	0	0	0	0	0
City Dues/Membershi		392000	0	0	392000	0	0	0
Citywide Training		0	0	0	0	0	0	0
Civil Svc Commissio		16508	0	0	16508	0	0	0
Comp Gen Plan Updat		0	0	0	0	0	0	0
Enter total expenses								

F1-Help F2-'I' select F3-Func. edit F4-Std. Expense F10-Esc. No Edit
 ShF1-Error Help ShF9-Next Err ShF10-Move
 Plan: CW14 Name: CW 13-14 COST A Dept. no.: 0 Dept. name:

Finance staff enters data by hand into the NGCS II application for each cost line item. Altogether, we estimate 1,100 data points require manual entry because NGCS II is not able to import Excel spreadsheets.

Source: Finance Department screenshot of NGCS II

²⁰ Similarly, our 2012 audit of IT General Controls found that many City computer systems are outdated and should be replaced. We recommended that the City “review the life expectancies of critical computer systems and determine a replacement schedule and budget for the highest-priority systems and hardware.” This report is available at <http://www.sanjoseca.gov/DocumentCenter/View/3168>.

²¹ This estimate is for the City-wide Plan only. The Airport Plan and Grant Plan require additional data entry of slightly smaller scope.

It appears that Finance staff entered the vast majority of the numbers correctly, but in our opinion, any large-scale data entry exercise introduces the risk of errors like mistyping digits, switching/transposing digits, and entering numbers on the wrong line. Several examples of such errors occurred in a sample of departments, as already described in this and preceding Findings.

Current Reporting Options Are Limited

NGCS II is also limited in its reporting: it does not export its calculation results to PDF or Excel format, instead only creating paper print-outs of schedules or the entire plan. The printed FY 2013-14 plan exceeded 250 pages. These reporting options make it very difficult for Finance staff to conduct more analysis of cost origins and trends and to communicate more clearly with departments about the reasonableness of allocation bases and costs.

Furthermore, the NGCS II reports are not user-friendly to line departments. While they show the software's calculation steps – if one follows the numbers through 250-some pages – they are organized by central service department, and not by line department. If analysts from the Environmental Services Department (ESD) wanted to understand where its cost rates are coming from or if all of its direct bills were accurately accounted for, they would have to look at detail schedules sprinkled throughout the 250-page plan because there is no summary page for ESD. See Appendix C for examples of such summary pages.

Because of NGCS II's heavy data entry requirements, its lengthy calculations, and its limited reporting options, it is difficult for Finance to calculate alternative scenarios, carry out sensitivity analyses, or make predictions. Such analyses could aid Finance and other departments to better understand the cost allocations and isolate factors of interest (such as a large one-time expense or an outsourced program). Potentially, Finance could then also analyze alternative scenarios to quantify the impact of different methodology choices. One other jurisdiction reported that they routinely analyze different cost allocation scenarios before finalizing changes to their methodology.

Finance Should Switch to Newer Software

Previous Finance staff purchased a software license for updated overhead software, Maxcars, in 2005. This software is from the same vendor that offered the NGCS II software and has improved functionality compared to NGCS II. Other jurisdictions which currently utilize Maxcars include Alameda County, Sacramento County, San Diego County, and Santa Clara County.

However, Finance does not currently use the Maxcars software to produce its overhead plan. Although the City made payments totaling \$6,200 to the vendor in 2009 and 2010 for support, upgrades, and training, because of staff turnover, current staff was unaware of the Maxcars license. This is despite the fact that Finance's procedures manual throughout refers to Maxcars as the software to be

used. Current Finance staff believes that the reason the City did not switch to the new software was because of the need to hire a consultant to transfer archived cost plan data into the new system.

Benefits of Maxcars include importing and exporting data via Excel, as well as adding notes and narratives, which Finding 4 also addresses and other agencies have found helpful. A Maxcars vendor further described the following functionalities of the software:

- Reports can be printed, exported as PDF, or exported to Excel
- Users can export a table to Excel, edit it in Excel, and re-import the revised table
- Users can create reports for year-to-year comparisons and error-checking
- Improved error-checking compared to NGCS II.

The Maxcars vendor has indicated that updates and support would cost \$2,500 annually, plus a one-time fee ranging from \$1,200 to \$4,000 for the City to renew its license and receive training; this does not appear cost-prohibitive.

Recommendation #10: To reduce its manual data entry and to improve its reporting, Finance should discontinue its use of NGCS II for producing the Cost Allocation Plan. Instead it should use Maxcars or another suitable software program.

Additional Staffing Can Improve the Cost Allocation Process

Only 0.5 FTE is assigned to work on cost allocation calculations, according to the Finance Department. While other Finance employees helped with specific data entry, the majority of the work was handled by one employee. This employee's other responsibilities were aiding the preparations of the Comprehensive Annual Financial Report (CAFR). Finance explained that the cost allocation calculations were constrained in time until after the completion of the CAFR each fall, but had to be completed in January before the annual budget process.

Other jurisdictions appear to assign more staffing to their cost allocation preparations. Generally they had one or two employees working on their cost allocation plans.²² Those agencies also prepared fewer plans (a federally compliant Grant Plan and perhaps a "full" plan), whereas San José prepares three different plans (the "full" City-wide Plan, a Grant Plan, and an Airport Plan).

²² Some agencies also contracted out their overhead calculations, but staff from these agencies explained that agency staff still is significantly involved in reviewing data and communicating with departments, whereas the contractor only prepares the cost allocation *plan*.

Moreover, the City staff who prepared the cost allocation calculations has frequently turned over. Since 2007, at least nine different individuals have prepared or supervised the preparations of the cost allocation plan. These frequent staff transitions eroded much of the institutional memory, as current Finance staff was unaware of the 2005 software purchase and relied on prior-year spreadsheets to compute cost allocations.

Adequate staffing and retention remains critical to the Finance Department's ability to complete cost allocation calculations timely and accurately.

Recommendation #11: To reduce the reoccurrence of errors identified, document methodologies, establish and clarify procedures, improve future Cost Allocation Plans, and to enhance analysis and communications with other departments to further transparency, the Administration should determine whether to assign additional staff resources to its preparations of the Cost Allocation Plans.

Finding 4 The Overhead Rate Calculation Can Be More Transparent

Summary

The current overhead plan is difficult to comprehend and is not documented in a clearly understandable format. Additionally, cost allocation information is not well communicated to City staff, leading to confusion about how overhead is calculated and how overhead rates should be applied. Other jurisdictions make their plans easier to understand and explain by including descriptive information about cost allocations. Finance should include such information and routinely explain rates to City departments. Explaining overhead to departments is particularly important when there are service delivery changes that might affect the application of overhead.

Although Overhead Calculations and Plans Are Complicated, the City Can Take Steps to Make the Overhead Plan Document More Transparent and Understandable

Overhead calculations and plans are generally complicated. With 15 central service cost pools being allocated to 25 line departments and funds in the City's plan, there is a significant amount of data entry, analysis, and calculation to produce a department's overhead rates. The complex methodology makes costs hard to trace (see Appendix A for a diagram of the methodology).

The Current Plan Is Difficult to Understand

The overhead plan for FY 2013-14 (which is the product of cost allocation software) contains more than 250 pages of detailed cost schedules. It shows the costs allocated from central service departments to line departments and the distribution of costs from larger line departments to their own core services.

The current plan provides limited explanations to help a reader understand the cost allocation process. It does not have an introduction or a statement of purpose that outlines the reason for allocating costs or the method by which costs are allocated. Accompanying each department's allocation is a very brief statement of what type of data was used to allocate the costs (such as department budget size, square feet of building occupied, or number of hours worked by staff). However, the data that is used and the services being allocated are not well explained. Several central service departments have broad function names with no description of what specific services these include. Simple descriptions could help line departments understand what services are included in their overhead rates. For example, the HR "Department Services" costs include Employment Services (including hiring and recruiting), Health and Safety (excluding Workers' Compensation), and a portion of Employee Benefits.

Explaining this in the plan would make it clearer which of HR's costs are allocated.

As noted in the Background, there are a variety of ways in which departments can be directly billed for services including: 1) direct bills that appear as offsets in the plan, 2) direct charges that are unallocated and reimbursed outside the plan, and 3) costs that are allocated fully to one department in the plan. The plan does not describe what these direct bills are or what they cover. Without explanation, it is difficult for departments to ensure that direct bills and allocations are correctly calculated.

The overhead plan also includes some costs that remain unallocated, as discussed in Finding I. These costs are marked in the overview of a central service department's allocation, but no rationales or explanations are included in the plan for why these costs are deemed unallocable. For example, a portion of HR costs is labeled only as "unallocated;" there is nothing in the plan to explain that these costs specifically relate to Deferred Compensation and are unallocated because the costs are separately charged. During our review, we found that there were several reasons for why a cost would not be allocated. Outlining these reasons in the plan would allow department staff to assess the appropriateness of their allocations.

Tracing cost allocations is not straightforward and the lack of explanation makes it even more difficult to comprehend. Without a plan that clearly explains cost allocation, it is difficult for line departments to review allocations and understand the calculation of their overhead rates.

There Are Ways to Make the Plan Easier to Understand

There are ways in which Finance could make the overhead plan more understandable for City staff. Including in the plan an introduction and descriptions of central service allocations, including direct bills, would facilitate understanding of the City's cost allocation.

The State Controller's Office has prepared a procedure manual for counties to follow when preparing their plans.²³ As part of the procedures, the Controller's Office requires counties to include narratives to describe the cost allocation and review the narratives annually. The Controller's Office *Handbook of Cost Plan Procedures for California Counties* states:

The importance of accurate and complete narratives in the cost plan cannot be over-emphasized.

The narrative for each central support service must include:

²³ The state of California requires that all counties submit their overhead plans annually to be reviewed and approved by the State Controller's Office.

1. *A description of the cost centers or functions within the service department and a concise summary of the extent to which each of these cost pools and/or functions provide services to other county departments;*
2. *A description of the types of costs that are considered to be allowable, an explanation of why these costs are allowable, and a discussion of the method or methods used to separate allowable costs from those costs considered to be unallowable;*
3. *A description of the allocation methods used to distribute costs in each cost pool and the source of the data used to distribute each cost pool's assigned expenditures; and*
4. *A description of the methodology used to identify any amounts billed to the user departments. The narrative for each schedule must include a specific identification of each revenue, interfund, and intrafund transfer received by the central support department whose expenditures are being allocated. If any of these resource inflows has not been used to reduce expenditure allocations, a complete explanation must be provided.*

Including Narratives in the Plan Document Would Help Departments Review Allocations

As the State Controller's Office identifies, narratives that describe the cost allocation "facilitate in-depth reviews of plans." If line departments could review the plan more thoroughly, including the allowable costs, the method of allocation, and the direct bills, it could help to ensure the accuracy of the plan data. A well-annotated plan could help the Finance Department communicate cost allocation information to City staff, further decreasing the risk of inaccuracy and incorrect use of overhead rates.

According to Finance and the Budget Office, it is critical that the plan does not result in double charging to departments and funds. The shared goal of avoiding double charges would be better achieved if the plan were clear enough that City staff could review their allocations and check to ensure that they are only being charged once for the services that they received.

Other Jurisdictions Include Explanatory Information in Their Overhead Plan Documents

In other jurisdictions, the inclusion of introductions and narratives in the overhead plan made the cost allocation easier to understand.

- *Introduction:* Both the County of San Mateo and the City of Long Beach include in their plans introductions that outline the purpose and process

of cost allocation. The introductions also explain the methodology used to allocate costs.

- *“Reading the Plan:”* Both of the above plans contain a section entitled “Reading the Plan,” which walks a reader through what is included in the document and how to find the information they might be looking for.
- *Cost allocation process:* The County of San Mateo’s plan also includes a description of the steps taken to prepare the cost allocation plan.
- *Narratives:* Several counties,²⁴ in accordance with the State Controller’s requirements, included with their plans narrative descriptions of central service department cost allocations. Cities such as Los Angeles and Long Beach also prepare such narratives to accompany their plans. Exhibit 8 is a page from the City and County of San Francisco’s plan. The narrative describes the allocation of Controller costs, and the service being allocated, the base used to allocate the costs, and what costs are not allocable.
- *Frequently Asked Questions:* The City of Los Angeles prepares a one-page Frequently Asked Questions handout that covers the basic concepts of the cost allocation process and the way city departments should use overhead rates. Los Angeles also distributes with the overhead rates a detailed explanation of what services are included in the rates, and how to adapt rates for individual departmental needs.
- *Online access:* Several jurisdictions, including San Francisco and Long Beach, make their plans available online to the public.

²⁴ The counties include: Santa Clara, San Francisco, San Mateo, Alameda, Sacramento, and San Diego.

Exhibit 8: Sample Page From the City and County of San Francisco's Plan

<p>City and County of San Francisco FY 2012-13 OMB A-87 Cost Allocation Plan</p> <p style="text-align: right;">January 27, 2012</p> <p style="text-align: center;"> CITY AND COUNTY OF SAN FRANCISCO, CALIFORNIA STATEMENTS OF FUNCTION AND BENEFIT FOR THE ACTUAL FISCAL YEAR ENDED JUNE 30, 2010 FOR USE DURING THE PLAN YEAR ENDING JUNE 30, 2012 </p> <p style="text-align: center;">SCHEDULE 4 – CONTROLLER</p> <p>The Controller's office provides general fiscal oversight for the City. This schedule consolidates four schedules that were reported separately in previous cost allocation plans: General Government, Administration and Accounting Operations, Payroll Services, and Audits.</p> <p>Controller's costs are divided into four functions: General Administration, Budget and Accounting Operations, Payroll and Personnel Services, and General Government/Audits/Nonallocable. Salaries are allocated to each function based on payroll records, time certification and time studies. Expenditures are offset by nonallocable capital costs and membership fees, and by revenues and expenditure recoveries, which are assigned to function based on an analysis of each recovery and revenue type.</p> <p>General Administration includes personnel and costs supporting the Department as a whole. These costs are allocated to other functions based on each function's share of salaries.</p> <p>Budget and Accounting Operations includes support of the City's budget and financial management systems and support to Departments in the review and approval of budget and accounting entries, and support for the annual Comprehensive Annual Financial Report (CAFR), single audit of federal expenditures, and other financial audits. Departments are direct charged for special accounting services. For purposes of this cost allocation, remaining costs after direct charges are allocated to Departments based on Department size, based on FY 2010-11 original budget.</p> <p>Payroll and Personnel Services provides payroll services for the employees of the City and County and ensures compliance with City, State and Federal tax, wage and hour regulations. This also includes Personnel support process charged to the Controller's General City index codes for unemployment management, fingerprinting, and certain union benefits. The division does not provide services to the San Francisco Unified School District and City College of San Francisco. Costs are allocated based on the number of employees by department excluding certificated.</p> <p>The Audits Division provides independent performance, financial and concession audits and reviews of City operations as a service to the City's boards, committees, commissions and departments. The division evaluates systems of internal controls and City finances and operations to assure assets are protected and managed in accordance with requirements stipulated in the Charter, Administrative Code, ordinances, policy statements and accepted business practices. Audit costs are direct-charged to Departments. Costs of the Division net of direct charges are allocated to Departments based on the unbilled and billed audit hour percentage for each Department.</p> <p>General Government/Non-Allocable includes functions that are general government in nature as defined by OMB Circular A-87 or otherwise non-allocable under its provisions. The Controller activities that fall into this category include property tax allocation, general revenue forecasting, and the Office of Public Finance.</p>

Source: 2012-13 City and County of San Francisco A-87 indirect cost allocation plan

Recommendation #12: To enhance transparency, Finance should include in the Cost Allocation Plan document descriptions of the services being allocated, the methodology used to allocate costs, and the decisions made regarding allocable and unallocable costs. Preceding the cost allocation schedules should be an introduction that describes the purpose of the plan and the process of cost allocation.

The Overhead Plan Is Not Well Communicated to City Staff

To facilitate distribution of overhead rates across the City, the Finance Department produces a two-page rate spreadsheet. This spreadsheet includes the components used to calculate the overhead rate (central service allocation, departmental strategic support costs, departmental non-personal costs, and the direct labor costs) for each core service. It has rates both with and without non-personal costs for the current year and the prior year. This spreadsheet is an easy reference for using an overhead rate, but does not provide detail on what costs are included in the central service allocations. To see this level of detail, a department would have to refer to the full overhead plan. However, the plan is not widely distributed or available to department staff.

Line department staff has reported that it was unclear exactly what central service costs a department was allocated. One department was also unsure which, if any, of the departmental administrative costs were included in its overhead rate. This led to confusion within the department over whether staff was correctly applying the overhead rate.

