



KING COUNTY
Signature Report

1200 King County Courthouse
516 Third Avenue
Seattle, WA 98104

September 16, 2014

Motion 14222

Proposed No. 2014-0250.1

Sponsors McDermott

1 A MOTION acknowledging receipt of a report on an
2 examination of administrative department costs and a
3 review of selected overhead and central rate charges in
4 compliance with the 2014 Annual Budget Ordinance,
5 Ordinance 17695, Section 18, Proviso P2, as amended.

6 WHEREAS, the 2014 Annual Budget Ordinance, Ordinance 17695, Section 18,
7 Proviso P2, as amended, requires the executive to transmit a motion and report on
8 administrative department costs and selected overhead and central rate charges by June
9 16, 2014, and

10 WHEREAS, the report examines the overhead allocation and central rate
11 methodologies and charges for services provided by the finance and business operations
12 division, King County information technology and the facilities management division,
13 and

14 WHEREAS, the report provides a description of the rates and methodologies and
15 how the methodology fits with best practices for governmental indirect service charges,
16 and

17 WHEREAS, the report provides a review and presentation of data for 2004
18 through 2013 showing charges for services by category of service and the rate of growth
19 for the ten-year period and year-over-year throughout the period for each category of

20 service and identifies contributing factors for any year-over-year change greater than two
21 percent or a total change of greater than twenty percent for the ten-year period, and

22 WHEREAS, the report includes recommendations for changes in methodology to
23 reflect best practices, current county practices and service utilization, and

24 WHEREAS, the report provides an examination of charges to divisions within the
25 department of public health for both central overhead and department overhead and
26 methodologies used by the public health director's office, and

27 WHEREAS, the report provides an implementation plan, including a timeline and
28 milestones, for incorporating report recommendations, including those that should be
29 implemented in the proposed 2015-2016 budget;

30 NOW, THEREFORE, BE IT MOVED by the Council of King County:

31 The report relating to an examination of administrative department costs and a
32 review of selected overhead and central rate charges in compliance with the 2014 Annual

33 Budget Ordinance 17695, Section 18, Proviso P2, as amended, which is Attachment A to
34 this motion, is hereby acknowledged.

35

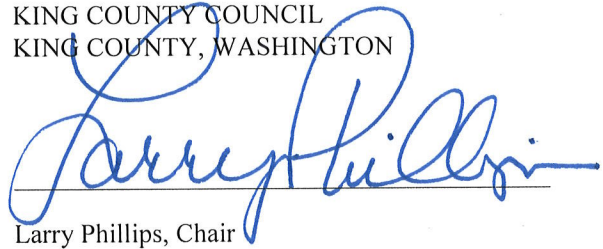
Motion 14222 was introduced on 6/23/2014 and passed by the Metropolitan King County Council on 9/15/2014, by the following vote:

Yes: 8 – Mr. Phillips, Mr. Gossett, Ms. Hague, Ms. Lambert, Mr. Dunn,
Mr. McDermott, Mr. Dembowski, and Mr. Upthegrove

No: 0

Excused: 1 – Mr. von Reichbauer

KING COUNTY COUNCIL
KING COUNTY, WASHINGTON



Larry Phillips, Chair

ATTEST:



Anne Noris, Clerk of the Council

Attachments: A. Report

Report on an Examination Administrative
Departmental Costs and a Review of Selected
Overhead and Central Rate Charges

Proviso Response

June, 2014

Office of Performance, Strategy, and Budget

Table of Contents

Executive Summary2

Proviso Text5

Finance and Business Operations Division Review7

King County Information Technology Department Review16

Facilities Management Division Review27

Public Health Department Review36

Appendix A – GFOA Best Practice Pricing Internal Services43

Appendix B – Revenue, Population, Consumer Price Index Table.....45

Executive Summary

This report responds to a proviso in the 2014 budget ordinance requesting 1. a review of internal service charges for the Finance and Business Operations Division (FBOD), King County Information Technology department (KCIT), and Facilities Management Division (FMD) over the past decade and 2. an examination of departmental central service overhead charges within the Public Health department..

Internal Service Charge Review

This report includes a review of the rate setting methodology and the alignment with best practices; a review and presentation of service charges data for the years 2004 through 2013; and recommendations for further analysis and changes to methodologies. The best practice reference utilized for this review is the Government Finance Officers Association (GFOA) best practice paper "Pricing Internal Services", published in February 2013 (Appendix A). GFOA recommends that governments follow the following steps when considering an internal service pricing system:

1. Identify goals of internal service pricing;
2. Develop allocation strategy;
3. Define level of costing detail;
4. Determine the cost of service;
5. Decide the basis of allocation;
6. Consider potential drawbacks.

The County has recently adopted Comprehensive Financial Management Policies (CFMP) that include guidance on overhead allocation:

- The full cost of central services will be spread through central rates or allocation models.
- The cost to be allocated will approximate the benefit received by the County fund receiving the charge.
- Recognizing that many services are indirect and not easily quantifiable, overhead and central rate charges may be estimated, where the law and accounting standards allow.
- Overhead and central rate charges will be calculated in a fair and consistent manner without requiring overly burdensome cost accounting.
- An agency will charge costs to other County funds and agencies consistent with the adopted budget.

The County's financial policies align closely with the GFOA best practice recommendations, addressing high level objectives of cost allocation strategy and balancing the cost and benefit of allocation methodologies. The CFMP do not currently clearly articulate pricing goals beyond full cost recovery. It is anticipated that the financial policies will be updated over time. For this review the service charge alignment to the potential goals and steps articulated in the GFOA best practice paper was performed.

All three agencies' service charge methodologies are rigorous, complex and align with elements of the GFOA best practice recommendations.

The proviso requires that year over year internal service charge growth be compared to a two percent per year benchmark and that contributing factors to growth beyond two percent per year be identified. In most cases the County's cost of living and benefits costs increase more than two percent per year with personnel charges comprising 70 to 80 percent of division or departmental costs. In addition to the two percent benchmark stipulated in the proviso, the rate of service charge growth was compared to the growth in total County revenues and an index of the consumer price index (CPI) for Seattle plus population growth. Total County revenues are an indicator of County resources available to pay for direct and indirect services. The CPI plus population growth index is an external indicator that has been identified as an estimate for long term County revenue growth. The additional comparisons were presented to provide additional perspective on the rates of growth and how the growth trends compare to the growth in the County's financial resources. In most years the rates of growth of the internal service charges reviewed are above two percent. All three service charges examined showed a decline in rate of growth that coincided with the 2009 recession and the decline in total County revenue.

There are limitations to the conclusions that can be drawn from a review of individual department or division service charges. Trend analysis for the ten year period is complicated by organizational and service level changes in each of the agencies. FBOD and KCIT have experienced organization transitions related to the implementation of the new County enterprise financial system and the creation of the Business Resource Center (BRC) in 2011 and 2012. Each agency contributed existing staff or positions in the formation of the BRC. Additionally, Executive branch technology resources were centralized in KCIT in 2012 and 2013 which results in a large increase in technology service charges offset by decreases in Executive agency direct technology service expenditures. The number of square feet of space maintained by FMD increased dramatically when new facilities were opened, and then decreased due to space consolidation all within the decade reviewed. Alternative measures for the cost of financial services and space costs are presented. The County's total cost of IT for 2013 is being compiled and will be reported in a subsequent report.

Public Health Department Charges

This portion of the report examined central and department overhead examined the proportion of Public Health resources that were spent on central services and overhead over the past decade. The review includes:

- Allocation methodologies used to distribute overhead costs across the department;
- Description of County overhead services; and
- Description of services in five clusters of departmental overhead, with 10-year trend data.

Overall, as a percentage of agency costs, overhead in Public Health has remained relatively constant for the past decade. County overhead has measured approximately three and one half percent and

departmental overhead about five and one half percent of direct service (all expenditures excluding overhead).

Based on a 2013 audit recommendation, Public Health made one change in the Cost Allocation Plan (CAP) to better align service delivery with charges for services: the Consolidated Contract cost pool (approximately \$100K) was merged with Budget and Financial Planning.

Additionally, Public Health is working with FBOD and the Office of Performance, Strategy and Budget (PSB) to conduct an overall review and optimization of departmental financial management policies and practices. This work will include examining the mechanical bases of overhead allocation, i.e., how overhead charges are spread within the department and represented within the budget. This component of the financial management review and implementation will be prioritized for completion in 2014.

Proviso Text

Ordinance 17695

Section 18

P2 PROVIDED FURTHER THAT:

Of this appropriation, \$200,000 shall not be expended or encumbered until the executive transmits a report on an examination of administrative department costs and a review of selected overhead and central rate charges and a motion that acknowledges receipt of the report and the motion is passed by the council. The motion shall reference the proviso's ordinance, ordinance section, proviso number and subject matter in both the title and body of the motion.

The executive must file the report and motion required by this proviso by May 1, 2014, in the form of a paper original and an electronic copy with the clerk of the council, who shall retain the original and provide an electronic copy to all councilmembers, the council chief of staff and the lead staff for the budget and fiscal management committee, or its successor.

The report shall examine the overhead allocation and central rate methodologies and charges for services provided by the finance and business operations division, the King County information technology department and the facilities management division.

Further, the report shall include a pilot examination of a county department for administrative costs that are passed to divisions within the organization. The department selected for examination shall be public health.

The report shall include, but not be limited to:

A. A review of overhead allocation and central rate methodologies, including:

1. A description of the rates and methodologies and how the methodology fits with best practices for governmental indirect service charges;
2. A review and presentation of data for at least 2004 through 2013 showing charges for services by category of service and the rate of growth for the ten-year period and year-over-year throughout the period for each category of service. The review should identify contributing factors for any year-over-year change greater than two percent or a total change of greater than twenty percent for the ten-year period; and
3. Any recommendations for changes in methodology to reflect best practices, current county practices and service utilization;

B. An examination of charges to divisions within the department for both central overhead and department overhead and methodologies used by the public health director's office, including:

1. A description of the services, charges, rates and methodologies;
2. An analysis of ten-year trend data for the overhead charges;
3. Any recommendations for changes in methodologies to more accurately reflect the relationship between charges for service and service delivery;
4. A review of the growth of individual charges and the costs associated with the charges and any recommendations that could result in either limiting growth or reducing user agency costs;
5. Any recommendations that would allow for standardization of policies for determining charges; and
6. Any recommended changes in how the department of public health charges for administration costs to divisions and any recommended changes that could be accomplished and standardized for other county agencies; and

C. An implementation plan, including a timeline and milestones, for incorporating report recommendations, including those that should be implemented in the proposed 2015-2016 budget.

Finance and Business Operations Division

This section of the report reviews the overhead allocation and central rate methodology for the Finance and Business Operations Division (FBOD).

FBOD supports all County agencies with treasury services, procurement and contract services, benefits and payroll services and accounting and reporting services. FBOD is an internal service fund that recovers about 85 percent of its expenses through billings to other County organizations.

Review of Service Charge Methodology

The rate model for FBOD services was originally created in 1999 and has been updated over time to reflect changes in FBOD services and business practices. Development of the model follows the following steps:

1. Establish cost pools
 2. Measure costs
 3. Determine allocation bases
 4. Determine exceptions
 5. True-up costs for last complete year and adjust charges
-
1. Establish Cost Pools: The model currently consists of eighteen different cost pools that represent division overhead and seventeen discrete services provided by Finance. The cost pools and the allocation bases are reviewed each budget cycle to determine whether they are still relevant and reflect current business practices. The model was recently updated to reflect FBOD and the County's implementation of new enterprise business systems. Financial management and payroll cost pools that were previously established to service separate legacy systems (ARMS/IBIS and PeopleSoft/MSA) were combined into single cost pools for EBS and PeopleSoft, and the bases were updated based on the new system transactions. The cost pools that will be utilized for preparation of the FBOD 2015/2016 service charges are listed in the chart that follows.

