

**CITY OF SEBASTOPOL CITY COUNCIL
 AGENDA ITEM REPORT FOR MEETING OF: May 5, 2026**

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To: Honorable Mayor and City Councilmembers
From: Ana Kwong, Administrative Services Director
Responsible Department: Administrative Services
Subject: Cost Allocation Plan Options for FY 2026-27

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RECOMMENDATION:

That the City Council review, discuss and provide direction to staff on the selection of the preferred Cost Allocation Plan implementation, which will establish the cost allocation framework and resulting interfund charges for FY 2026–27 City Budget.

Process for Implementation:

1. Select one of the cost allocation options presented.
2. Apply an annual Consumer Price Index (CPI)–based inflationary adjustment for subsequent fiscal years.
3. Conduct a comprehensive Cost Allocation Plan study every three to five years to reassess the methodology and underlying assumptions.

PROCESS OF AGENDA ITEM:

- a. Presentation of the agenda item by the Administrative Services Director
- b. Introduction of Consultant
- c. Questions and Discussion from Councilmembers
- d. Public Comment Period
- e. Council Deliberation and Motion

EXECUTIVE SUMMARY:

This report proposes for consideration the City’s cost allocation plan methodology used for allocating indirect costs, which sets the interfund charge for services budgeted in the utility enterprise funds. The City has been using the current cost plan allocation methodology for two years and the methodology utilized is “full cost” recovery. Full cost recovery is the policy of recovering all expenses incurred—both direct and indirect (overhead)—whenever a department provides goods or services to others. It requires capturing all costs attributable to an activity, including central service costs, to ensure sustainability.

Since the last update to the cost allocation plan, there has been discussion about whether modifications to the plan should be considered. City staff have received input from community members and the Enterprise Fund Oversight Committee on the current method of cost allocation and whether the changes to the existing full cost recovery method could increase accuracy. In response, staff worked with the consultant to review the methodology and develop several options for consideration.

BACKGROUND

The purpose of the City’s Cost Allocation Plan is to identify the total costs of providing specific City services. Why is a separate cost accounting analysis required to do this? Because in almost all organizations—whether in the private or the public sector—the cost of producing goods or delivering services can be classified into two basic categories: direct and indirect costs.

“Direct costs” by their nature are usually easy to identify and relate to a specific service; such as supplies, materials, staff salaries and benefits, or consultant fees that support a single department or project. However, this is not the case for “indirect costs.” Indirect costs, commonly referred to as "overhead costs" or central services, are for support services that are shared by multiple departments, such as accounting, payroll, administration, human resource; legal

fees, information technology (IT) services for the entire municipality; or operating and maintenance costs for city hall or other buildings shared by multiple departments. As such, if we want to know the “total cost” of providing a specific service, then we need to develop an approach—a plan—for reasonably allocating indirect costs to direct cost programs. Although indirect costs are generally not readily identifiable with direct cost programs, their cost should be included if we want to know the total cost of delivering specific services.

The City’s Water and Wastewater utilities rely on a variety of administrative and support services that are provided through the General Fund (Fund 100). These services include functions such as financial management, human resources, legal services, information technology, and overall management and oversight.

Because these services support the operation of the utilities, a portion of their cost is allocated to the Water Fund (Fund 500) and Wastewater Fund (Fund 510). These allocations are recorded as Interfund Charges – Cost Plan (Account 4998).

In simple terms, this means the Water and Wastewater funds reimburse the General Fund for the support services they receive. This accounting practice helps ensure that each fund pays its fair share of City services and that the General Fund—supported primarily by taxes—is not covering costs that are associated with operating the utilities.

The current cost allocations are based on a comprehensive Indirect Cost Allocation Plan developed during FY 2023-24, reviewed and approved by City Council on February 20, 2024, and published on the City’s website with other key documents.¹

During the development of FY 2025-26 budget, the City engaged ClearSource Financial Consulting, who prepared the previous comprehensive plan, to conduct an update to the analysis for use in budget development for FY 2025-26.

It is important to stress that the goal of the Cost Allocation Plan is a reasonable allocation of indirect costs, not a “perfect” one. This approach is consistent with the requirements of Proposition 218 and 26, which allows rate revenue to be paid to cover the reasonable estimated cost of services provided by the General Fund. There is no one correct way to allocate costs, and different agencies use different approaches. By their very nature, indirect costs are difficult to link with direct costs. As such, in developing an allocation approach, it is important to keep this goal in mind as we balance the cost and of effort of complicated allocation methods with the likely benefits from the end results.

The Indirect Cost Allocation Plan is solely focused on recovery of central support costs, commonly referred to as overhead. The Indirect Cost Allocation Plan does not replace additional decisions the City makes in developing its annual budget, which includes direct allocation of shared expenses, such as certain direct labor positions, materials, services, and supplies.

The City provides many shared support services—such as accounting, payroll, billing, Information Technology, and human resources—that benefit all departments. Instead of charging these costs randomly, the City uses a cost allocation plan to divide them fairly and logically among the departments that use them.

An explanation of how the current allocations are calculated are listed below for the current cost allocation plan methodology:

How the Allocation Works:

Step 1 — Determine the “Cost Pools” – Example: The Administrative Services’ total budget less any direct services (such as Business Licenses) becomes a cost pool — a bucket of money that needs to be divided fairly.

¹ <https://www.cityofsebastopol.gov/your-government/key-documents/>

Step 2 — Decide How to Split or Allocate each Cost Pool - To divide the cost fairly, the plan uses a logical and measurable factor for each Cost Pool. Example: For the Administrative Services Department, the Cost Pools and their corresponding Allocation Factors are:

Cost Pool	How It Is Shared (Allocation Factor)
Citywide Accounting	Net Operating Expense
Utility Billing & Support	Number of utility accounts
Payroll	Amount of staff time
Accounts Payable	Services and supplies spending
Accounts Receivable	Amount of revenue collected
IT Management	Number of employees
Human Resources	Amount of staff time

EXAMPLE:

→ Net Operating Expenses

This is simply each department’s operating budget (minus items such as debt, capital, and transfers). The idea is that departments with larger or more complex operations use more finance time, so they should pay a larger share. This method is standard across many agencies.

Step 3 — Apply the Formula

Here’s what happens behind the scenes using Net Operating Expenses as an example.

1. We calculate what percentage of Citywide Net Operating Expenses each department represents.
2. We multiply that percentage by the Administrative Services cost pool.
3. That number becomes the department’s allocated “share.”

Example: Based on allocable cost pool of Administrative Services budget of \$1,411,268

If Water represents 10% of Citywide operating expenses, then Water would receive 10% of the Finance cost.

This is what you see in the allocation worksheets. For example:

- Water receives \$48,834 (1st allocation) and \$5,716 (2nd allocation) for a total of \$54,550.
- Sewer receives \$84,128 (1st allocation) and \$9,846 (2nd allocation) for a total of \$93,974.

Why There Are Two Steps (First and Second Allocation)

First Allocation:

The Administrative Services Department provides services to all operating departments. Therefore, the Administrative Services cost is allocated broadly to all departments.

Second Allocation:

Central service departments (City Manager, Finance, City Clerk, etc.) don’t keep those costs—they pass them through to the final end users.

