



# COST ALLOCATION PLAN

*Marina Coast Water District*

February 2018



## 1 Introduction

Carollo was engaged by Marina Coast Water District (“District”) to update and review the District’s existing Cost Allocation Plan methodology. The purpose of this report is to document a methodology so that the District can periodically review existing practices and cost allocations, and determine if significant changes need to be administered, and the scale of those changes.

A cost allocation plan is a method by which an agency allocates expenses that are not directly identifiable to a particular activity, or to allocate expenses that benefit more than one cost center on a consistent, fair, and equitable basis. Based on this definition, the cost allocation is focusing on shared administrative expenses. A Cost Allocation Plan (CAP) is used for determining how these indirect or general benefit costs are allocated to the appropriate cost pool.

In developing this CAP, work was completed to identify, confirm, and update the indirect cost pools by choosing allocation factors that serve as the best basis for achieving an equitable and explainable distribution of costs. The goal of this CAP is to achieve continued equity for ratepayers and to thoroughly document the process for future efforts.

The CAP is achieved through the following steps:

- Determine the most relevant level of functional detail with which to allocate departmental costs, working from a top-down approach.
- Identify the appropriate costs to include in the cost pools.
- Recommend workload measures that can be implemented over time, and provide a reasonable and equitable means for distributing costs.

Overhead costs analyses are a crucial part of the District’s allocation process to accurately reflect the true level of service in each cost center.

## 2 Overhead Cost Analysis

The District’s budget reflects costs incurred in support of its four cost centers (water and sewer services for both the Marina and Ord communities). Recouping these costs is essential to funding all aspects of water and sewer services throughout the District’s service area.

Indirect costs are those that have been incurred for common or joint purposes. These costs benefit more than one cost objective and cannot be readily associated with a single cost center. Furthermore, a full investigation of the allocation of those costs would require a level of effort disproportionate with the benefit gained. For that reason, it is appropriate to develop a single allocation measure for these indirect costs that represents a typical allocation of benefits. An example of indirect costs includes administrative operations, which provide an indication of the variety of activities needed to operate a large organization.

### 2.1 Direct Costs Allocations

Much of the District’s costs are directly allocated to each of the four cost center, such as water laboratory expenses or water conservation program funding. These directly allocated expenses are not a part of this review. These are directly allocated based on the cost center benefiting from the cost incurred. These directly allocated costs encompass approximately 77 percent of the District’s annual operating budget, or approximately \$8.5 million.

## 2.2 Indirect Cost Allocations

The remaining 23 percent of the District’s budget is allocated based on a variety of metrics. The District uses several allocations to allocate administrative costs among the four cost centers:

- **Customer Billing** costs are allocated on the number of customer bills to each cost center, which can change from month to month. As in a majority of cases a customer has both a water and sewer bill, the billing costs for Central Marina are allocated 50/50 between Marina Water and Marina Sewer. Ord is addressed in the same manner. This allocation excludes staff labor associated with customer billing. Account numbers are not necessarily correlated with effort or services provided by staff.
- **Groundwater Sustainability Agency (GSA)** activities are allocated based on the amount each water cost center is allowed to draw from Salinas Valley Groundwater (8,023 AFY total) as well as water agreements (2,977 AFY total) the District has to provide water and requires the draw from the sub-basin.
  - Marina Water: 3,020 AFY + 1,400 AFY = 4,420 AFY (40%)
  - Ord Water: 5,023 AFY + 1,577 AFY = 6,600 AFY (60%)
- **Ord Annexation** related costs are allocated 50/50 between Ord Water and Ord Sewer
- **Master Plan** related costs and system studies are based on miles of pipeline:

Cost Center	Total Miles	%	Water Miles	%	Sewer Miles	%
01 - Marina Water	47.70	14%	47.70	25%		
02 - Marina Sewer	43.38	12%			43.38	28%
03 - Ord Water	146.80	42%	146.80	75%		
04 - Ord Sewer	110.40	32%			110.40	72%
Totals	348.28	100%	194.50	100%	153.78	100%

- **All other administrative** costs, or roughly 15% (or \$1.6 million) of the District’s total costs are allocated based on audited Operating Expenses net of Depreciation. This approach is also referred to by “as all others” – essentially that general benefit functions mirror how the first 85% of the District’s costs. These costs include Admin salaries and benefit costs, Board related costs, information technology related costs, accounting services, rate study costs etc. These functions serve the District as a whole and cannot be reasonably allocated on a direct basis or one of the above metrics.