Cost Pool	Allocation Basis
Treasury - Cash Management Services	All to General Fund, except for parts of two positions
Treasury - Property Tax	Current year levy amounts
Treasury - Cash Management, Warrant	All to General Fund, except for parts of two positions
Procurement - Goods & Services	Procurement staff service hours
Procurement - Contracts	Three year average of contract service hours
Business Development & Contract Compliance	Number of contracts
Financial Management Financial Accounting Unit	Accountant hours
Financial Management Financial Systems Unit	GL System transaction count
Financial Management Accounts Payable	Number of invoices by payment type
Financial Management Accounts Receivable	Weighted invoice count
Financial Management Collection Enforcement	Accounts referred
Financial Management Grants Team	Grant expenditures and number of grants
Benefits Payroll & Retirement Operations Payroll	PeopleSoft paycheck count
Benefits Payroll & Retirement Operations Benefits Operations	Enrollee count
Benefits Payroll & Retirement Operations Retirement Operations	Enrollee count
Benefits Payroll & Retirement Operations LEOFF Disability	All to Sheriff/General Fund
Waste Reduction Recycling	All to Solid Waste
Director's Office	To section - burden on FTE
FMD - Sub cost pool	To section based on usage-square feet
KCIT- Sub cost pool	To section based on usage
PAO's Time - Sub cost pool	To section based on usage hours

2. Measurement of Costs: The FBOD charge model is prepared in conjunction with the proposed budget. The cost pools are developed based on proposed budget estimates and include direct and indirect costs of services.

3. Determine Allocation Bases: The allocation bases are chosen to provide an equitable distribution of costs based on the principle that the beneficiary of the service pays for the service. In most cases the allocation bases are established using the last full year of data available. For preparation of the 2015/2016 budget 2013, transaction, paycheck and utilization statistics will be utilized. Finance division overhead is allocated based on FTE and usage.

4. Determine Exceptions: FBOD reviews the allocations and makes adjustments for closed funds, reorganizations, changes in grant or capital fund status. A \$500 minimum threshold is applied. The exceptions are documented in the rate model worksheets.
5. True-up Costs: Since 2010 FBOD has performed a reconciliation process in preparation of the service charge model. The proposed rates include adjustments of billed rates to actual expenses of cost pools and actual experience of the allocation basis. The reconciliation has resulted in savings for some funds and increased costs for some other funds based on the actual transaction counts and service levels provided to each agency.

Alignment with GFOA Best Practices

The FBOD service charge model achieves several of the potential goals articulated by the GFOA best practice paper.

Goal Alignment:

GFOA Goals of Internal Service Pricing	How FBOD Methodology Aligns
1. Govern demand for a service	Charges are based on level of service.
2. Develop enterprise rate models	The current model allocates all direct and indirect costs and is utilized in development of enterprise rates.
3. Calculate indirect cost reimbursement for grants	
4. Provide input for full-costing model	Charges represent the full cost of the county's financial services.
5. Promote discussion about the value of the service provided	Steps toward increased transparency are being made through creation of a service catalog.
6. Examine value of a shared service model	
7. Promote competition in service delivery	
8. Ability to customize service levels for different customers	Charges are based on consumption and are responsive to customer demands.

Allocation Strategy: The Financial Services internal service fund was established in 1998. The majority of the division's services can be viewed as market services in which the user departments play the role of consumer. The reporting and auditing functions can be viewed as regulatory in nature. Continuing to price and allocate financial services to county agencies achieves a level of awareness about the amount of services being consumed and provides some incentive to limit over-use.

Level of Costing Detail: The costing model currently employed by FBOD is quite detailed. Although it has been revised and updated, it still contains a large number of discrete cost pools and requires significant effort to compile and update. A higher level of detail is generally perceived to lead to a more accurate costing system. It may be beneficial to re-evaluate the level of complexity of the model and determine if the benefit of the model is worth the cost of developing and maintaining it or if there are modifications would be advisable.

Determining Costs: The County's budgeting and accounting practices record the direct costs, any relevant interest costs and service costs from other support services in the FBOD division's accounts. The proposed budget captures informed estimates of these costs and is a reasonable basis for the cost model and the allocation model is trued-up to actual costs. There is a lag of two years between the time that charges are collected and rebates are distributed, i.e. the difference between 2013 estimated and actual charges will be applied to the 2015 service charges.

Basis of Allocation: FBOD considers cause and effect, benefit received, fairness and legal constraints in determining the allocation bases for the service model. The allocation bases have remained relatively static over the past decade. It may be beneficial to review the allocation bases of the cost pools to determine if there are alternatives that might strengthen the relationship between allocation basis and cost drivers.

Are There Drawbacks to the Current Model? The FBOD rate model is technically sound and it achieves a number of the potential goals of an internal costing model: supporting full cost recovery and enterprise rate development, promoting discussion of the value of financial services and to some extent, limiting the over-use of services. Some observed challenges that may warrant further analysis include:

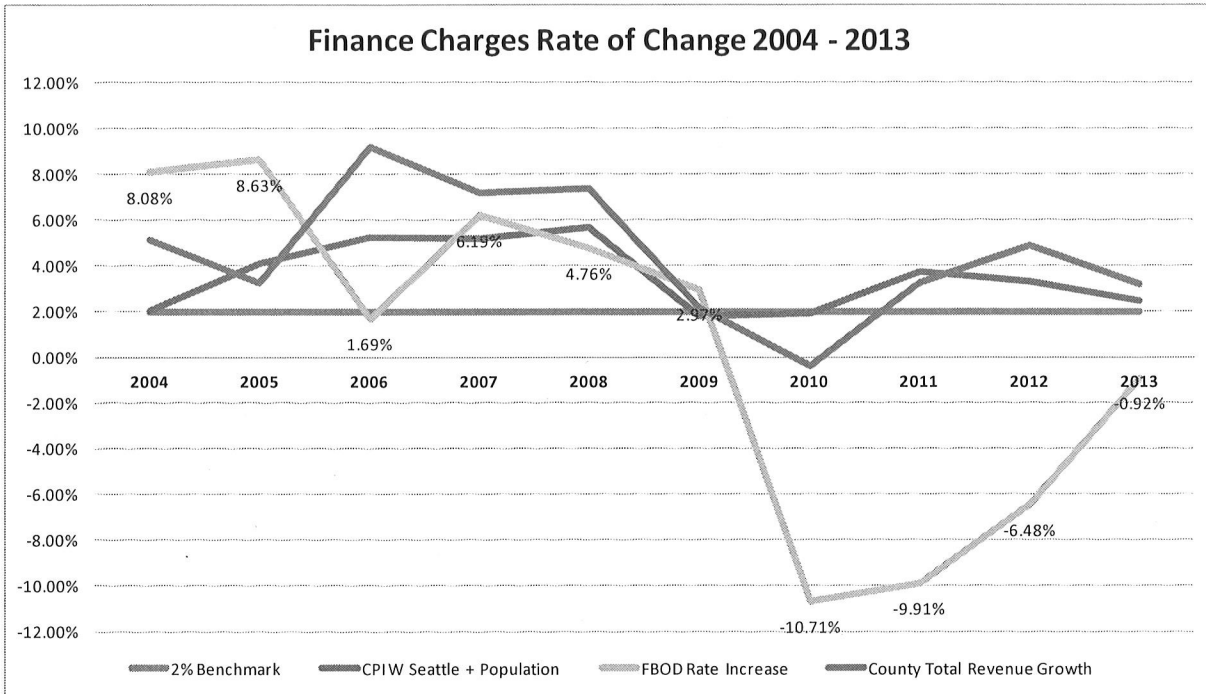
- The model is complex and requires significant resources to develop and maintain.
- FBOD and other internal service providers have improved the transparency of documentation and information about charges available to customers through the development of a service catalog. FBOD has also participated in the annual service day organized by KCIT. Whether these efforts have resulted in a better understanding of rates is not yet known.
- Customers have expressed concern over the lag in adjusting allocation bases. Utilizing a lagged allocation basis produces more accurate estimates when agency budgets are relatively stable. Current financial forecasts indicate that a number of County funds are facing significant reductions in 2015/2016, which suggests that compensatory measures to adjust the lagged bases may be necessary.

Historical Financial Service Charges

FBOD Charges for services and rate of growth 2003 – 2013

Year	Charges	% Change	> 2%
2003	21,738,486		
2004	23,494,394	8.08%	X
2005	25,521,301	8.63%	X
2006	25,952,901	1.69%	
2007	27,559,755	6.19%	X
2008	28,870,409	4.76%	X
2009	29,727,454	2.97%	X
2010	26,543,589	-10.71%	
2011	23,913,766	-9.91%	
2012	22,364,574	-6.48%	
2013	22,158,889	-0.92%	
2003 - 2013	420,403	1.93%	

The chart below shows the year over year change in the FBOD service charges in comparison to the 2% benchmark the proviso calls for as well as to the change in total County revenues and to an index of the Seattle CPI-W + population growth. Total County revenue is an indicator of County resources available to pay for direct and indirect services. The CPI-W + population growth index is an external indicator that has been identified as an estimate for long term County revenue growth.



The year over year change in FBOD charges is greater than 2% in five of the years reviewed. Factors contributing to the rates of increase greater than two percent in 2004, 2005, 2007, 2008 and 2009 are described below.

2004

- COLA increase of 2.03% and Benefits rate increase of 19.18%.
- Transfer of two positions from Employee Benefits to FBOD Benefits Payroll and Retirement section. There was a corresponding decrease in Employee Benefits.
- Purchase of remittance processors for Treasury.
- Payroll improvement and MSA payroll system standardization work.

2005

- COLA increase of 2.19%.
- Data entry consolidation which moved two data entry operators from Technology Services to Financial Management section.
- Significant increase in Technology Services charges.

2007

- COLA increase of 2% and Benefits rate increase of 11.3%.
- Benefits education support for Healthy Incentives and other benefits during peak workload times.
- MSA online project which streamlined business processes, reduced cycle time and improved data integrity.

2008

- COLA increase of 2.49% and Benefits rate increase of 4.48%.
- Lower rebate than prior year resulting in a larger year over year increase.

2009

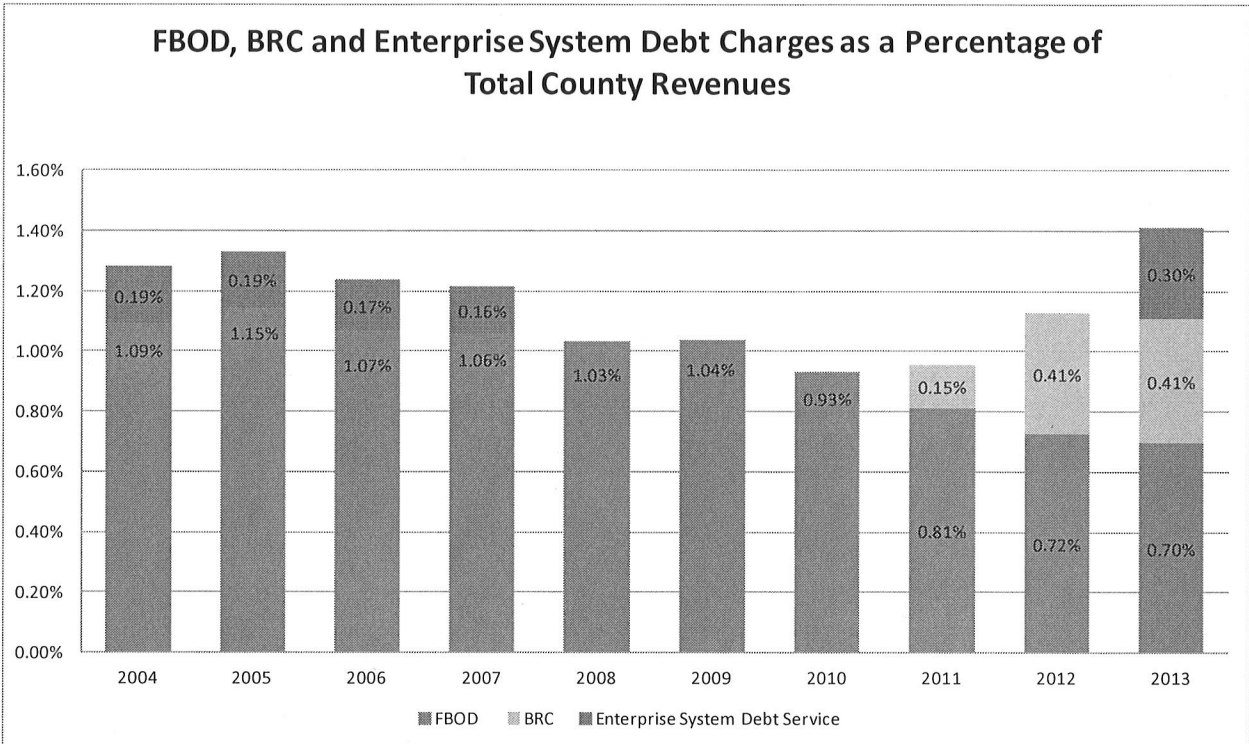
- COLA increase of 4.88% and Benefits rate increase of 2.54%.
- No rate rebate resulting in a larger year over year increase.

