July 30, 2012

TO: City Council Members
    City Department Heads

FROM: Larry Kwarsick, Mayor

SUBJECT: Cost Allocation Program

We are currently soliciting for professional services to develop a Cost Allocation Plan (CAP). The purpose of the CAP is to provide a reasonable and consistent method to allocate indirect costs to direct operations and to ensure full cost recovery for services supported by the general and special revenue funds. The benefit of hiring a consultant is to ensure the CAP will meet the State Auditor’s Office requirements. The CAP must be developed from consistent, readily available data that could be updated by the city on an ongoing basis. Under RCW 43.09.210, city officials may charge a portion of the costs for their central overhead services to city utility funds but only to the extent that each utility benefits from those services.

The controlling State law is RCW 43.09.210:

All service rendered by, or property transferred from, one department, public improvement, undertaking, institution, or public service industry to another, shall be paid for at its true and full value by the department, public improvement, undertaking, institution, or public service industry receiving the same, and no department, public improvement, undertaking, institution, or public service industry shall benefit in any financial manner whatever by an appropriation or fund made for the support of another.

The RCW does not specifically address how "full value" is to be determined.

The General Fund is supported largely by sales tax and property tax, both of which are typically subject to voter-approved caps. When costs go up, tax rates don’t. These two types of revenue sources may support any city fund or operation, including the utilities and their share of city-wide overhead costs.

City utilities charge user fees based on the cost of maintaining, operating, and upgrading the utilities, and deposit those fees into utility operating accounts. Utilities are supported by these user fees. When costs go up, utilities must charge customers more to cover those costs.

The allocation of utility funds to the General Fund must demonstrate that the benefit is commensurate with the amount charged. Completion of the CAP and adoption of the CAP by the Council is a critical component of developing the 2013 budget.