Finance does not have a systematic way to communicate the cost allocation process to departments. When a line department has asked, Finance staff has explained rates to the department staff. The Finance Department reports that if a line department's rates have changed significantly in a given year, an explanation is included in a memo sent to the Budget Office. Finance may also explain the changes to the department upon request. Otherwise, departments receive rates without explanation.

Better Communication Would Improve Understanding of Overhead

More communication between Finance and department staff would improve understanding about overhead and overhead rates. In general, departments should understand how their overhead rates are calculated, how their data is used to allocate costs, what costs are included in the plan, and where their costs are originating. Cost breakdowns, as shown in Appendix C, should be provided to line departments. Such breakdowns are already prepared in some instances by Finance staff, but are not done for every line department.

If Finance were to improve communication with departments regarding overhead, it might help clear misconceptions about overhead trends and costs. For example, providing department staff with the breakdown of cost allocation over time would illustrate that overhead does not simply increase year after year but instead that individual costs can decrease or increase. This type of cost breakdown (as demonstrated in Appendix G) would educate staff about what may affect their overhead rates and what costs are included in their overhead allocation.

These explanations and data would also help department staff find errors in their overhead allocation. The ability to see where overhead costs originate and compare year-to-year central service cost allocations makes it clear which costs are contributing to a department's overhead rate. If department staff can review allocations independently, they can check to ensure their overhead rate is correctly calculated. With software that could export cost allocation data to Excel, as discussed in Finding 3, Finance could more easily prepare data to be distributed in this format.

Overhead Needs to Be Discussed With Departments When There Are Organizational Changes

Lack of understanding about overhead can be particularly problematic during times of organizational change. When City functions are moving between departments, when departments are being combined or created, or when City functions are being eliminated or outsourced, there is confusion about how overhead should be affected and how overhead rates should be applied.

For example, when Animal Care and Services (ACS) was transferred from the Parks, Recreation, and Neighborhood Services Department to the General Services Department in 2008-09, it began using an incorrect overhead rate. During the City Auditor's Audit of Animal Care and Services in 2009,²⁵ it was determined that ACS was using a rate of 109 percent instead of a more appropriate rate of 65 percent to calculate cost recovery. Since FY 2010-11, Finance has created a separate rate for ACS. More communication between Finance, ACS, and General Services during the transfer of the function might have ensured that the correct rate had been applied from the beginning.

The Effect of Outsourcing on Overhead Should Be Clearer to Staff

As discussed in the Background section of this report, outsourcing a program will change the type of central service costs allocated to a department or fund, but probably will not eliminate the overhead altogether. The changes in budgeted costs and staff will be reflected in the plan data (e.g., increases in overhead associated with non-personal contract costs would offset some of the decrease in overhead associated with staffing costs).

However, there is a concern that as a result of outsourcing a program, the responsible department will not be allocated its fair amount of central service costs even though the City is still providing oversight to the outsourced functions.

Similar to internal organizational changes, when programs or functions are being outsourced it is important that Finance discuss the impacts on overhead. It should be clear to departments and the Budget Office how outsourcing will affect the core service overhead rate that the outsourced program was housed in as well as the other core service rates in the department. Finance should make clear in what ways overhead will still be applied to the department, and where the department can expect changes, and, as mentioned in Finding 2, the Finance Department should ensure that any organizational changes are reflected in the cost allocation plan.

²⁵ The audit report can be found here: <http://www.sanjoseca.gov/DocumentCenter/View/3231>

Recommendation #13: To improve transparency and understanding, upon the annual completion of the Cost Allocation Plan Finance should post the plan document online and establish a process by which:

- **The plan document is distributed to departments**
- **Overhead and overhead rates are explained to line departments to ensure they are appropriately applied, particularly in instances when there have been service delivery changes**
- **Departments can review the data being used, ask questions, and make suggestions about the allocations**

Conclusion

The City of San José allocates indirect costs (“overhead”) to determine the full cost of providing services to the public. The objective of our audit was to review and evaluate the City’s fiscal year 2013-14 City-wide Cost Allocation Plan (overhead plan) for appropriateness and accuracy. We found that the indirect cost allocation process needs improved procedures and the results of cost allocation should be better communicated to City staff. Finance should clarify, review, and update its definition of indirect costs and the methodology by which indirect costs are allocated. Improved procedures and resources would enhance Finance’s ability to perform and analyze cost allocation. Finally, cost allocation and the calculation of overhead rates could be more transparent and better communicated.

RECOMMENDATIONS

Recommendation #1: To ensure that central service costs are treated appropriately and consistently, the Finance Department should update its procedures to more clearly define what costs should and should not be allocated within the Cost Allocation Plan. Specifically, the procedures should:

- Provide guidance on how to determine whether a central service department, a City-Wide program, or an individual central service program provides services to the public versus to another City department
- More clearly define what a “direct use building” is in determining allocated costs within the building occupancy cost pool
- Require that staff document decisions regarding whether costs should be deemed allocable or unallocable in accordance with the above

Recommendation #2: To conform to the updated procedures (as outlined in Recommendation 1) in the FY 2014-15 Cost Allocation Plan, the Finance Department should review and revise its lists of:

- Allocated and unallocated central service costs
- City-Wide Expenses
- Direct use buildings

Indirect Cost Allocation

Recommendation #3: Before the Cost Allocation Plan is developed, the Finance Department should meet annually with central service departments, and the Budget Office, to review the allocation bases of their programs to ensure costs are appropriately allocated and identify any significant changes in departmental workloads. This review should include the allocation bases for City-Wide Expenses. Any changes resulting from the above should be documented and Finance Department's procedures should be updated accordingly.

Recommendation #4: As part of its review of the FY 2014-15 Cost Allocation Plan, the Finance Department should review and revise the allocation bases to better reflect workload. This revision should include the Mayor and City Council's allocation to the Successor Agency, the allocation of Public Works' facility management costs, the allocation of Finance costs for utility fund accounting, and any other bases that are identified.

Recommendation #5: To improve how it allocates overhead to capital projects, the Finance Department should:

- Utilize a workload estimate or other appropriate alternative allocation methodology to account for City Manager, Mayor and City Council, and other central service costs related to capital programs
- Back out capital rebudgets from the calculation of the department budget size allocation base

Recommendation #6: To ensure that vehicle and equipment costs in the Equipment Usage cost pool are consistently and accurately allocated, the Finance Department should:

- Treat grant-funded vehicles and equipment as unallocated costs (similar to how grant-funded building assets are treated in the Building Occupancy cost pool)
- Treat vehicles and equipment purchased through departmental non-personal budgets consistently
- Review and standardize the vehicle and equipment fixed asset schedules in the Cost Allocation Plan
- Remove any assets which are more than 15 years old and whose historical cost has been recaptured in past Cost Allocation Plans

Recommendation #7: To ensure that Building Occupancy costs are accurately and appropriately allocated, the Finance Department should remove any assets more than 50 years old and whose historical cost has been recaptured in past Cost Allocation Plans.

Recommendation #8: To align the Cost Allocation Plan with City Council Policy I-18 and to provide for estimates of indirect costs that better reflect workload, the Finance Department should reorder the central service departments in the Cost Allocation Plan such that central service departments that serve the most central service departments (in terms of numbers and dollars) are at the beginning of the allocation order, and those that serve the fewest are at the end.

Recommendation #9: To improve the accuracy of its indirect cost allocation calculations and ensure the previously identified errors do not reoccur, Finance should:

- Establish a review process of critical data entry areas and key calculations. These should include direct bills from enterprise and special funds; utility, capital, and paid absence rate calculations; and other data entry or calculations which Finance deems critical or where there is a high risk of material error. Finance should also update its procedures to specify management and staff roles and timelines for such reviews.
- Document its methodologies and purposes for calculating utility overhead rates, the capital overhead rate, and paid absence rates. It should also document reasons for any adjustments made.

Recommendation #10: To reduce its manual data entry and to improve its reporting, Finance should discontinue its use of NGCS II for producing the Cost Allocation Plan. Instead it should use Maxcars or another suitable software program.

Recommendation #11: To reduce the reoccurrence of errors identified, document methodologies, establish and clarify procedures, improve future Cost Allocation Plans, and to enhance analysis and communications with other departments to further transparency, the Administration should determine whether to assign additional staff resources to its preparations of the Cost Allocation Plans.

Recommendation #12: To enhance transparency, Finance should include descriptions in the Cost Allocation Plan document of the services being allocated, the methodology used to allocate costs, and the decisions made regarding allocable and unallocable costs. Preceding the cost allocation schedules should be an introduction that describes the purpose of the plan and the process of cost allocation.

Recommendation #13: To improve transparency and understanding, upon the annual completion of the Cost Allocation Plan Finance should post the plan document online and establish a process by which:

- The plan document is distributed to departments
- Overhead and overhead rates are explained to line departments to ensure they are appropriately applied, particularly in instances when there have been service delivery changes
- Departments can review the data being used, ask questions, and make suggestions about the allocations

APPENDIX A

Appendix A

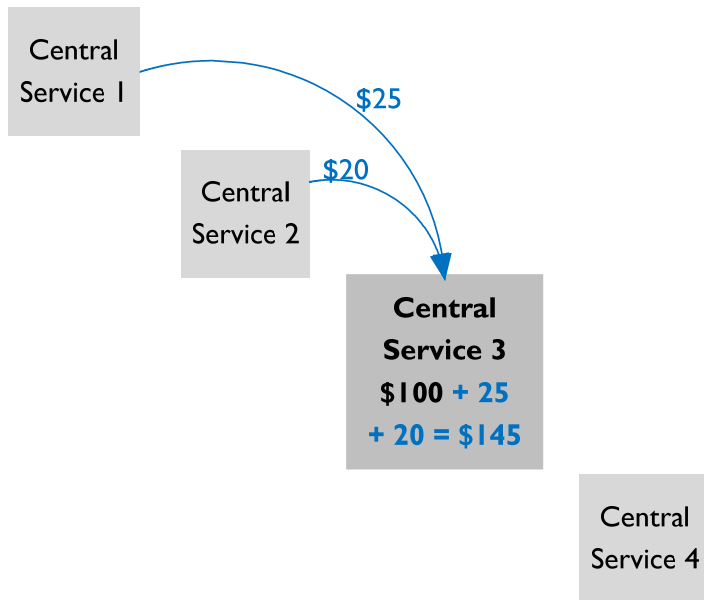
Cost Allocation Methodology

This example shows a simplified version of the two-step cost allocation methodology used in the City of San José. This example focuses on how one Central Service Department's costs are allocated. In this example, Central Service 3 has a budget of \$100 and comes third in the set order of allocations.

Step One

Costs flow into Central Service 3

Before Central Service 3 allocates costs in Step One, central services that come before it in the specified order allocate their Step One costs to Central Service 3 based on budget and workload data (blue). Step One costs include the central services' own budget and those costs received from central services that came higher in the order.

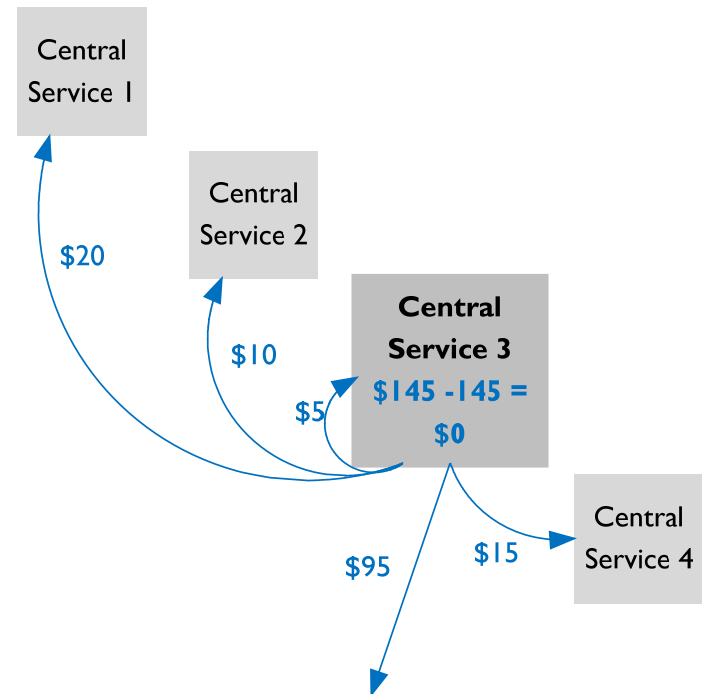


Line Departments and Funds

A-2

Costs flow out of Central Service 3

Central Service 3 allocates its Step One pool of costs (blue) out to all central services including itself, line departments, and funds based on budget and workload data.



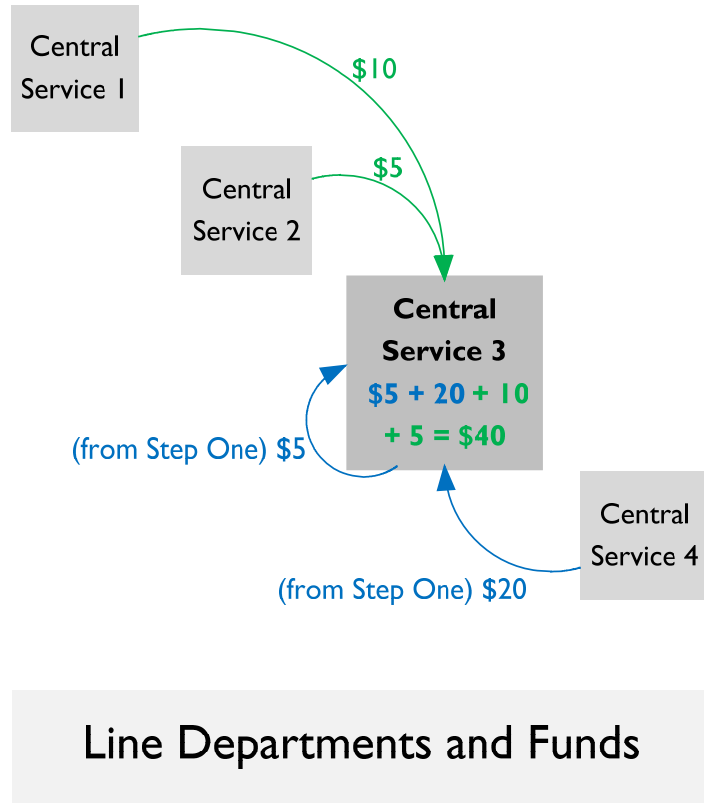
Line Departments and Funds

Step Two begins after the last central service has allocated its Step One pool of costs. In Step Two, central services only allocate costs to those central services that come below them in the order as well as line departments and funds.

Step Two

Costs flow into Central Service 3

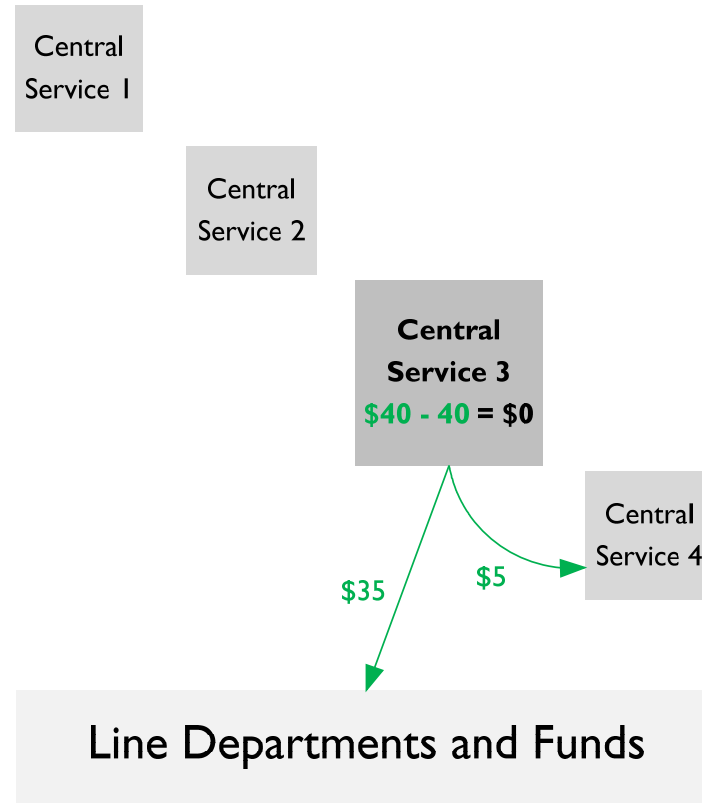
After Step One, Central Service 3 has Step One costs from itself and the central services below it in the order (blue). In Step Two, Central Service 3 also receives Step Two costs from the central services above it in the order (green). All these costs make up Central Service 3's Step Two pool of costs.



Costs flow out of Central Service 3

Central Service 3 allocates its Step Two pool of costs out to only those Central Services that come after it in the order, line departments, and funds (green).