For example:

- Finance receives part of the City Manager cost.
- But since Finance also supports all departments, that portion is redistributed (“second allocation”) to the final service departments such as Planning, Building, Police, Water, Sewer, etc.

This ensures no central service department ends up “holding” overhead that should be passed along. For additional contexts, please refer to the attachment titled *Finance Allocable Expense*.

DISCUSSION:

On September 15, 2025, ClearSource attended a Budget Committee meeting to provide an overview of potential revisions to the City's Cost Allocation Plan (CAP) methodology. Staff and ClearSource presented a conceptual proposal to transition from the City's current full-cost allocation approach to a methodology based on federal cost principles. Federal cost principles are federal regulations (primarily 2 CFR Part 200/Uniform Guidance) that establish standards for determining allowable, reasonable, and allocable costs when charging grant funds. They ensure costs are necessary for performance, consistent with policies, and apportioned based on benefits received, preventing overcharging. This proposed change would exclude certain overhead and indirect costs that are currently allocated across City funds and, if implemented, could result in a material fiscal impact to the General Fund.

During the discussion, Councilmember Phill Carter (Budget Committee Member) raised concerns regarding the potential magnitude of the annual impact to the General Fund and recommended that any methodology changes, if pursued, be implemented gradually through a phased approach. ClearSource clarified that the proposed methodology would rely on actual prior-year expenditures rather than adopted budget figures, which could affect both the timing and scale of financial impacts.

Following discussion, the Budget Committee agreed that no further analysis should move forward until the City's existing Cost Allocation Plan was reviewed in detail. The Budget Committee further recommended that this item be postponed to allow for additional review and policy discussion prior to Council consideration.

Subsequently, the Enterprise Fund Oversight Committee (EFOC) was formed and held its first meeting in January 2026. A list of the Committee's duties is listed below for information:

Duties. The Committee shall act in an advisory capacity to the City Council and no express authority or power to act on behalf of the City is hereby delegated. To carry out its stated purpose, the Committee shall perform the following duties:

- a) **Reviewing Annual Budgets and Financial Reports:** The Committee will analyze the financial health of the Enterprise Funds, ensuring that budgets and financial statements reflect accurate and sustainable practices.
- b) **Analyzing Rate Studies and Rate Adjustment Proposals:** The Committee will evaluate proposed rate changes, including providing recommendations on cost allocation methods to ensure fairness and financial viability.
- c) **Evaluating Long-Term Financial Planning and Capital Improvement Needs:** The Committee will assess capital improvement plans (CIP), master plans, and long-term financial forecasts related to Enterprise Fund operations, ensuring that projects are properly prioritized and funded and that master planning efforts align with Enterprise Fund financial sustainability.
- d) **Engage with the public and other stakeholders** to ensure that the community's interest and concerns are reflected in the Committee's recommendations.
- e) **Such other duties as assigned by the City Council.**
- f) **Shall submit an annual report to the Council in early June before the next fiscal year budget is adopted.**

The Budget Committee and Enterprise Fund Oversight Committee conducted meetings to discuss the proposed cost allocation plan. The table below was presented at these public meetings. is listed below. Additional information can be found at the following links: https://www.cityofsebastopol.gov/boards-commissions-committees/budget-committee/?dpt=&search_month=3&search_year=2026

Assumption / Variable in Plan Iteration	Cost Allocation Plan Iteration			Alternative Paths		
	Current for FY2025-26	Scenario A for FY 2026-27	Scenario B for FY 2026-27	Scenario 1 for FY 2026-27	Scenario 2 for FY 2026-27	Scenario 3 for FY 2026-27
Fiscal Year Basis for Allocated Expenditures	FY 2024-25 Budget	FY 2024-25 Actual	FY 2024-25 Actual	Inflation over FY 2024-25 Budget-Based CAP	Inflation over FY 2024-25 Budget-Based CAP	Inflation over FY 2024-25 Budget-Based CAP
Inclusion of City Attorney as an Allocated Cost Pool	Yes	No	No	Yes	No	No
Inclusion of City Council as an Allocated Cost Pool	Yes	Yes	No	Yes	Yes	No
Exclusions of Costs Based on Federal Cost Claiming Principles	No	No	Yes	No	No	No

The following options have been developed for discussion. Each option represents a different approach to applying or revising the Cost Allocation Plan for FY 2026–27. It’s important to note that the City’s Cost Allocation Plan was developed through a structured and established process. The current methodology was informed by interviews with City staff, reflects operational responsibilities, and was based on widely recognized industry standards for municipal cost allocation.

The Cost Allocation Plan, consistent with standard practice, incorporates reasonable estimates and defined assumptions and is developed through a systematic approach to ensure appropriate allocation of shared costs across funds. The City remains committed to providing clear, factual information to support transparency and understanding of the Cost Allocation Plan and its methodology.

Following is a table showing an overall resulting interfund charges on the water and wastewater utilities and impact to the General Fund for each of the options:

Assumption / Variable in Plan Iteration		Interfund Charge for FY 2026-27		
		Water	Wastewater	Impact to General Fund
0	Budgeted Charge in FY 2025-26 Based on CAP Use of Budgeted Expenditures	\$ 845,358	\$ 950,965	\$ -
1	Inflation-Adjusted Charge in FY 2026-27 Based on Current Year CAP Outcomes "Status Quo"	\$ 866,492	\$ 974,739	\$ 44,908
2	Inflation-Adjusted Charge in FY 2026-27 Based on Current Year CAP Outcomes "Excluding City Attorney"	\$ 773,874	\$ 828,478	\$ (193,971)
3	Inflation-Adjusted Charge in FY 2026-27 Based on Current Year CAP Outcomes "Excluding City Attorney & City Council"	\$ 722,058	\$ 771,232	\$ (303,033)
A	CAP-Based Charge in FY 2026-27 Use of Prior Year Actual Expenditures Excluding City Attorney	\$ 770,772	\$ 816,504	\$ (209,047)
B	CAP-Based Charge in FY 2026-27 Use of Prior Year Actual Expenditures Excluding City Attorney & Other Items Not Allowed in Federal Cost Claiming	\$ 717,187	\$ 755,874	\$ (323,262)

To further break down the impact with each option for the City Council’s consideration:

Option 1:

Use the prior year’s Cost Allocation Plan, apply a 2.5% inflationary adjustment, and carry the adjusted allocations forward to FY 2026–27. The result of this adjustment will yield this outcome.

Assumption / Variable in Plan Iteration		Interfund Charge for FY 2026-27		
		Water	Wastewater	Impact to General Fund
0	Budgeted Charge in FY 2025-26 Based on CAP Use of Budgeted Expenditures	\$ 845,358	\$ 950,965	\$ -
1	Inflation-Adjusted Charge in FY 2026-27 Based on Current Year CAP Outcomes "Status Quo"	\$ 866,492	\$ 974,739	\$ 44,908

Option 2:

Same as Option 1, but excluding City Attorney costs from the general allocation methodology. Identifiable City Attorney costs would be directly allocated to the enterprise funds. The result of this adjustment will yield this outcome.

Assumption / Variable in Plan Iteration		Interfund Charge for FY 2026-27		
		Water	Wastewater	Impact to General Fund
0	Budgeted Charge in FY 2025-26 Based on CAP Use of Budgeted Expenditures	\$ 845,358	\$ 950,965	\$ -
2	Inflation-Adjusted Charge in FY 2026-27 Based on Current Year CAP Outcomes "Excluding City Attorney"	\$ 773,874	\$ 828,478	\$ (193,971)

Option 3:

Same as Option 1, but excluding both City Attorney costs (with identifiable costs directly allocated to the enterprise funds) and City Council costs from the allocation methodology.