As the chart indicates FBOD charges increased at a higher rate than the CPI-W + Population index in four of the years reviewed. FBOD charges increased at a higher rate than total County revenues in three of the years reviewed.

FBOD charges begin to decline on a year over year basis starting in 2010. This is attributable to efficiency reductions made in the Accountable Business Transformation (ABT) as well as actions taken to reduce expenditures in response to the recession. ABT efficiency reductions and position transfers to the newly established Business Resource Center (BRC) continue in 2011 and 2012.

A significant component of the rate variance from year to year is attributable to truing up budgeted estimates to actual charges. During the time period reviewed service rebates varied from zero in 2009 to a 13 percent reduction in charges in 2011. The magnitude of the variation in rebate amounts and the fluctuation in usage counts have resulted in dramatic swings in customer rates. Some of the variance between actual and budgeted costs is attributable to the ABT, both from the resources that the division loaned to the project and to vacancies that were held in order to reduce positions by attrition.

The chart below shows the relationship between Financial Service charges and total County revenue. In order to show a more complete picture of the County's cost of financial services the debt service for enterprise business systems and the BRC service charges are also charted. The chart shows that in 2013 the County spent an amount equal to 1.41% of total revenues on financial services.



Recommendations and Timeline for Implementation

2015/2016 Budget and Service Charges: In 2014 FBOD reviewed the division's true-up methodology and recommends simplifying it. The true-up method to be implemented in the 2015/2016 rate model will allocate adjustments based on actual costs only. This will result in more stable and predictable rates. The variability in rates has exacerbated by the size of the FBOD rebates. Consideration will also be given to ensuring that estimated costs are closer to actual costs for 2015/2016. The impact of lagged bases on the equitability of 2015/2016 service charges for distressed funds will be modeled for FBOD and other internal service providers. Compensatory adjustments to mitigate the impacts will be implemented to mitigate where necessary.

2017/2018 Budget and Service Charges: FBOD has articulated a vision to be a partner and leader in providing excellent service every day to King County agencies. The division will continue to focus our work on providing effective central finance services at a low cost to each customer. Going forward, FBOD plans to identify standard work that can be provided at a reduced cost. With that in mind, the division will work with customer agencies to tailor their menu of services to customers' needs and to incentivize customers to participate in controlling costs by leveraging standard work with FBOD.

Anticipated Timeline:

2014 – Pilot prototype design

2015 – Pilot implementation

2016 – Pilot evaluation, potential expansion and integration into 2017/2018 budget

King County Information Technology

This section of the report reviews the overhead allocation and central rate methodology for King County Information Technology (KCIT).

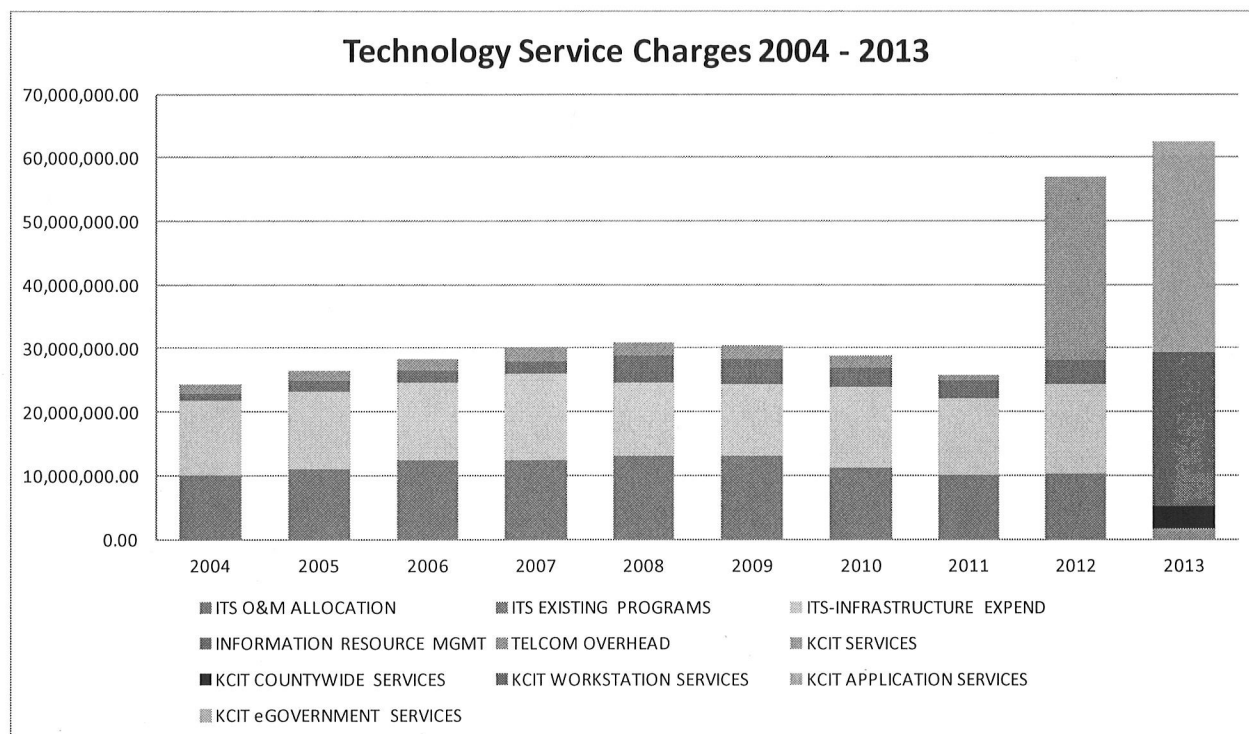
Background

King County Information Technology (KCIT) is responsible for providing information technology services internally to King County agencies and to several external customers. All agencies in the Executive branch provision their technology services from KCIT. Separately elected agencies provision a subset of technology services from KCIT which are mainly infrastructure based, such as network connectivity and the Data Center, and enterprise level such as e-mail and Internet. Prior to 2013, IT internal services included only some countywide infrastructure. Other IT support and the application layers were embedded in each department reflecting a decentralized IT organization. Therefore, IT internal service rates represented only part of total County IT costs.

In July 2012 the King County Council adopted an ordinance that called for IT consolidation in the Executive branch. This consolidation of IT organizations from seven Executive departments to one King County Information Technology (KCIT) department has allowed KCIT to develop a service model with standard IT rates for its services starting with the 2013/2014 biennial budget. It is the goal of KCIT to provide its customers excellent services with competitive prices; and at the same time to provide transparency of its cost to provide the services. KCIT service offering includes engagement with customers to review their IT needs and assist them to get the best value from IT that fit their business needs. KCIT is committed to transparency of service cost and accountability for service delivery, along with continuous service improvements. Most importantly, KCIT is focusing on collaboration and partnerships with its customers. Countywide customers can leverage this approach to control the cost of their IT by provisioning only services they need to conduct their business.

Review of Service Charge Methodology

The chart below depicts the IT Technology service charges from 2004 through 2013. The chart illustrates the transition from a 'category of service' pricing strategy pre 2013 to the line of service pricing strategy implemented in 2013. The impact of the centralization of Executive branch IT organizations into KCIT is evident in the increase in charges in 2012.



Prior to 2013 technology service charges were comprised of the following categories:

- Technology operations and maintenance
- Information resource management (governance & administration)
- Technology existing programs (applications support and development)
- Telecommunications overhead

The review that follows will focus on the methodology developed to support the new KCIT organizational model based on lines of service. This model was implemented beginning with 2013/2014 service rate development.

The guiding principles that KCIT follows in developing its rate methodology are simplicity, ease of understanding, fair allocation, analytics of cost drivers, and benefit for the customers. KCIT offers eight end-user services that are related to day to day employee activities in an IT supported environment:

- Workstation
- Applications
- Business Solution
- E-government Services
- Business Analysis
- Project Management
- Regional Services
- IT End User Training

The end user services are supported by a number of technical services, or IT to IT services. The IT to IT services provide a platform and infrastructure that are necessary to support the end user services. These include services such as data center, network, servers, and email. The costs for these services are provisioned based on the consumption and the need to support and deliver the end user services. For example, each application will need a platform to host the application that is translated to the number and type of servers specifically for the application.

All IT staff and IT business operations are supported by IT support services. These services include facilities, supplies, human resources, labor relations, payroll, finance, contracts, budget, and other services that are commonly needed to support an organization. This cost is included in each KCIT position within a service.

KCIT Mandated, Business Foundation and central rate are services underlying all KCIT services mentioned above. KCIT Mandated services are required by county codes. The Chief Information Officer, IT Strategic Planning, IT Security, IT Governance, and IT customer services are part of the KCIT Mandated services. Business Foundation services are necessary to ensure KCIT services are based on best practices. This includes business continuity and project management coordination. KCIT central rates represent costs charged by other county internal services (such as cost of facilities, central finance, risk management and motor pool). The cost of Mandated, Business Foundation, and central rates services are added as a percentage for each agency based on the end-user services consumed by the agency.

Each biennial budget, KCIT develops the rates based on the estimated demand and the estimated cost to provide the services. There are specific factors and data used to develop the estimates. KCIT engages its customers to assess the business demands and uses various data such as payroll information and past actual experience in determining the cost to provide the services, which is translated to rates.

KCIT creates the rates by cost components that are necessary for the delivery of the services. Table 1 on the next page is an example of the workstation services rate component.

Components	Standard Desktop (\$)	Performance Desktop (\$)	Standard Laptop (\$)	Rugged Laptop (\$)	Tablet (\$)
Network	566	566	566	566	566
Equipment Cost (with supplies/monitors, etc)	291	325	405	740	583
Service Center	216	216	216	216	216
Labor	1,103	1,103	1,103	1,103	1,103
License	250	250	250	250	250
Tech Products	252	252	252	252	252
Unified Communications	305	305	305	305	305
Asset Mgmt	30	30	30	30	30
File/Print Services	80	80	80	80	80
Contingency	50	50	50	50	50
Total	3,142	3,176	3,256	3,591	3,434
Mandated/Business Foundation/Central Rates	319	322	330	364	348
Total Cost per workstation per year	3,461	3,498	3,587	3,955	3,782

Table 1

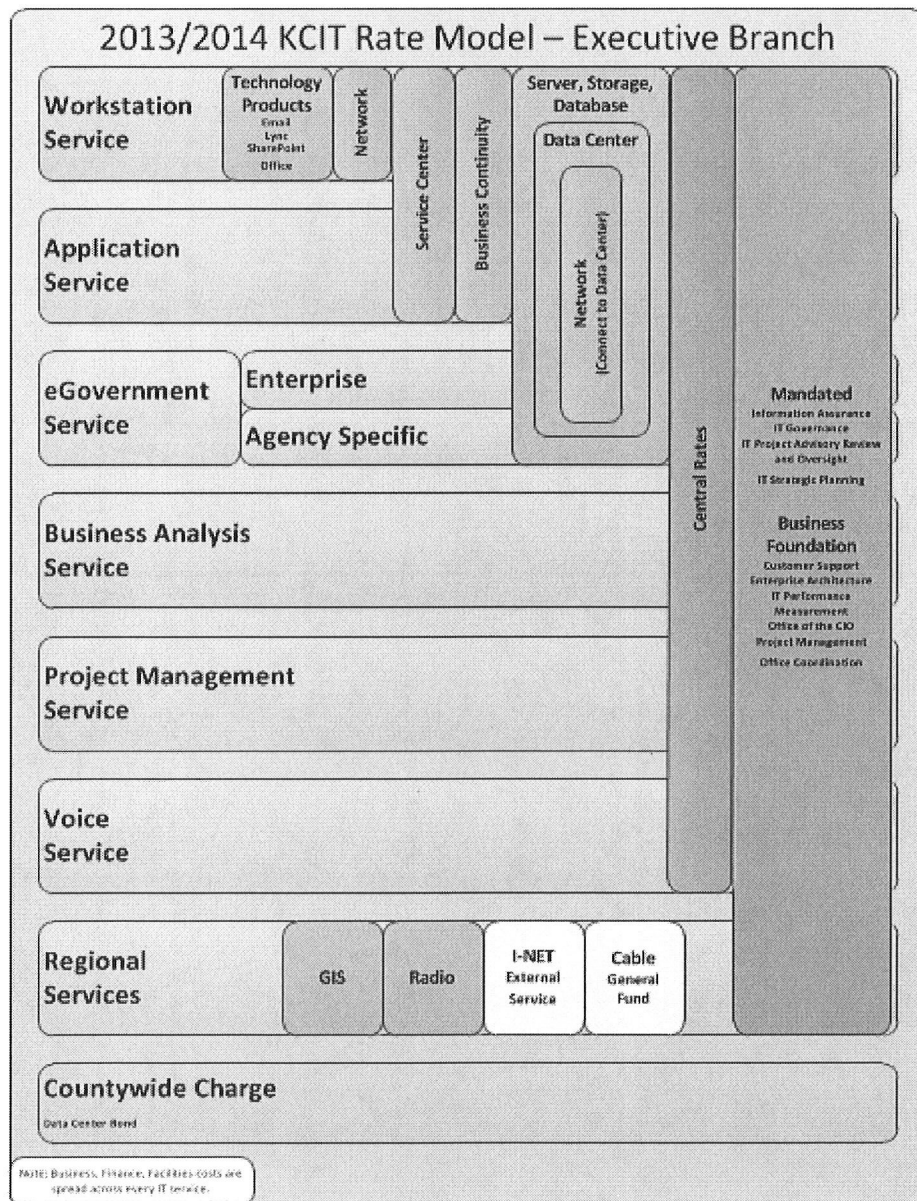
The pricing of the components also provides flexibility to create a new service offering that may require only a few of the components to provide customers with a different option that may fit their business needs:

