



County of Santa Cruz

0017

AUDITOR - CONTROLLER'S OFFICE

GARY A. KNUTSON, AUDITOR - CONTROLLER

October 16, 2000

Agenda Date: October 24, 2000

County **Board** of Supervisors
701 Ocean Street
Santa Cruz, California 95060

Dear Chair Wormhoudt and Members of the Board:

Subject: Report on Use of County-wide Overhead Charges **and** Internal Service Fund Charges

During budget hearings, your Board asked for a report back explaining why internal service fund charges are billed to the user County Department (except for the liability **insurance** which is billed to major cost recovery departments only) and County-wide **Overhead** charges are not all direct billed to every County Department.

Internal Service Funds are established to account for business type activities that are supported by service charges to its governmental clients. The objective is to account for all associated current costs of the activity on a full accrual basis of accounting including charges for indirect costs. All the costs are accounted for in a separate fund in order to measure the results of operation (full cost recovery) and providing management a tool to compare benefits of performing an inter-governmental service or purchasing it from a vendor.

In order to assure the reimbursement from Federal and State agencies, it is required to use internal **service** funds to account for self-insurance programs to provide for the recognition of claims on an actuarial basis of accounting for both the known and reported incidents and the incurred but not reported claims. A self-insurance program based on a claims paid method are generally not recognized as allowable costs by Federal and State agencies. Self-insurance costs are allocated to user departments using appropriate formulas based upon risk and experience. The general liability costs are billed only to the large federal or state funded departments and internal service funds for cost recovery on a current basis to speed up the actual cost recovery cycle. The remaining departments are charged through an allocation in the County-Wide Cost Allocation Plan as discussed below. Workers' Compensation and Unemployment costs are direct billed to all

departments because these are costs that under departmental control. The general liability costs are less controllable and tend to have a very long tail between the date of occurrence and settlement.

County-wide overhead charges, also known as an A-87 Cost Plan, are the result of performing a cost study that allocates the cost related to the central support departments to the direct service providing departments. Cost Plans were developed to provide a mechanism for public agencies to recover its indirect county-wide costs from state and federal grantors, and non-general fund operations under the control of the Board of Supervisors (a listing is attached including the internal service funds). Unlike the internal service fund that recovers its cost on a current basis, the cost plan charges are based on past costs that are two years in arrears. There are three methods of budgeting generally used, each with its pros and cons discussed below:

- Each department is provided a copy of the Cost Plan and includes the costs allocated in their claims for reimbursement from grantor agencies. Under this method no appropriations are established but the estimated cost plan amounts are reflected as a portion of the estimated revenues. The problem is that these significant costs may be over looked if an appropriation is not provided as a reminder and special attention is required to make sure the revenues in excess of appropriations is not perceived as an opportunity to authorize additional spending. Under this method if a department was 100% grant funded, the revenues would be greater than the appropriations.
- Each major grant funded department is provided an appropriation for the Cost Plan amounts to remind the agency to include these costs in its claims for reimbursement. The Cost Plan amounts are also included in the estimated revenues. The pro is that this method provides a built in reminder as a balanced budget. The con is that it requires a more formal accounting effort. Under this method if an agency is 100% grant funded, the total budget would reflect a zero net county cost.
- Every direct service department is charged for the amounts shown in the Cost Plan. The result is that the full cost of operations are reflected in the department and the central service departments net cost would be zero except for fixed asset appropriations. The pro is that full activity based accounting is achieved. The con is that it requires significantly more formal accounting effort and that it is unnecessary in that not all direct service departments are on a full or even partial cost recovery basis. For example consider these departments: Probation, Parks, and others.

Only a few counties use the full activity based accounting approach due to the accounting effort required and to the lack of benefit derived. Most counties use the latter two methods due to the reduced accounting effort. Most direct service departments prefer not having to have an appropriation for the Cost Plan in their budgets because it is perceived

as a cost beyond their control. Central Support Departments support full activity based accounting because the budgetary effects of its operation are passed along to other entities. However, while I personally support full activity based accounting, we believe that the best blend of control features and formal accounting effort is afforded by the method presently used with the current staffing resources available. Because the County is required to develop a cost plan, central support departments which bill on a direct service basis should do this only when services are performed fairly consistently year after year. If the annual billings are not consistent year after year, then the cost plan will reflect significant swings year after year because the cost plan is in arrears by two years.

In summary, the County-wide Cost Allocation Plan is a unique method that provides us a process to recover costs that should be paid by grantor agencies, non-general fund agencies, customers of our internal service funds, and fee based cost recovery departments.

I hope this information addresses the questions you had regarding the various methods of charging overhead costs.

It is recommended that your Board accept and file this report.

Sincerely,



Gary A. Knutson
Auditor-Controller

Recommended By: _____



Susan A. Mauriello

County Administrative Officer

cc: Personnel Department

PROPOSED BUDGET General County Overhead			2000-01 Proposed	2000-01 Final	Change
	Index	Subobject			
Charges To:					
DA Family Support	271310	3550	8213,019	\$213,019	so
Health Services	380110	3550	1,319,962	1,319,962	0
Social Services	392100	3550	1,117,529	1,117,529	0
Social Services - MSSP	392500	3550	24,509	24,509	0
Planning	541100	3550	627,333	627,333	0
County Service Area 53	130320	3550	1,140	1,140	0
Library	131855	3550	2,355	2,355	0
County Service Area 12	133607	3550	(2,973)	(2,973)	0
County Service Area 12 zone A	133608	3550	(2,475)	(2,475)	0
Off Highway	134938	3550	30	30	0
Fish and Game	135420	3550	(368)	(368)	0
SC Flood Control Zone 4	135461	3550	(533)	(533)	0
Flood Control and Water Conservation	135462	3550	(1,114)	(1,114)	0
County Fire	304100	3550	10,207	10,207	0
CSA 4	304300	3550	(4,661)	(4,661)	0
Service Center	333500	3550	56,087	56,087	0
JTPA	396000	3550	144,989	144,989	0
Information Services	421000	3550	269,203	269,203	0
Central Duplicating	423000	3550	19,809	19,809	0
Risk Management	515100	3550	149,319	149,319	0
Liability and Property	515200	3550	12,331	12,331	0
Workers Comp	515300	3550	26,524	26,524	0
Unemployment Insurance	515400	3550	1,668	1,668	0
Dental	515100	3550	5,791	5,791	0
DPW	601000	3550	1,259,024	1,259,024	0
RDA Administration	610110	3550	93,754	93,754	0
RDA LOW/MOD Admin.	610120	3550	(318)	(318)	0
Transportation Commission	721100	3550	3,582	3,582	0
Courts	741010	3550	191,876	191,878	0
County Service Area 11	134910	3550	215,281	215,281	0
County Service Area 38	136601	3550	1,444,665	1,444,665	0
Total			\$7,197,545	\$7,197,545	\$0
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