Assumption / Variable in Plan Iteration		Interfund Charge for FY 2026-27		
		Water	Wastewater	Impact to General Fund
0	Budgeted Charge in FY 2025-26 Based on CAP Use of Budgeted Expenditures	\$ 845,358	\$ 950,965	\$ -
3	Inflation-Adjusted Charge in FY 2026-27 Based on Current Year CAP Outcomes "Excluding City Attorney & City Council"	\$ 722,058	\$ 771,232	\$ (303,033)

Scenario A:

Recalculate the Cost Allocation Plan using actual FY 2024–25 expenditures to calculate FY 2026–27 allocations, excluding City Attorney costs, with identifiable costs allocated directly to the enterprise funds.

Assumption / Variable in Plan Iteration		Interfund Charge for FY 2026-27		
		Water	Wastewater	Impact to General Fund
0	Budgeted Charge in FY 2025-26 Based on CAP			
	Use of Budgeted Expenditures	\$ 845,358	\$ 950,965	\$ -
A	CAP-Based Charge in FY 2026-27			
	Use of Prior Year Actual Expenditures Excluding City Attorney	\$ 770,772	\$ 816,504	\$ (209,047)

Scenario B:

Recalculate the Cost Allocation Plan using actual FY 2024–25 expenditures, excluding City Attorney costs (allocated directly to the enterprise funds) and excluding any costs that are not allowable under federal cost principles, such as governmental oversight, travel, and similar non-allowable expenditures.

Assumption / Variable in Plan Iteration		Interfund Charge for FY 2026-27		
		Water	Wastewater	Impact to General Fund
0	Budgeted Charge in FY 2025-26 Based on CAP			
	Use of Budgeted Expenditures	\$ 845,358	\$ 950,965	\$ -
B	CAP-Based Charge in FY 2026-27			
	Use of Prior Year Actual Expenditures Excluding City Attorney & Other Items Not Allowed in Federal Cost Claiming	\$ 717,187	\$ 755,874	\$ (323,262)

Note: The impact to the general fund for Options 1-3 and Scenario A & B are before any City Attorney direct charges are accounted for. The impact will be decreased by the amount of the direct charges.

As reflected in the five options presented above, Scenario B results in the greatest reduction when compared to the other alternatives. This option is based on an iteration of the Cost Allocation Plan based on prior year actual expenditures rather than budgeted amounts, providing a more accurate reflection of costs incurred.

One additional option, which falls outside the consultant’s current scope of work, would involve departments tracking staff time in greater detail and using that information as the basis for directly charging certain salary and benefit costs to the Enterprise Funds. Some departments began time tracking in mid-February, and the data collected may reasonably be used to support allocation of payroll-related expenses from the General Fund to the Enterprise Funds. A similar approach could also be applied to certain contracted services where costs can be clearly attributed.

While direct charging may increase transparency for specific costs, it does not eliminate the use of estimates. In practice, staff time allocations, salary and benefit charges, and related costs are typically based on proportional assumptions even when detailed time-tracking systems are in place. In addition, many supporting infrastructure and overhead costs—such as information technology, facilities, utilities, administrative support, building maintenance, office supplies, equipment rental, and telecommunications—cannot be directly measured and would continue to require allocation using reasonable assumptions.

Implementing a broader direct-charge model would require increased time tracking, data collection, and administrative effort across departments. As a result, this approach represents a policy and operational consideration that would require separate City Council direction if pursued.

In parallel, the City consulted with two neighboring agencies of similar size to Sebastopol—Cotati and Cloverdale—to better understand their respective approaches to cost allocation. A summary of their methodologies is provided in the

attached materials. The City’s consultant has offered a professional opinion that adopting another agency’s precise methodology is not recommended, as cost allocation practices are not one-size-fits-all and approaches effective for one agency may not be appropriate for another agency. These cities are simply presented as examples of alternative approaches.

For all options under consideration, future annual updates may be implemented by applying a Consumer Price Index (CPI)–based inflationary adjustment to provide a streamlined and sustainable approach for ongoing updates. For example, if the combined Water and Sewer interfund charge for FY 2026–27 is \$1,500,000 and a 3 percent inflation factor is applied based on the San Francisco–Oakland–Hayward–San Jose CPI, the adjusted total would be \$1,545,000 in FY27-28 and the split evenly, \$772,500 would be allocated to the Water Fund and \$772,500 to the Sewer Fund.

The Cost Allocation Plan has been the subject of extensive review and discussion over an extended period, and updating it yearly is not in the best practice for cities and is not operationally or fiscally sustainable. Applying an inflation factor in subsequent years between periodic comprehensive Cost Allocation Plan studies would provide predictability and stability in financial planning, allow staff to redirect time and resources to other critical operational priorities, and maintain consistency in cost recovery. It is a best practice to complete a comprehensive Cost Allocation Plan update at least every five years.

STAFF ANALYSIS:

Staff is recommending that the Council move forward with Option A (Scenario A) with CPI Based Inflation Adjustment. Under this option, the City would adopt Option A, as developed and presented by the consultant, which applies a full cost allocation methodology using standardized allocation factors consistent with industry practices. The plan would be adjusted using a 2.5% inflation factor based on the Consumer Price Index (CPI) to maintain alignment with changing cost levels. Legal fees related to the water and wastewater matters would be directly charged to the Enterprise Funds estimated to be \$50,000 annually to be divided equally between water and wastewater.

BUDGET COMMITTEE REVIEW & ENTERPRISE FUND OVERSIGHT COMMITTEE REVIEW:

The joint meeting of the Budget Committee and the Enterprise Fund Oversight Committee was held on March 30, 2026, during which the committees reviewed the cost allocation plan outcomes presented by ClearSource. The committees requested a recommendation from the consultant, and based on the feedback received and the results of the refreshed cost allocation plan, ClearSource recommended—and staff concurred—that Scenario A be used with a 2.5% inflation factor based on CPI as a placeholder. This approach allows the FY 2026–27 budget development process to continue moving forward.

Subsequently, the Enterprise Fund Oversight Committee met on April 28, 2026, and reaffirmed support for Scenario A; with one member present in opposition. Committee members voting in favor included Chair Phill Carter, Vice Chair Greg Dabel, and Committee Member Oliver Mark; Committee Member Kate Haug opposed, and Committee Member Mary Meihaus was absent.

CITY COUNCIL GOALS/PRIORITIES/ AND OR GENERAL PLAN CONSISTENCY:

This agenda item represents the City Council goals/priorities as follows:

Goal 4 – High Performance Organization

Achieving staffing/ Program targets that match best standards and efficiency/operational staffing efficiencies/baseline budgets/performance management

This agenda item represents the City Council General Plan Consistency (if applicable):

N/A

FISCAL IMPACT:

In the currently adopted budget, \$6,000 has been set aside for the routine annual update of the City’s Cost Allocation Plan (CAP). Dependent upon the methodology chosen, there will be impacts to the General Fund compared to the status quo.

