

## Budget Committee

Councilmember Phill Carter  
Councilmember Sandra Maurer



## City of Sebastopol

**Agenda Item Number 4**  
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**Date:** October 8, 2025  
**To:** Budget Committee  
**From:** Ana Kwong – Administrative Services Director  
**Subject:** Cost Allocation Plan Update

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### **Background:**

ClearSource Financial Consulting has been engaged by the City to provide expert support in developing and updating its Indirect Cost Allocation Plan—a key financial tool used to allocate central service costs (such as oversight, management, and administrative functions) across various city departments and enterprise funds.

They initially prepared a comprehensive cost plan for Fiscal Year 2024–25, which was reviewed by the City Council and published on the City’s website. Due to the plan’s effectiveness, the City re-engaged ClearSource to update the analysis for FY 2025–26, ensuring that the cost allocations remain relevant for budget development.

The updated plan identified over \$4.3 million in **allocable** shared costs, helping the City recover overhead expenses through interfund charges—particularly from the Water and Wastewater enterprise funds. These charges serve as reimbursements to the General Fund for services provided.

### **DISCUSSION:**

To ensure the public has a shared understanding, it's important to clarify a few key terms:

1. **Direct Cost** – These cost are expenses that can be clearly and exclusively attributed to a specific department, service, or project. These include:
  - Labor directly assigned to a task (e.g., road maintenance crews)
  - Materials and supplies used for a specific operation
2. **Indirect Costs** – These are shared administrative and support expenses that benefit multiple departments but cannot be directly tied to one. Examples include:
  - Council and Legal support
  - City Manager’s Office
  - Finance and HR services

These costs are captured in the Indirect Cost Allocation Plan, which distributes them across departments using a methodology based on service relationships and proportional benefit.

3. **Fees:** These are charges to external users for services provided by the City. These are typically:
  - Based on the full cost of service (including direct and indirect costs)
  - Reviewed annually to ensure alignment with actual service delivery costs

The Water Fund (Fund 500) and Wastewater Fund (Fund 510) are being charged for shared city services through interfund reimbursements. These charges, established in the current 24-25 adopted budget, are as follows:

- Water Fund: **\$845,358**
- Wastewater Fund: **\$950,965**

Following the Budget Committee meeting on September 15, staff met with ClearSource to address several concerns related to the cost allocation plan. The discussion focused on:

1. Preserving the current cost allocation framework
2. Identifying and removing specific cost layers
3. Updating the plan during next year's budget cycle using actual expenditures rather than estimates
4. Phasing in adjustments over the FY26–27 budget period

**Important Context on Interfund Charges:**

Interfund charges—used to allocate shared City service costs to the Water Fund (Fund 500) and Wastewater Fund (Fund 510)—are highly specific to our agency. Staff recommends caution when comparing our cost allocation approach to that of other agencies, as each operates under distinct structures and assumptions. Such comparisons are not equivalent and may lead to misleading conclusions.

The current charges are based on a cost allocation plan developed in FY24–25, which distributes the City's indirect costs across departments. These charges function as internal allocations to the water and wastewater funds to cover shared services such as administration, City Council, legal, and executive management—services that cannot be directly tied to specific projects or tasks.

The plan was reviewed during the FY25–26 budget process, and appropriate interfund charges were set. It relies on budget estimates and a combination of data and assumptions to fairly allocate overhead. However, if the City determines that using actuals would provide a more accurate or acceptable methodology, the plan can be revised accordingly.

**Next Steps for Revisions:** The proposed revisions are derived from function-specific actions outlined in the Indirect Cost Allocation Plan. These functions—and their associated costs—can be reevaluated during the next update cycle, depending on the chosen methodology and the availability of supporting data.

### Allocated Overhead by Departmental Designation in the FY2025-26 Indirect Cost Allocation Plan

NOTE: THESE REVISIONS ARE CALCULATED BY SIMPLY REMOVING THE RECEIVED COST LAYER RATHER THAN RECALCULATING THE CAP TO REMOVE ALLOCATED FUNCTION

Allocated Indirect Cost Pool	Water	Wastewater	Total	Change
City Council	49,767	54,891	104,658	
City Manager	128,272	157,791	286,063	
City Attorney	69,512	119,751	189,263	
Assistant City Manager/City Clerk	38,096	65,629	103,725	
Finance   Admin. Services - All General Fund	303,546	338,102	641,648	
Engineering - All General Fund Programs	91,734	94,161	185,895	
Public Works - Corporation Yard	147,373	105,858	253,231	
Public Works - Governmental Building	8,558	7,217	15,775	
Non Departmental	8,500	7,564	16,064	
<b>Total in FY25-26 Adopted Budget - Original</b>	<b>845,358</b>	<b>950,964</b>	<b>1,796,322</b>	
Less: City Manager	(128,272)	(157,791)	(286,063)	
<b>Revised Total #1</b>	<b>717,086</b>	<b>793,173</b>	<b>1,510,259</b>	<b>(286,063)</b>
Less: City Attorney	(69,512)	(119,751)	(189,263)	
<b>Revised Total #2</b>	<b>647,574</b>	<b>673,422</b>	<b>1,320,996</b>	<b>(475,326)</b>

Given that a full overhaul of interfund charges is not feasible at this time—and is not being recommended by staff—the City may consider a more targeted approach. This would involve removing specific components of the charge that may not directly support utility operations. For example:

- **City Manager's costs:** This component could be reevaluated based on the extent of involvement in utility-related activities.
- **City Attorney's costs:** Adjustments may be appropriate if legal services are not substantially tied to utility matters.

This selective refinement allows the City to maintain fairness and transparency in its cost allocation while addressing specific concerns. It also provides flexibility for continued review and discussion during the FY26–27 budget development process.

#### FISCAL IMPACT:

In FY25-26 adopted budget, there's a amount of \$6,000 for an annual update of the cost plan.

#### ATTACHMENTS:

None