

To: Board of Trustees
From: Jessica Flintoft, Clerk
Re: Indirect Cost Allocation Plan
Date: February 27, 2023

Purpose

Scio Township provides diverse services to our community: protection of open space, water and sewer services, tax collection, fire services, parks maintenance, elections administration, to name a few. Each service has both a *direct cost* as well as an *indirect cost*. Indirect costs are real costs of providing the service, such as the cost of information technology, facilities and grounds maintenance, and the costs of basic treasury and finance operations. Some of these indirect costs are covered by dedicated the costs of tax collection and assessment through the 1% fee assessed under MCL211 .44(3), while others are borne by the General Fund year after year. The purpose of the Cost Allocation Plan is to define the indirect costs, set a legally justifiable basis for allocation of those costs, and set a standard method for budgeting these costs, and recovering these costs throughout the year.

History

Prior to FYE22, over the prior decade, the Township allocated certain indirect costs, based on estimates of benefit received, not on actual use. These indirect costs were proposed to, and adopted by, the Board of Trustees year after year as part of the annual budget process. The Township annually budgeted, and the funds incurred these allocated costs either throughout the year, or at year end.

Indirect Cost Allocations usually used in FYE13 through FYE19

Indirect Cost	Basis of Allocation	Cost Allocation to Funds	Cost Recovery
Township Manager	Estimated benefit of salary and fringe received by each fund	10% to Fire; 15% Water; 15% Sewer; 60% General.	Throughout year
Finance Director and Finance Staff	Estimated costs caused by each fund	10% to Fire; 20% Water; 20% Sewer; 60% General.	Throughout year
Audit	(Unsure)	11% Fire; 16% Water; 16% Sewer; 10% DDA; 0.3% to Open Space, Bus, and each of 9 other funds; 42% General in FYE21.	Year end
Grounds and Maintenance Worker	Estimated costs caused by each fund	16.67% Water; 16.67% Sewer; 66.66% General.	Throughout year
Utilities Department use of 827 N. Zeeb (Township Hall)	Estimated square footage by estimated commercial rental market rate	\$30,470 per year for several years, then up to \$41,975 per year from Water and Sewer in FYE19.	Year end

Information Technology	Actual costs caused by Water, Sewer, Fire. General Fund absorbed all other funds costs.		Throughout year
Sheriff's facility operating costs of 1055 N. Zeeb (Fire Station)	The amount the Township used to charge the Sheriff for rent	\$22,500 through FYE19. Then in FYE20 and FYE21 Fire Fund paid these costs directly.	Year end transfer from General Fund to Fire Fund through FYE19. Fire Fund paid costs in FYE20 and FYE21.

Beginning in fall 2019, the Clerk began examining the issue of indirect costs with finance team, finding that the bases for these allocations were insufficient. In particular, the Clerk determined that the Township needed a legally justifiable basis for indirect costs, particularly those that would be charged to Water or Sewer the Township's two enterprise funds. More broadly though, the Clerk noted that the Township had grown considerably, diversifying its services to include land preservation, road construction and maintenance, and parks development, yet—none of these dedicated funds paid for the true costs of the services that residents had mandated the Township provide. With year over year deficit spending by the General Fund, it was untenable to continue the Township's failure to recover these costs caused by the legitimate activities of the growing number of special funds.

Cost Allocation Plan: Implemented in FYE22

Beginning in spring 2020, the Township contracted with the [Woodhill Group](#) to provide capacity building services to its finance team, including the development of the [FYE22 Proposed Budget](#) which included an improved budget development process. The FYE22 Cost Allocation Plan developed in accordance with best practices including those adopted by GFOA on [Pricing Internal Services](#) and [Indirect Cost Allocation](#). The FYE22 Cost Allocation Plan was incorporated as part of the FYE22 adopted budget, providing the Township a basis of allocation of indirect costs that is systematic, and replicable, supported by data that is readily available. For FYE22 Cost Allocation Plan, the following indirect costs were included, with bases in data from Township financial records for either period of Calendar Year 2020, or point in time of December 31, 2020, as appropriate for data point. The FYE Cost Allocation Plan included 20 funds.

Summary of the FYE22 Cost Allocation Plan

Indirect Cost	Basis of Allocation	Cost Allocation to Funds	Cost Recovery
Finance Director	75% based on \$ spent 25% based on # employees	Proportionate across funds	Throughout year
Finance Manager	20% based on # AP Checks 10% based on # employees 40% # cash receipts 10% based on \$ spent	Proportionate across funds	Throughout year
	Exclude 20%: covered by tax admin fee, tax collection of millage funds	None	None
Audit	\$ spent	Proportionate across funds	Throughout year

All Township Hall Building and Grounds costs, including Grounds and Maintenance worker	% of Township Hall square footage used	Proportionate across funds	Throughout year
Information Technology: data processing	# computer workstations	Proportionate across funds	Throughout year

Further, in FYE22 we implemented the recovery method of using a monthly cost allocation journal entry so that 1/12 of the budgeted allocation was deducted each of the first 11 months, with the actual costs being reconciled in the final month if the actual were beyond +/-5% of actual to budgeted. This method can save staff time no longer coding regular invoice across several funds; and can assist department heads with managing budget to actuals throughout the year, instead of just at year end.