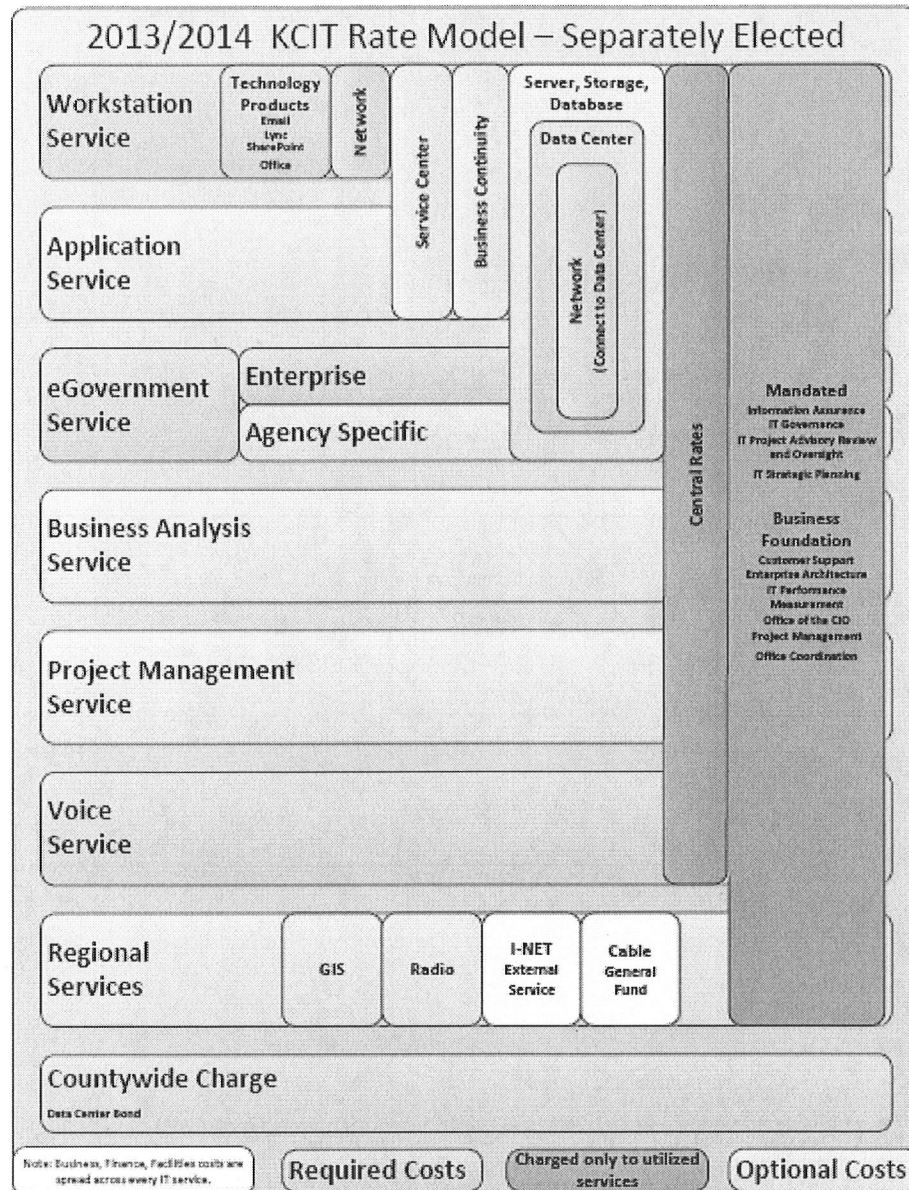
Components	Kiosk	Seasonal
Network	566	141
Equipment Cost (with supplies/monitors, etc)	265	265
Service Center	-	54
Labor	331	276
License	50	250
Tech Products	252	63
Unified Communications		
Asset Mgmt	30	30
File/Print Services	-	20
Contingency	-	-
Total	1,493	1,099
Mandated/Business Foundation/Central Rates	151	111
Total Cost per workstation per year	1,645	1,210

Table 2

To assess the demand and capture customers' needs, KCIT offers customers an order form where they fill out the quantity and type of services they need to support their business. That provide customers a cost control opportunity with clear and transparent cost information, where their IT cost is calculated based on their order quantity.

The charts that follow illustrate the components of KCIT service charges for the Executive Branch and for agencies or offices headed by separately elected officials.





Alignment with GFOA Best Practices

The KCIT service charge model achieves several of the potential goals articulated by the GFOA best practice paper.

Goal Alignment:

GFOA Goals of Internal Service Pricing	How KCIT Methodology Aligns
1. Govern demand for a service	Charges are based on level of service.
2. Develop enterprise rate models	The current model allocates all direct and indirect costs and is utilized in development of enterprise rates.
3. Calculate indirect cost reimbursement for grants	
4. Provide input for full-costing model	Charges represent the full cost of the county's technology services.
5. Promote discussion about the value of the service provided	Steps toward increased transparency are being made through creation of a service catalog.
6. Examine value of a shared service model	The Executive branch model is designed to provide transparency and accountability for IT service provision.
7. Promote competition in service delivery	
8. Ability to customize service levels for different customers	Charges are based on customer service order quantity.

Allocation Strategy: KCIT services are comprised of both market services, such as workstations and applications, and policy or regulatory services such as IT governance and IT Infrastructure Architecture. KCIT has developed a pricing strategy that recognizes the nature of both types of service offerings. The market services are based on the quantity of service agreed to in the customer service order form. The mandated or foundational services are included in the cost of the market services. Continuing to price and allocate technology services to County agencies achieves a level of awareness about the amount of services being consumed and provides incentives to limit over-use.

Level of Costing Detail: The costing model currently employed by KCIT is quite detailed. A higher level of detail is generally perceived to lead to a more accurate costing system. Because KCIT's model and pricing strategy are so new it is difficult to evaluate the value and effectiveness and determine if the level of effort is commensurate with the benefit.

Determining Costs: The County's budgeting and accounting practices record the direct costs, any relevant interest costs and service costs from other support services in KCIT's accounts. The proposed budget captures informed estimates of these costs and is a reasonable basis for the cost model. KCIT's preliminary rates and service charges are developed early in the budget cycle based on the best available data at the time that the rates are estimated. Evaluation of KCIT's pricing and cost estimates as part of the Executive budget review is necessary to determine if refinements to prices are in order.

Basis of Allocation: KCIT considers cause and effect, benefit received, fairness and legal constraints in determining the allocation bases for the service model. The pricing model is developed based on lines of service, which is consistent with the County's emphasis on value streams and understanding the cost of the products or services the County provides.

Are There Drawbacks to the Current Model? The KCIT service charge model was designed to provide transparent rates for IT services. It is technically sound and achieves a number of the potential goals of an internal costing model: supporting full cost recovery and enterprise rate development, promoting discussion of the value of technology services and limiting the over-use of services. Some observations that may warrant further analysis in the future include:

- The model is complex and requires significant resources to develop and maintain.
- KCIT has led the internal service agencies in their efforts to improve the transparency of documentation and information about charges available to customers through the development of a service catalog. KCIT has organized an annual service day event that is designed to present cost and service information and encourage customer engagement. It is apparent that KCIT's efforts have increased the awareness of price and quantity of services consumed, and has resulted in customers making adjustments in quantity ordered when feasible.
- Current financial forecasts indicate that a number of County funds are facing significant reductions in 2015/2016. Technology services represent a significant cost to all County agencies and customer agencies. Customer agencies are looking to internal service agencies to reduce costs as well. KCIT's ability to scale costs and service offerings should be evaluated.

Historical Technology Service Charges

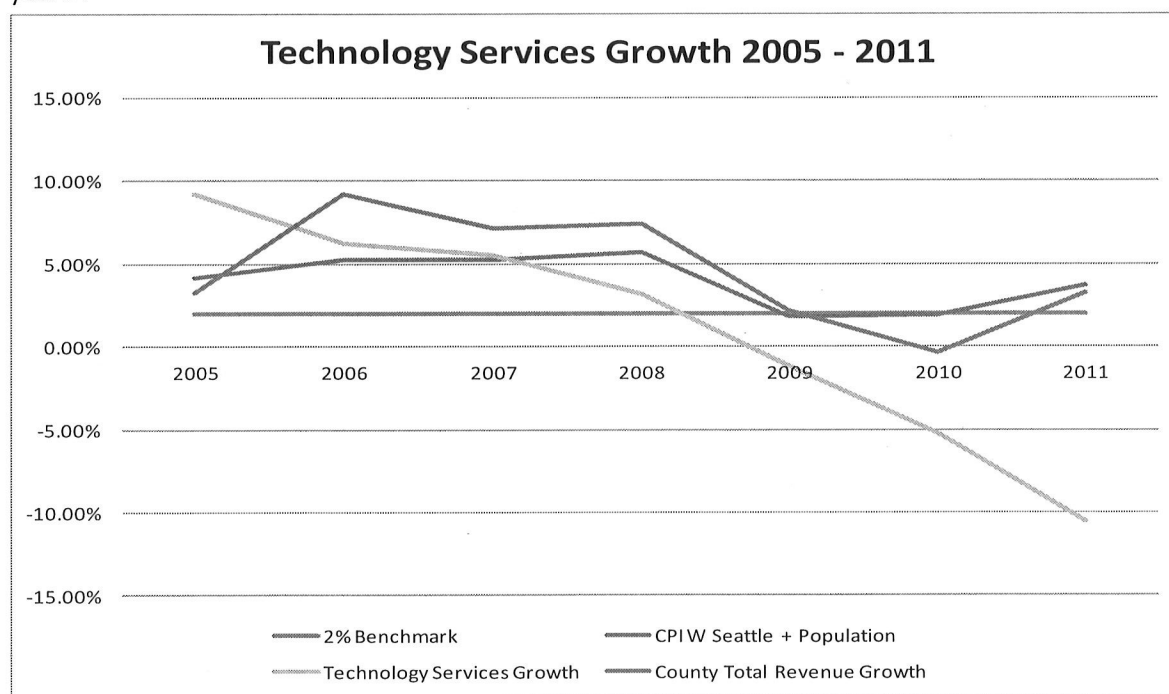
The charts that follow show the year over year change in technology service charges in comparison to the 2% benchmark the proviso calls for as well as to the change in total County revenues and to an index of the Seattle CPI-W + population growth. Total County revenue is an indicator of County resources available to pay for direct and indirect services. The CPI-W + population growth index is an external indicator that has been identified as an estimate for long term County revenue growth. The chart

depicts the trend data for 2005 through 2011. The transition to a centralized IT organization for the Executive branch in 2012 and the inclusion of equipment replacement and enterprise licensing in the new service model in 2013 results in total charges that are not easily compared to 2005 through 2011.

