

Portland, Oregon

FINANCIAL IMPACT and PUBLIC INVOLVEMENT STATEMENT For Council Action Items

(Deliver original to Financial Planning Division. Retain copy.)

1. Name of Initiator Josh Harwood		2. Telephone No. 503-823-6954	3. Bureau/Office/Dept. OMF/BFS/FPD
4a. To be filed (date): November 21, 2011	4b. Calendar (Check One) Regular <input checked="" type="checkbox"/> Consent <input type="checkbox"/> 4/5ths <input type="checkbox"/>		5. Date Submitted to Commissioner's office and FPD Budget Analyst: 11/21/11
6a. Financial Impact Section: <input checked="" type="checkbox"/> Financial impact section completed		6b. Public Involvement Section: <input checked="" type="checkbox"/> Public involvement section completed	

1) Legislation Title: Accept report of General Fund Overhead Advisory Committee and adopt recommendations (Resolution)

2) Purpose of the Proposed Legislation: Accept report of General Fund Overhead Advisory Committee and adopt recommended changes to the General Fund Overhead Model and Current Appropriation Level Targets to be used in the FY 2012-13 budget development.

3) Which area(s) of the city are affected by this Council item? (Check all that apply—areas are based on formal neighborhood coalition boundaries)?

- | | | | |
|---|------------------------------------|------------------------------------|--------------------------------|
| <input type="checkbox"/> City-wide/Regional | <input type="checkbox"/> Northeast | <input type="checkbox"/> Northwest | <input type="checkbox"/> North |
| <input type="checkbox"/> Central Northeast | <input type="checkbox"/> Southeast | <input type="checkbox"/> Southwest | <input type="checkbox"/> East |
| <input type="checkbox"/> Central City | | | |
| <input checked="" type="checkbox"/> Internal City Government Services | | | |

FINANCIAL IMPACT

4) Revenue: Will this legislation generate or reduce current or future revenue coming to the City? If so, by how much? If so, please identify the source.

None.

5) Expense: What are the costs to the City related to this legislation? What is the source of funding for the expense? (Please include costs in the current fiscal year as well as costs in future years. If the action is related to a grant or contract please include the local contribution or match required. If there is a project estimate, please identify the *level of confidence*.)

The effect of this act will change the manner in which overhead costs are attributed to city funds. With respect to the General Fund the impact will be to decrease overhead costs by approximately \$400,000 in FY 2012-13. It should be noted that each year will fluctuate as changes occur to bureau budgets, employee counts, and service usage. For more detailed impacts to the General Fund and other funds for FY 2012-13 please see Exhibit #1.

6) Staffing Requirements:

- **Will any positions be created, eliminated or re-classified in the current year as a result of this legislation?** *(If new positions are created please include whether they will be part-time, full-time, limited term, or permanent positions. If the position is limited term please indicate the end of the term.)* None.
- **Will positions be created or eliminated in future years as a result of this legislation?**

None.

(Complete the following section only if an amendment to the budget is proposed.)

7) Change in Appropriations *(If the accompanying ordinance amends the budget please reflect the dollar amount to be appropriated by this legislation. Include the appropriate cost elements that are to be loaded by accounting. Indicate "new" in Fund Center column if new center needs to be created. Use additional space if needed.)*

Fund	Fund Center	Commitment Item	Functional Area	Funded Program	Grant	Sponsored Program	Amount

[Proceed to Public Involvement Section — REQUIRED as of July 1, 2011]

PUBLIC INVOLVEMENT

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8) Was public involvement included in the development of this Council item (e.g. ordinance, resolution, or report)? Please check the appropriate box below:

- ☐ **YES:** Please proceed to Question #9.
☒ **NO:** Please, explain why below; and proceed to Question #10.

City overhead cost calculations are internal to the City budget process and do not directly impact bureau service levels or public interaction.

9) If "YES," please answer the following questions:

a) What impacts are anticipated in the community from this proposed Council item?

b) Which community and business groups, under-represented groups, organizations, external government entities, and other interested parties were involved in this effort, and when and how were they involved?

c) How did public involvement shape the outcome of this Council item?

d) Who designed and implemented the public involvement related to this Council item?

e) Primary contact for more information on this public involvement process (name, title, phone, email):

10) Is any future public involvement anticipated or necessary for this Council item? Please describe why or why not.