COMMUNITY OUTREACH:

This item has been noticed in accordance with the Ralph M. Brown Act and was available for public viewing and review at least 72 hours prior to schedule meeting date. The City has also used social media to promote and advertise the City Council Meeting Agenda Items.

As of the writing of this agenda item report, the City has not received any public comment. However, if staff receives public comment from interested parties following the publication and distribution of this agenda item report, such comments will be provided to the City Council as supplemental materials before or at the meeting.

RESTATED RECOMMENDATION:

That the City Council review and choose how city costs are shared across programs and services for FY 2026–27. It is recommended that the Council:

1. Pick one of the cost allocation options presented.
2. Adjust costs each year for inflation using the Consumer Price Index (CPI).
3. Every three to five years, do a full review to make sure the method is still accurate and fair.

CITY COUNCIL OPTION(S):

That the Council select the following option:

Option 1 – Adopt Option A (Scenario A) with CPI-Based Inflation Adjustment (*Recommended*)

Under this option, the City would adopt Option A, as developed and presented by the consultant, which applies a full cost allocation methodology using standardized allocation factors consistent with industry practices. The plan would be adjusted using a 2.5% inflation factor based on the Consumer Price Index (CPI) to maintain alignment with changing cost levels. Legal fees related to the water and wastewater matters would be directly charged to the Enterprise Funds estimated to be \$50,000 annually to be divided equally between water and wastewater.

Option 2 – Select one of the remaining four options identified in the table below

Assumption / Variable in Plan Iteration		Interfund Charge for FY 2026-27		
		Water	Wastewater	Impact to General Fund
0	Budgeted Charge in FY 2025-26 Based on CAP Use of Budgeted Expenditures	\$ 845,358	\$ 950,965	\$ -
1	Inflation-Adjusted Charge in FY 2026-27 Based on Current Year CAP Outcomes "Status Quo"	\$ 866,492	\$ 974,739	\$ 44,908
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B	CAP-Based Charge in FY 2026-27 Use of Prior Year Actual Expenditures Excluding City Attorney & Other Items Not Allowed in Federal Cost Claiming	\$ 717,187	\$ 755,874	\$ (323,262)

ATTACHMENTS:

Indirect Cost Allocation Plan Presentation

Administrative Services Department – Finance Allocable Expense
Cost Allocation Plan Methodology Used by Neighboring Agencies (Cotati and Cloverdale)

APPROVALS:

Department Head Responsible for Agenda Item: Approval Date: 3/6/26
CEQA Determination (Community Development/Planning): Approval Date: N/A
The action is not a project under the California Environmental Quality Act (CEQA).
Administrative Services (Financial): Approval Date: N/A
Costs authorized in City Approved Budget: Yes No N/A
Account Code: 100-14-01-4210-000-000000-000 \$6,000

City Attorney Approval Approval Date: 4/29/26
City Manager Approval: Approval Date: 4/29/26

CITY OF SEBASTOPOL

Indirect Cost Allocation Plan to Inform Budget FY 2026-27

Executive Summary | Prepared for Committee March 30, 2026

WORKING DRAFT AS OF 3/17/2026



PRIMARY OUTCOME OF THIS COST ALLOCATION PLAN

- An **interfund charge for service** (4998 Interfund Charges – Cost Plan) assessed on certain enterprise funds to reimburse the General Fund for central oversight, management, and support services
- Updates the Indirect Cost Allocation Plan developed in 2024 and updated in 2025, which replaced an allocation methodology previously established in 2001
- Outcomes presented here should inform budget development for next Fiscal Year 2026-27
- Specific direction was provided by the City to evaluate the impacts of alternative allocated cost pools, all of which result in **decreased cost recovery to the General Fund in varying amounts**, caused by reduced allocable costs serving as the basis for interfund charges

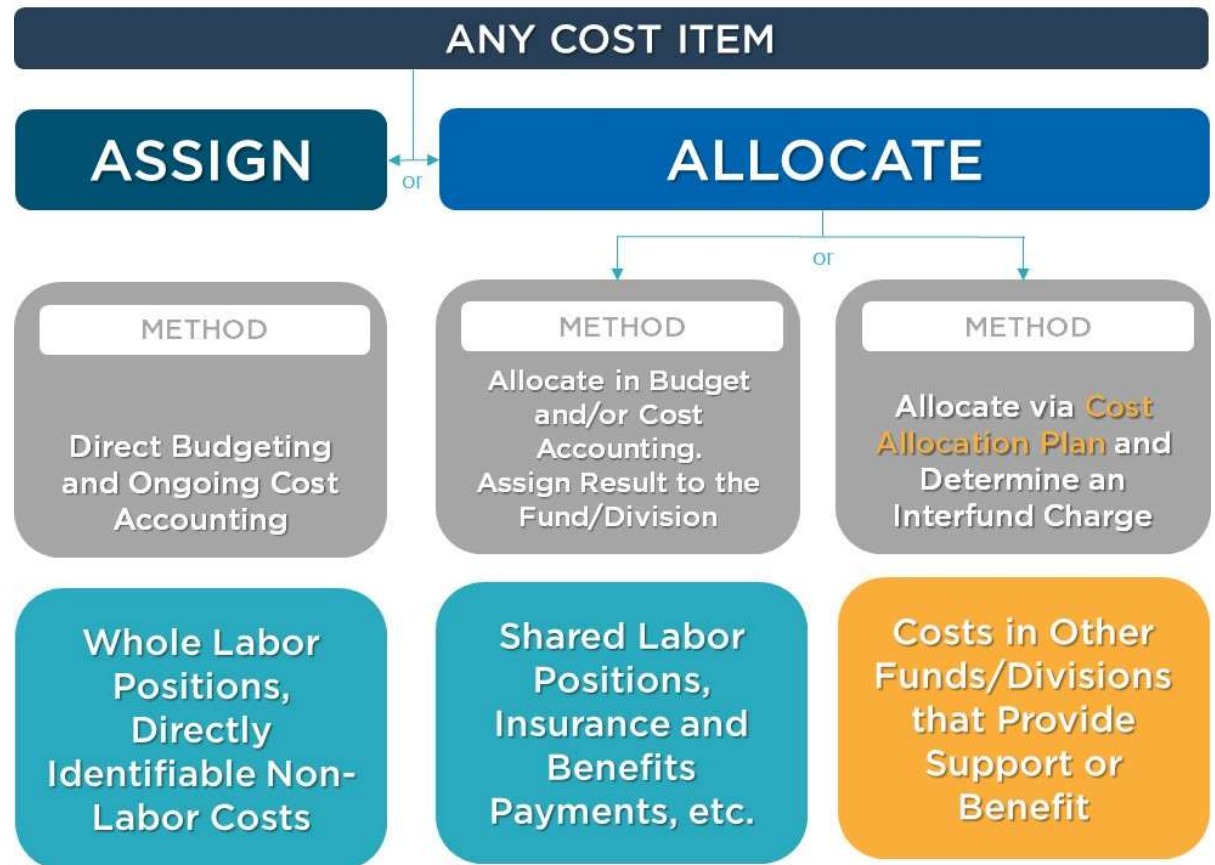


Orientation to the Cost Allocation Plan



HOW DO COSTS GET TO A FUND AND/OR DIVISION?

