

INDIRECT COST ALLOCATION

PURPOSE

To apportion all the indirect costs associated with the Town's water enterprise fund and the various programs operated jointly with neighboring municipalities in an equitable manner that reflects their true shared costs, this policy provides guidelines for calculating, allocating, and reviewing those costs.

APPLICABILITY

This policy applies to the Town Manager, Finance Director, and Director of Public Works.

BACKGROUND

Under authority established in [M.G.L. c. 44 § 53F½](#), the water service is managed and accounted for separately from the general fund and has its own financial statements. Consolidating the program's direct and indirect costs, debt service, and capital expenditures into a segregated fund allows the Town to demonstrate to the public the true, total cost of providing the service.

The Town's joint programs with other municipalities are governed by inter-municipal agreements (IMAs) as defined under [M.G.L. c. 40, § 4A](#). Each IMA includes specific provisions for allocating shared personnel and operational expenses between the two communities.

POLICY

As part of the annual budget process, the Finance Director, with approval by the Town Manager, will calculate the indirect costs to the general fund of the Town's water department and those of each joint program. Each of the calculations will take into account the given entity's personnel expenses budgeted in the general fund, as well as any-related expenses of the Town departments that provide administrative services to that operation, which include the Town Manager, Finance Director, and Treasurer/Collector departments. The Finance Director will review the calculations with the responsible department manager or town official.

The Finance Director will calculate costs using the most recent fiscal year's appropriations and based on one or more of the following methodologies: actual, transactional, estimated support, and proportional (as outlined on the next page). The following expenses shall be included in the calculations:

- Benefits for active and retired employees, including insurances, Medicare tax, unemployment, and workers' compensation
- Pension costs
- Vehicle insurance
- Property insurance
- Administrative costs
- Audit services
- Actuarial services
- Legal services
- Information technology expenses
- Other costs that may be considered and agreed to, such as: printing, postage, materials, supplies, software, infrastructure, and fuel

The Finance Director will maintain written instructions detailing the calculation methodology and will track and record operating transfers between the relevant funds, as well as reimbursements from and payments to the Town’s partner municipalities.

Options for Calculating Indirect Costs

1. **Actual cost** uses specific schedules to provide documentation of indirect costs, which generally include debt service and life, health, and property insurances.
2. The **transaction-based** method is calculated based on the number transactions attributed to a service as a percentage of the whole. For example, the number of bills issued by the Treasurer/Collector for water service as a percentage of the total bills issued. This percentage is applied against the Treasurer/Collector’s total budget, including health and life insurance, Medicare, retirement and any worker’s compensation attributable to the department.

$$\frac{\text{Number of transactions for the water department}}{\text{Total number of transactions processed by the non-enterprise department}} \times \text{Total budget plus benefits of the department processing enterprise transactions} = \text{Indirect Departmental Salaries}$$

3. A department or official may be able to provide a reasonable **estimate of support**, or estimate of the average time spent to support a particular service. For example, the Town Manager estimates that he spends on average four hours weekly, or 10 percent of his time, on water- related activities (e.g., meetings, commitment/billing, budgeting, clerical tasks). This percentage is applied against the department’s or official’s salary and benefits, including health and life insurance, Medicare, retirement and any worker’s compensation.

$$\frac{\text{Hours worked on enterprise activities per year by individual(s)}}{\text{Total hours worked per year by individual(s)}} \times \text{Salary and benefits of individual(s) working on enterprise activities} = \text{Indirect Departmental Salaries}$$

Any department’s or official’s expenses related to water activities are charged directly to the water budget.

4. The **proportional** method is a straightforward calculation of the water department’s direct budget (net of debt) as a percentage of the gross general fund (net of debt) and enterprise fund (net of debt) budgets. This percentage is applied against a town department’s budget, including employees’ benefits, that provides support to the water department.

REFERENCES

[M.G.L. c. 40, § 4A](#)

Hamilton-Wenham IMAs: Recreation; Veterans Memorial Pool; Assessing; Energy Manager; Emergency Center Operations; Vaccination Clinics; Collection of Refuse, Garbage, Recycling, and Organic Waste; Library; Pleasant Pond; and Grounds Maintenance

Town of Hamilton Shared Services governed by this agreement at time of adoption:

Hamilton-Wenham: Recreation; Inspectional Services; Director of Assessing

Hamilton-Manchester: Animal Control Officer

Hamilton-Manchester-Rockport: Human Resources

Hamilton-Wenham-Essex-Rockport: Regional Public Health

Government Finance Officers Association Best Practices: [Indirect Cost Allocation](#) and [Full Cost Accounting for Government Services](#)

EFFECTIVE DATE

This policy was adopted on November 7, 2022.

WATER ENTERPRISE FUND

The Department of Revenue/Local Services has issued a manual on enterprise funds and the following description is taken in part from this document.

The enterprise fund statute, MGL Chapter 44 S53F1/2 was enacted in 1986 for the purpose of allowing cities and towns the flexibility to account separately for all financial activities associated with business type municipal services, such as public utilities (water, sewer, trash).

An enterprise fund establishes a separate accounting and financial reporting mechanism for municipal services for which a fee is charged in exchange for goods or services. Revenues and expenditures of the service are segregated into a separate fund with its own financial statements.

Enterprise accounting allows a community to demonstrate to the public the portion of total costs of a service that is recovered through user charges and the portion that is subsidized by the tax levy or other available funds, if any. A community may choose to recover total service costs through user charges, but it is not required.