No public involvement is anticipated.


Rich Goward, Jr., Director, Bureau of Financial Services

BUREAU DIRECTOR (Typed name and signature)

Introduction

As part of the FY 2011-12 Adopted Budget, City Council included the following budget note:

“Council directs the Office of Management and Finance to update the General Fund Overhead Model. Updates to the model may include adjustments to cost pools, bureau metrics, and allocation methodologies. A report to Council outlining the changes to the model will be delivered to Council during the FY 2011-12 Fall Budget Monitoring Process. Upon receipt of the report, Council may authorize General Fund target adjustments for FY 2012-13 as recommended in the report.”

The General Fund Overhead Advisory Committee (GFOAC), in consultation with the Financial Planning Division, has reviewed the model and made recommendations for changes, summarized in this report.

History

The last major review of the City’s overhead allocation model was in 2004, prior to the implementation of the SAP enterprise business solution. That review was performed by an outside consultant, FCS Group, Incorporated (FCSG). A number of improvements were implemented subsequent to that review; particular emphasis was placed on establishing stability and predictability in charges. Prior to the FCSG review, the model had been mostly unchanged since 1989 when cost allocation practices were documented in a study titled *General Fund Overhead Committee Report*.

Basic Principles of Cost Allocation

Central support service and general government costs can be difficult to charge to customer bureaus through a rate times unit model or interagency. These services are more appropriately charged through an overhead cost allocation plan, referred to as the City’s General Fund Overhead Model. Examples of these costs include accounting, legal, purchasing, human resources, financial planning, and the City Council.

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

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

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

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

Existing Methodology

Currently, the City collects and allocates overhead resources over 48 distinct cost pools. These cost pools are represented by SAP structures, including funds centers, functional areas, internal orders, or even specific positions.

Each of these cost pools are allocated based on a metric or set of metrics (e.g. budget size, position count, council calendar items). Under the existing model, 36 different metrics are used (see Exhibit #3 for a list of cost pools and metrics). In addition, each cost pool may apply different weights or allocation percents for each metric depending on the number and type of metrics used. For example, Audit Services uses 50% number of employees and 50% budget size, and Accounting uses 73% number of accounting records and 27% number of employees. Metric data is currently collected from SAP reports and downloads, spreadsheets maintained by provider bureaus, spreadsheets maintained by FPD, and the Adopted Budget document. The existing model uses a three-year rolling average of allocation metrics in order to smooth out changes and combat instability of charges.

Since bureaus that provide overhead services (also referred to as cost pools) also utilize overhead services (e.g. Council Offices utilize Attorney's Office services), the model incorporates a second step that redistributes all overhead allocations charged to overhead cost pools based on the allocation metrics of that cost pool. Simply put, overhead receiving bureaus are not charged for overhead services.

For any given budget year, the existing model allocates costs based on current appropriation level (CAL) targets plus any true-up adjustments from the previous year. Current appropriation level targets are comprised of the last Adopted Budget figures for ongoing General Fund discretionary and overhead resources plus an inflation factor and any other Council directed target adjustments (usually contained in budget notes). The true-up adjustment is calculated by re-running the Overhead Model for the last closed fiscal year based on updated metrics (bureau usage during the fiscal year) and actual expenditures in the cost pools. The adjustments (increases or decreases) from the true-up for each paying fund are added to the budget year charges (charges required to fund current appropriation level targets) to get the final overhead charge.

Overhead Model Review Process

In August and September 2011, Financial Planning met with the bureaus who are the largest recipients of General Fund overhead. These bureaus included Procurement Services, Auditor's Office, Accounting, City Attorney's Office, Bureau of Human Resources, and Planning and Sustainability. The intent of the meetings was to find out if the existing cost pools and methodology of allocation of costs were appropriate and if there would be objection to moving to simplified allocation metrics. The discussions uncovered a few instances where the metrics used for cost pools don't reflect the actual cost of service. In addition, none of the overhead receiving bureaus objected to changing from bureau-specific allocation metrics to simple, consistent metrics.