Central Service 3 now has no costs in its pool and will not receive costs again. Its allocation is complete.



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APPENDIX B

Appendix B

Central Service Costs and Allocation Bases in FY 2013-14 Cost Allocation Plan

This table summarizes the City's central services which Finance included in its City-Wide Cost Allocation Plan for FY 2013-14 (approximately \$170 million).¹ Costs are primarily budgeted costs as reported in the FY 2012-13 Adopted Operating Budget. The exceptions are the Building Occupancy and Equipment Usage cost pools which are based on the historical cost of buildings, vehicles, and equipment.

Costs include a portion of the administrative costs within central service departments (e.g., Human Resources' Strategic Support core service). Some of the costs below are offset by direct bills paid for by special funds. In total, \$120 million of costs are allocated as overhead within the plan, \$39 million remain unallocated, and \$11 million are offset by direct bills.

The allocation base describes how Finance estimated each department's usage of the City central service.

Description of central services included in the Cost Allocation Plan		Total Costs	Allocation Base (FY 2013-14)
Building Occupancy	Selected buildings include service yards, communication buildings, and other direct use buildings	\$4,305,342	Use allowance calculated as 2% of the historical cost of buildings. Allocated based on department's % of building occupancy
	Grant-funded buildings; those whose costs are charged outside of plan (e.g., City Hall); other select buildings	\$24,240,141	Unallocated
Equipment Usage	Vehicles and Equipment	\$6,901,275	Use allowance calculated as 6.67% of the historical cost of equipment. Allocated to department utilizing asset.
City-Wide Programs	Personal benefits (e.g., City dues/memberships, management training)	\$608,508	# of budgeted FTEs
	Support services (e.g., single audit)	\$1,511,250	Relative size of departmental budget
	General liability insurance (and claims costs)	\$2,535,000	Ratio of prior year claims' cost
	Workers' compensation	\$17,370,000	Ratio of prior year claims' cost
	Revenue collection (e.g., property tax administration)	\$3,751,441	Relative size of departmental budget
	Sick leave payments upon retirement	\$6,200,000	Ratio of prior year payments

¹ Finance also prepares a Grant Plan and an Airport Plan. Those plans are based on two years' prior actual expenditures and exclude some costs that are unallowable under federal rules (e.g., Mayor & City Council costs are excluded from the Grant Plan).

	Departmental programs (Note: Not all Budgeted City-Wide Expenses from the FY 2012-13 Adopted Budget are included in the overhead plan.)	\$578,345	100% to individual departments
Building Leases	Building lease costs	\$1,821,253	Building lease contracts
City Manager	City Manager department services	\$7,620,498	Relative size of departmental budget
	Budget Office services – general	\$2,987,236	Survey of staff time allocation
	Budget Office services – capital	\$413,993	100% to Public Works – Public Facilities
	Budget Office services – Sewer Service & Use Charge	\$25,881	100% to Sewer Service & Use Charge Fund
	City-wide programs (non-departmental services)	\$64,482	Unallocated
Emergency Services	Departmental services – emergency response	\$281,681	Relative size of departmental budget
	Grant-funded programs	\$312,364	Unallocated
	Direct services to the public	\$49,708	Unallocated
Independent Police Auditor	Departmental services – Police Department	\$1,065,761	100% to Police Department
Mayor & City Council	Departmental services (50%)	\$5,511,179	Relative size of departmental budget
	Redevelopment/Successor Agency (RDA/SARA) services (25%)	\$2,755,590	100% to Successor Agency
	Direct public service (25%)	\$2,755,590	Unallocated
Finance	General accounting	\$1,390,929	Relative size of departmental budget
	Payroll services	\$1,002,005	# of budgeted FTEs
	Accounts payable	\$936,582	# and \$ amount of invoices processed in prior year
	Procurement	\$1,166,517	# of purchase requisitions processed in prior year
	Materials management	\$321,976	Relative size of departmental budget
	Accounts receivable	\$1,342,578	\$ and volume of invoices processed in prior year
	Special assessment accounting (for community facility and maintenance districts)	\$167,703	Relative size of departmental budget
	Debt services	\$714,529	Survey of staff time allocation
	Debt services – Housing	\$194,804	100% to Housing Fund
	Fixed assets accounting	\$110,670	# of capitalized fixed asset transactions by department in prior year
	Fixed assets accounting – Airport	\$27,666	100% to Airport
	Sewer Service & Use Charge accounting	\$461,860	100% to Sewer Service & Use Charge Fund

	Utility billing accounting services	\$1,544,933	100% to various utility funds based on allocated staff costs
	Special accounting – Public Works	\$54,033	100% to Public Works
	Insurance services	\$272,364	Contract processing workload distribution and direct to individual departments/funds where appropriate
	RDA/SARA accounting	\$120,345	100% to Successor Agency
	Procurement costs paid for by utility funds	\$600,929	Unallocated
	Unallocable revenue management costs (e.g., investment services, business tax certificates)	\$4,277,780	Unallocated
	Unallocable financial reporting costs (e.g., special fund reporting)	\$321,098	Unallocated
Information Technology	Information systems (City-wide system support services)	\$11,292,561	IT Department level of service reports
	Telephone administration (administration of phone services)	\$174,962	# of phone lines per department
	Telephone expenses (processing department work order requests)	\$860,619	Work order hours per department
	Special fund services	\$4,200,485	100% direct charges to special funds based on staff budgeted to support systems
	Unallocable costs associated with the Customer Contact Center and Development Services activities	\$633,714	Unallocated
City Attorney	Department counsel	\$6,143,164	City Attorney survey of department assignments by FTE
	Litigation services	\$5,329,603	Ratio of prior year actual costs
	Workers' compensation	\$998,280	Ratio of prior year claims' cost
	Sewer Services & Use Charge Fund (litigation services)	\$518,492	100% to Sewer Service & Use Charge Fund
	RDA Counsel (SARA)	\$1,463,190	100% to Successor Agency
	Treatment Plant (WPCP) Operating Fund (litigation services)	\$117,269	100% to treatment plant operating fund
	Air litigation services	\$76,868	100% to Airport
City Clerk	Department services (60%)	\$1,241,526	Relative size of departmental budget
	Direct public service programs (40%)	\$827,684	Unallocated
City Auditor	Audit services	\$2,117,479	Actual prior year audit hours
Human Resources	Department services (recruitment; health & safety)	\$3,484,169	# of budgeted FTEs
	Workers' compensation administration	\$2,422,026	Ratio of prior year claims' cost

	Employee benefits administration	\$2,278,697	Unallocated (charged separately through the benefit funds)
General Services	Facility management (routine facility maintenance, non-work order)	\$4,122,178	Square footage and # of FTE
	Contract custodial	\$1,978,889	Square footage and budgeted costs
	Facility management (maintenance/repairs requested through a work order)	\$4,079,492	Labor hours and material costs of prior year work orders
	Utilities and elevator maintenance	\$2,519,960	Square footage and actual prior year utility and elevator maintenance costs
	Facility management – capital funds	\$3,824,063	100% to Public Works
	Radio shop services	\$827,192	Physical distribution of radio and other communication equipment
Total		\$170,228,380	

Source: Auditor analysis of FY 2013-14 City of San José City-Wide Cost Allocation Plan and Finance's procedure manual.

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APPENDIX C

Appendix C

Components of Overhead and Rate Calculations, by Line Department

This Appendix shows the components of overhead and the overhead rate calculation for each department and its core services. Also shown are the rate calculations for the utility funds and capital rate. The rates are “full” rates from the FY 2013-14 City-wide Plan (Grant Plan and Airport Plan rates exclude some costs which federal grant or other guidelines disallow). Below is a guide to understand the information presented in the tables that follow. See Appendix D for a comparison of all departments and funds.

Library Example

	Access to Information, Library Materials and Digital Resources	Formal and Lifelong Self-Directed Education			
Cost of City central services					
from General Services	\$668,131	\$41,677	\$709,808	7.8%	
City-wide Programs	\$507,756	\$31,673	\$539,429	5.9%	
Building Occupancy	\$469,409				
Equipment Usage	\$327,061				
Information Technology	\$313,778				
City Manager	\$269,696	\$16,823	\$286,519	3.2%	
Finance	\$244,281	\$15,238	\$259,519	2.9%	
Human Resources	\$146,674	\$9,149	\$155,823	1.7%	
Mayor & City Council	\$136,530	\$8,517	\$145,047	1.6%	
City Attorney	\$67,487	\$4,210	\$71,697	0.8%	
City Clerk	\$30,783				
City Auditor	\$22,873				
Emergency Services	\$6,975				
Building Leases	\$4,486				
Independent Police Auditor	\$0				
A Sub-total	\$3,215,919	\$200,606	\$3,416,525	37.6%	
Departmental Indirect Costs					
B Non-Personal costs	\$2,850,055	\$126,411	\$2,976,466		
C Strategic Support	\$2,535,944	\$158,190	\$2,694,134		
Total Overhead Amount					
D A+B+C	\$8,601,918	\$485,207	\$9,087,125		
Departmental Direct Labor Costs					
E	\$13,342,865	\$832,314	\$14,175,179		
Overhead Rates					
D/E Divide Overhead by Direct Labor	64.47%	58.30%			

1: The Finance Department calculated these allocations using central services' FY 2012-13 Adopted Budget costs and FY 2011-12 (generally) workload measurements (see Appendix B). These allocations are already offset for direct bills, except when the direct bills are shown explicitly. Source: Finance Department's City-wide FY 2013-14 Cost Allocation Plan, NGCS II Schedule G

2: City-wide Programs include Workers' Compensation, Sick Leave Payouts upon Retirement, Property Tax Admin Fee, etc.

3: In FY 2013-14, Library activities are supported by \$145,047 of Mayor & City Council costs

4: Each department's core service received a share of the department's allocated central service costs generally proportional to the core service's share of direct labor (line E) within the department. Central service costs may not add up exactly to line A due to rounding within the NGCS II software.

5: Finance obtained departmental non-personal costs from the FY 2012-13 Adopted Budget. It spread Library's Strategic Support (admin) FY 2012-13 adopted costs across each core service according to its share of Library direct labor (line E). Source: Finance's rate sheet (unaudited).

6: Finance uses direct labor costs as the base for its overhead rates. Direct labor includes Object Details 4001-4010. Source: Finance's rate sheet (unaudited)

7: Overhead rates are for use in FY 2013-14. \$1 of Library salaries in the Access to Information core service in FY 2013-14 is associated with \$0.64 of overhead. Rates shown here include non-personal costs (line B), but the City also uses rates that exclude those non-personal costs.

Economic Development

Components of Overhead and FY 2013-14 Rate Calculation

	Arts and Cultural Development	Regional Workforce Development	Business Development and Economic Strategy	Real Estate Services	Total	
Cost of City central services						
from General Services	\$684,706	\$77,472	\$33,171	\$14,699	\$810,048	21.5%
City Attorney	\$52,467	\$305,283	\$65,924	\$29,213	\$452,887	12.0%
City-Wide Programs	\$99,645	\$136,971	\$59,331	\$26,291	\$322,238	8.5%
Information Technology	\$61,780	\$146,226	\$65,998	\$29,246	\$303,250	8.0%
City Manager	\$41,475	\$149,103	\$42,912	\$19,016	\$252,506	6.7%
Finance	\$37,852	\$59,860	\$27,320	\$12,106	\$137,138	3.6%
Equipment Usage	\$88,489	\$25,107	\$11,176	\$4,953	\$129,725	3.4%
Human Resources	\$17,947	\$39,038	\$17,709	\$7,847	\$82,541	2.2%
Mayor & City Council	\$15,664	\$25,770	\$11,538	\$5,113	\$58,085	1.5%
City Auditor	\$3,915	\$11,083	\$3,756	\$1,664	\$20,418	0.5%
Building Occupancy	\$3,854	\$7,252	\$3,358	\$1,488	\$15,952	0.4%
City Clerk	\$3,544	\$5,845	\$2,613	\$1,158	\$13,160	0.3%
Building Leases	\$1,473	\$1,350	\$516	\$229	\$3,568	0.1%
Emergency Services	\$799	\$1,317	\$589	\$262	\$2,967	0.1%
Independent Police Auditor	\$0	\$0	\$0	\$0	\$0	0.0%
A Sub-total	\$1,113,605	\$991,671	\$345,911	\$153,283	\$2,604,470	69.0%
Departmental Indirect Costs						
B Non-Personal costs	-	-	\$244,848	\$475,000	\$719,848	19.1%
C Strategic Support	\$75,946	\$225,192	\$104,557	\$46,332	\$452,027	12.0%
Total Overhead Amount						
D A+B+C	\$1,189,551	\$1,216,863	\$695,316	\$674,615	\$3,776,345	100.0%
Departmental Direct Labor Costs						
E	\$987,395	\$2,927,792	\$1,359,381	\$602,377	\$5,876,945	
Overhead Rates						
D/E Divide Overhead by Direct Labor	120.47%	41.56%	51.15%	111.99%		

Source: Finance Department's City-wide FY 2013-14 Cost Allocation Plan, NGCS II Schedule G, and Finance's rate sheet. Note that the cost of City central services may not add exactly to line A due to rounding within the NGCS II software.

Fire

Components of Overhead and FY 2013-14 Rate Calculation

	Emergency Response	Fire Prevention	Fire Safety Code Compliance	Total	
Cost of City central services					
from City-Wide Programs *	\$8,342,641	\$290,111	\$215,891	\$8,848,643	24.0%
Equipment Usage	\$1,931,345	\$67,162	\$49,979	\$2,048,486	5.6%
City Attorney	\$1,586,323	\$55,163	\$41,051	\$1,682,537	4.6%
General Services	\$1,530,321	\$53,216	\$39,602	\$1,623,139	4.4%
Human Resources	\$1,247,233	\$43,372	\$32,276	\$1,322,881	3.6%
Building Occupancy	\$1,219,357	\$42,402	\$31,555	\$1,293,314	3.5%
Information Technology	\$1,057,211	\$36,764	\$27,358	\$1,121,333	3.0%
City Manager	\$1,055,775	\$36,715	\$27,321	\$1,119,811	3.0%
Finance	\$687,382	\$23,903	\$17,788	\$729,073	2.0%
Mayor & City Council	\$593,008	\$20,622	\$15,346	\$628,976	1.7%
City Auditor	\$329,281	\$11,451	\$8,521	\$349,253	0.9%
City Clerk	\$133,803	\$4,653	\$3,463	\$141,919	0.4%
Emergency Services	\$30,306	\$1,055	\$784	\$32,145	0.1%
Building Leases	\$19,297	\$672	\$499	\$20,468	0.1%
Independent Police Auditor	\$0	\$0	\$0	\$0	0.0%
A Sub-total	\$19,763,289	\$687,258	\$511,435	\$20,961,982	56.8%
Departmental Indirect Costs					
B Non-Personal costs	\$1,196,744	\$171,813	\$155,773	\$1,524,330	4.1%
C Strategic Support	\$13,592,708	\$472,679	\$351,752	\$14,417,139	39.1%
Total Overhead Amount					
D A+B+C	\$34,552,741	\$1,331,750	\$1,018,960	\$36,903,451	100.0%
Departmental Direct Labor Costs					
E	\$75,159,181	\$2,613,619	\$1,944,970	\$79,717,770	
Overhead Rates					
D/E Divide Overhead by Direct Labor	45.97%	50.95%	52.39%		

* City-Wide Programs included \$5.7 million for Fire Department workers' compensation claims.

Source: Finance Department's City-wide FY 2013-14 Cost Allocation Plan, NGCS II Schedule G, and Finance's rate sheet. Note that the cost of City central services may not add exactly to line A due to rounding within the NGCS II software.

Library

Components of Overhead and FY 2013-14 Rate Calculation

	Access to Information, Library Materials and Digital Resources	Formal and Lifelong Self- Directed Education	Total	
Cost of City central services				
from General Services	\$668,131	\$41,677	\$709,808	7.8%
City-wide Programs	\$507,756	\$31,673	\$539,429	5.9%
Building Occupancy	\$469,409	\$29,281	\$498,690	5.5%
Equipment Usage	\$327,061	\$20,401	\$347,462	3.8%
Information Technology	\$313,778	\$19,573	\$333,351	3.7%
City Manager	\$269,696	\$16,823	\$286,519	3.2%
Finance	\$244,281	\$15,238	\$259,519	2.9%
Human Resources *	\$146,674	\$9,149	\$155,823	1.7%
Mayor & City Council	\$136,530	\$8,517	\$145,047	1.6%
City Attorney	\$67,487	\$4,210	\$71,697	0.8%
City Clerk	\$30,783	\$1,921	\$32,704	0.4%
City Auditor	\$22,873	\$1,427	\$24,300	0.3%
Emergency Services	\$6,975	\$436	\$7,411	0.1%
Building Leases	\$4,486	\$280	\$4,766	0.1%
Independent Police Auditor	\$0	\$0	\$0	0.0%
A Sub-total	\$3,215,919	\$200,606	\$3,416,525	37.6%
Departmental Indirect Costs				
B Non-Personal costs	\$2,850,055	\$126,411	\$2,976,466	32.8%
C Strategic Support	\$2,535,944	\$158,190	\$2,694,134	29.6%
Total Overhead Amount				
D A+B+C	\$8,601,918	\$485,207	\$9,087,125	100.0%
Departmental Direct Labor Costs				
E	\$13,342,865	\$832,314	\$14,175,179	
Overhead Rates				
D/E	Divide Overhead by Direct Labor	64.47%	58.30%	

* The amount from Human Resources to the Library was offset in the plan by a direct bill credit of \$62,586.