Total Technology Service Charges from 2004 – 2013

Year	Charges	% Change	>2%
2004	24,454,661		
2005	26,576,157	8.68%	X
2006	28,263,893	6.35%	X
2007	29,908,555	5.82%	X
2008	30,848,010	3.14%	X
2009	30,498,794	-1.13%	
2010	28,913,445	-5.20%	
2011	25,865,014	-10.54%	
2012	57,010,816	120.42%	X
2013	62,424,847	9.50%	X
2003 - 2013	37,970,186	55.27%	

This chart shows the change in IT service charges from 2005 to 2011. The centralization of Executive branch IT service costs in 2012 and 2013 results in a shift in costs that is not comparable to the prior years .



The year over year change in technology service charges is greater than 2% in six of the years reviewed. Factors contributing to the rates of increase greater than two percent in 2005 – 2008, 2012 and 2013 are described below.

2005

- COLA increase of 2.19%.
- Added security program.
- Enterprise technology projects.
- Asset management program.

2006

- COLA increase of 4.66% and Benefits rate increase of 5.03%.
- Addition of the Business continuity program.
- Increased customer demands on application support and development.

2007

- COLA increase of 2% and Benefits rate increase of 11.3%.

2008

- COLA increase of 2.49% and Benefits rate increase of 4.48%.

2012

- COLA increase of 1.63% and benefits rate increase of 8%.
- IT consolidation in the Executive Branch. Moved IT staff and overhead from departments to KCIT.

2013

- COLA increase of 2.00% and benefits rate increase of 1.01%.
- Maintenance for eGovernment.
- Desktop equipment replacement lease charges.
- Include Microsoft enterprise agreement in direct charges to reflect full costs.

Because the current service pricing methodology has only been in place since 2013 it is too early to make any observations about the impact on cost trends.

Recommendations and Timeline for Implementation

2014: One benefit of the consolidation of Executive branch IT resources in KCIT is enhanced visibility of and accountability for the costs of IT. Because IT costs are not fully centralized, KCIT and PSB have partnered to survey, compile and report the full costs of IT for both Executive branch and the offices of separately elected officials. This effort will result in a report that quantifies the total County resources spent on IT operations, capital projects and debt service for 2013. Prospectively, KCIT and PSB will determine whether it is practicable to continue this effort on an annual basis or whether a biennial effort at the end of each biennium would make more sense.

2015/2016 Budget and Service Charges: 2013 was the first year that KCIT's new service charge model was implemented. Preparation of the 2015/2016 service rates and model presents the first opportunity to true-up 2013 rates to actual services consumed. The impact of this true-up on 2015 charges will be evaluated in the review of rates for inclusion in the 2015/2016 proposed budget.

Facilities Management Division

The Facilities Management Division (FMD) provides clean, safe, secure, environmentally sustainable and cost-effective facilities for King County and the public. FMD is also responsible for designing and managing capital construction projects that are responsive to customer needs.

The FMD Internal Service fund comprises four lines of business:

Building Services Operations and Maintenance (O&M)

- Maintain and oversee daily building operations and maintenance, such as heating, cooling, cleaning, security and signage;
- Manage tenant relocation and furniture moves;
- Construct office space alterations and minor remodels triggered by tenant agency work requests;
- Collaborate with building tenants during the service level agreement renewal process.

Major Projects and Strategic Initiatives

- Countywide space planning and energy management services;
- Implement strategic initiatives and major capital projects.

Capital Project Management

- Implement major capital projects;
- Manage general government capital projects;
- Maintain a 20-year general government building major maintenance program.

Printing Services

- Provide high quality printing services for County departments.

Review of Service Charge Methodology

As an internal service fund (ISF), FMD is required to operate under a full cost recovery business model. To the extent possible rates should be set so that each line of business is self supporting. Charge-for-services functions should not subsidize building O&M operations or vice versa.

There are two central rates associated with FMD operations. The first is the per square foot (PSF) tenant rates which recovers the annual operating and maintenance (O&M) costs of the FMD managed County facilities. This cost is allocated to the tenants of each FMD managed facility based on the space they occupy. Each facility has a discrete rate reflecting the costs of operation for that particular facility. The exceptions to this are the District Court, Health Clinics, and Precinct facilities where the costs are pooled

for each of these three building groups and a single per square foot rate is charged for all the related facilities in the group.

Hourly reimbursable work outside of normal O&M such as electrical, plumbing, carpentry, moving, and minor tenant improvements are billed to agencies requesting work on a per job basis. Costs are recovered via burdened direct labor hours plus material costs via FMD's work order system.

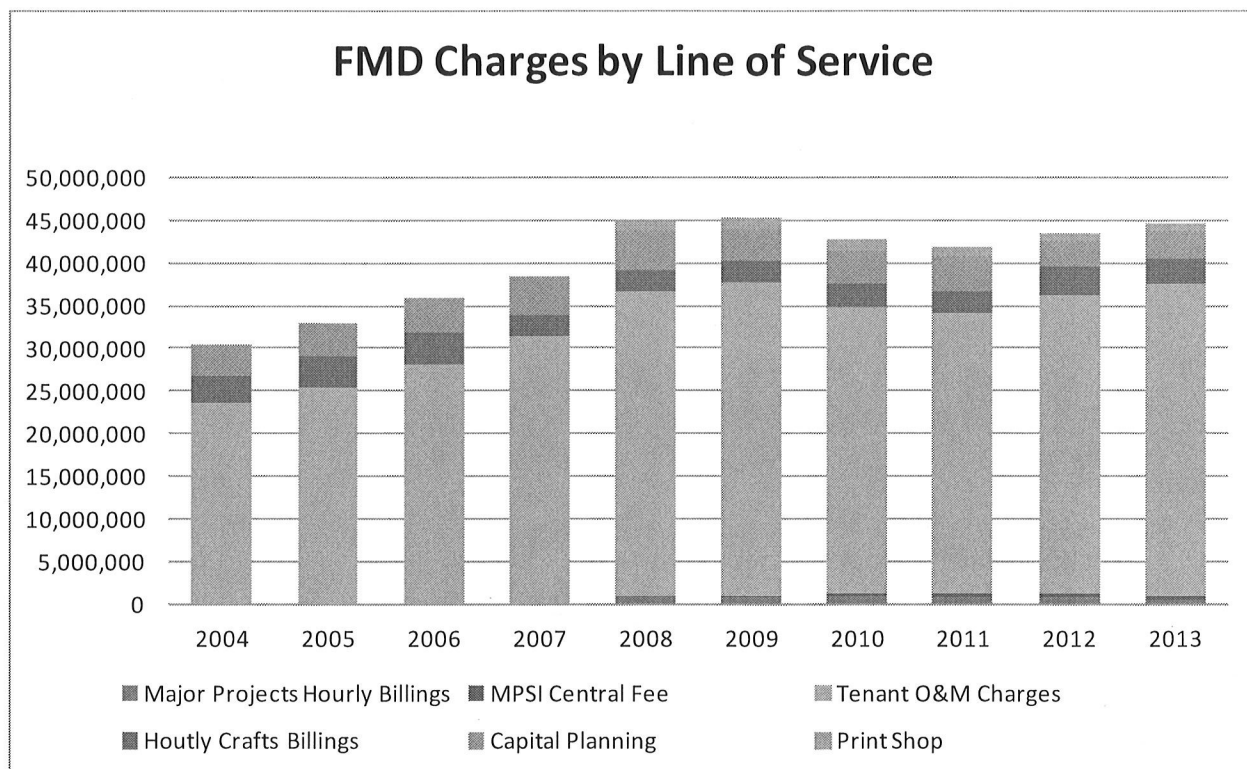
The second central rate is the Major Projects and Strategic Initiatives (MPSI) fee. This fee was first adopted in 2009 and is charged to all County agencies. It was initially intended to recover the costs of FMD's staff work on countywide space planning. In 2011 the scope of the fee was expanded to cover FMD's staff work on County-wide energy management initiatives. The total amount to be recovered is zero-based each year via an update of the MPSI time and effort staffing matrix. The MPSI is allocated based on client agency FTE counts.

Major CIP and Strategic Initiative project administration cost are recovered via burdened direct labor. For unbudgeted or unbillable projects, the costs are absorbed by the FMD fund balance.

Capital planning and development for the County's General Government and Major Maintenance CIP program costs are recovered via burdened project manager direct labor hours charged to individual capital projects. In the event that billable hours do not cover both direct and indirect costs, costs would be absorbed by the FMD fund balance.

Print Shop Operations was a new line of business for FMD starting in 2008. Costs are recovered via charges for work performed by job.

The chart below displays the FMD charges for service from 2004 through 2013.



The building services tenant O&M rates comprise about 80 percent of the FMD service charges and will be the primary focus of this review.

Alignment with GFOA Best Practices

The FMD tenant O&M service charge model achieves several of the potential goals articulated by the GFOA best practice paper.

Goal Alignment:

GFOA Goals of Internal Service Pricing	How FMD Methodology Aligns
1. Govern demand for a service	Charges are based on square footage occupied.
2. Develop enterprise rate models	The current model allocates all direct and indirect costs and is utilized in development of enterprise rates.
3. Calculate indirect cost reimbursement for grants	
4. Provide input for full-costing model	Tenant O&M charges are indirect costs for other agencies, supporting full costing modeling.

5. Promote discussion about the value of the service provided	Steps toward increased transparency are being made through creation of a service catalog.
6. Examine value of a shared service model	
7. Promote competition in service delivery	
8. Ability to customize service levels for different customers	

Allocation Strategy: The Facilities Management Division's services can be viewed as market services in which the user departments play the role of consumer. Continuing to price and allocate county tenant service charges to county agencies achieves a level of awareness about the amount of space occupied, energy utilization and provides some incentive to limit over-use.

Level of Costing Detail: The costing model currently employed by FMD is rigorous and thorough. The burden rate methodology is technically sound and allocates all budgeted costs. Costs are tracked and estimated by on building. The level of detail appropriately matches costs with space that is occupied by client agencies.

Determining Costs: The County's budgeting and accounting practices record the direct costs, any relevant interest costs and service costs from other support services in the Facilities Management division's accounts. The proposed budget captures informed estimates of these costs and is a reasonable basis for the cost model.

Basis of Allocation: Costs are allocated based on planned square footage occupancy by building and agency, at the time that the proposed budget and rate model is finalized. In 2012 the County's practices around adjusting tenant charges for changes in occupancy mid-year were revised to decrease the time lag between changes in occupancy and adjustment of PSF charges. This puts additional strain on the FMD ISF's fund balance, as it now needs to absorb shortages in budgeted revenue when occupancy patterns change mid-year.

Are There Drawbacks to the Current Model? The FMD rate model is technically sound and it achieves a number of the potential goals of an internal costing model: supporting full cost recovery and enterprise rate development, promoting awareness of the cost of client agency occupancy footprint, and to some extent, limiting the over-use of space. Some observed challenges that may warrant further analysis include:

- FMD services are perceived by as expensive by client agencies.
- While the rate methodology is technically rigorous and sound, the efficacy in achieving full cost recovery is problematic. A five year review to determine whether each FMD business line was achieving full cost recovery indicated that only tenant services O&M was consistently recovering

both direct and indirect costs. Capital planning, MPSI and the Print Shop are not consistently generating revenues that recover both direct and indirect allocated costs.