Financial Planning staff then worked on developing scenarios using different allocation metrics, with an emphasis on simplicity and consistency. In October, the scenarios were presented to the City's General Fund Overhead Advisory Committee (GFOAC), which is comprised of bureau staff as designated in Financial Policy 2.08. The GFOAC met twice as a body and FPD staff met with individual bureau finance staff as requested to explain the different methodologies and scenarios. The advisory committee decided, at the close of the second meeting, to recommend to Council the concept of simplifying the methodology and reducing the number of cost pools and metrics.

Recommendation

As seen in Exhibit #2, bureaus have experienced large swings in their overhead charges over the last five years. The purpose of the changes outlined in this recommendation is to stabilize the year-to-year charges so that bureaus can better predict and plan for their overhead charges for the next budget year. The GFOAC was in general consensus that they were willing to give up detailed metrics aimed at providing a true cost of service model for stability and predictability which can be accomplished through simplified metrics.

In addition, simplified metrics allow the Overhead Model to be better understood by the bureaus because the calculations are basic and the metrics can be easily gathered by anyone in the City. Under the current model, a significant number of the metrics are only visible to the service provider who is collecting the data in an offline spreadsheet. Furthermore, the weighting of the metrics are different depending on the service being provided. Bureaus are much more comfortable paying for a charge that they can verify on their own rather than assuming the numbers are accurate.

To further support the General Fund Overhead Advisory Committee's ultimate recommendations, Financial Policy 2.08 states:

The cost allocation system shall include a methodology that provides for the stability, predictability and equity of charges – in that order of priority. The primary metrics available to be used for allocating costs are the size of an agency's budget and the number of full-time equivalent employees.

For the reasons above, the GFOAC recommends simplifying the model to only track metrics for total position count and budget size. Budget size and position counts remain relatively stable from year to year, and in addition, are a good indicator of overall use of the services included in the model, thus providing equity. The weighting of the metrics are proposed at 75% budget size and 25% position count. The committee reviewed several weighting proposals, and ultimately decided on the 75/25 split for the following reasons:

- A 50/50 split would significantly increase the charges to the General Fund. Historically the split required to keep the General Fund neutral would have been 88% budget size and 12% position count. The proposed 75/25 split was the agreed upon compromise.
- Although not all bureau charges can remain constant under a simplified metric, the agreed upon 75/25 split had the least impact for most bureaus.

To further enhance stability and predictability, the budget size metric was updated to utilize prior year actuals rather than the most recent Adopted Budget. Actual expenditures provide a more stable metric because the bureaus are not charged overhead for large one-time projects or other budget increases that don't materialize into actual expenses throughout the year. In addition, using actual expenditures allows the bureaus to predict the overhead charges for the next year based on the prior year activity, and it reduces the amount of true-up adjustments (updating Adopted Budget figures with actual expenditures) that are required under the existing model. In the updated model, budget size will be calculated as follows:

- Utilizes a three-year average to increase stability
- Only prior year actual expenditures in personal services, external materials and services, and capital outlay will be used.
- Internal materials and services will no longer be included in the calculation. Under the existing model, the bureau requesting the service is charged overhead based on the expenses identified as internal materials and services. In addition, the bureau providing the service is charged overhead based on the actual work completed (expenses identified as personal services, external materials and services, and/or capital outlay). The bureau providing the services typically includes the overhead charges in the interagency charge back to the bureau requesting the service, thus the requesting bureau is charged twice for the same expense. Eliminating the charge for internal materials and services will move the entire overhead charge to the bureau providing the service, which can then be passed on to the bureau requesting the service via the interagency. This methodology improves equity within the model by eliminating the double charge.