Source: Finance Department's City-wide FY 2013-14 Cost Allocation Plan, NGCS II Schedule G, and Finance's rate sheet. Note that the cost of City central services may not add exactly to line A due to rounding within the NGCS II software.

Parks, Recreation & Neighborhood Services

Components of Overhead and FY 2013-14 Rate Calculation

		Parks Maintenance and Operations	Recreation and Community Services	Total	
Cost of City central services					
	from General Services	\$1,557,091	\$996,129	\$2,553,220	13.3%
	City-wide Programs	\$1,135,887	\$726,671	\$1,862,558	9.7%
	Information Technology	\$744,311	\$476,164	\$1,220,475	6.4%
	City Manager	\$528,637	\$338,189	\$866,826	4.5%
	City Attorney	\$446,596	\$285,705	\$732,301	3.8%
	Equipment Usage	\$339,491	\$217,186	\$556,677	2.9%
	Finance	\$329,797	\$210,983	\$540,780	2.8%
	Human Resources	\$284,658	\$182,107	\$466,765	2.4%
	Mayor & City Council	\$248,185	\$158,773	\$406,958	2.1%
	City Clerk	\$56,043	\$35,853	\$91,896	0.5%
	City Auditor	\$46,718	\$29,887	\$76,605	0.4%
	Building Occupancy	\$24,081	\$15,406	\$39,487	0.2%
	Emergency Services	\$12,685	\$8,115	\$20,800	0.1%
	Building Leases	\$8,478	\$5,424	\$13,902	0.1%
	Independent Police Auditor	\$0	\$0	\$0	0.0%
A	Sub-total	\$5,762,661	\$3,686,592	\$9,449,253	49.2%
Departmental Indirect Costs					
B	Non-Personal costs	\$4,748,314	\$1,225,410	\$5,973,724	31.1%
C	Strategic Support	\$2,313,034	\$1,479,735	\$3,792,769	19.7%
Total Overhead Amount					
D	A+B+C	\$12,824,009	\$6,391,737	\$19,215,746	100.0%
Departmental Direct Labor Costs					
E		\$12,820,522	\$8,201,772	\$21,022,294	
Overhead Rates					
D/E	Divide Overhead by Direct Labor	100.03%	77.93%		

Source: Finance Department's City-wide FY 2013-14 Cost Allocation Plan, NGCS II Schedule G, and Finance's rate sheet. Note that the cost of City central services may not add exactly to line A due to rounding within the NGCS II software.

Planning, Building & Code Enforcement

Components of Overhead and FY 2013-14 Rate Calculation

	Development Plan Review and Building Construction Inspection	Community Code Enforcement	Long Range Land Use Planning	Total	
Costs from City central services					
from Information Technology	\$498,056	\$211,088	\$51,083	\$760,227	10.3%
City Attorney	\$497,725	\$209,598	\$51,049	\$758,372	10.3%
City-Wide Programs	\$490,336	\$212,248	\$50,291	\$752,875	10.2%
General Services	\$380,654	\$285,548	\$39,042	\$705,244	9.6%
City Manager	\$238,201	\$101,876	\$24,431	\$364,508	5.0%
Equipment Usage	\$151,716	\$78,944	\$15,561	\$246,221	3.3%
Finance	\$142,583	\$63,235	\$14,624	\$220,442	3.0%
Human Resources	\$136,854	\$58,277	\$14,036	\$209,167	2.8%
Mayor & City Council	\$93,807	\$40,734	\$9,622	\$144,163	2.0%
City Auditor	\$24,330	\$10,418	\$2,495	\$37,243	0.5%
City Clerk	\$21,275	\$9,236	\$2,182	\$32,693	0.4%
Emergency Services	\$4,794	\$2,083	\$491	\$7,368	0.1%
Building Occupancy	\$4,030	\$1,959	\$414	\$6,403	0.1%
Building Leases	\$3,811	\$1,806	\$391	\$6,008	0.1%
Independent Police Auditor	\$0	\$0	\$0	\$0	0.0%
Adjustment *	(\$651,374) *	\$0	\$0	(\$651,374)	-8.8%
A Sub-total	\$2,036,790	\$1,287,044	\$275,713	\$3,599,547	48.9%
Departmental Indirect Costs					
B Non-Personal costs	\$1,677,776	\$545,159	\$1,053,712	\$3,276,647	44.5%
C Strategic Support	\$319,185	\$133,888	\$32,737	\$485,810	6.6%
Total Overhead Amount					
D A+B+C	\$4,033,751	\$1,966,091	\$1,362,162	\$7,362,004	100.0%
Departmental Direct Labor Costs					
E	\$11,682,571	\$4,900,463	\$1,198,228	\$17,781,262	
Overhead Rates					
D/E	Divide Overhead by Direct Labor	34.53%	40.12%	113.68%	

* Finance credited PBCE \$651,374 in February 2013, after the initial rate release, for shared positions' costs.

Source: Finance Department's City-wide FY 2013-14 Cost Allocation Plan, NGCS II Schedule G, and Finance's rate sheet. Note that the cost of City central services may not add exactly to line A due to rounding within the NGCS II software.

Police

Components of Overhead and FY 2013-14 Rate Calculation

		Respond to Calls for Service	Investigative Services	Traffic Safety Services
Cost of City central services^a				
	from City-Wide Programs ^b	\$10,461,373	\$2,946,168	\$661,110
	City Attorney	\$2,396,586	\$674,935	\$151,453
	General Services	\$1,760,316	\$495,746	\$111,244
	Building Occupancy	\$1,595,495	\$449,329	\$100,828
	Information Technology	\$1,468,197	\$413,479	\$92,784
	Human Resources	\$1,462,753	\$411,946	\$92,439
	City Manager	\$1,320,565	\$371,902	\$83,454
	Building Leases	\$1,198,094	\$337,411	\$75,714
	Equipment Usage	\$919,695	\$259,008	\$58,120
	Mayor & City Council	\$830,633	\$233,926	\$52,492
	Finance	\$826,830	\$232,855	\$52,251
	Independent Police Auditor	\$761,714	\$214,516	\$48,137
	City Auditor	\$237,243	\$66,814	\$14,993
	City Clerk	\$187,413	\$52,780	\$11,844
	Emergency Services	\$42,448	\$11,955	\$2,683
A	Sub-total	\$25,469,374	\$7,172,772	\$1,609,546
Departmental Indirect Costs				
B	Non-Personal costs	\$6,833,712	\$4,382,617	\$397,208
C	Strategic Support	\$21,175,025	\$5,963,383	\$1,338,164
Total Overhead Amount				
D	A+B+C	\$53,478,111	\$17,518,772	\$3,344,918
Departmental Direct Labor Costs				
E		\$103,040,897	\$29,018,729	\$6,511,708
Overhead Rates				
D/E	Divide Overhead by Direct Labor	51.90%	60.37%	51.37%

^a Also see Appendix G for a five-year trend of the Police Department's allocations received from central services.

^b City-Wide Programs included \$7.8 million for Police Department workers' compensation claims.

Police (continued)

Crime Prevention and Community Education	Regulatory Services	Special Events Services	Total		
					Cost of City central services
\$305,022	\$210,658	\$52,831	\$14,637,162	18.9%	City-Wide Programs
\$69,877	\$48,260	\$12,102	\$3,353,213	4.3%	City Attorney
\$51,325	\$35,447	\$8,890	\$2,462,968	3.2%	General Services
\$46,520	\$32,129	\$8,056	\$2,232,357	2.9%	Building Occupancy
\$42,808	\$29,564	\$7,414	\$2,054,246	2.7%	Information Technology
\$42,649	\$29,455	\$7,387	\$2,046,629	2.6%	Human Resources
\$38,504	\$26,592	\$6,668	\$1,847,685	2.4%	City Manager
\$34,933	\$24,126	\$6,051	\$1,676,329	2.2%	Building Leases
\$26,816	\$18,519	\$4,645	\$1,286,803	1.7%	Equipment Usage
\$24,219	\$16,727	\$4,194	\$1,162,191	1.5%	Mayor & City Council
\$24,108	\$16,650	\$4,175	\$1,156,869	1.5%	Finance
\$22,209	\$15,338	\$3,847	\$1,065,761	1.4%	Independent Police Auditor
\$6,917	\$4,777	\$1,198	\$331,942	0.4%	City Auditor
\$5,465	\$3,773	\$946	\$262,221	0.3%	City Clerk
\$1,237	\$854	\$215	\$59,392	0.1%	Emergency Services
\$742,610	\$512,871	\$128,621	\$35,635,794	46.1%	Sub-total
\$170,167	\$226,612	\$61,320	\$12,071,636	15.6%	
\$617,400	\$426,396	\$106,934	\$29,627,302	38.3%	
\$1,530,177	\$1,165,879	\$296,875	\$77,334,732	100.0%	
\$3,004,363	\$2,074,908	\$520,358	\$144,170,963		
50.93%	56.19%	57.05%			

Source: Finance Department's City-wide FY 2013-14 Cost Allocation Plan, NGCS II Schedule G, and Finance's rate sheet. Note that the cost of City central services may not add exactly to line A due to rounding within the NGCS II software.

Public Works

Components of Overhead and FY 2013-14 Rate Calculation

		Plan, Design, and Construct					
		Public Facilities and Infrastructure	Regulate/Facilitate Private Development	Animal Care and Services	Total *		
		direct bill credits	direct bill credits				
Cost of City central services							
from	General Services	\$4,446,661	(\$1,891,168)	\$128,789	(\$455,666)	\$572,043	\$2,800,659 25.4%
	City Attorney	\$804,076		\$183,930		\$45,623	\$1,033,629 9.4%
	Information Technology	\$789,454		\$171,050		\$72,312	\$1,032,816 9.4%
	Equipment Usage	\$862,256		\$92,686		\$72,702	\$1,027,644 9.3%
	City Manager	\$868,327		\$93,851		\$45,787	\$1,007,965 9.1%
	City-Wide Programs	\$766,401		\$132,089		\$92,362	\$990,852 9.0%
	Finance	\$481,004	(\$53,707)	\$89,814	(\$12,940)	\$189,821	\$693,992 6.3%
	Mayor & City Council	\$184,289		\$33,643		\$31,778	\$249,710 2.3%
	Human Resources	\$199,986	(\$114,165)	\$41,257	(\$27,507)	\$45,891	\$145,462 1.3%
	City Auditor	\$64,354		\$9,089		\$5,014	\$78,457 0.7%
	City Clerk	\$41,642		\$7,620		\$7,151	\$56,413 0.5%
	Building Occupancy	\$19,193		\$2,604		\$1,539	\$23,336 0.2%
	Building Leases	\$13,423		\$1,301		\$1,587	\$16,311 0.1%
	Emergency Services	\$9,418		\$1,720		\$1,621	\$12,759 0.1%
	Independent Police Auditor	\$0		\$0		\$0	\$0 0.0%
A	Sub-total	\$7,491,452		\$493,332		\$1,185,241	\$9,170,025 83.0%
Departmental Indirect Costs							
B	Non-Personal costs	\$8,000		\$15,000		\$851,961	\$874,961 7.9%
C	Strategic Support	\$804,032		\$193,727		-	\$997,759 9.0%
Total Overhead Amount							
D	A+B+C	\$8,303,484		\$702,059		\$2,037,202	\$11,042,745 100.0%
Departmental Direct Labor Costs							
E		\$15,926,685		\$3,837,440		\$3,435,288	\$23,199,413
Overhead Rates							
D/E	Divide Overhead by Direct Labor	52.14%		18.29%		59.30%	

* The Department of General Services was consolidated into Public Works in 2010-11, but Finance continues to treat General Services separately as a central service. Thus the core services of *Facilities Management* and *Fleet and Equipment Services* are not included in the total shown here.

Source: Finance Department's City-wide FY 2013-14 Cost Allocation Plan, NGCS II Schedule G, and Finance's rate sheet. Note that the cost of City central services may not add exactly to line A due to rounding within the NGCS II software.

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Transportation

Components of Overhead and FY 2013-14 Rate Calculation

		Sanitary		Storm		
		Sewer	Transp.	Pavement	Sewer	Traffic
		Maintenance	Operations	Maintenance	Management	Maintenance
Cost of City central services						
from City-Wide Programs		\$328,518	\$184,509	\$169,827	\$166,152	\$148,411
City Manager		\$206,968	\$116,242	\$106,992	\$104,676	\$93,499
General Services		\$171,901	\$96,547	\$88,864	\$86,941	\$77,658
Information Technology		\$169,300	\$95,086	\$87,519	\$85,626	\$76,483
City Attorney		\$157,040	\$88,200	\$81,181	\$79,425	\$70,944
Finance		\$156,081	\$87,661	\$80,685	\$78,939	\$70,511
Equipment Usage		\$137,130	\$77,018	\$70,889	\$69,355	\$61,950
Mayor & City Council		\$116,757	\$65,575	\$60,357	\$59,051	\$52,745
Human Resources		\$75,665	\$42,497	\$39,115	\$38,268	\$34,183
City Clerk		\$26,317	\$14,781	\$13,605	\$13,310	\$11,889
City Auditor		\$16,097	\$9,041	\$8,321	\$8,141	\$7,272
Building Occupancy		\$7,684	\$4,315	\$3,972	\$3,886	\$3,471
Emergency Services		\$5,966	\$3,351	\$3,084	\$3,018	\$2,696
Building Leases		\$2,069	\$1,162	\$1,070	\$1,046	\$934
Independent Police Auditor		\$0	\$0	\$0	\$0	\$0
A	Sub-total	\$1,577,498	\$885,986	\$815,484	\$797,836	\$712,649
Departmental Indirect Costs						
B	Non-Personal costs	-	\$460,310	\$43,128	\$135,064	\$2,360,341
C	Strategic Support	\$266,270	\$149,548	\$137,648	\$134,669	\$120,290
Total Overhead Amount						
D	A+B+C	\$1,843,768	\$1,495,844	\$996,260	\$1,067,569	\$3,193,280
Departmental Direct Labor Costs						
E	Direct Labor costs	\$6,022,217	\$3,382,318	\$3,113,173	\$3,045,798	\$2,720,591
Overhead Rates						
D / E	Divide Overhead by Direct Labor	30.62%	44.23%	32.00%	35.05%	117.37%

Source: Finance Department's City-wide FY 2013-14 Cost Allocation Plan, NGCS II Schedule G, and Finance's rate sheet. Note that the cost of City central services may not add exactly to line A due to rounding within the NGCS II software.

Transportation (continued)

Transp. Planning and Project Delivery	Parking Services	Parking Fund	Street Landscape Maintenance	Maintenance Assessment Districts	Total		
							Cost of City central services
\$134,396	\$130,463	\$81,284	\$70,360	\$36,707	\$1,450,627	10.9%	City-Wide Programs
\$84,670	\$82,192	\$103,253	\$44,327	\$53,672	\$996,491	7.5%	City Manager
\$70,324	\$68,267	(\$32,761) ^a	\$36,817	\$17,241	\$681,799	5.1%	General Services
\$69,261	\$67,233	\$48,523 ^b	\$36,260	\$20,887	\$756,178	5.7%	Information Technology
\$64,245	\$62,364	\$35,375	\$33,634	\$16,418	\$688,826	5.2%	City Attorney
\$63,853	\$61,984	\$45,100	\$33,429	\$20,734	\$698,977	5.3%	Finance
\$56,099	\$54,458	\$27,891	\$29,369	\$12,781	\$596,940	4.5%	Equipment Usage
\$47,765	\$46,367	\$59,876	\$25,006	\$27,666	\$561,165	4.2%	Mayor & City Council
\$30,955	\$30,048	\$25,099	\$16,205	\$10,918	\$342,953	2.6%	Human Resources
\$10,766	\$10,451	\$13,485	\$5,636	\$6,232	\$126,472	1.0%	City Clerk
\$6,585	\$6,392	\$7,417	\$3,447	\$3,603	\$76,316	0.6%	City Auditor
\$3,143	\$3,052	\$17,568	\$1,646	\$736	\$49,473	0.4%	Building Occupancy
\$2,440	\$2,370	\$3,059	\$1,278	\$1,414	\$28,676	0.2%	Emergency Services
\$847	\$822	\$804	\$443	\$365	\$9,562	0.1%	Building Leases
\$0	\$0	\$0	\$0	\$0	\$0	0.0%	Independent Police Auditor
\$645,350	\$626,466	\$435,966	\$337,858	\$229,377	\$7,064,470	53.2%	Sub-total
\$94,017	\$933,492	-	\$1,037,120	-	\$5,063,472	38.1%	
\$108,930	\$105,743	\$51,221	\$57,028	\$23,706	\$1,155,053	8.7%	
\$848,297	\$1,665,701	\$487,187	\$1,432,006	\$253,083	\$13,282,995	100.0%	
\$2,463,672	\$2,391,580	\$1,158,468	\$1,289,798	\$536,164	\$26,123,779		
34.43%	69.65%	42.05%	111.03%	47.20%			

^a The amount from General Services to the Parking Fund was negative because a direct bill credit of \$70,184 exceeded the cost allocation within the plan.