Over the last two years, Finance staff have suggested improvements to the initial FYE22 Cost Allocation Plan, and these have been incorporated into the proposed Cost Allocation Plans for FYE23 forward:

- Make the Cost Allocation Plan more accessible, beyond just an excel spreadsheet, so that it is plain and transparent which indirect costs are included and how calculated;
- Require that every fund, not just largest ones, pay something, with the exception of inactive subcomponent unit funds (currently, that is the Economic Development Corporation);
- Implement different recovery methods for different costs, depending on Finance Director preferences. For example, recover personnel costs by splitting time and benefits costs at time of pay, but recover information technology costs through use of 1/12 of budgeted amount for the first 11 months, and reconcile in month 12.
- Simplify the weighting of bases for the Finance Manager, and include Financial Consultants with same weighting as Finance Director given the vacancy since November 2021.
- Incorporate the newly established Deputy Treasurer and additional Treasury staff, limiting the allocation to only those non millage funds that do not charge the tax collection admin fee.

Outside of the Cost Allocation Plan, the Clerk, Finance Manager, Fire Chief, and Office Coordinator have made refinements to the allocation of other indirect costs to ensure that they are legally justifiable and have a basis for calculation of the indirect cost that is based on regularly available data:

- Beginning in FYE22, Township established the 'activity' of Sheriff within the General Fund so that all revenues and expenditures related to Sheriff's patrol were accurately captured. The Fire Department apportions the actual costs of operating the facility by square footage, charging all Sheriff costs to 101-301 including electric, gas, water, rubbish removal, building maintenance, grounds maintenance.
- Beginning FYE23, the Township worked with Decker Insurance agency to apportion the property schedule across Funds by use of property, resulting in budgeted insurance costs across funds.
- There remain indirect costs that are allocated outside of the Plan, according to other justifiable formulas, including office supplies, postage, telephone use, attorney time, and Township retirement contributions to closed defined benefits plan. These warrant further examination as the Township continues to refine its Cost Allocation Plan.

- One of benefit of a Cost Allocation Plan is the calculation of a justified indirect cost for administration of grants. In the last couple of years, the Township has started pursuing major state and federal grants, and has failed to recoup any indirect costs of administering the grants.

Cost Allocation Plan: Disrupted by the Board of Trustees in March 2022

The Cost Allocation Plan for FYE23 was similar to the FYE22 Cost Allocation Plan, and was submitted timely to the Supervisor who was preparing the proposed budget for the Board of Trustees. The full Cost Allocation Plan was not included in the budget proposed to the Board of Trustees on March 29, 2022 for adoption. The Supervisor explained that he had included some proposed cost allocations, others removed entirely from certain millage-based special revenue funds and other funds. A majority of the Board of Trustees agreed to adopt the proposed budget as is, despite the proposed cost allocation numbers being not only unjustified by data.

Worse, the negative results of leaving in place the originally adopted cost allocation budgeted numbers are: 1) Water, Sewer, Fire, and General Funds are budgeted to bear indirect costs beyond those they incurred; and 2) there has been no cost recovery throughout the year, and so, any FYE23 adjustments must be made at once, as part of year end budget adjustments.

Recommendation

Any plan should be justifiable through data that can be consistently pulled year after year, and fairly applied across funds. The Board should rely upon the expertise of Woodhill Group, the sound work of the Clerk, the input of Maner Costerisan, and the recommendation of the Interim Manager. The Clerk has submitted the following Method to the Interim Manager for consideration in development of proposed FYE23 year end budget adjustments and proposed FYE24 budget.

FYE23 and FYE24 Indirect Cost Allocation Methodology

Indirect Cost	Basis of Allocation	Cost Allocation to Funds
Finance Director and Financial Consultants	25% based on \$ spent	Proportionate across funds
	75% based on # employees	
Finance Manager and Finance Assistant	20% based on # cash disbursements	Proportionate across funds
	10% based on # employees	
	70% based on \$ spent	
Deputy Treasurer and other Treasury staff	# cash receipts by Fund, excluding funds covered by 1% admin fee	Proportionate across funds
Audit	Size of fund balance/working capital	Proportionate across funds
All Township Hall Building and Grounds costs, including Grounds and Maintenance worker	% of Township Hall square footage used	Proportionate across funds
Information Technology: data processing	# computer workstations	Proportionate across funds