- Debt service expenditures will no longer be included in the calculation. The cost of providing debt management services are already captured via interagencies with the Public Finance and Treasury division within the Office of Management and Finance. To charge for these services again through the Overhead Model adds unnecessary inequities for the services provided.
- As in the existing model, other fund level requirements (cash transfers, contingency, and ending fund balance) will continue to be excluded from the model.
- Capital expenditures (those tagged with a capital project funded program) receive a 50% discount. Expenditures in capital outlay that are not tagged with a capital project will not receive the 50% discount.
- Operating projects for the TIF Reimbursement Fund and Housing Investment Fund receive a 50% discount (similar to capital projects).
- Retirement payments, PERS contributions, and disability and death benefits are excluded from FPDR when calculating its budget size.
- Insurance claim payouts are excluded from the Health Fund when calculating its budget size.
- Excludes trust and endowment funds (Parks Trust, Parks Endowment, and Fire & Police Supplemental Retirement Reserve Fund).
- Excludes the Special Finance and Resource Fund. The fund transfers bond proceeds to the Portland Development Commission.

Under the new model, the metric for number of employees will remain consistent with the existing model. The position count metric is calculated as follows:

- Utilizes a three-year average to increase stability
- Positions are allocated by fund and business area as assigned in SAP.
- Captures all active personnel numbers on January 1 of the previous fiscal year (e.g. the metric for FY 2012-13 will be based on the download from January 1, 2011)
- Bureaus are encouraged to inactivate casual positions that are not in use. To remain consistent with the existing model, active casual positions in Portland Parks and Recreation that did not receive a paycheck for the pay period ending 1/19/2011 were excluded from the calculation. In future years, it is expected that these positions will be inactivated before the download from SAP.
- The download includes all employee groups: regular (full-time and part-time), limited term, casual, budgeted temporaries, and working retirees.
- Vacant positions at the time of the download are not captured

The GFOAC also recommends FY 2012-13 General Fund CAL target adjustments to maintain consistency in the funding model for specific overhead functions. The specific adjustment amounts can be found in Exhibit #4. Over the past few years, overhead funded bureaus have increased the use of interagency agreements because of the lack of available General Fund discretionary resources for requested programs and projects. To mitigate this trend, the committee proposes to include the programs below in the FY 2012-13 Overhead Model. Furthermore, the committee will continue to analyze other interagency agreements within the overhead funded bureaus to identify future candidates for inclusion in the model.

- Increase OMF – Human Resources’ target by \$453,348 for 4.00 FTE that provide an increased level of service to the Police Bureau. The Police Bureau would take an equivalent cut to its ongoing General Fund discretionary target to maintain General Fund neutrality.
- Increase OMF – Human Resources’ target by \$68,000 for 1.00 FTE that provides additional payroll support for the OMF – EBS Services division. Since EBS Services is supported via interagencies from all City bureaus, CAL target reductions would be made to General Fund bureaus for their portion of the position costs to maintain General Fund neutrality. The loss of discretionary resources would be offset by lower interagency charges from EBS Services. Non-General Fund bureaus would see a decrease in EBS Services interagency charges and a subsequent increase in General Fund Overhead charges. Current interagency charges to bureaus range from \$9 to \$10,407.
- Increase OMF – Financial Planning division target by \$62,950 for the salary and materials and services costs of a 0.4 FTE that provides budget mapping and performance management services to all City bureaus. Since the position is currently supported via interagencies from all City bureaus, CAL target reductions would be made to General Fund bureaus for their portion of the position costs to maintain General Fund neutrality. The loss of discretionary resources would be offset by lower interagency charges from Financial Planning. Non-General Fund bureaus would see a decrease in Financial Planning interagency charges and an increase in General Fund Overhead charges. Current charges to bureaus range from \$11 to \$11,167.



AMENDMENT

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OFFICE OF MAYOR SAM ADAMS CITY OF PORTLAND

The original report filed included a target adjustment in the Bureau of Human Resources for 3.00 FTE and \$332,100 with a subsequent target adjustment to the Police Bureau of (\$332,100). Upon further discussion with the Police Bureau, it was determined that an adjustment of 4.00 FTE and \$453,348 was required to properly transfer the funding to the Bureau of Human Resources. The following amendments are required to execute this change.

Amend the first bullet on page 6 of the report to read:

“Increase OMF – Human Resources’ target by \$453,348 for 4.00 FTE that provide an increased level of service to the Police Bureau”

Amend first two lines of Exhibit #4 to read:

Bureau	Position or Activity	Target Adjustment
OMF - Human Resources	HR Police Services (4.00 FTE)	\$453,348
Police Bureau	HR Police Services (4.00 FTE)	(\$453,348)