^b The amount from Information Technology to the Parking Fund was offset in the plan by a direct bill credit of \$15,501.

Other Departments and Funds

Components of Overhead and FY 2013-14 Rate Calculation

	Housing Fund 346	Convention & Cultural Affairs Fund 536	SARA/RDA
Cost of City central services			
from Mayor & City Council	\$40,463	\$63,462	\$2,775,878
City Attorney	\$675,063	\$75,856	\$1,576,173
City Manager	\$222,577	\$192,383	\$100,401
Finance	\$454,666	\$27,917	\$211,331
City-wide Programs	\$157,474	\$136,099	\$120,362
General Services	\$162,550	\$38,104	\$235,986
Information Technology	\$245,827	\$22,603	\$88,359
City Auditor	\$23,025	\$120,241	\$13,549
Human Resources	\$49,956	\$26,631	\$12,158
Equipment Usage	\$30,075	\$31,263	\$32,793
City Clerk	\$9,146	\$14,306	\$4,429
Building Occupancy	\$1,192	\$266	\$868
Emergency Services	\$2,069	\$3,243	\$1,037
Building Leases	\$2,077	\$1,047	\$1,037
Independent Police Auditor	\$0	\$0	\$0
A Sub-total	\$2,076,169	\$753,416	\$5,174,354
Departmental/Fund Indirect Costs			
B Non-Personal costs	-	-	-
C Strategic Support	-	-	-
Total Overhead Amount			
D A+B+C	\$1,052,140	\$753,416	\$5,174,354
Departmental/Fund Direct Labor Costs			
E Direct Labor costs	\$4,284,030	-	-
Overhead Rates			
D / E Divide Overhead by Direct Labor	24.56%	-	-

Other Departments and Funds (continued)

Retirement	Stores Fund	Vehicle Maint. & Op. Fund 552	Benefit Funds	
				Cost of City central services
\$19,565	\$104	\$32,911	\$62,151	Mayor & City Council
\$7,238	\$1,164	\$17,546	\$8,800	City Attorney
\$100,927	\$22,049	\$79,966	\$138,047	City Manager
\$38,484	\$140	\$103,169	\$20,996	Finance
\$17,679	\$2,350	\$89,966	\$23,876	City-wide Programs
\$7,248	\$585	\$80,483	\$6,431	General Services
\$76,118	\$1,058	\$56,473	\$11,381	Information Technology
\$7,107	\$1,151	\$6,015	\$8,172	City Auditor
\$23,602	\$598	\$58,414	\$3,037	Human Resources
\$5,694	\$176	\$12,174	\$1,844	Equipment Usage
\$4,412	\$21	\$7,409	\$13,988	City Clerk
\$173	\$14,359	\$23,565	\$178	Building Occupancy
\$999	\$5	\$1,688	\$3,177	Emergency Services
\$767	\$89	\$1,044	\$573	Building Leases
\$0	\$0	\$0	\$0	Independent Police Auditor
<u>\$310,008</u>	<u>\$43,848</u>	<u>\$570,805</u>	<u>\$302,653</u>	Sub-total
-	-	-	-	
-	-	-	-	
<u>\$310,008</u>	<u>\$43,848</u>	<u>\$570,805</u>	<u>\$302,653</u>	
<u>\$3,012,823</u>	<u>-</u>	<u>\$4,147,323</u>	<u>\$529,643</u>	
10.29%	-	13.76%	57.14%	

Source: Finance Department's City-wide FY 2013-14 Cost Allocation Plan, NGCS II Schedule G, and Finance's rate sheet. Note that the cost of City central services may not add exactly to line A due to rounding within the NGCS II software.

Capital Rate

Components of Overhead and FY 2013-14 Rate Calculation

Finance calculated a capital overhead rate that relates overhead to staff time paid for by capital funds. The rate calculation is a weighted average of the core services (e.g., Public Works—*Plan, Design, Construct Public Facilities*, DOT—*Pavement Maintenance*, DOT—*Transportation Planning* etc.) whose direct labor is paid for partially by capital funds (line G). Overhead includes the cost of central services allocated to those core services (offset for any direct bills, line A) and non-personal (line B) and administrative costs (line C) in those core services. Overhead is pro-rated to capital's direct labor share (line E).

	Public Works Plan, Design, Construct Public Facilities	Transportation				Parks, Recreation & Neighborhood Services		
		Pavement Maintenance	Transp. Planning	Transp. Operations	Street Landscape Maintenance	Parks Maintenance and Operations	Recreation and Community Services	Strategic Support
Cost of City central services								
from General Services	\$2,555,493	\$88,864	\$70,324	\$96,547	\$36,817	\$1,557,091	\$996,129	
City-wide Programs	\$766,401	\$169,827	\$134,396	\$184,509	\$70,360	\$1,135,887	\$726,671	
City Manager	\$868,327	\$106,992	\$84,670	\$116,242	\$44,327	\$528,637	\$338,189	
Information Technology	\$789,454	\$87,519	\$69,261	\$95,086	\$36,260	\$744,311	\$476,164	
City Attorney	\$804,076	\$81,181	\$64,245	\$88,200	\$33,634	\$446,596	\$285,705	
Equipment Usage	\$862,256	\$70,889	\$56,099	\$77,018	\$29,369	\$339,491	\$217,186	
Finance	\$427,297	\$80,685	\$63,853	\$87,661	\$33,429	\$329,797	\$210,983	
Mayor & City Council	\$184,289	\$60,357	\$47,765	\$65,575	\$25,006	\$248,185	\$158,773	
Human Resources	\$85,821	\$39,115	\$30,955	\$42,497	\$16,205	\$284,658	\$182,107	
City Auditor	\$64,354	\$8,321	\$6,585	\$9,041	\$3,447	\$46,718	\$29,887	
City Clerk	\$41,642	\$13,605	\$10,766	\$14,781	\$5,636	\$56,043	\$35,853	
Building Occupancy	\$19,193	\$3,972	\$3,143	\$4,315	\$1,646	\$24,081	\$15,406	
Emergency Services	\$9,418	\$3,084	\$2,440	\$3,351	\$1,278	\$12,685	\$8,115	
Building Leases	\$13,423	\$1,070	\$847	\$1,162	\$443	\$8,478	\$5,424	
Independent Police Auditor	\$0	\$0	\$0	\$0	\$0	\$0	\$0	
A Sub-total	\$7,491,444	\$815,481	\$645,349	\$885,985	\$337,857	\$5,762,658	\$3,686,592	
Departmental Indirect Costs								
B Non-Personal	\$8,000	\$43,128	\$94,017	\$460,310	\$1,037,120	\$4,748,314	\$2,142,410 ^a	
C Strategic Support	\$804,032	\$137,648	\$108,930	\$149,548	\$57,028	\$2,313,034	\$1,479,735	
Total Overhead Amount								
D A+B+C	\$8,303,476	\$996,257	\$848,296	\$1,495,843	\$1,432,005	\$12,824,006	\$7,308,737	
E % from capital funds ^b	91.45%	85.70%	95.23%	46.72%	12.77%	7.69%	1.08%	
F D*E Overhead (pro-rated)	\$7,593,529	\$853,792	\$807,832	\$698,858	\$182,867	\$986,166	\$78,934	
Direct Labor costs								
G Direct Labor from capital funds	\$14,564,585	\$2,668,058	\$2,346,176	\$1,580,136	\$164,668	\$985,499	\$88,372	\$1,633,958

^a Finance, however, used \$1,225,410 to calculate the overhead rate for PRNS—*Recreation and Community Services*.

^b Source: Finance calculation worksheets "Special Funds Rate Calculation Detail"

Capital Rate (continued)

For example, 91.45 percent of direct labor in Public Works' Plan, Design, and Construct Public Facilities core service was paid out of capital funds, so 91.45 percent of this core service's overhead of \$8.3 million factors into the capital rate calculation.

Economic Development		Environmental Services		Planning, Building & Code Enf.		Fire		Pro-rated Sum	
Arts and Cultural Development	Real Estate Services	Waste-water Management	Potable Water Delivery	Plan Review/ Building Inspections	Long Range Land Use Planning	Fire Safety Code Compliance	Strategic Support		
\$684,706	\$14,699	\$493,764	\$46,404	\$380,654	\$39,042	\$39,602		\$2,929,461	23.8% General Services
\$99,645	\$26,291	\$556,562	\$52,306	\$490,336	\$50,291	\$215,891		\$1,248,574	10.2% City-wide Pgms
\$41,475	\$19,016	\$806,010	\$75,749	\$238,201	\$24,431	\$27,321		\$1,139,069	9.3% City Manager
\$61,780	\$29,246	\$1,117,996	\$105,069	\$498,056	\$51,083	\$27,358		\$1,073,264	8.7% IT
\$52,467	\$29,213	\$637,650	\$59,927	\$497,725	\$51,049	\$41,051		\$1,019,816	8.3% City Attorney
\$88,489	\$4,953	\$99,466	\$9,348	\$151,716	\$15,561	\$49,979		\$1,010,626	8.2% Equipment
\$37,852	\$12,106	\$590,049	\$55,453	\$142,583	\$14,624	\$17,788		\$644,961	5.2% Finance
\$15,664	\$5,113	\$544,723	\$51,193	\$93,807	\$9,622	\$15,346		\$357,827	2.9% Mayor/Council
\$17,947	\$7,847	\$72,390	\$6,803	\$136,854	\$14,036	\$32,276		\$202,777	1.6% HR
\$3,915	\$1,664	\$215,075	\$20,212	\$24,330	\$2,495	\$8,521		\$94,609	0.8% City Auditor
\$3,544	\$1,158	\$122,897	\$11,550	\$21,275	\$2,182	\$3,463		\$80,772	0.7% City Clerk
\$3,854	\$1,488	\$3,929	\$370	\$4,030	\$414	\$31,555		\$31,015	0.3% Bldg Occupancy
\$799	\$262	\$27,841	\$2,617	\$4,794	\$491	\$784		\$18,285	0.1% Emerg Svcs
\$1,473	\$229	\$7,031	\$661	\$3,811	\$391	\$499		\$16,332	0.1% Bldg Leases
\$0	\$0	\$0	\$0	\$0	\$0	\$0		\$0	0.0% Police Auditor
\$1,113,610	\$153,285	\$5,295,383	\$497,662	\$2,688,172^c	\$275,712	\$511,434		\$9,867,389	80.2% Sub-total
-	\$475,000	\$0	\$0	\$1,677,776	\$1,053,712	\$155,773		\$1,144,271	9.3%
\$75,946	\$46,332	\$2,845	\$267	\$319,185	\$32,737	\$351,752		\$1,285,988	10.5%
\$1,189,556	\$674,617	\$5,298,228	\$497,929	\$4,685,133	\$1,362,161	\$1,018,959			
33.88%	51.76%	3.84%	14.86%	0.62%	1.51%	1.61%			
\$403,022	\$349,182	\$203,452	\$73,992	\$29,048	\$20,569	\$16,405		\$12,297,648	100.0%
\$397,679	\$311,769	\$879,992	\$320,384	\$72,837	\$18,082	\$31,411	\$244,924	\$26,308,530	

Overhead Rate		
F/G	Divide Overhead by Direct Labor	46.74%

^c Finance adjusted PBCE's central service cost allocations down by \$651,374 in February 2013, after the rates were originally published. This adjustment is not reflected here.

Source: Finance Department's City-wide FY 2013-14 Cost Allocation Plan, NGCS II Schedule G, and Finance's rate sheet. Note that the cost of City central services may not add exactly to line A due to rounding within the NGCS II software.

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APPENDIX D

Appendix D

Comparison of Central Service Allocations Among Departments

This table compares the results of the central service allocations for FY 2013-14. For example, 17.2 percent of General Services' allocated costs of \$14.3 million were allocated to the Police Department (also see Appendix C). A special fund with a significant amount of direct bills may have a lower-than-expected overhead allocation; however, it is also charged separately for its central service support activities. Percentages on each row do not add to 100% because (1) allocations to the Airport are not shown here, (2) some allocations to DOT are also shown under Utility Funds, and (3) allocations to capital are derived from allocations already shown under Public Works and other departments.

		% of allocated City central service costs to line departments and funds															
		Public										Housing		C&C A		Utility	
		Police	Fire	PRNS	Works ^a	DOT ^b	SARA	PBCE ^c	Library	OED	F346	F536 ^d	Other ^e	Funds ^f	Capital ^g		
Allocated City central service costs																	
from City-wide Programs ^h	\$32,312,393	45.3%	27.4%	5.8%	3.1%	4.5%	0.4%	2.3%	1.7%	1.0%	0.5%	0.4%	0.4%	6.6%	3.9%		
General Services	\$14,320,542	17.2%	11.3%	17.8%	19.6%	4.8%	1.6%	4.9%	5.0%	5.7%	1.1%	0.3%	0.7%	7.9%	20.5%		
City Attorney	\$12,291,452	27.3%	13.7%	6.0%	8.4%	5.6%	12.8%	6.2%	0.6%	3.7%	-0.9% ⁱ	0.6%	0.3%	15.7%	8.3%		
Information Technology	\$11,808,209	17.4%	9.5%	10.3%	8.7%	6.4%	0.7%	6.4%	2.8%	2.6%	2.1%	0.2%	1.2%	29.3%	9.1%		
City Manager	\$10,619,137	17.4%	10.5%	8.2%	9.5%	9.4%	0.9%	3.4%	2.7%	2.4%	1.7%	1.8%	3.2%	25.2%	10.7%		
Mayor & City Council	\$8,211,594	14.2%	7.7%	5.0%	3.0%	6.8%	33.8%	1.8%	1.8%	0.7%	0.5%	0.8%	1.4%	19.1%	4.4%		
Finance	\$7,559,568	15.3%	9.6%	7.2%	9.2%	9.2%	2.8%	2.9%	3.4%	1.8%	3.8%	0.4%	2.2%	23.8%	8.5%		
Equipment Usage	\$6,753,757	19.1%	30.3%	8.2%	15.2%	8.8%	0.5%	3.6%	5.1%	1.9%	0.4%	0.5%	0.3%	7.5%	15.0%		
Human Resources	\$5,258,303	38.9%	25.2%	8.9%	2.8%	6.5%	0.2%	4.0%	3.0%	1.6%	0.4%	0.5%	1.6%	4.5%	3.9%		
Building Occupancy	\$4,281,644	52.1%	30.2%	0.9%	0.5%	1.2%	0.0%	0.1%	11.6%	0.4%	0.0%	0.0%	0.9%	0.6%	0.7%		
City Auditor	\$2,015,073	16.5%	17.3%	3.8%	3.9%	3.8%	0.7%	1.8%	1.2%	1.0%	1.1%	6.0%	1.1%	35.3%	4.7%		
Building Leases	\$1,795,994	93.3%	1.1%	0.8%	0.9%	0.5%	0.1%	0.3%	0.3%	0.2%	0.1%	0.1%	0.1%	1.9%	0.9%		
City Clerk	\$1,229,912	21.3%	11.5%	7.5%	4.6%	10.3%	0.4%	2.7%	2.7%	1.1%	0.7%	1.2%	2.1%	28.7%	6.6%		
Independent Police Auditor	\$1,065,761	100.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%		
Emergency Services	\$278,860	21.3%	11.5%	7.5%	4.6%	10.3%	0.4%	2.6%	2.7%	1.1%	0.7%	1.2%	2.1%	28.8%	6.6%		
Total (line A)	\$119,802,199	29.7%	17.5%	7.9%	7.7%	5.9%	4.3%	3.0%	2.9%	2.2%	0.9%	0.6%	1.0%	14.3%	8.2%		

^a Public Works, as shown here, excludes the *Facilities Management* and *Fleet and Equipment Services* core services which are treated as General Services.