- **Directly assigned** through budgeting and ongoing cost accounting
- **Allocated** through budgeting and/or cost accounting or through a **cost allocation plan (CAP)**



SCENARIO ATTRIBUTES IN THE CAP

Assumption / Variable in Plan Iteration	Cost Allocation Plan Iteration		
	Prior for FY 2025-26	Scenario A for FY 2026-27	Scenario B for FY 2026-27
Fiscal Year Basis for Allocated Expenditures	FY 2024-25 Budget	FY 2024-25 Actual	FY 2024-25 Actual
Inclusion of City Attorney as an Allocated Cost Pool	Yes	No	No
Exclusions of Costs Based on Federal Cost Claiming Principles	No	No	Yes

ALLOCATED ORGANIZATIONS IN THIS PLAN

- The General Fund accounts for departments or divisions which provide central oversight, management, or support service Citywide
- Total Allocable Central Services Cost is the value allocated in the CAP to benefitting departments Citywide

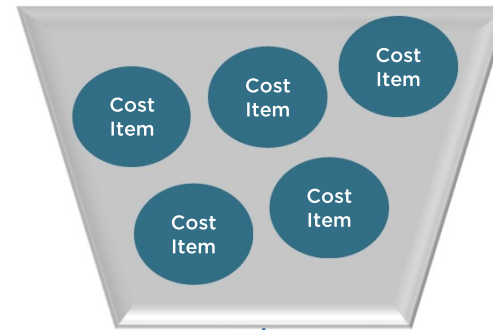
ALLOCATED ORGANIZATIONS			
Central Services Department or Division	Allocable Cost Pool		
	FY 2025-26 Plan	FY 2026-27 Plan	
		Scenario A	Scenario B
Expenditure Year Basis for Allocated Costs	2024-25 Budget	2024-25 Actual	2024-25 Actual
100-10 City Council	\$ 195,825	\$ 172,504	\$ -
100-11 City Manager	\$ 698,385	\$ 826,812	\$ 805,112
100-12 City Attorney	\$ 647,900	\$ -	\$ -
100-13 City Clerk	\$ 335,603	\$ 331,395	\$ 326,337
100-14 Finance / Administrative Services	\$ 1,411,268	\$ 1,353,783	\$ 1,331,447
100-23 Engineering	\$ 258,296	\$ 212,414	\$ 212,393
100-41-02 Public Works - Corporation Yard	\$ 471,275	\$ 491,133	\$ 490,889
100-41-06 Public Works - Governmental Building	\$ 212,539	\$ 164,750	\$ 164,750
100-00 Non Departmental	\$ 146,940	\$ 97,126	\$ 97,126
Total Allocable Central Services Cost	\$ 4,378,031	\$ 3,649,917	\$ 3,428,053
Difference from Prior Plan		\$ (728,115)	\$ (949,978)

INDIRECT COST ALLOCATION PLAN (ANALYSIS)

- A rational method to distribute costs which support multiple activities across the City
- Processes costs that cannot be easily assigned to an end beneficiary without effort disproportionate to the results achieved
- Attributes the allocated cost to the City’s direct public services
- Allocated costs are commonly referred to as “overhead”
- Informs a variety of cost recovery opportunities

Indirect Cost Pool*

A cost traced to multiple service functions, typically a central service, general governmental, or administrative function. Not reasonably assigned directly.



Expense categories, such as labor, materials, supplies, and services.

Allocation Base

The data set used as the basis for distributing indirect cost pools to benefitted units.



Benefitted Units or “Direct Services”

Organizational departments/programs that represent the mission of the City: the final public service.

* Frequently referred to in this plan as a “Central Services Function.”

GUIDING PRINCIPLES IN CAP DEVELOPMENT

- Allocate across the entire organization **without bias** for ability or preference to pay
- Root allocated costs in **recent or current documented fiscal year** with confidence in reported or budgeted expense items
- Use allocation metrics based on **readily available and replicable information** to reflect current conditions, not created solely for cost allocation
- Generate allocated shares that **reasonably reflect service or benefit** received or represent an **acceptable proportionality** between benefitting units
- Attempt to **avoid large swings** from year to year unless underlying organizational change has occurred and warrant such swings
- Create a tool and method to **support annual update** and application of continually improving metrics
- Be mindful of **downstream impacts** to cost of service-based rates/fees (Prop 218, Prop 26), and transparent accounting for other programs

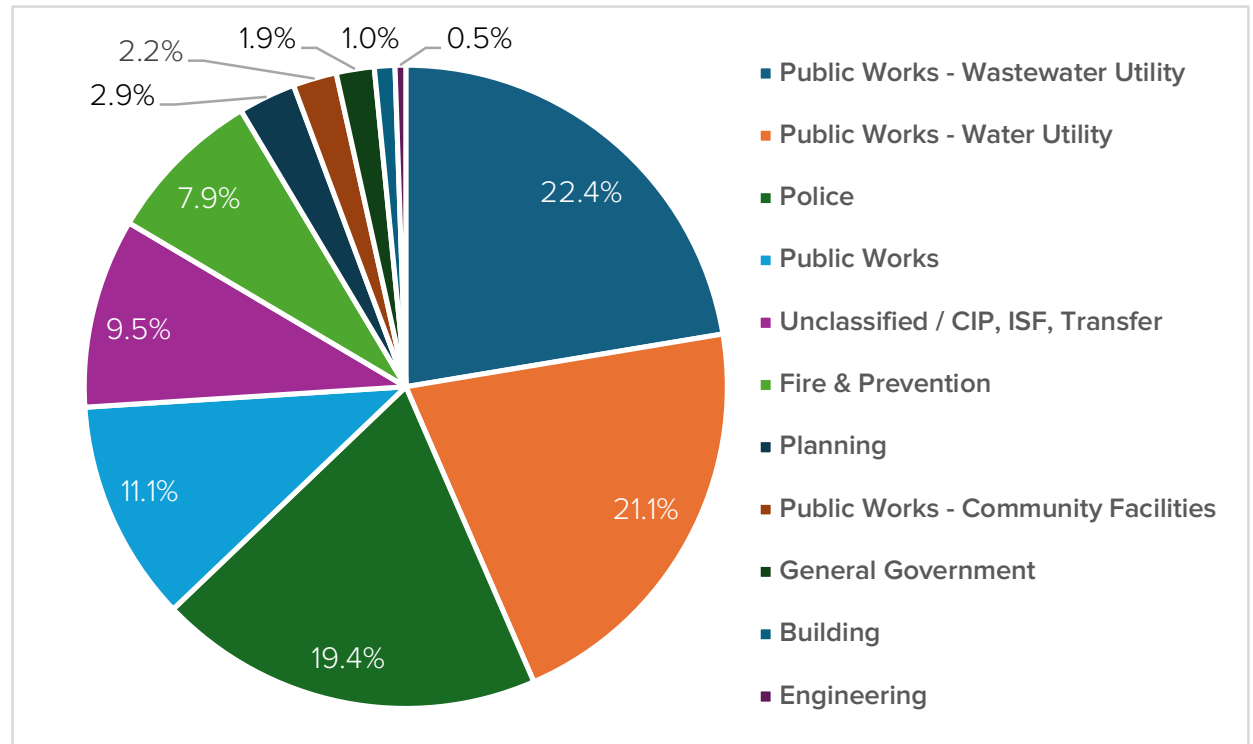
ALLOCATED COST POOLS AND ALLOCATION BASES IN THIS PLAN

- The CAP uses data from existing City systems, industry methods, and staff time estimates to derive a functional cost pool to be allocated from each cost center
- The CAP sets a readily accessible and replicable basis for reasonably allocating each function to benefitting departments