For FYE 2018 the allocation is Marina Water – 25%, Marina Sewer – 7%, Ord Water– 54%, Ord Sewer – 14%. The tables can be found on page 4 of the District’s annual budget. FYE 2016 audited operating costs can be found on page 8 of the FYE 2016 CAFR.

Carollo finds these results and allocation bases reasonable and well-founded based on the cost drivers demonstrated in the District’s Annual Budget. It is recommended, however, that the District regularly review these factors and modify as expenses vary or services provided change.

### 3 Additional Considerations

#### 3.1 Review or High Cost Items

Concerns have been raised that a few high dollar expenses for the Ord Community such as franchise fees and developer fees artificially inflate or skew Ord's share of allocated administrative costs and thus expenditures are not a reasonable proxy to allocate the remaining portion of the District's administrative costs. As such, Carollo worked with staff to identify whether these were "empty costs" or whether these costs scaled with administrative effort (benefit).

Based on discussions with staff, these expenses do require additional administration in reporting and management, such as the tracking of developer accounts, additional processing of payments to vendors that work on the developer projects, billings and cash receipt processing of developer payments, compiling and providing reports to the Board and the FORA WWOC. Additionally, as franchise fees are paid based on what is actually collected rather than what is billed, additional report creation and verification are necessary to calculate and process the payments to the various jurisdictions. As such, a reasonable nexus is observed between costs incurred and the administrative effort required to provide the service.

As the District is seeking to annex the Ord Service Area, the FORA franchise fees and administrative fees will be eliminated, which will greatly reduce the Ord cost centers' expenses. As such, the Ord allocation would reduce as would staff effort and focus on providing these additional services.

#### 3.2 Administrative Time Survey

An alternative to using the "as all others" methodology, the idea of a time-study was introduced to the Board from an engaged ratepayer, with the proposal advocating that a time-survey would better reflect administrative effort and eliminate the need to allocate administrative overhead costs based on direct actual expenses.

Based on the recommendation, the District performed a limited time-survey between December 2017 and January 2018. Given this limited time-frame, there is limited applicability of the results and it may not be indicative of each cost center's share of the cost burden. The results of the Senior Management Time Survey were as follows:

Position	MW	MS	OW	OS
General Manager	19%	1%	73%	7%
District Engineer	12%	3%	78%	7%
Director of Admin Services	14%	4%	67%	15%

Based on the results of the limited survey, the Ord cost centers would bear a greater percentage of administrative costs. However, given the narrow time frame it is not recommended that the District modify the existing methodology at this time.

While the District could begin tracking 100% of administrative hours for future changes to the methodology, time surveys often demonstrate high variability (significant annual changes that may have major budgeting and rate impacts) and challenges in consistent application of allocations. For example, one employee may allocate a Board meeting equally to each cost center, while another employee may charge that same meeting based on the actual time to prepare and discuss individual items. Furthermore, allocating time is less clearly defined for management staff due to the overlapping nature of some issues across cost centers.

Time surveys are well utilized in other circumstances however. For instance, it is straightforward for field staff to allocate time spent in each cost center, simply based on where the work is taking place.

In addition to the likely month-to-month or year-to-year volatility, the additional burden on staff is not reasonable. Attempts to parse out every activity performed by staff on a daily basis are not reasonable. Administrative overhead is truly an indirect service and these costs are best allocated based on expenditures – as there is a clear and appropriate nexus between the service provided and the cost incurred.

#### **4 Federal Compliance**

As federal awards are performed within the individual operating cost centers, there needs to be a process whereby these central service (Administrative) costs can be identified and assigned to benefitted activities on a reasonable and consistent basis. The CAP methodology provides that process.

While the methodology is the same as the normal CAP, a separate CAP is usually necessary to claim indirect costs under Federal awards. Indirect costs include: (1) The indirect costs originating in each department or agency of the governmental unit carrying out Federal awards and (2) The costs of central governmental services distributed through the central service cost allocation plan and not otherwise treated as direct costs.

In order for the District to develop a compliant cost allocation, certain costs would have to be excluded from the allocation methodology. While not a complete list, excluded costs included those for public relations, bad debts, bonding costs, collections of improper payments, alcoholic beverages, advisory councils, and legal fees. Once these costs are excluded, the CAP would be in compliance with CRF, Title 2, Part 200, Subpart E – Cost Principles, Uniform Requirements, Cost Principles, and Audit Requirements for Federal Awards.