^b The Department of Transportation, as shown here, includes Parking Fund and Maintenance Assessment Districts. It also includes *Sanitary Sewer Maintenance* and *Storm Sewer Management*, which are also shown under Utility Funds.

(Footnotes continued on next page)

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^c Finance credited Planning, Building & Code Enforcement \$651,374 in February 2013, after the initial rates had been calculated. This credit is included in the total line, but not above the total line.

^d See the Background for more information on overhead to the Convention and Cultural Affairs Fund 536. The City's Convention and Cultural Facilities are operated by Team San Jose.

^e "Other" includes: Stores Fund, Vehicle Maintenance and Operations Fund 522, Benefit Funds, and Retirement.

^f Utility Funds include: Integrated Waste Management Fund 423, Storm Sewer Operating Fund 446, Treatment Plant Operating Fund 513, Water Utility Fund 515, Sewer Service and Use Charge Fund 541, and their associated Environmental Services Department and DOT core services. Utility Funds received additional, small allocations that are not shown here; for details, see Appendix C.

^g Allocations to the capital overhead rate are derived from allocations already shown under some other department, mainly Public Works. For details, see Appendix C.

^h City-wide Programs costs are mainly workers' compensation costs. They also include: Sick Leave Payouts, Property Tax Admin Fee, etc.

ⁱ The amount from City Attorney to Housing Fund 346 was negative because a direct bill credit exceeded the cost allocation within the plan.

This table does not show overhead rates.

Source: Auditor analysis of the Finance Department's City-wide FY 2013-14 Cost Allocation Plan, NGCS II Schedule G, and Finance's Special Funds Rate spreadsheet.

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APPENDIX E

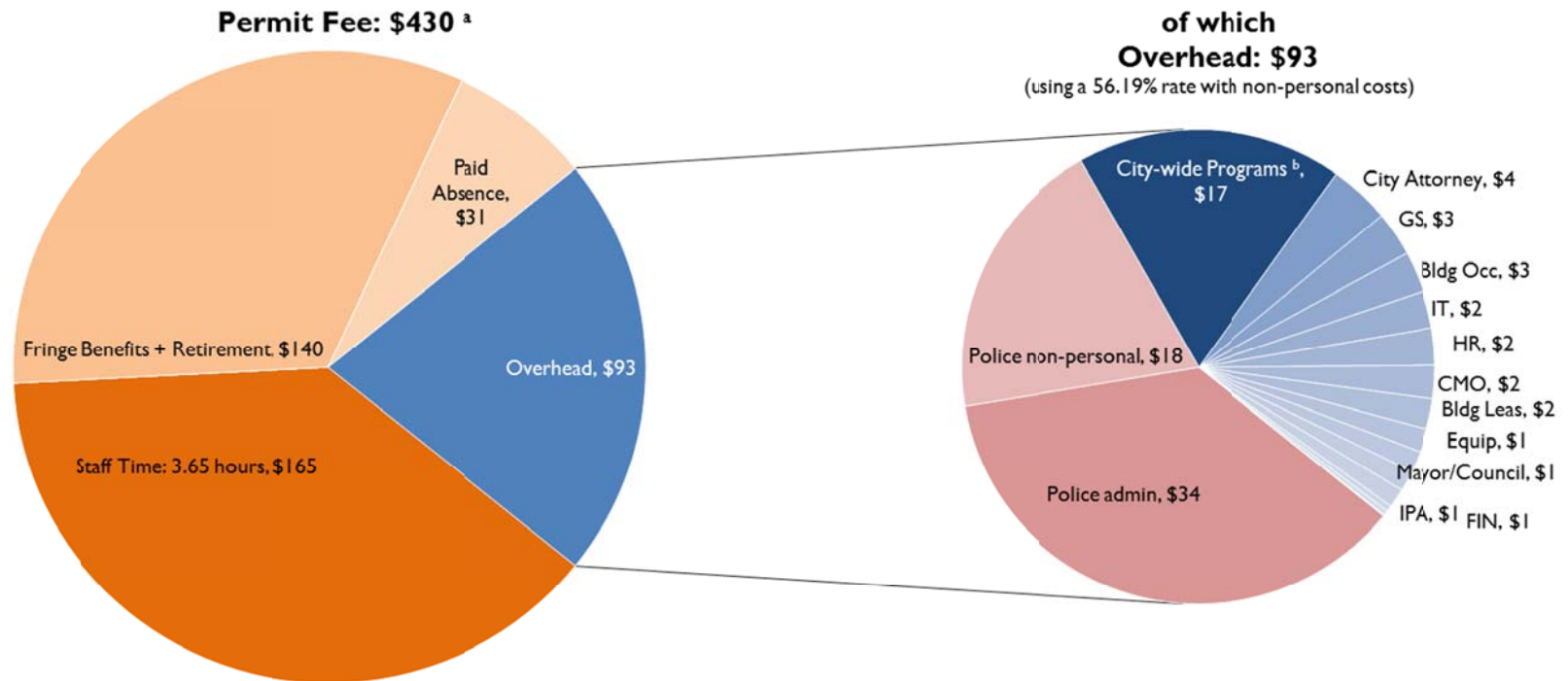
Appendix E

Applying Overhead to Fees and Special Funds, Examples

The City's fees and charges include both the direct cost of providing a service as well as indirect costs, such as departmental administrative costs, departmental non-personal costs, central service costs, and others. This Appendix illustrates these components on three example fees, including a breakdown of overhead costs included in the fee. As another example, one utility fund's overhead costs are broken out among its expenditures.

Appendix E1 – Police Department’s Taxicab Driver’s Permit Fee

The Police Department estimated the 3.65 staff hours for processing one taxi permit (orange: \$165). Included in the fee are also fringe benefits and retirement contributions (light orange: \$140), as well as paid absence costs (light orange: \$31) – the costs of vacation, sick, and holiday leaves associated with the 3.65 hours of direct labor. The 56.19 percent overhead rate applies to direct labor (i.e., salaries, orange: \$165) only. Overhead (\$93) includes both the indirect costs from central services (blue: \$41) as well as the Police Department’s administrative and non-personal costs (pink: \$34+\$18).



^a The permit is valid for two years.

^b City-wide Programs costs are mainly workers’ compensation costs. They also include: Sick Leave Payouts, Property Tax Admin Fee, etc.

Source: Auditor analysis of Police fee calculation, Finance Department’s City-wide FY 2013-14 Cost Allocation Plan (NGCS II Schedule G), Finance’s rate sheet.

Figures may not sum exactly due to rounding.

Appendix E2 – Planning, Building & Code Enforcement’s (PBCE) Residential Occupancy Permit Fee

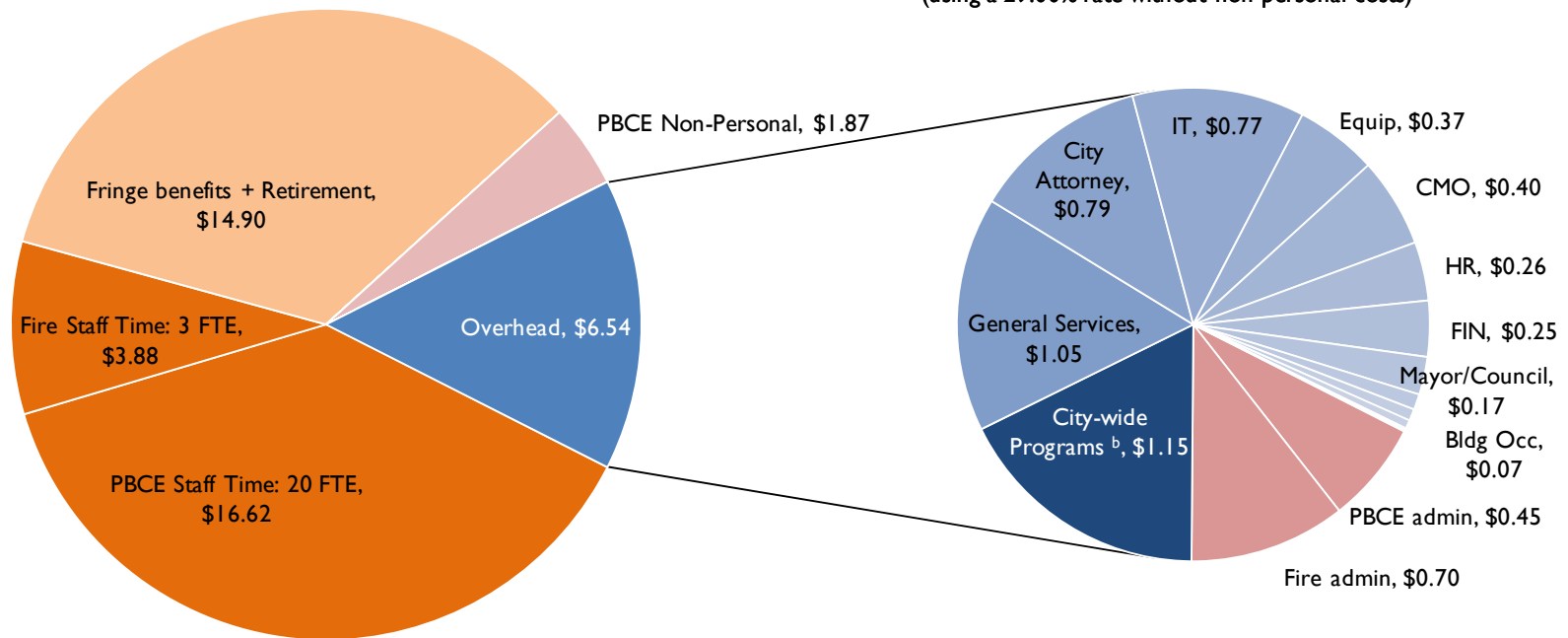
Planning, Building & Code Enforcement’s (PBCE) permit fee for multiple housing (e.g. apartment houses) includes staff time costs from both PBCE and the Fire Department. The fee calculation begins with the staff cost of the entire program (orange: \$16.62+\$3.88). The fee also includes fringe benefit and retirement costs (light orange: \$14.90) and PBCE’s non-personal costs (pink: \$1.87). Because PBCE’s non-personal costs are already included in the fee calculation (pink: \$1.87), the overhead (\$6.54) excludes those non-personal costs.

Permit Fee: \$43.81^a

of which

Overhead: \$6.54

(using a 29.00% rate without non-personal costs)



^a The permit fee is per unit and the fee calculation assumed costs would be split among 86,736 units.

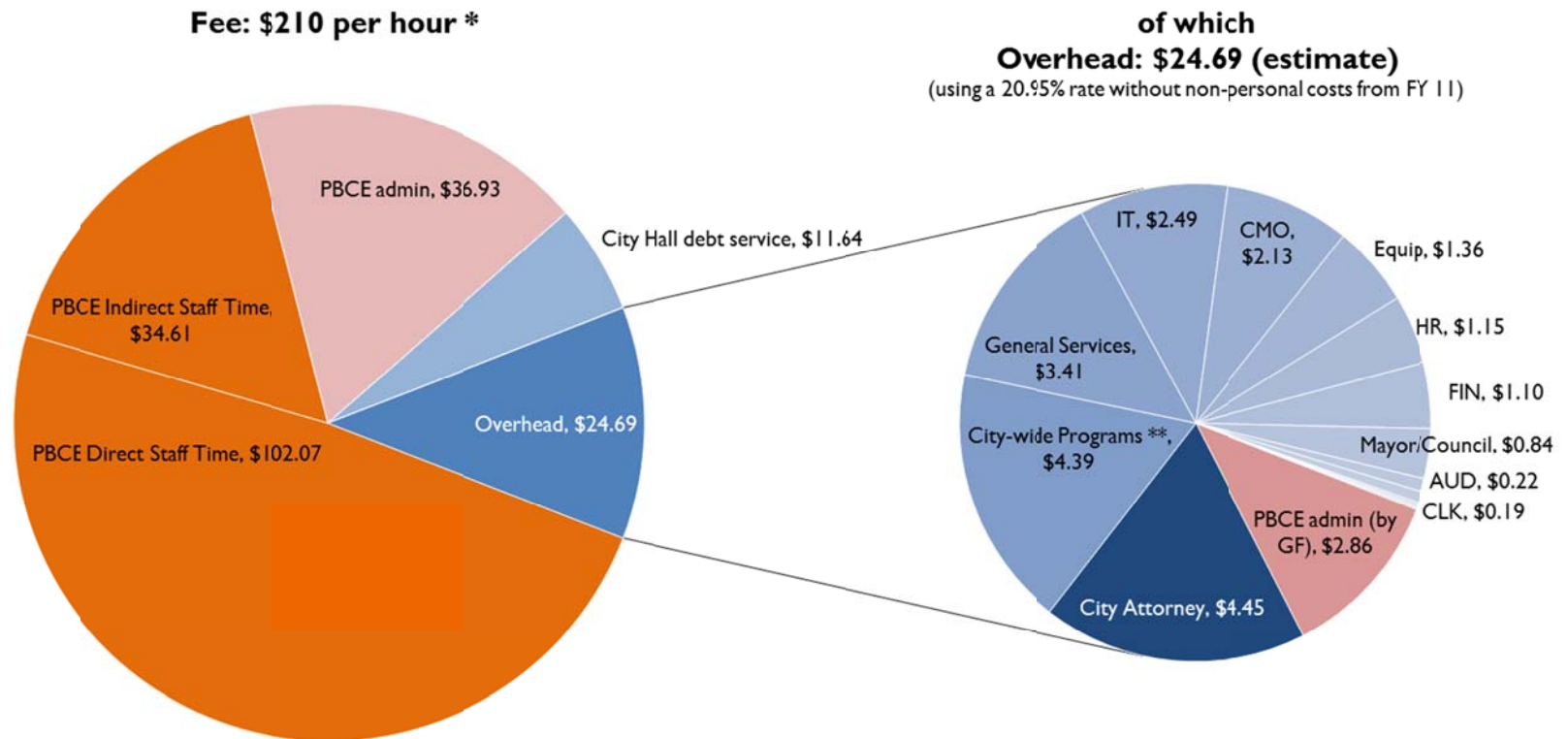
^b City-wide Programs costs are mainly workers’ compensation costs. They also include: Sick Leave Payouts, Property Tax Admin Fee, etc.

Source: Auditor analysis of PBCE fee calculation, Finance Department’s City-wide FY 2013-14 Cost Allocation Plan (NGCS II Schedule G), Finance’s rate sheet.

Figures may not sum exactly due to rounding.

Appendix E3 – Planning, Building & Code Enforcement’s Plan Review Fee

PBCE’s fee for reviewing development plans is charged on an hourly basis. To achieve full cost recovery, PBCE estimated the full cost of its plan review program and divided the total by its billable hours. The total program costs included direct (“billable”) staff time (\$102.07), as well as indirect staff time (\$34.61), and administrative costs (\$36.93). Those costs already include fringe benefits and retirement. Overhead (\$24.69) includes additional PBCE administrative costs (from General Fund staff, \$2.86). City Hall debt service is not part of the overhead rate and thus included separately (\$11.64).



* The fee calculation assumed costs would be split among 19,542 billable hours. Fringe benefits and retirement are included.