At year end, the performance of an enterprise fund is measured in terms of positive and negative operations. An operating surplus (the result of revenue collected in excess of estimates and appropriation turn backs) translates into retained earnings that are maintained in the fund rather than closing to general fund. Retained earnings of an enterprise fund are certified as an available fund after the submission of a June 30th balance sheet to the Department of Revenue/Local Services. Once certified, retained earnings may be appropriated only for expenditures relating to the fund. Conversely, if during the year, the enterprise fund incurs an operating loss, the loss must be raised in the subsequent year's budget.

Establishing an enterprise does not create a separate or autonomous entity from the municipal government operation. The municipal department operating the enterprise service continues to fulfill financial and managerial reporting requirements like every other department.

The enterprise budget includes both revenue and expenditure estimates:

REVENUES: May include user charges and fees, investment income, other revenues such as grants and apportioned and unapportioned betterments, and retained earnings.

EXPENDITURES: All cost must be identified and may include direct costs and indirect costs, employee benefits, legal and borrowing cost, and capital expenditures. These costs may also include an appropriation for an emergency reserve and a budgeted surplus.

Direct Costs are those associated directly with the enterprise fund, including salaries and wages of enterprise employees, other operating expenses and contractual payments. Those direct costs that are billed directly to the town such as health care insurance and retirement will be allocated accordingly.

Indirect Costs are those costs that cannot be directly or exclusively assigned to one service. Enterprises often benefit from expenditures made by the general fund and may include employee benefits, legal and borrowing costs, capital expenditures or improvements and emergency reserve.

INDIRECT COST ALLOCATION AGREEMENT CERTAIN MUNICIPAL EXPENSES

ADMINISTRATIVE SERVICES

Administrative services include: accounting, auditing, central data processing, central purchasing, collections, and other treasury and financial services. Expenses that may be allocated include salary and wages for professional, technical, clerical and support staff and all expenses including, but are not limited to, professional and technical services, supplies and materials, dues and subscriptions, travel expenses and other related costs.

The cost of administrative services shall be computed separately for personnel and operating expenses.

PERSONNEL EXPENSES:

Salaries & Health Insurance: The ratio for Budgeted Fiscal Year will be the total town-wide salary budget divided by the Enterprise Fund salary budget to arrive at a percentage. This percentage will be applied to the personnel expenses of salaries and benefits of the following administrative departments: Town Administrator; Finance Director; Treasurer/Collector and Town Counsel. The DPW Director salary, benefits and retirement expense will be shared based the Full time Equivalent ratio between DPW and Water Enterprise.

Retirement: Retirement costs include, but are not limited to, the cost of administering employee retirement programs; the cost of non-contributory pensions; assessments paid to the Essex County Retirement System, the State retirement system, or any other regional or municipal retirement system; contributions to Social Security and Medicare and other retirement plans. The cost of retirement programs will be included in the indirect cost allocation. The allocation for indirect retirement costs will be based on the percent charged by Essex Regional Retirement for the current fiscal year. Only compensation that is applied towards pension calculations will be used.

It is agreed that the cost of salaries and expenses for the Town Clerk/Elections will not be included in the allocation of indirect costs. The expenses for specialized Town Counsel services will be directly billed to each Enterprise Fund and paid as a direct cost, not an indirect cost.

Operating Expense:

The calculation to arrive at the administrative overhead expenses will be the same. The total amount of the town-wide expense budget will be divided by the Enterprise Fund expense budgets to arrive at a percentage. This percentage will be applied to the operating expense of the following administrative departments: Town Administrator, Finance Director, and Treasurer/Collector.

The costs associated with the MIS/IT and Municipal Audit are part of the Finance Department operating expenses.

Insurance includes the cost of administering insurance programs, as well as the cost of: unemployment, workers compensation and other employee benefits paid by the town; the premiums paid for property, casualty and liability insurance; premiums for fidelity bonds, and funding of self-insurance programs.

OPERATIONS AND MAINTENANCE

The cost of operating and maintaining facilities, including administrative and support facilities, include custodial services, heating of buildings, utility services, maintenance of grounds, maintenance of buildings and maintenance of equipment. The costs shall include salary, wages and benefit costs for professional, technical, maintenance, clerical and support staff, and all expenses including, but are not limited to, professional and technical services, supplies and materials, dues and subscriptions, travel expenses, and other related costs for the ordinary and extraordinary maintenance. Costs for employees and resources that are shared between departments will be the (1) total cost of the identified service multiplied by (2) the percentage of square footage of the space used by the enterprise/special revenue fund.

Costs that will be included in the calculation of total costs multiplied by percent of square footage of space include Town Hall Electric; Natural Gas; Trash; and the Cleaning and Maintenance budget.

Vehicle Maintenance will be calculated as an average of actual hours DPW Mechanics worked on Enterprise vehicles. Vehicles parts, supplies and fuel will be paid for directly by the Enterprise funds and not be included in the indirect cost calculation.

Telecommunications is allocated by lines, minute usage and actual long distance. It is a direct allocation.

DEBT

For reporting purposes, cost of debt and capital shall include the actual interest paid on revenue anticipation notes (RANS) for enterprise purposes, interest charges on short term borrowing for bond anticipation notes (BANS) for enterprise purposes, the annual principal and interest paid on loans used to finance the purchase or construction of buildings. The debt expense will be broken-out so that principal and interest by line item can be identified.

OTHER EXPENSES

Although this agreement is intended to identify services and expenses that are provided to the Enterprise Departments and how such costs shall be allocated between the Town and these departments for reporting purposes, it is recognized and further agreed that other costs which may be incurred by the Town that are not directly appropriated to the Enterprise Departments, and have been identified to be in part or entirety expended on behalf of these departments shall be allocated and reported. Such allocation will be determined and mutually agreed to in writing between the respective Department Heads, Boards and Town of Hamilton.