Central Services Department/Division and Functional Cost Pool Created by the Plan	Allocable Cost Pool			Allocation Basis
	Prior Plan	Scenario A	Scenario B	
100-10 City Council	\$ 195,825	\$ 172,504	\$ -	
Administrative Oversight	48,956	43,126	-	Compensated Labor Hours (Approx. FTEE)
General Fiscal Oversight	48,956	43,126	-	Net Operating Expense
Capital Fiscal Oversight	97,912	86,252	-	Capital Asset Value (Infrastructure)
100-11 City Manager	\$ 698,385	\$ 826,812	\$ 805,112	
Administrative Management	126,046	206,698	201,273	Compensated Labor Hours (Approx. FTEE)
General Fiscal Management	352,246	206,721	201,296	Net Operating Expense
Capital Fiscal Management	220,092	413,392	402,542	Capital Asset Value (Infrastructure)
100-12 City Attorney	\$ 647,900	\$ -	\$ -	
Citywide Service	647,900	-	-	Net Operating Expense
100-13 City Clerk	\$ 335,603	\$ 331,395	\$ 326,337	
Citywide Service	335,603	331,395	326,337	Net Operating Expense
100-14 Finance / Administrative Services	\$ 1,411,268	\$ 1,353,783	\$ 1,331,447	
Citywide Accounting / Budget	500,543	596,036	577,411	Net Operating Expense
Utility Billing & Support	340,734	304,493	302,241	Utility Accounts
Payroll	95,362	82,482	81,769	Compensated Labor Hours (Approx. FTEE)
Accounts Payable	83,442	72,171	71,548	Services & Supplies Expense
Accounts Receivable / Cash Receipts	47,681	41,241	40,885	Revenues Received
Information Technology Management	162,408	154,749	154,803	Personnel Count
Human Resources	181,098	102,612	102,790	Compensated Labor Hours (Approx. FTEE)
100-23 Engineering	\$ 258,296	\$ 212,414	\$ 212,393	
Technical Support - Public Projects	258,296	212,414	212,393	Capital Asset Value (Infrastructure)
100-41-02 Public Works - Corporation Yard	\$ 471,275	\$ 491,133	\$ 490,889	
Department Administrative Management	235,637	245,567	245,445	Public Works Personnel Count
Department Fiscal Management	235,637	245,567	245,445	Public Works Modified Operating Expense
100-41-06 Public Works - Governmental Building	\$ 212,539	\$ 164,750	\$ 164,750	
Governmental Facility Maintenance	212,539	164,750	164,750	Personnel Count
100-00 Non Departmental	\$ 146,940	\$ 97,126	\$ 97,126	
Personnel Services	74,520	86,095	86,095	Compensated Labor Hours (Approx. FTEE)
Information Technology Services	72,420	11,031	11,031	Personnel Count
Total Allocable Central Services Cost	\$ 4,378,031	\$ 3,649,917	\$ 3,428,053	

DISTRIBUTION OF CITYWIDE OVERHEAD TO DEPARTMENTS

- This is the resulting spread of the total \$3.65 million in allocated central services costs to departmental designation in the CAP for Scenario A. (The spread is not materially different for Scenario B.)
- This informs Indirect Cost Rates (ICRs), which are used to determine interfund charges for service.



These are department “designations” in the CAP, not always exact departments in the City’s accounting and organization structure. These departmental designations are structured to consolidate divisions of like services and produce expressions of Citywide overhead reasonable and undistorted to the underlying direct service provided by the grouped divisions.

INDIRECT COST RATE (ICR) BY DEPARTMENT

- A percent of a cost basis that reflects a department’s share of Citywide overhead
- ICR as a percent of direct expense by “Department” will likely be most appropriate for Sebastopol
- Overhead follows departments into each fund and/or to other cost recovery applications
- Provides a relatively stable outcome applicable to changing costs year over year
- Caution: Comparisons between departments are not meaningful. Each department has a unique cost profile on which its allocated overhead is expressed.

INDIRECT COST RATES (RATIO OF RECEIVED OVERHEAD TO RECEIVER'S DIRECT COSTS)			
Departmental Designation in the CAP	Prior Plan	Scenario A	Scenario B
Planning	15.2%	11.6%	10.8%
Building	16.4%	12.3%	11.6%
Engineering	11.1%	7.6%	7.1%
Fire & Prevention	24.1%	18.6%	17.8%
Police	17.5%	13.9%	12.8%
Public Works	31.4%	27.6%	26.7%
Public Works - Community Facilities	23.4%	22.7%	21.9%
Public Works - Water Utility	37.2%	35.5%	33.0%
Public Works - Wastewater Utility	24.3%	21.6%	20.0%
Composite for the City	16.6%	13.7%	12.4%

Interfund Charges for Central Service



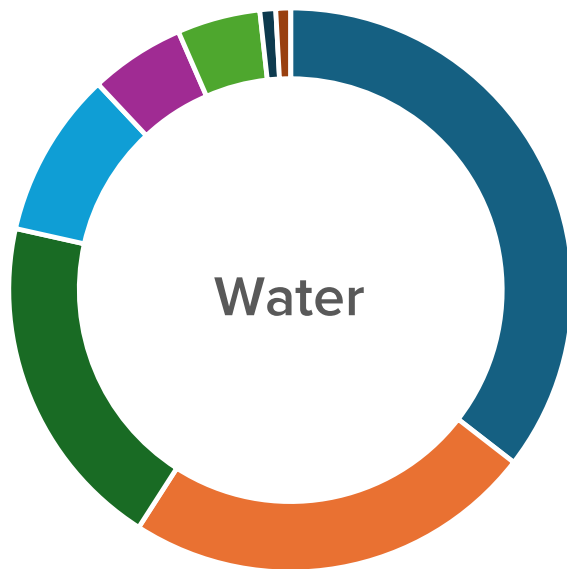
CALCULATED INTERFUND CHARGES FOR SERVICE

These values are directly comparable to values presented in the FY 2025-26 adopted budget, accounted as “4998 Interfund Charges – Cost Plan.”