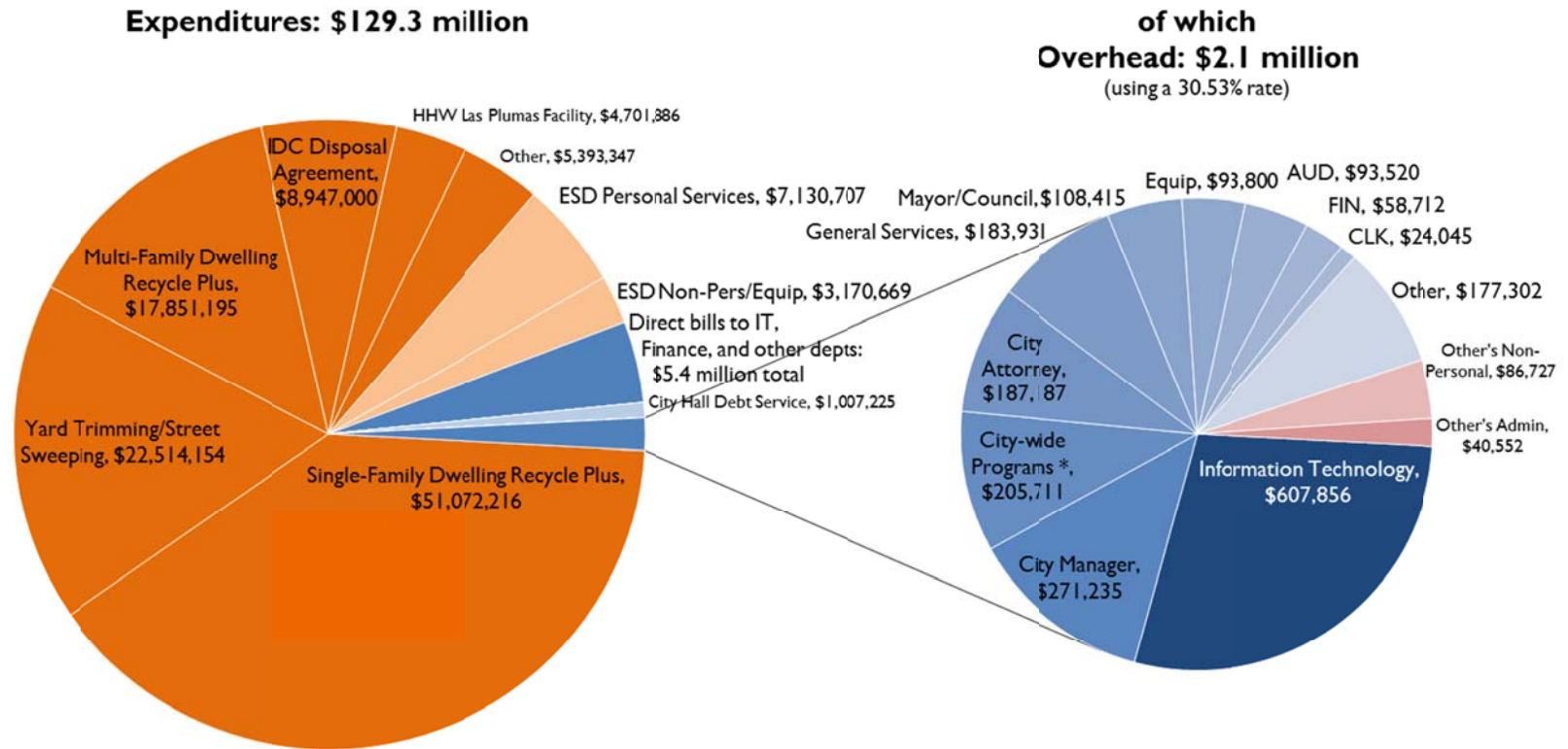
** City-wide Programs costs are mainly workers’ compensation costs. They also include: Sick Leave Payouts, Property Tax Admin Fee, etc.

Source: Auditor analysis of PBCE FY 2010-11 fee calculation, Finance Department’s City-wide FY 2013-14 Cost Allocation Plan (NGCS II Schedule G), Finance’s rate sheet.

Figures may not sum exactly due to rounding.

Appendix E4 – Integrated Waste Management Fund 423’s Expenditures

The Integrated Waste Management Fund 423 mainly pays for garbage pick-up and recycling services for San José residents (orange). The fund also paid directly for staff in the Environmental Services Department (ESD, light orange) and in other departments, like Information Technology and Finance (“direct bills”). The fund paid overhead of \$2.1 million to the General Fund, using a 30.53 percent rate on direct labor costs only. This reimbursement covers the overhead cost of central services for Fund 423’s direct labor.



* City-wide Programs costs are mainly workers’ compensation costs. They also include: Sick Leave Payouts, Property Tax Admin Fee, etc.

Source: Auditor analysis of Fund 423’s Adopted FY 2013-14 Budget Source and Use Statement, Finance Department’s City-wide FY 2013-14 Cost Allocation Plan (NGCS II Schedule G), Finance’s rate sheet.

Figures may not sum exactly due to rounding.

APPENDIX F

Appendix F

Five-Year Trend of Overhead Rates

Finance calculates two different overhead rates: one with departmental non-personal costs, and one without. Overhead rates for all departments' core services have fluctuated for the last five years. Rates may vary as a result of changes to central services and their workload, changes to the department's administrative and non-personal costs, and changes to the department's direct labor costs.

Department Core Service	Rates with Department's Non-Personal costs						Rates without Department's Non-Personal costs							
	Rate = $\frac{\text{cost share of: Central service} + \text{Dept's admin} + \text{Dept's NP}}{\text{Core Service's Direct labor costs}}$						Rate = $\frac{\text{cost share of: Central service} + \text{Dept's admin}}{\text{Core Service's Direct labor costs}}$							
	09-10	10-11	11-12	12-13	2013-14	5-year change	09-10	10-11	11-12	12-13	2013-14	5-year change		
Parks, Recreation & Neighborhood Services														
Parks Maintenance and Operations	75.91%	71.10%	69.10%	93.45%	100.03%		24.12%	51.85%	46.77%	48.71%	59.32%	62.99%		11.14%
Recreation and Community Services	87.37%	70.60%	70.85%	72.80%	77.93%		-9.44%	51.85%	46.77%	48.71%	59.32%	62.99%		11.14%
Community Strengthening Services	81.13%	81.86%	54.53%					51.85%	46.77%	48.71%				
Economic Development														
Arts and Cultural Development	91.59%	105.85%	107.11%	115.03%	120.47%		28.88%	75.70%	88.54%	85.39%	102.76%	120.47%		44.77%
Real Estate Services					111.99%						33.14%			
Business Development and Econ. Strategy	40.88%	35.70%	35.74%	44.83%	51.15%		10.27%	26.54%	21.25%	19.89%	30.93%	33.14%		6.60%
Regional Workforce Development	33.52%	31.63%	31.63%	42.08%	41.56%		8.04%	33.52%	31.63%	31.63%	42.08%	41.56%		8.04%
Outdoor Special Events	38.89%	33.38%	34.39%	136.08%				26.55%	21.25%	19.89%	30.93%			
Library														
Access to Information, Library Materials	54.63%	49.10%	61.29%	65.13%	64.47%		9.84%	36.18%	31.60%	38.44%	42.36%	43.11%		6.93%
Formal and Lifelong Self-Directed Educ.	37.07%	40.21%	42.35%	53.86%	58.30%		21.23%	33.43%	31.52%	38.34%	42.36%	43.11%		9.68%
Police														
Investigative Services	51.65%	52.61%	56.91%	63.79%	60.37%		8.72%	46.38%	41.82%	45.74%	50.94%	45.27%		-1.11%
Special Events Services	53.40%	50.50%	55.71%	62.23%	57.05%		3.65%	46.38%	41.82%	45.74%	50.94%	45.27%		-1.11%
Regulatory Services	57.40%	52.51%	57.19%	61.49%	56.19%		-1.21%	46.38%	41.82%	45.74%	50.94%	45.27%		-1.11%
Respond to Calls for Service	53.42%	47.77%	51.22%	57.33%	51.90%		-1.52%	46.38%	41.82%	45.74%	50.94%	45.27%		-1.11%
Traffic Safety Services	50.29%	47.26%	51.70%	57.30%	51.37%		1.08%	46.38%	41.82%	45.74%	50.94%	45.27%		-1.11%
Crime Prevention and Comm. Education	53.49%	48.60%	52.18%	57.54%	50.93%		-2.56%	46.38%	41.82%	45.74%	50.94%	45.27%		-1.11%
Transportation														
Traffic Maintenance	96.49%	94.91%	95.63%	106.40%	117.37%		20.88%	24.23%	28.18%	26.32%	31.98%	30.62%		6.39%
Street Landscape Maintenance	74.79%	95.88%	98.38%	117.58%	111.03%		36.24%	24.23%	28.18%	26.32%	31.98%	30.62%		6.39%
Parking Services	85.36%	69.23%	63.17%	77.36%	69.65%		-15.71%	24.23%	28.18%	26.32%	31.98%	30.62%		6.39%
Transportation Operations	33.96%	37.76%	38.45%	46.02%	44.23%		10.27%	24.23%	28.18%	26.32%	31.98%	30.62%		6.39%
Storm Sewer Management	28.23%	31.94%	29.50%	36.13%	35.05%		6.82%	24.23%	28.18%	26.32%	31.98%	30.62%		6.39%
Transportation Planning and Project Deliv.	26.44%	30.81%	29.91%	36.29%	34.43%		7.99%	24.23%	28.18%	26.32%	31.98%	30.62%		6.39%
Pavement Maintenance	61.29%	64.64%	61.69%	33.14%	32.00%		-29.29%	24.23%	28.18%	26.32%	31.98%	30.62%		6.39%
Sanitary Sewer Maintenance	24.23%	28.18%	26.32%	31.98%	30.62%		6.39%	24.23%	28.18%	26.32%	31.98%	30.62%		6.39%
Maintenance Assessment Districts	42.48%	46.95%	45.84%	51.60%	47.20%		4.72%	42.48%	46.95%	45.84%	51.60%	47.20%		4.72%
Parking Fund	36.05%	43.75%	48.13%	48.89%	42.05%		6.00%	36.05%	43.75%	48.13%	48.89%	42.05%		6.00%

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Five-Year Trend of Overhead Rates (continued):

Department Core Service	Rates with Department's Non-Personal costs						Rates without Department's Non-Personal costs							
	09-10	10-11	11-12	12-13	2013-14	5-year change	09-10	10-11	11-12	12-13	2013-14	5-year change		
Fire														
Fire Safety Code Compliance	37.45%	44.27%	45.87%	48.67%	52.39%		14.94%	32.00%	37.20%	40.63%	46.27%	44.38%		12.38%
Fire Prevention	38.60%	45.15%	47.49%	53.65%	50.95%		12.35%	32.00%	37.20%	40.63%	46.27%	44.38%		12.38%
Emergency Response	33.57%	38.75%	42.21%	48.12%	45.97%		12.40%	32.00%	37.20%	40.63%	46.27%	44.38%		12.38%
Public Works														
Animal Care and Services		60.54%	60.03%	58.76%	59.30%			33.85%	29.69%	35.39%	34.50%			
Plan, Design, Construct Public Facilities	39.20%	35.62%	36.80%	48.50%	52.14%		12.94%	38.39%	35.09%	36.06%	48.45%	52.09%		13.70%
Regulate/Facilitate Private Development	23.56%	18.34%	20.62%	24.78%	18.29%		-5.27%	23.52%	18.30%	18.98%	24.21%	17.90%		-5.62%
Planning, Building & Code Enforcement														
Long Range Land Use Planning	39.36%	54.72%	57.88%	62.25%	113.68%		74.32%	26.16%	27.79%	32.54%	26.14%	25.74%		-0.42%
Community Code Enforcement	36.28%	38.84%	43.35%	41.46%	40.12%		3.84%	31.14%	33.31%	37.86%	31.46%	29.00%		-2.14%
Dev. Plan Review and Bldg. Constr. Insp.	25.72%	35.89%	38.83%	29.45%	34.53%		8.81%	17.73%	20.95%	23.58%	17.31%	20.17%		2.44%
Housing Fund 346 (replaced Fund 443)	20.04%	14.48%	16.28%	17.45%	24.56%		4.52%	20.04%	14.48%	16.28%	17.45%	24.56%		4.52%
Convention & Cultural Affairs Fund 536 (facilities are operated by Team San Jose)	23.68%	19.40%	54.71%	109.63%				23.68%	19.40%	54.71%	109.63%			
Redevelopment Agency	147.26%	190.19%	127.94%					147.26%	190.19%	127.94%				
Vehicle Maintenance & Operations Fund 552	15.22%	14.39%	16.75%	8.84%	13.76%		-1.46%	15.22%	14.39%	16.75%	8.84%	13.76%		-1.46%
Retirement	32.40%	14.96%	18.57%	19.52%	10.29%		-22.11%	32.40%	14.96%	18.57%	19.52%	10.29%		-22.11%
Benefit Funds	40.36%	39.42%	42.19%	71.28%	57.14%		16.78%	40.36%	39.42%	42.19%	71.28%	57.14%		16.78%
Stores Fund	13.50%	11.68%	14.48%	23.68%				13.50%	11.68%	14.48%	23.68%			
Special Funds														
Capital	34.33%	34.33%	40.83%	39.86%	46.74%		12.41%							
Integrated Waste Management Fund 423	22.25%	21.60%	21.70%	27.71%	30.53%		8.28%							
Storm Sewer Operating Fund 446	28.06%	31.50%	29.74%	33.86%	29.71%		1.65%							
Treatment Plant Operating Fund 513	23.79%	24.71%	24.35%	25.63%	31.15%		7.36%							
Water Utility Fund 515	28.41%	29.97%	35.33%	39.45%	30.36%		1.95%							
Sewer Service & Use Charge Fund 541	49.85%	43.63%	41.24%	47.42%	54.74%		4.89%							
Paid Absence Rates														
Police	17.09%	17.41%	15.67%	19.09%	19.07%		1.98%							
Fire	14.49%	13.71%	15.24%	16.72%	16.76%		2.27%							
All Other Departments	18.68%	19.34%	19.02%	20.96%	21.37%		2.69%							
Central Services														
Information Technology		60.47%	70.29%	63.27%	97.49%			22.49%	24.62%	20.60%	38.61%			
General Services	109.39%	94.54%	95.52%	65.91%	90.16%		-19.23%	64.82%	56.99%	59.54%	47.70%	47.77%		-17.05%
City Clerk	84.76%	61.01%	273.69%	50.86%	85.78%		1.02%	73.01%	46.35%	236.92%	37.80%	67.46%		-5.55%
Finance	76.82%	47.12%	53.37%	40.57%	73.32%		-3.50%	66.38%	36.97%	42.19%	31.27%	62.47%		-3.91%
City Manager				42.85%	63.91%						33.03%	48.45%		
City Attorney	41.77%	33.47%	36.27%	28.63%	42.25%		0.48%	31.38%	26.81%	28.71%	22.77%	31.48%		0.10%








Source: Auditor analysis of Finance Department's rate sheets. FY 2009-10 through FY 2012-13 are unaudited.

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APPENDIX G

Five-Year Trend of Overhead Components – Example: Police Department

For the last five years, the Police Department's overhead allocations and rates have fluctuated. The rates may rise or fall due to many different factors: Some central service allocations increased (e.g., Building Occupancy, due to the new South San José substation), some decreased.^a The Police Department's administrative and non-personal costs also varied. Finally, the Police Department's direct labor costs, the denominator of the overhead rate, decreased.

	FY 09-10	10-11	11-12	12-13	2013-2014	5-year change	5-year % change
Cost of City central services							
from City-Wide Programs ^a	\$15,900,187	\$17,884,993	\$18,564,330	\$17,656,085	\$14,637,162	(\$1,263,025)	-7.94%
City Attorney	\$4,126,809	\$4,744,570	\$2,078,434	\$3,481,552	\$3,353,213	(\$773,596)	-18.75%
General Services	\$3,583,538	\$3,538,539	\$3,392,689	\$2,777,321	\$2,462,968	(\$1,120,570)	-31.27%
Building Occupancy	\$573,766	\$543,159	\$543,259	\$2,233,958	\$2,232,357	\$1,658,591	289.07%
Information Technology	\$1,696,102	\$2,458,791	\$2,185,740	\$3,154,791	\$2,054,246	\$358,144	21.12%
Human Resources	\$2,521,597	\$2,867,390	\$2,395,524	\$2,039,968	\$2,046,629	(\$474,968)	-18.84%
City Manager	\$1,720,233	\$1,985,646	\$1,859,807	\$1,732,098	\$1,847,685	\$127,452	7.41%
Building Leases	\$1,835,353	\$1,755,066	\$1,755,106	\$1,649,645	\$1,676,329	(\$159,024)	-8.66%
Equipment Usage	\$1,499,812	\$1,650,655	\$1,574,030	\$1,493,357	\$1,286,803	(\$213,009)	-14.20%
Mayor & City Council	\$863,330	\$1,021,209	\$1,070,458	\$1,075,038	\$1,162,191	\$298,861	34.62%
Finance	\$1,251,626	\$1,237,126	\$1,234,801	\$1,297,707	\$1,156,869	(\$94,757)	-7.57%
Independent Police Auditor	\$822,778	\$800,785	\$825,184	\$963,329	\$1,065,761	\$242,983	29.53%
City Auditor	\$180,184	\$700,702	\$384,541	\$512,329	\$331,942	\$151,758	84.22%
City Clerk	\$408,592	\$377,663	\$421,083	\$293,824	\$262,221	(\$146,371)	-35.82%
Emergency Services	\$42,155	\$27,492	\$90,713	\$110,990	\$59,392	\$17,237	40.89%
A Sub-total	\$37,026,062	\$41,593,786	\$38,375,699	\$40,471,992	\$35,635,768	(\$1,390,294)	-3.75%
Police's Indirect Costs							
B Non-Personal	\$10,498,664	\$12,200,191	\$10,714,174	\$10,928,377	\$12,071,636	\$1,572,972	14.98%
C Strategic Support	\$36,624,275	\$31,147,203	\$33,357,033	\$30,441,710	\$29,627,302	(\$6,996,973)	-19.10%
Total Overhead Amount							
D A+B+C	\$84,149,001	\$84,941,180	\$82,446,906	\$81,842,079	\$77,334,706	(\$6,814,295)	-8.10%
Police's Direct Labor Costs							
E	\$159,516,674	\$173,294,925	\$156,814,092	\$139,197,313	\$144,170,963	(\$15,345,711)	-9.62%
Overhead Rates							
D/E Weighted Average	52.75%	49.02%	52.58%	58.80%	53.64%	0.89%	
Traffic Safety	50.29%	47.26%	51.70%	57.30%	51.37%	1.08%	
Crime Prev/Comm. Educ.	53.49%	48.60%	52.18%	57.54%	50.93%	-2.56%	
Investigative Services	51.65%	52.61%	56.91%	63.79%	60.37%	8.72%	
Regulatory Services	57.40%	52.51%	57.19%	61.49%	56.19%	-1.21%	
Respond to Calls for Service	53.42%	47.77%	51.22%	57.33%	51.90%	-1.52%	
Special Events Services	53.40%	50.50%	55.71%	62.23%	57.05%	3.65%	

^a The largest central service allocation to Police was from City-wide Programs and mainly included:

- Workers' compensation costs (\$8.1 million for FY 2013-14, an increase of \$1.5 million to FY 2009-10)
- Sick leave payouts upon retirement (\$2.7 million for FY 2013-14, a decrease of \$1.6 million to FY 2009-10)
- Revenue collection costs (\$1.7 million for FY 2013-14, an increase of \$0.3 million to FY 2009-10)
- General liability claims (\$1.0 million for FY 2013-14, a decrease of \$1.0 million to FY 2009-10)

^b In FY 2009-10 and FY 2010-11, it appears Finance made adjustments to the cost allocations, not shown here. These adjustments, however, did not materially impact the overhead rates.