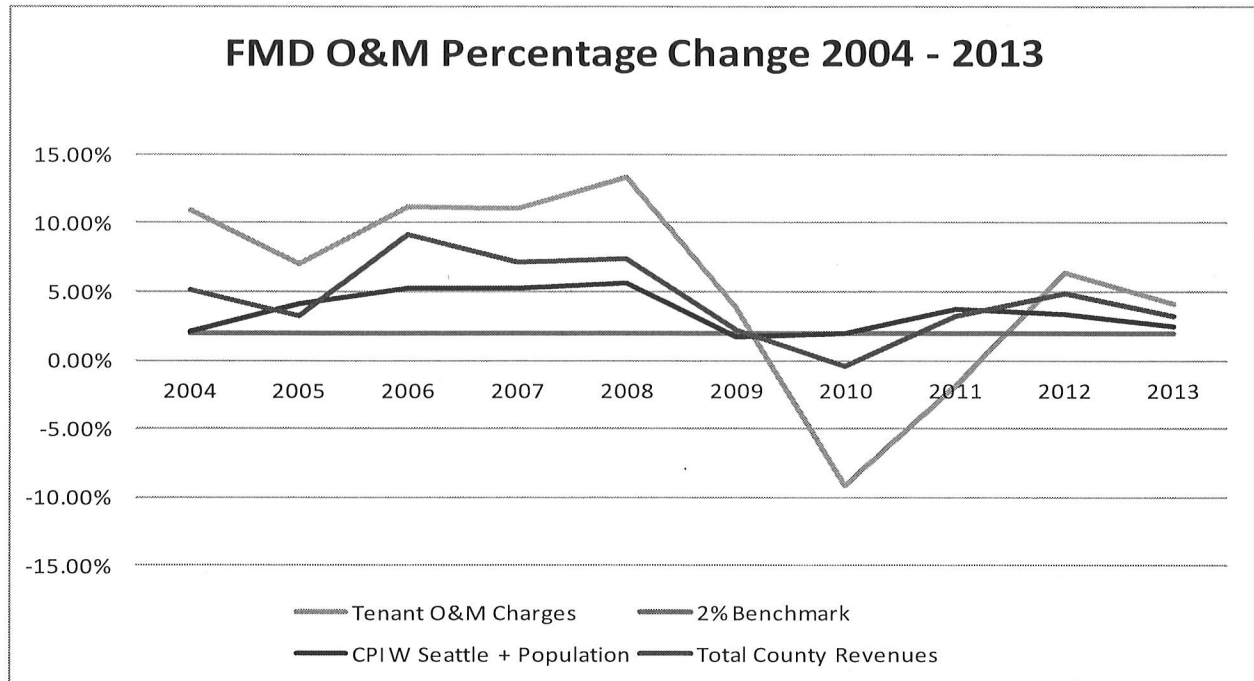
- FMD and other internal service providers have improved the transparency of documentation and information about charges available to customers through the development of a service catalog. FMD has also participated in the annual service day organized by KCIT. Whether these efforts have resulted in a better understanding of rates is not evident.

Historical Tenant Service Charges

The charts that follow show the year over year change in the FMD service charges in comparison to the 2% benchmark the proviso calls for as well as to the change in total County revenues and to an index of the Seattle CPI-W + population growth. Total County revenue is an indicator of County resources available to pay for direct and indirect services. The CPI-W + population growth index is an external indicator that has been identified as an estimate for long term County revenue growth. This comparison was made in light of the comparison asked for in the proviso language. The FMD O&M rates represent only a subset of the County's building occupancy costs and it is difficult to draw conclusions based on the trends in the total amount of charges for this activity alone. During the time period observed the County opened three new facilities and mothballed one. In addition there was likely a shift in the total square footage of leased space occupied.

FMD Charges for tenant services and rate of growth 2003 – 2013

Year	Charges	% Change	> 2%
2003	21,382,534		
2004	23,715,618	10.91%	X
2005	25,387,247	7.05%	X
2006	28,241,076	11.24%	X
2007	31,350,789	11.01%	X
2008	35,539,406	13.36%	X
2009	36,928,615	3.91%	X
2010	33,544,599	-9.16%	
2011	32,955,996	-1.75%	
2012	35,065,130	6.40%	X
2013	36,514,227	4.13%	X
2003 - 2013	15,131,693	70.77%	



The year over year change in FMD tenant service charges is greater than 2% in eight of the years reviewed. Factors contributing to the rates of increase greater than two percent in 2004 – 2009, 2012 and 2013 are described below.

2004

- COLA increase of 2.03% and Benefits rate increase of 19.18%.
- Rebate of \$1.4 million in 2003 results in a larger year over year increase in 2004.
- First full year of operations of the regional emergency operations building.
- Projected 5% increase in utility costs.
- Cost of six security positions is included in the rate model.

2005

- COLA increase of 2.19%.
- Rate surcharge to rebuild depleted fund balance.

2006

- COLA increase of 4.66% and Benefits rate increase of 5.03%.
- Additional staffing for Youth Service Center after hours security.
- Additional garage security escorts.
- Rate surcharge to rebuild depleted fund balance.

2007

- COLA increase of 2% and Benefits rate increase of 11.3%.
- Additional building services and security staffing for new Chinook building operations.
- Cedar Hills mothball costs.

2008

- COLA increase of 2.49% and Benefits rate increase of 4.48%.
- Additional building services staffing and O&M costs for new Chinook and Elections Earlington building operations.
- Utility costs.

2009

- COLA increase of 4.88% and Benefits rate increase of 2.54%.
- Annualization of Elections Earlington building O&M costs.

2012

- COLA increase of 1.63% and benefits rate increase of 8%.
- Fund balance draw down in the prior year results in a higher rate of increase in 2012 despite space consolidation.

2013

- COLA increase of 2.00% and benefits rate increase of 1.01%.
- Utility costs.
- Addition of funding to begin building a security equipment replacement reserve.

As the charts indicate FMD charges increased at a higher rate than the CPI-W + Population index in eight of the years reviewed. FMD charges also increased at a higher rate than total County revenues in eight of the years reviewed. The most significant cost driver for total building services O&M charges is the amount of square footage that the County maintains. During the time period observed the County opened three facilities and mothballed one. A truer picture of the trend in O&M costs can be seen in the relationship of costs to square footage maintained.

Year	Tenant O&M Charges	Square Footage	Average Rate PSF	% Change in Average PSF
2008	35,539,406	2,811,791	12.64	
2009	36,928,615	2,835,385	13.02	3.04%
2010	33,544,599	2,816,747	11.91	-8.56%
2011	32,955,996	2,809,652	11.73	-1.51%
2012	35,065,130	2,771,566	12.65	7.86%
2013	36,514,227	2,636,151	13.85	9.48%

It is observable from the chart above that while total square footage allocated in the model has declined over the past three years the cost per square foot has risen the past two years. Further analysis of the reasons for the increase in PSF costs and additional comparisons may be worthwhile. Some of the objectives of the space consolidation effort were to utilize space more effectively by co-locating functions and position the County to mothball or market facilities by freeing up contiguous space. These objectives were achieved, but reducing the amount of occupied square footage also creates a smaller base upon which fixed program costs can be recovered, putting upward pressure on PSF rates.

Recommendations and Timeline for Implementation

2014: During 2014 the FMD Internal Service fund balance has been depleted from a revision of the target fund balance to three percent (implemented via a reduction in budgeted revenue) coinciding with its transition to a biennial budget and insufficient billable work to completely cover the costs of the MPSI, Capital Project and Print Shop business lines. PSB staff have partnered to enhance reporting capabilities and business processes to more proactively monitor FMD billable services and implement strategies to ensure that both direct and indirect costs of billable staffing hours achieve full cost recovery.

2015/2016 Budget and Service Charges: Further analysis of burden rates charged by the division is warranted. Both the allocation methodology and the total costs will be reviewed to determine if changes to the allocation methodology are warranted and if cost reductions are practicable. Alternatives to ensure full cost recovery and build an appropriate fund balance will be explored. For example, if there is a lag between available project funding and billable work being performed that the ISF is required to accommodate, this would indicate that a cash flow reserve may be warranted.

Further review of the total cost of County space costs and trends, to include the costs of outside leases, major maintenance of buildings and debt service will be performed. This will provide a more complete picture of the County's cost of space.

Public Health – Seattle and King County

Summary

This section of the report provides information about central (County) and department overhead in the Public Health department. Overall, as a percentage of agency costs, overhead has remained relatively constant for the past decade. As illustrated in Figure 1, County overhead has measured approximately 3.5 percent, and departmental overhead about 5.5 percent of direct service (all expenditures excluding overhead).

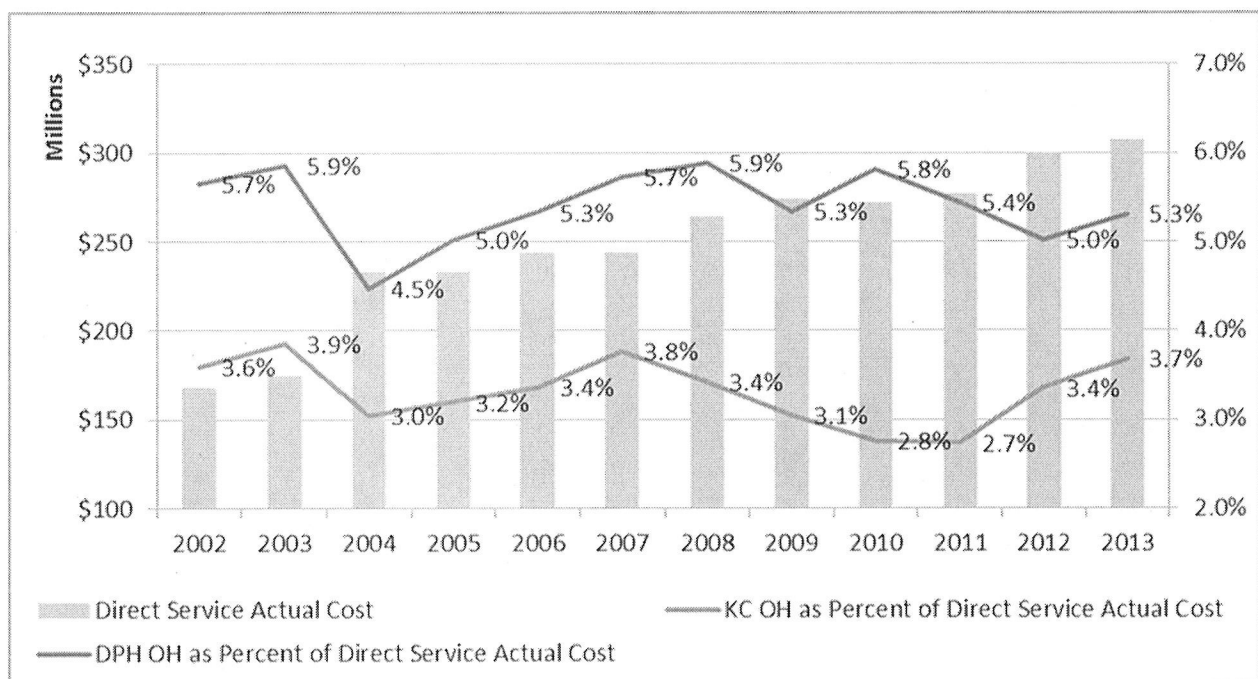


Figure 1 – County and DPH Overhead as a Percent of Direct Service: Over time, overhead has remained relatively constant as a percentage of direct service costs.

The remainder of this section describes the following:

- Allocation methodologies used to distribute overhead costs across the department;
- Description of County overhead services; and
- Description of services in five “clusters” of departmental overhead, with 10-year trend data.

Overhead Allocation Methodologies

There are three models by which overhead is distributed in King County: burdening (by salary and wages), direct distribution (by a measure other than salary and wage) and usage-based distribution. Public Health primarily uses burdening and direct distribution.

Direct distribution allows overhead costs to be more equitably distributed when the benefit of those overhead functions does not track salary and wage. For example, the costs of Financial Services are allocated by a measure of the number of financial system transactions performed for each program unit, rather than by salary and wages. The Finance and Business Operations Division (FBOD) certifies Public Health's indirect cost allocation plan (CAP) annually and reviews the agency-wide direct distributed allocations.

County Overhead

County overhead (central rates) pays for services provided to Public Health by County entities external to the department, such as the Prosecuting Attorney and Debt Service. Central rate levels and allocation models across King County appropriation units are determined by County leadership and the internal service fund agencies providing the services, and not by Public Health. This section, which focuses on Public Health, does not enumerate all of the different costs included in King County overhead.

Public Health primarily spreads these County overhead costs within its appropriation units using salary and wages.

As described and illustrated in Figure 1 above, County overhead charges to Public Health have remained relatively stable, at about 3 to 4 percent of Public Health direct service costs. This does not include King County Information Technology. Since IT shifted organizationally from a departmental-based service to an independent organization only in 2013, it is considered against its historical level in the department overhead cluster below.

Departmental Overhead

The next five sections describe categories of overhead service provided and allocated within the Public Health department:

- Information Technology;
- Procurement and Real Estate;
- Human Resources and Compliance;
- Administration and Planning; and
- Financial Services.

These costs are charted in actual dollars and as a percentage of departmental direct service costs over the past decade. These five clusters together make up the total departmental overhead costs, which comprise approximately 5.5% of departmental direct costs, as described in Figure 1.

Information Technology Cluster

This cluster of services supports the department's development and use of computing, telephony, mobile devices, and software. While information technology support shifted organizationally from PHSKC to the new department of King County Information Technology (KCIT) in 2013, this transition did not materially impact overall information technology spending.