Fund Receiving an Interfund Charge for Service and Reimbursing the General Fund	Interfund Charge for Service			
	SCENARIO A		SCENARIO B	
	Maximum Charge in This Plan	Distribution of Outcomes	Maximum Charge in This Plan	Distribution of Outcomes
500 Water	\$ 770,772	21%	\$ 717,187	21%
510 Wastewater	\$ 816,504	22%	\$ 755,874	22%
Reimbursement to the General Fund for Allocated Central Services in this Plan	\$ 1,587,276	43%	\$ 1,473,061	43%
Other Non-General Funds Not Previously Charged	\$ 129,504 [a]	4%	\$ 123,758 [a]	4%
100 General Fund - Remaining Central Services Borne	\$ 1,933,137	53%	\$ 1,831,234	53%
Total Central Services Allocated in this Plan	\$ 3,649,917	100%	\$ 3,428,053	100%

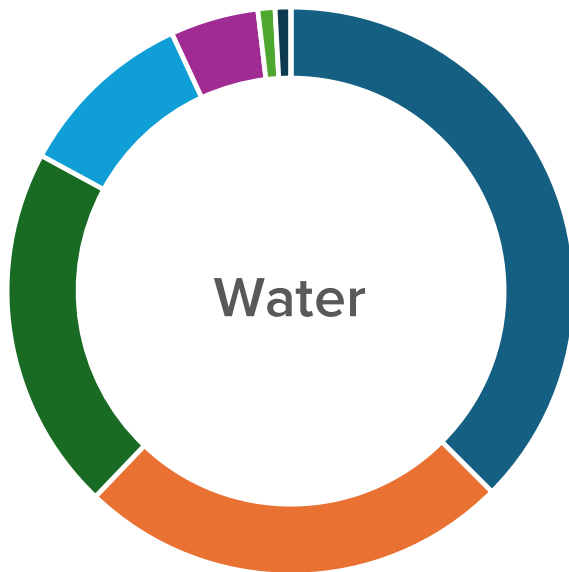
[a] The City would need to evaluate eligibility and sufficiency of funding sources to accept the calculated charge from this Plan.

SCENARIO A COMPOSITION OF INTERFUND CHARGE ON UTILITIES



Central Services Department/Division or Functional Cost Pool Created by the Plan	Received by Water	Received by Wastewater
100-14 Finance / Administrative Services:		
Citywide Accounting / Budget	\$ 63,483	\$ 110,284
Utility Billing & Support	\$ 162,058	\$ 162,058
Payroll	\$ 6,374	\$ 5,806
Accounts Payable	\$ 11,064	\$ 3,032
Accounts Receivable / Cash Receipts	\$ 16,880	\$ 22,647
Information Technology Management	\$ 5,555	\$ 4,685
Human Resources	\$ 7,929	\$ 7,223
100-11 City Manager	\$ 181,933	\$ 200,781
100-41-02 Public Works - Corporation Yard	\$ 149,777	\$ 102,480
100-23 Engineering	\$ 73,404	\$ 75,345
100-10 City Council	\$ 42,000	\$ 46,403
100-13 City Clerk	\$ 36,787	\$ 63,907
100-00 Non Departmental	\$ 6,973	\$ 6,325
100-41-06 Public Works - Governmental Building	\$ 6,555	\$ 5,528
100-12 City Attorney	\$ -	\$ -
Total Allocated Central Services Cost Received	\$ 770,772	\$ 816,504

SCENARIO B COMPOSITION OF INTERFUND CHARGE ON UTILITIES



Central Services Department/Division or Functional Cost Pool Created by the Plan	Received by Water	Received by Wastewater
100-14 Finance / Administrative Services:		
Citywide Accounting / Budget	\$ 61,236	\$ 106,381
Utility Billing & Support	\$ 160,391	\$ 160,391
Payroll	\$ 6,299	\$ 5,738
Accounts Payable	\$ 10,932	\$ 2,995
Accounts Receivable / Cash Receipts	\$ 16,686	\$ 22,386
Information Technology Management	\$ 5,538	\$ 4,670
Human Resources	\$ 7,918	\$ 7,213
100-11 City Manager	\$ 176,433	\$ 194,687
100-41-02 Public Works - Corporation Yard	\$ 149,165	\$ 102,062
100-23 Engineering	\$ 73,172	\$ 75,108
100-13 City Clerk	\$ 35,936	\$ 62,429
100-00 Non Departmental	\$ 6,949	\$ 6,304
100-41-06 Public Works - Governmental Building	\$ 6,533	\$ 5,509
100-10 City Council	\$ -	\$ -
100-12 City Attorney	\$ -	\$ -
Total Allocated Central Services Cost Received	\$ 717,187	\$ 755,874

COMPARISON TO PRIOR YEAR CHARGES (1/2)

- Total reimbursement to the General Fund would **decrease from utility** funds in FY 2026-27 in both scenarios:
- This **increases cost burden on the General Fund** compared to current fiscal year recovery
 - \$209,048 additional burden to the General Fund in Scenario A
 - \$323,263 additional burden to the General Fund in Scenario B

Fund Receiving an Interfund Charge for Service and Reimbursing the General Fund	Interfund Charge for Service - SCENARIO A		
	Maximum Charge in This Plan for FY 2026-27	Current Charge in FY 2025-26 Budget	Change in This Plan
500 Water	\$ 770,772	\$ 845,358	\$ (74,586)
510 Wastewater	\$ 816,504	\$ 950,965	\$ (134,461)
Reimbursement to the General Fund for Allocated Central Services in this Plan	\$ 1,587,276	\$ 1,796,323	\$ (209,048)
Other Non-General Funds Not Previously Charged	\$ 129,504		
100 General Fund - Remaining Central Services Borne	\$ 1,933,137		
Total Central Services Allocated in this Plan	\$ 3,649,917		

Fund Receiving an Interfund Charge for Service and Reimbursing the General Fund	Interfund Charge for Service - SCENARIO B		
	Maximum Charge in This Plan for FY 2026-27	Current Charge in FY 2025-26 Budget	Change in This Plan
500 Water	\$ 717,187	\$ 845,358	\$ (128,171)
510 Wastewater	\$ 755,874	\$ 950,965	\$ (195,091)
Reimbursement to the General Fund for Allocated Central Services in this Plan	\$ 1,473,061	\$ 1,796,323	\$ (323,263)
Other Non-General Funds Not Previously Charged	\$ 123,758		
100 General Fund - Remaining Central Services Borne	\$ 1,831,234		
Total Central Services Allocated in this Plan	\$ 3,428,053		

COMPARISON TO PRIOR YEAR CHARGES (2/2)

- Outcomes continue to represent an overall decrease in historical levels of General Fund cost recovery from the utilities, due to the recent implementation of a new Indirect Cost Allocation Plan

Fund Receiving an Interfund Charge for Service and Reimbursing the General Fund	Interfund Charge for Service by Year				Total Four-Year Change	
	FY 2023-24 [a]	FY 2024-25 [b]	FY 2025-26 [c]	FY 2026-27 [d]	\$-Change	%-Change
SCENARIO A						
500 Water	\$ 1,363,096	\$ 852,863	\$ 845,358	\$ 770,772	\$ (592,324)	-43%
510 Wastewater	\$ 1,113,046	\$ 908,934	\$ 950,965	\$ 816,504	\$ (296,543)	-27%
Reimbursement to the General Fund for Allocated Central Services	\$ 2,476,143	\$ 1,761,797	\$ 1,796,323	\$ 1,587,276	\$ (888,867)	-36%
SCENARIO B						
500 Water	\$ 1,363,096	\$ 852,863	\$ 845,358	\$ 717,187	\$ (645,910)	-47%
510 Wastewater	\$ 1,113,046	\$ 908,934	\$ 950,965	\$ 755,874	\$ (357,172)	-32%
Reimbursement to the General Fund for Allocated Central Services	\$ 2,476,143	\$ 1,761,797	\$ 1,796,323	\$ 1,473,061	\$ (1,003,082)	-41%

[a] Based on values derived from a cost allocation methodology established in 2001.

[b] Based on a new Indirect Cost Allocation Plan developed in 2024.

[c] Based on an update to the Indirect Cost Allocation Plan in 2025.