Source: Finance Department's City-wide Cost Allocation Plans, NGCS II Schedules G, and Finance's rate sheets. FY 2009-10 through FY 2012-13 are unaudited.

Note that the cost of City central services may not add exactly to line A due to rounding within the NGCS II software.

Memorandum

TO: Sharon W. Erickson
City Auditor

FROM: Julia H. Cooper

**SUBJECT: RESPONSE TO THE AUDIT
“INDIRECT COST ALLOCATION:
IMPROVED PROCEDURES AND
BETTER COMMUNICATIONS
NEEDED”**

DATE: November 12, 2013

Approved



Date

11/12/13

The Administration has reviewed the Audit “*Indirect Cost Allocation: Improved Procedures and Better Communication Needed*” and is in general agreement with the recommendations identified in the report. The following are the Administration's response to each recommendation.

BACKGROUND

The Administration agrees with many of the recommendations contained in the “*Indirect Cost Allocation: Improved Procedures and Better Communication Needed*” Audit (the “Cost Allocation Audit” or “Audit”) report prepared by the Internal Auditor (“Auditor”).

The Cost Allocation Audit along with several other recently released audit reports from the Auditor illustrates how unprepared the organization was for the level of turnover, chronic vacancies, and loss of institutional knowledge (often times undocumented knowledge) that has recently been experienced. Long-tenured employees previously provided stability to the organization especially during the significant downsizing of the organization in FY 2010-11. In addition to the staffing reductions and staff retention issues, the organization continues to struggle with providing strategic support services on a centralized or decentralized basis.

The theme in the Administration’s response to the Cost Allocation Audit, coupled with the Administration’s responses in the “*Regional Wastewater Facility Master Agreements: New Procedures and Better Contract Management Needed*” and the “*Consulting Agreements: Better Enforcement of Procurement Rules, Monitoring, and Transparency is Needed*” is a need to return to basics. This return to basics will involve a careful examination of resources dedicated to contract monitoring/administration along with the upfront and ongoing training provided to staff to ensure the best contract management. These themes of sufficiently dedicated and educated workforce are repeated again in other soon to be released audits. The Administration acknowledges there is always room for improved management and oversight; however without

more adequate levels of staffing in key areas, coupled with targeted upfront and ongoing training, the ability to change current practices has been and will continue to be challenging.

RECOMMENDATIONS AND ADMINISTRATION'S RESPONSE

Overall Comments

As noted in the Cost Allocation Audit, the cost allocation program is currently staffed with one half (0.50) full-time equivalent position. The senior accountant assigned the responsibility of preparing the City's cost allocation plans is also assigned to the team that prepares the City's Comprehensive Annual Financial Report. The Finance Department has additionally been challenged with staff retention in the senior accountant classification. The Audit notes that since 2007 at least nine different individuals have prepared or supervised the preparation of the Cost Allocation Plans ("Plan(s)"). Staffing changes are almost entirely related to staff turnover within the Finance Department as illustrated by the tenure of the seven (7) senior accountants in the Accounting Division: two (2) positions are currently vacant, four (4) incumbents have less than one year of experience with the City, and one (1) incumbent has been in his position for approximately six years and with the City for twelve years. The Finance Department acknowledges that better documentation of the cost allocation calculation process would have made these transitions easier and calculations more transparent and consistent over time.

Given that the preparation of the Cost Allocation Plans occurs once each fiscal year and is generally completed by mid to late January in order to incorporate the new rates into the budget development process, it make take several fiscal years for all of the recommendations to be implemented and incorporated in to the Cost Allocation Plans.

Recommendation #1: To ensure that central service costs are treated appropriately and consistently, the Finance Department should update its procedures to more clearly define what costs should and should not be allocated within the Cost Allocation Plan. Specifically, the procedures should:

- Provide guidance on how to determine whether a central service department, a City-Wide program, or an individual central service program provides services to the public versus to another City department
- More clearly define what a "direct use building" is in determining allocated costs within the building occupancy cost pool
- Require that staff document decisions regarding whether costs should be deemed allocable or unallocable in accordance with the above

Administration Response: The Administration agrees with this recommendation and has begun taking steps in updating and documenting procedures with the assistance of a temporary employee who is providing coverage during a leave of absence. It is the Finance Department's goal to retain the temporary staffing resources through the balance of the fiscal year to assist in

preparing the Plans for FY 2014-2015 and begin the process of implementing many of the recommendations contained in the Cost Allocation Audit, most importantly those recommendations revolving around the need for more documentation, transparency and communication with departments.

Recommendation #2: To conform to the updated procedures (as outlined in Recommendation 1), in the FY 2014-15 Cost Allocation Plan the Finance Department should review and revise its lists of:

- allocated and unallocated central service costs
- City-Wide expenses
- direct use buildings.

Administration Response: The Administration agrees with this recommendation and believes some of the items will be implemented with the development of the FY 2014-2015 Plans. The Finance Department's ability to fully implement this recommendation in the development of the upcoming cost allocation plans may be constrained by the resources, workload and staffing levels in other departments. We believe the analysis of direct building use will require more coordination with other City departments and it is unlikely it will be completed for the FY 2014-15 Plans, however the Finance Department believes the elements of the Cost Allocation Plan for allocated/unallocated central service costs and city-wide expenses will be completed for the FY 2014-15 plans.

Recommendation #3: Before the Cost Allocation Plan is developed, the Finance Department should meet annually with central service departments, and the Budget Office, to review the allocation bases of their programs to ensure costs are appropriately allocated and identify any significant changes in departmental workloads. This review should include the allocation bases for Citywide Expenses. Any changes resulting from the above should be documented and Finance Department's procedures should be updated accordingly.

Administration Response: The Administration agrees with this recommendation and has already taken steps to commence implementation of the recommendation. As the Finance Department begins the preparation work for the FY 2014-2015 Plans, meetings with key departments and the Budget Office have been scheduled. Additionally, the Finance Department has updated its request for information memos to departments to include a description of the purpose and use of the information, adding a request for department organizational charts with position codes and requesting information on organization changes during the last fiscal year. Finally, the Finance Department will prepare written notes after meetings with departments to aid in the documentation process.

Recommendation #4: As part of its review of the FY 2014-15 Cost Allocation Plan, the Finance Department should review and revise the allocation bases to better reflect workload. This revision should include the Mayor and City Council's allocation to the Successor Agency, the allocation of Public Works' facility management costs, the allocation of Finance costs for utility fund accounting, and any other bases that are identified.

Administration Response: The Administration agrees with this recommendation and the Finance Department has taken steps to commence implementation for the FY 2014-2015 Cost Allocation Plans, however full implementation for FY 2014-2015 plan is will require additional time to complete the necessary analysis especially as it relates to utility fund accounting and Public Works facility management costs. This additional analysis is expected to be completed for the development of the FY 2015-16 plans.

Recommendation #5: To improve how it allocates overhead to capital projects, the Finance Department should:

- Utilize a workload estimate or other appropriate alternative allocation methodology to account for City Manager, Mayor and City Council, and other central service costs related to capital programs
- Back out capital rebudgets from the calculation of the department budget size allocation base

Administration Response: The Administration agrees with this recommendation however implementation of this recommendation will require more detailed conversations and documentation with departments including Public Works, Parks, Recreation & Neighborhood Services, Planning, Building & Code Enforcement, Environmental Services, and Transportation. The Finance Department expects implementation for the FY 2015-2016 Cost Allocation Plans.

Additionally within the context of the implementation of this recommendation the Finance Department will continue the dialogue with departments on the appropriate allocation methodology for outsourced services such as custodial services, graffiti abatement, security services and landscape maintenance to ensure central support services are appropriately allocated to these services. During the development of the FY 2014-15 plans the Finance Department will survey departments who both provide management oversight of outsourced services and central support departments on their work efforts related to outsourced services so staff can begin the analysis on appropriate allocation methodologies with the goal of implementing a documented allocation methodology for the FY 2015-16 plans. To the extent the Administration's work effort in this area requires an independent review; assistance from the City Auditor may be requested.

Recommendation #6: To ensure that vehicle and equipment costs in the Equipment Usage cost pool are consistently and accurately allocated, the Finance Department should:

- Treat grant-funded vehicles and equipment as unallocated costs (similar to how grant-funded building assets are treated in the Building Occupancy cost pool)
- Treat vehicles and equipment purchased through departmental non-personal budgets consistently
- Review and standardize the vehicle and equipment fixed asset schedules in the Cost Allocation Plan
- Remove any assets which are more than 15 years old and whose historical cost has been recaptured in past Cost Allocation Plans.

Administration Response: The Administration agrees with this recommendation and expects that the Finance Department will be able to partially implement for the FY 2014-2015 Plans. This recommendation included four specific elements related to vehicle and equipment allocations. The Finance Department believes it will be able to complete the necessary coordination with Public Works/Fleet Maintenance to treat grant funded vehicles and equipment as unallocated costs and to ensure consistent treatment of vehicles and equipment purchased with non-personal/equipment funds in the FY 2014-2015 Plans. The analysis of the fixed asset schedule to both standardize and remove vehicles and equipment older than 15 years or where historical cost has been recaptured in past Plans will require more analysis and the expectation is that this component of the recommendation based on sufficient resource allocation should be implemented as part of the FY 2015-16 Plans.

Recommendation #7: To ensure that Building Occupancy costs are accurately and appropriately allocated, the Finance Department should remove any assets more than 50 years old and whose historical cost has been recaptured in past Cost Allocation Plans.

Administration Response: The Administration agrees with this recommendation and the Finance Department expects to implement with the development of the FY 2014-2015 Plans to the extent there is sufficient time and resources to coordinate with the Public Works Department and other departments as necessary, if not the recommendation will be implemented for the FY 2015-16 plans

Recommendation #8: To align the Cost Allocation Plan with City Council Policy 1-18 and to provide for estimates of indirect costs that better reflect workload, the Finance Department should reorder the central service departments in the Cost Allocation Plan such that central service departments that serve the most central service departments (in terms of numbers and dollars) are at the beginning of the allocation order, and those that serve the fewest are at the end.

Administration Response: The Administration agrees with this recommendation and the Finance Department is working on a reordering of the central service departments in the Indirect Cost Allocation Plan for FY 2014-15.

Recommendation #9: To improve the accuracy of its indirect cost allocation calculations and ensure the previously identified errors do not reoccur, Finance should:

- Establish a review process of critical data entry areas and key calculations. These should include direct bills from enterprise and special funds; utility, capital, and paid absence rate calculations; and other data entry or calculations which Finance deems critical or where there is a high risk of material error. Finance should also update its procedures to specify management and staff roles and timelines for such reviews.
- Document its methodologies and purposes for calculating utility overhead rates, the capital overhead rate, and paid absence rates. It should also document reasons for any adjustments made.

Administration Response: The Administration agrees with this recommendation and the Finance Department plans on commencing a more detailed review process with the preparation of the FY 2014-2015 Plans. Detailed documentation of the methodology for calculating various overhead rates will require more time and resources. The Finance Department will work towards implementing this recommendation for the FY 2015-2016 Plans.

Recommendation #10: To reduce its manual data entry and to improve its reporting, Finance should discontinue its use of NGCS II for producing the Cost Allocation Plan. Instead it should use Maxcars or another suitable software program.

Administration Response: The Administration agrees with this recommendation. The software currently utilized does not meet the needs of the organization. The Finance Department will work on exploring other available options and the possibility of adding to the request for proposals for a new budgeting system a module for a cost allocation plan. In order to implement this recommendation it will be necessary to identify resources to both acquire a new cost allocation calculation software package and provide necessary training to fully utilize the capacity of a new software program. This recommendation may take a longer period of time to

implement; optimistically it could be implemented for the FY 2015-16 plan calculations, more realistically it could be several fiscal years before a change in the software can be facilitated.

Recommendation #11: To reduce the reoccurrence of errors identified, document methodologies, establish and clarify procedures, improve future Cost Allocation Plans, and to enhance analysis and communications with other departments to further transparency, the Administration should determine whether to assign additional staff resources to its preparations of the Cost Allocation Plans.

Administration Response: The Administration agrees with this recommendation and believes that insufficient resources are currently assigned to the preparation of the Cost Allocation Plans. As part of the FY 2014-2015 budget process the Finance Department will evaluate resource allocations within the department, and based upon the City's budget situation and other Finance Department priorities, will make recommendations for additional staff and consulting resources as appropriate to address this recommendation.

Recommendation #12: To enhance transparency, Finance should include descriptions in the Cost Allocation Plan document of the services being allocated, the methodology used to allocate costs, and the decisions made regarding allocable and unallocable costs. Preceding the cost allocation schedules should be an introduction that describes the purpose of the plan and the process of cost allocation.

Administration Response: The Administration agrees with this recommendation and will start the process of creating more transparency in the development, calculation and presentation of the Plans. The Finance Department believes implementation of this recommendation will need to take place over the next two Plan development years. The detailed written documentation of allocable and unallocable costs will require the commitment of more resources than are currently devoted to the Cost Allocation Plan development. The Finance Department will explore ways to devote sufficient resources toward this work effort, one effort currently underway is the extension of temporary staffing until the end of the fiscal year.

Recommendation #13: To improve transparency and understanding, upon annual completion of the Cost Allocation Plan Finance should post the plan document online and establish a process by which:

- The plan document is distributed to departments
- Overhead and overhead rates are explained to line departments to ensure they are appropriately applied, particularly in instances when there have been service delivery changes
- Departments can review the data being used, ask questions, and make suggestions about the allocations.

Administration Response: The Administration agrees with this recommendation and will post the FY 2014-2015 and future Cost Allocation Plans on the intranet for reference by departments. The Finance Department will also work on a more robust dialogue with departments regarding the allocation process.

CONCLUSION

The Audit has surfaced issues regarding the development and documentation of the City's Cost Allocation Plans. The thirteen recommendations speak to the need for more transparency, more discussion and dialogue with departments, education of the organization on the purpose of the Cost Allocation Plan and most importantly better documentation on allocation of various costs.

Budget reductions in prior years have negatively affected staffing devoted to the preparation of the Cost Allocation Plans. The consistency in the development and management of the Plans has additionally been impacted by staffing turnover and as the Audit notes since 2007 at least nine different individuals have prepared or supervised the preparation of the Plans. Better written documentation of the calculation and methodologies within the Finance Department would have made these staff transitions easier. The Audit also accurately identifies that insufficient resources are devoted to preparation of the Plans. The Finance Department will evaluate this resource allocation in context of the 2014-2015 budget situation and departmental priorities and bring forward budget proposals as appropriate to address the audit recommendations.

The Administration would like to thank the City Auditor's Office for conducting this audit.

/s/

JULIA H. COOPER
Director of Finance

For more information please contact, Julia H. Cooper, Director of Finance at (408) 535-7011.