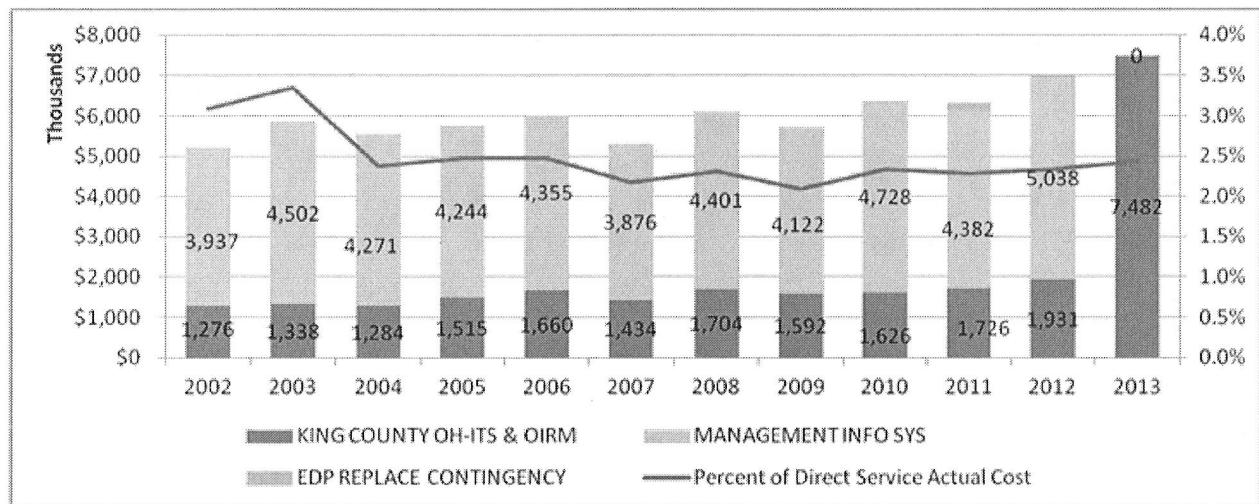


Figure 2: Public Health IT Costs: Information Technology costs have dropped slightly as a percentage of direct service costs.

This organizational shift manifests in Figure 2 as elimination of the "department" spending on information technology in 2013, replaced by county central rates. As technology matures, the overall cost of support as a percentage of direct program costs has declined from nearly 3.5% in 2003 to its current level of 2.4% in 2013.

Procurement and Real Estate Cluster

This cluster of services supports materiel management through the Public Health Distribution Center (a bulk ordering service which enables public health programs to save on supply costs, and that provides daily courier service of goods and laboratory specimens between sites), and the Contracting team which drafts contracts and manages Requests for Proposals on behalf of public health programs, ensures compliance with procurement policies, manages the department's fleet of vehicles, and allocates space among the department's programs and facilities.

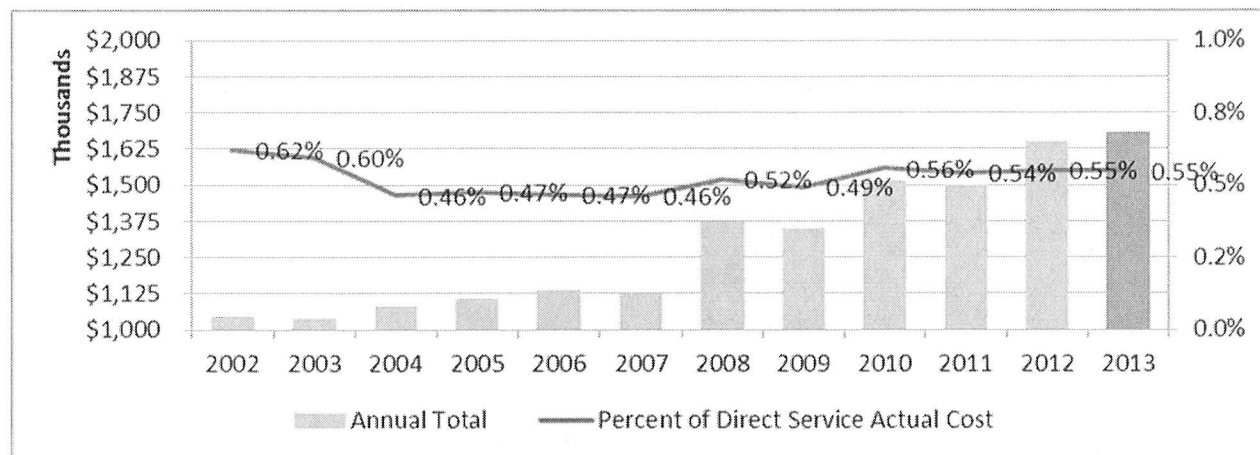


Figure 2: Procurement and Contracts comprise a steady and small (0.5%) portion of departmental costs.

There have been several strategic investments on this team in the last 10 years including:

- 2008: Acquisition and implementation of new contract management software;
- 2010: Centralization to a single point of contact in this team coordinating work with FMD, including asset maintenance and work tracking software application; and
- 2012: Centralized utility payments and work order processing

Despite these investments, the cost of operating this cluster has remained stable around one-half of one percent of direct service cost. Increased efficiency over time has enabled the addition of new services for minimal cost increases.

Human Resources and Compliance Cluster

This cluster ensures the department's compliance with myriad rules and regulations, from the Family and Medical Leave Act (FMLA) and the Health Insurance Portability and Accountability Act (HIPAA), to those policies and procedures surrounding recruitment and retention, and public records requests. This is the newest of the clusters (with the initiation of the Office of Business Standards and Accountabilities in 2005), and the cost data show its maturation from 2004 to 2008.

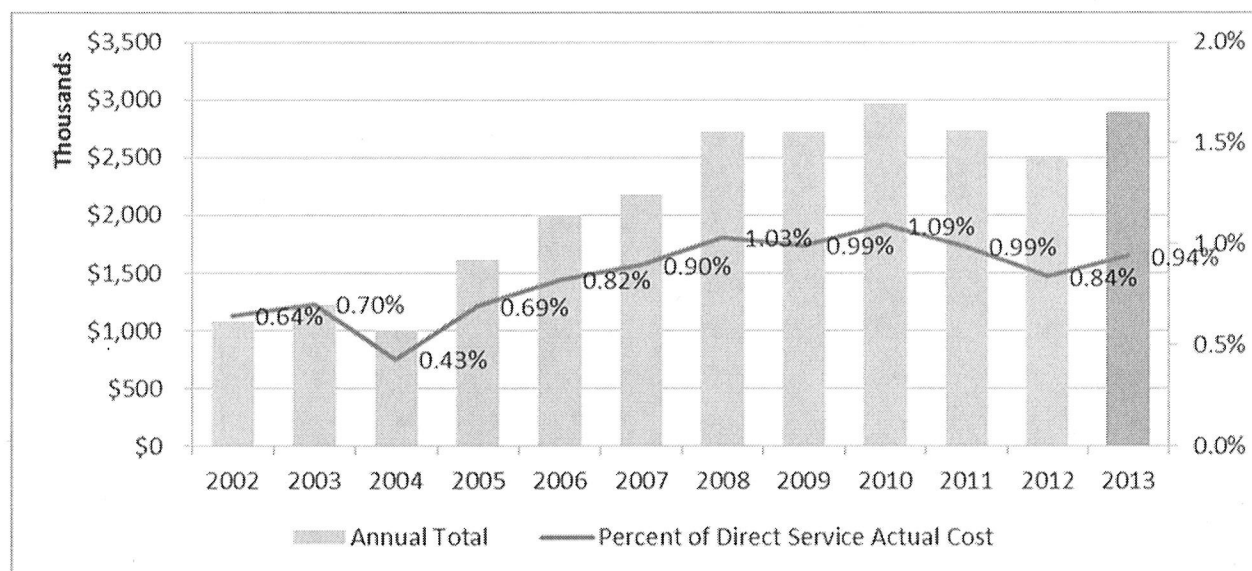


Figure 3: Human Resources and Compliance costs grew to accommodate compliance with the federal HIPAA regulations, and have since stabilized.

The cluster has been stable since 2008, with cost savings in recent years resulting from efficiency improvements from standardization of work.

Administration and Planning Cluster

The administration and planning cluster includes the Director and Health Officer's immediate office, and those operations which support communication of the department's strategic direction internally and externally. The department has diligently weighed investments, like creation of the Chief Administrative Officer in 2003, against the cost of this cluster to program areas. In recent years, costs as a percent of department size have declined and are presently near historic lows.

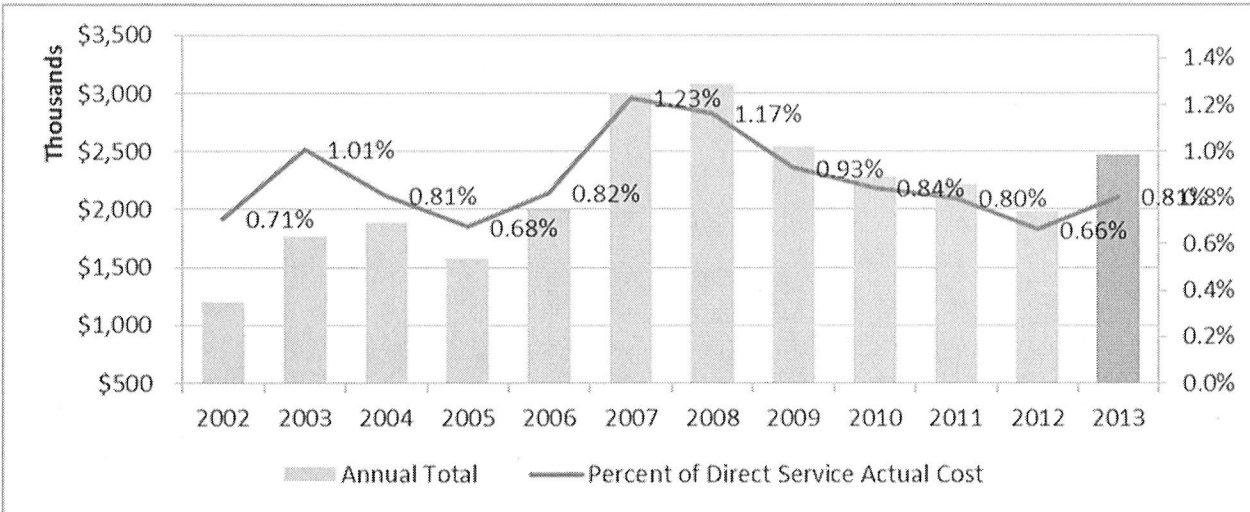


Figure 4: Administration and Planning costs have varied to support strategic investments to maintain service quality.

Finance and Business Cluster

This cluster provides accounting and business support through the Office of the Chief Financial Officer (CFO). Cost growth in 2004 related to the centralization of the Payroll function under the CFO.

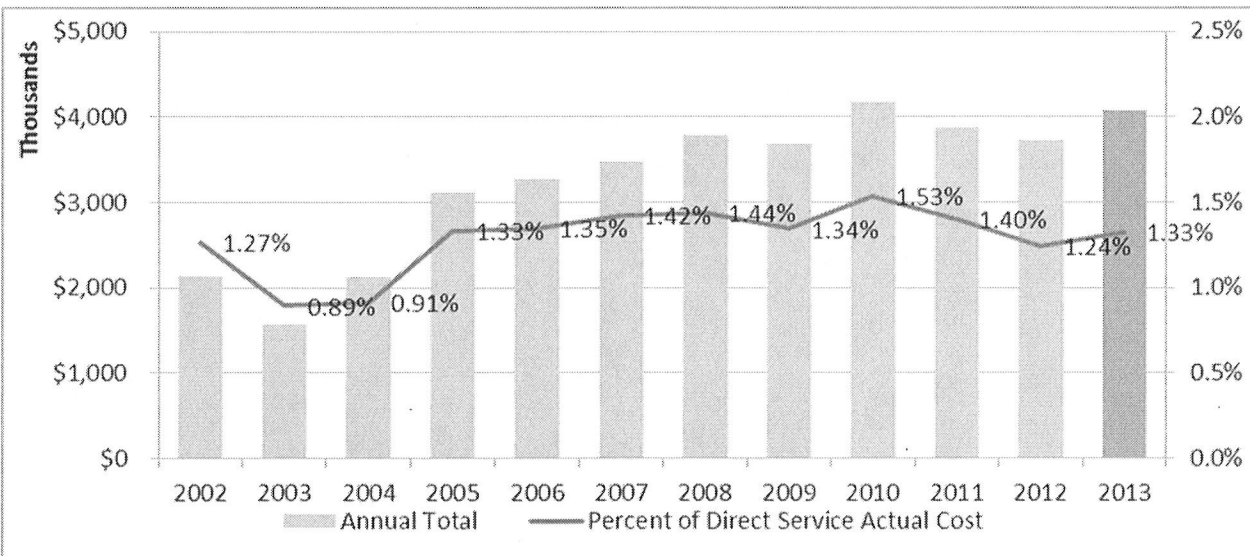


Figure 5: Finance and Business costs rose with centralization of the payroll function across the department, but have been relatively stable (between 1 and 1.5%) since then.