[d] Based on an update to the Indirect Cost Allocation Plan with material changes to allocable costs from prior two years in 2026.

NEXT STEPS

- Review these outcomes at Committee(s) level
- Examine alternate paths (next slide)
- Receive and accept the final Cost Allocation Plan or alternate path at City Council level
- Apply results in budget development for Fiscal Year 2026-27 by using the dollar values presented as the budgeted interfund charge (4998, Interfund Charge-Cost Plan)



Alternate Paths



ALTERNATE PATHS FOR THE INTERFUND CHARGES FOR SERVICE

Additional Scenarios 1-3 are described at right and compared to the previously presented Scenarios A-B.

Assumption / Variable in Plan Iteration	Interfund Charge for FY 2026-27		
	Water	Wastewater	Impact to General Fund
0 Budgeted Charge in FY 2025-26 Based on CAP Use of Budgeted Expenditures	\$ 845,358	\$ 950,965	\$ -
1 Inflation-Adjusted Charge in FY 2026-27 Based on Prior Year CAP Outcomes "Status Quo"	\$ 866,492	\$ 974,739	\$ 44,908
2 Inflation-Adjusted Charge in FY 2026-27 Based on Prior Year CAP Outcomes Excluding City Attorney	\$ 773,874	\$ 828,478	\$ (193,971)
3 Inflation-Adjusted Charge in FY 2026-27 Based on Prior Year CAP Outcomes Excluding City Attorney & City Council	\$ 722,058	\$ 771,232	\$ (303,033)
A CAP-Based Charge in FY 2026-27 Use of Prior Year Actual Expenditures Excluding City Attorney	\$ 770,772	\$ 816,504	\$ (209,048)
B CAP-Based Charge in FY 2026-27 Use of Prior Year Actual Expenditures Excluding City Attorney & Other Items Not Allowed in Federal Cost-Claiming	\$ 717,187	\$ 755,874	\$ (323,263)

Administrative Services Department

Finance Allocable Expense	
1st Allocation	2nd Allocation ²
Overhead is allocated across all organizations Citywide - this shows the portion allocated to Sewer	First Allocation Overhead Received from other Departments to be Redistributed
24-25 Budget less Direct Services ¹ \$1,447,765 - \$36,497	
\$1,411,268	\$134,127

Agenda 11 Pg #	Allocable Cost Pool							Allocable Cost Pool							Agenda 11 Pg #
67	Citywide Accounting	Utility Billing & Support	Payroll	Accounts Payable	Accounts Receivable	IT Mgt	HR	Citywide Accounting	Utility Billing & Support	Payroll	Accounts Payable	Accounts Receivable	IT Mgt	HR	67
	\$500,543	\$340,734	\$95,362	\$83,442	\$47,681	\$162,408	\$181,098	\$47,571	\$32,383	\$9,063	\$7,930	\$4,532	\$15,435	\$17,212	
	Multiplied by Allocation %							Multiplied by Allocation %							
	Allocation Basis ³							Allocation Basis ³							
	Distribution to All Services							Distribution Only to Direct Services							
73-77	Net Operating Expense	Utility Accounts	Compensated Labor Hours	Services & Supplies Exp	Revenues Received	Personnel Count	Compensated Labor Hours	Net Operating Expense	Utility Accounts	Compensated Labor Hours	Services & Supplies Exp	Revenues Received	Personnel Count	Compensated Labor Hours	73-77
	16.8%	50.0%	6.6%	5.9%	51.6%	2.8%	6.6%	20.7%	50.0%	7.0%	7.0%	51.6%	3.4%	7.0%	
	Equals							Equals							
81	Allocated Expense							Allocated Expense							81
	\$84,128	\$170,367	\$6,284	\$4,948	\$24,598	\$4,565	\$11,935	\$9,846	\$16,192	\$632	\$552	\$2,338	\$518	\$1,199	
	TOTAL							TOTAL							
	\$306,825							\$31,277							

Total Sewer
\$338,102

¹ Direct Services Percentage of budgetted amounts that are considered direct. Each account has its own rationale for allocation. See Exhibits 4, pg 67 and Exhibit 3 pg 58

² 2nd Allocation Portion of Citywide services that were allocated in the first allocation that are received by department to be reallocated. This department is a service department, so any services received must be reallocated to the departments that are benefiting.

³ Allocation Basis Each functional cost pool is assigned an allocation basis. This determines the degree to which City departments receive the costs. The determination was done based on information in existing City reports, staff interviews, common industry methods, or combination of t

An allocable cost pool is a bucket of related costs that gather together so it can fairly spread (allocate) them across the function that provide the service.

Example:

Defintion

Group similar costs into one "pool." such as several people share a house. The total internet, PG&E are considered cost pool

Then decide how much of that pool each person should pay based on how much they use or benefit from the service - .eg someone working from home all day might pay more than someone who only uses it at night.

MEMORANDUM

Date: March 2026

Subject: Cost Allocation Options

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This memo provides an overview of a neighboring city’s model for allocating General Fund departmental costs to the Enterprise Funds.

City of Cotati

The agency uses an internal cost allocation plan built primarily on historical employee time tracking, but with several distinct purposes:

Time tracking and payroll

- City Council: Each Councilmember is counted as 0.5 Full Time Equivalent (FTE) where costs are allocated across general fund, water, sewer, and successor agency based on informed historical overall time spent on agenda items and board appointments. The current allocation for all members is 26%, 11%, 11% and 2% accordingly.
- All Employees: Time tracked across multiple functional categories and used as the basis for cost allocation.
 - City Manager allocation is 60% General Fund, 15% Water, 15% Sewer, and 10% Successor Agency.
 - City Clerk allocation is 76% General Fund, 11% Water, 11% Sewer and 2% Successor Agency.

Enterprise fund allocations

- City-wide expenses are allocated to enterprise funds using the City-Wide combined all staff FTE allocation.

Utility Customer Service Support Survey

- Utility Billing work (both front- and back-office functions) occurs throughout the day.
- There is no restricted timeframe limiting Utility Billing support activities. After-hours support is provided via police dispatch and on-call public works.

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City of Cloverdale

Cost Allocation Approach

- The process begins with total General Fund departmental budgets.

- From those totals, salaries already charged to enterprise funds are excluded before any allocation is calculated.
- The remaining expenses are then allocated between the General Fund and enterprise funds using established allocation drivers.

Allocation Methodology

- Most departments are allocated based on total revenue.
- Human Resources costs are allocated based on the number of employees.
- City Clerk costs are allocated based on the number of agenda items processed.
- These metrics are intended to represent the most reasonable cost drivers for each department.

General Fund Retention Percentage

- For departments allocated based on revenue, 45% of the allocable costs remain with the General Fund.
- The remaining portion is distributed among enterprise funds in proportion to each fund's share of total revenue.
- The 45% figure is described as a long-standing and reasonable percentage, historically tied to how wages and departmental effort are split between the General Fund and enterprise funds.

Utility Customer Service Support Survey

- Utility Billing work (both front- and back-office functions) occurs throughout the day.
- There is no restricted timeframe limiting Utility Billing support activities.

The budget-based allocation model, with clear exclusion of already-identified enterprise fund salaries, the use of reasonable cost drivers by department, and a consistent General Fund retention percentage. Her approach reinforces that even identifiable expenses remain allocated in nature, rather than treated as purely "direct charges."