The increase in 2005 related to the transfer of a departmental function (Medicaid Administration oversight) from the Community Health Services division into this cluster as a department wide resource. Public Health created the CFO position in 2008.

Recommendations for Changes in Overhead Charge Methodology

Based on a 2013 audit recommendation, Public Health made one change in the Cost Allocation Plan (CAP) to better align service delivery with charges for services: the Consolidated Contract cost pool (approximately \$100K) was merged with Budget and Financial Planning.

Additionally, Public Health is working with FBOD and the Office of Performance, Strategy and Budget (PSB) to conduct an overall review and optimization of departmental financial management policies and practices. This work will include examining the mechanical bases of overhead allocation, i.e., how overhead charges are spread within the department and represented within the budget. This component of the financial management review and implementation will be prioritized for completion in 2014.

Appendix A – GFOA Best Practice Pricing Internal Services



BEST PRACTICE

Pricing Internal Services (Budget) (2013)

Background. Internal services are those responsibilities a government provides to support its own internal operations. Common examples of internal services include information technology, payroll, motor pool, budgeting, legal, accounting, and human resources. Certain management objectives are served by creating a system to assign prices for the use of these internal services, which are then assessed to the departments that use the services. However, there is a cost to develop and maintain internal pricing systems. Governments must weigh the benefits of an internal services costing system against the cost and complexity of system design choices. Please note that this best practice is intended to apply to internal service charges regardless of whether it is accounted for in an internal service fund or as a general fund overhead allocation.

Recommendation. GFOA recommends that governments follow these steps when considering an internal service pricing system: 1) Identify goals of internal service pricing; 2) Develop allocation strategy; 3) Define level of costing detail; 4) Determine cost of service; 5) Decide basis of allocation; and 6) consider potential drawbacks.

Identify goals of internal service pricing. As a first step, GFOA recommends that governments identify the goals they hope to achieve through a pricing system for internal services. The goals will guide the design of the system. Potential goals for a pricing system include:

1. *Govern demand for a service.* If the customers of an internal service are not charged based on their level of use they may have an incentive to over-use the service. Alternatively, charges may cause customers to limit their use of the service.
2. *Develop enterprise rate models.* Government enterprises (e.g., a water utility) may use services provided by the general government. A pricing system could provide an input into the rate model used to calculate fees for the customers of the enterprise.
3. *Calculate indirect cost reimbursement for grants.* Some grants may allow indirect costs to be reimbursed. An internal pricing system provides support for the reimbursement request.
4. *Provide input for full-costing model.* A full costing model provides the total cost of a given service, which enables better informed budgeting and planning. The “full cost” of a program is equal to the direct cost of program plus the indirect costs. Internal service pricing is essential to calculating indirect costs.
5. *Promote discussion about the value of the service provided.* Charging customer departments for use of a service will raise questions about the value received from the service and what the best service delivery model is (e.g., centralized, decentralized, outsourced, etc.). A pricing system can facilitate comparisons with alternative methods of service delivery, including outside providers.
6. *Examine value of a shared service model.* Shared services are thought to deliver greater efficiency through economies of scale. A solid pricing model is important for determining if a shared service model is delivering on this promise.
7. *Promote competition in service delivery.* Internal services could be run much like a private business, including service level agreements with customers and competition from outside providers (e.g., private firms). Accurate internal charges are essential for a level competitive field.¹
8. *Ability to customize service levels for different customers.* A detailed rate model makes it easier to provide a higher level of service to a customer that demands it because they can be charged a higher fee.

¹ However, it should be noted that comparing internal charges to a potential external service provider's proposed fee cannot be the basis for a sound outsourcing decision because the external provider's proposed cost must be compared to the internal costs the government will avoid (i.e., no longer have to incur) by using the external provider (known as “avoidable costs”). For example, there may be overhead costs included in an internal charge that will not be eliminated (avoided) by using an external provider.

Develop allocation strategy. After the goals have been identified, the organization must decide which internal services will be priced and allocated to user departments. To make this decision, it may be useful to differentiate between “market” services and those that have more of a policy or regulatory character.

1. *Market services* are those where the user departments play the role of consumer. Examples of market services include IT, fleet, and perhaps facilities.
 - a. The charges for market services have application to goals like promoting competition in service delivery, governing demand, and/or examining the value of a shared service model. Charging user departments for regulatory/policy services could be necessary for goals like developing a full costing system or calculating indirect cost reimbursement for grants.
2. *Policy or regulatory services* are used to establish organization-wide policies or ensure compliance with standards. Users of these services cannot be as easily described as “customers,” but more accurately as “regulated.” Examples of policy/regulatory services include budgeting, internal auditors, or a chief executive.

Define level of costing detail. Governments need to determine the level of detail associated with costing services.

1. A *low level* of detail might define internal services at the department level (e.g., finance department, IT department). A low level of detail might be sufficient for a costing system with limited goals, such as developing enterprise rate models or obtaining reimbursement for indirect costs under a grant.
2. A *high level* of detail would define services at the level of programs or other subunits (e.g., the various subdivisions of finance and IT cited earlier). A high level of detail might be needed for goals like governing the demand for service or promoting discussions about the value of a service.

In summary, a higher level of detail will lead to a more accurate costing system since the activities represented by the internal service categories will be more specified. However, more detail also leads to a more complex internal services pricing system. The government must decide if greater complexity (and its associated costs) will be worth the benefits.

Determine cost of service. With the internal services identified at either a high or low level of detail, the next step is to determine the cost of the service. The elements of the cost that should be considered include:

1. *Direct costs.* Direct costs are the most essential cost element. This includes the service’s personnel, materials, supplies, and contractors.
2. *Interest costs from internal loans.* If the internal service takes loans from other parts of the government then a market interest rate may be applied.²
3. *Services used from other support services.* A cost model can be designed such that the cost of the internal service reflects not only its direct costs, but also the indirect cost from other support services that it uses (e.g., an IT service uses payroll). This aspect of costing can be performed at varying levels of complexity – methods that fully reflect how each internal service uses the services of other internal providers can become much more complex than those that provide less precise estimates.³

Decide basis of allocation. With cost of the service decided, the bases for allocating costs from the internal service to customers must be decided. Table 1 provides examples of internal services and cost allocation bases. Below are general principles that should be observed when determining bases.

1. *Cause-and-effect relationship.* Costs should be allocated based on usage or causal factors relating to costs incurred by service provider. See Table 1 for examples of how cost bases for internal services can be related to the usage of various internal services.

² If used, the interest rate should be consistent with any governing laws/regulations.

³ For example, “single step allocations” are the least complex, but is less precise, while “reciprocal allocations” are more precise, but much more complex. For a complete explanation of these methods please consult: R. Gregory Michel. *Cost Analysis and Activity-Based Costing for Government*. (Chicago, Illinois: GFOA) 2004

2. **Benefit received.** The basis for allocation should bear a relationship to the benefit the customer receives from the service. For example, while “miles driven” might be a good barometer of the benefit that police patrol receives from its vehicles, “hours used” might be a better measure for public works.
3. **Fairness.** The method of cost allocation that will be used must be seen as fair and legitimate by the users of the costing system. The fee should be charged equitably based on use and other considerations.⁴ Users must understand how the costs are calculated and should have a role in determining how the price system will be structured.⁵
4. **Legal constraints.** State laws may place constraints on how charges are developed. For example, if the charge for providing a service exceeds the true cost of the service, it could be construed as a tax under the law. Also, federal regulations on grants may place limits on internal charges against grant programs.⁶

Table 1 – Examples of Internal Services Cost Allocation Bases

Internal Service	Allocation Basis
Payroll processing	Number of employees, number of checks
Budgeting	Labor hours, size of budget
Insurance	Number of employees, experience
Legal services	Direct labor hours
Office space / rent	Square feet of space occupied
Procurement services	Number of P.O.s, dollar volumes, direct labor
Vehicle costs	Miles driven, hours used
Information technology	Number of devices, server time, number of calls to help desk, direct labor hours

A government might also consider the accounting mechanism for the internal charge. An internal service fund provides the most detailed accounting, but also entails the most administrative effort. If the goals of the internal charge are modest (e.g., not charging back to federal grants, full cost recovery is not a goal), then it may be easier to simply recognize the charge as a general revenue in the general fund (or some other fund as may be appropriate to the circumstances).

Governments should also regularly review their internal charge rates against actual experience for appropriate adjustments. Governments should also develop guidelines to determine what will happen to excess funds should an internal charge generate cost recovery proceeds in excess of actual costs.

Consider potential drawbacks of internal costing systems. Finally, governments should be aware of the drawbacks of internal costing systems below and should consider mitigating strategies.

1. *Diminished trust between providers and customers.* A charge system could create a suspicion among customers about how charges are developed and/or administered, especially if the basis of the charges is not adequately communicated to customers.
2. *Subverting processes or not using shared services.* If customers perceive charges to be too high or unfair, they may respond by developing their own service capabilities. This can lead to duplication of resources and wasted effort.
3. *Acrimony and debate over the charge system.* Even if users do not subvert the system, a costing system that is viewed negatively by users could generate a great deal of debate and discussion – energy that could be better spent on other pursuits.
4. *Costs exceed the benefits of the system.* A precise internal costing system can be relatively complex. Complexity entails cost, such as training managers to use cost information. Whether this complexity and cost is worth it should be seriously considered in light of the goals for the system and system design choices.

⁴ For example, the customer may provide value back to the internal service in some way that justifies a lower charge.

⁵ IT governance systems are an example of a means for giving customer departments input into rate modeling decisions. See GFOA’s publication *IT Budgeting and Decision Making (2009)*

⁶ For example, the Federal Office of Management and Budget circular A-87 outlines standards for determining costs which can be charged to Federal grants and reimbursement contracts.

5. *Unmet expectations.* Managers can become frustrated with the system if they do not understand what it can and cannot accomplish. For example, if internal charges cause users to lower their consumption of a service they may see their per unit cost rise as the fixed cost of service is now allocated over a lower volume.

Approved by the GFOA's Executive Board, February, 2013.

Appendix B – Revenue, Population and Consumer Price Index Table

Year	King County Revenue ¹	Revenue % Change	King County Population Estimate ²	Population % Change	CPI - W Seattle ³	CPI - W Seattle % Change	CPI - W + Population
2003	2,053,249,421		1,779,300		186.7		
2004	2,158,784,991	5.14%	1,788,300	0.51%	189.6	1.55%	2.06%
2005	2,228,435,000	3.23%	1,808,300	1.12%	195.3	3.01%	4.12%
2006	2,433,227,000	9.19%	1,835,300	1.49%	202.6	3.74%	5.23%
2007	2,607,651,000	7.17%	1,861,300	1.42%	210.3	3.80%	5.22%
2008	2,800,266,000	7.39%	1,884,200	1.23%	219.7	4.47%	5.70%
2009	2,861,126,000	2.17%	1,909,300	1.33%	220.7	0.46%	1.79%
2010	2,850,367,000	-0.38%	1,931,249	1.15%	222.4	0.77%	1.92%
2011	2,943,549,000	3.27%	1,942,600	0.59%	229.4	3.15%	3.74%
2012	3,088,039,000	4.91%	1,957,000	0.74%	235.3	2.57%	3.31%
2013	3,187,180,000	3.21%	1,981,900	1.27%	238.1	1.19%	2.46%

1. Revenue as reported in the King County Comprehensive Annual Financial Report, Total Governmental Fund Revenue & Enterprise Fund Operating and Non-Operating Revenue.

2. Population estimates from the Washington State Office of Financial Management.

3. CPI - W Annual Data, Seattle-Tacoma-Bremerton, US Bureau of Labor Statistics.

