



April 13, 2010

Mark Finigan  
 Assistant City Manager  
 City of Key West  
 626 Josephine Parker Drive  
 Suite 201  
 Key West, FL 33040

Re: General Fund Cost Allocation Study Proposal

Dear Mr. Finigan:

Red Oak Consulting, a Division of Malcolm Pirnie, Inc. ("Red Oak") is pleased to provide the City of Key West ("City") with this proposal for completing a General Fund Cost Allocation Study. This proposal was prepared based on our recent discussions with the City regarding the City's desire to complete such a study. The information provided herein consists of our understanding of the project, our firm qualifications, and a detailed scope of services and cost estimate for your consideration.

### PROJECT UNDERSTANDING

Red Oak understands that the City's General Fund consists of several departments including the following:

- City Commission
- City Manager
- City Clerk
- Finance
- Human Resources
- Information Technology
- City Attorney
- Planning
- Non-Departmental
- Community Service
- General Services
- Police
- Fire
- Building Services
- Code Compliance
- Port Operations

The General Fund incurs expenditures in the range of \$38 million annually and is supported by Ad Valorem tax revenue, charges for services, intergovernmental revenue, transfers from other funds, and various fees and charges.

The General Fund supports the enterprise funds and internal service funds of the City in various ways. For example, human resources and information technology provide support to each of the funds within the City. Red Oak understands that the City is interested in developing a cost allocation plan that quantifies and captures the cost of

the services provided by the General Fund to the enterprise funds and internal service funds. Consideration should be given to the direct and indirect services provided by the General Fund, as well as other considerations, such as payment in lieu of taxes for police and fire services, and the use of the City's right-of-ways for water and sewer services. The enterprise, special revenue and internal service funds of the City are as follows:

*Enterprise Funds:*

- Sewer Fund
- Stormwater Utility Fund
- Solid Waste Fund
- Key West Bight Fund
- Transit System Fund
- Garrison Bight Fund

*Special Revenue Funds:*

- Infrastructure Surtax Fund
- Internal Improvements Fund
- Fort Taylor Surcharge Fund
- Affordable Housing Fund
- Truman Property Fund
- Law Enforcement Trust Fund
- Bahama Village / Caroline Street Tiff Fund
- Navy Outer Mole Payments Fund

Internal Services Funds:

- Insurance Programs Fund

**FIRM QUALIFICATIONS**

Red Oak Consulting is the management consulting division of Malcolm Pirnie, Inc. and focuses on the unique financial, management, organizational, and information technology needs of our clients. Red Oak has completed hundreds of financial projects for city governments and municipalities including cost allocation plans, revenue requirements analyses, cost-of-service studies, and rate design analyses, from very large to medium-sized municipalities across the Country.

Red Oak has over 25 rate consultants and analysts dedicated full-time to completing financial studies for municipalities. In order to best serve our clients, these professionals operate out of offices strategically located around the country, including in Orlando, Florida, where the bulk of the work on this project will be completed.

The uniqueness of our approach is our ability to identify and understand the nature of all the services that the City's General Fund is currently providing and could potentially provide in the future, appropriately allocate costs among departments, and assign rational estimates of the time it takes to accomplish each task, thereby resulting in an accurate, cost-based, defensible Cost Allocation Plan for the City.



Our qualifications include:

- Municipal Operations Experience
- Extensive Regional Knowledge and Resources
- Thorough Understanding of Cost Allocation Plans and User Fee Studies
- Financial Leadership
- Innovative Excel Modeling Experience

We have assembled an experienced project team with experts in completing cost allocation plans that meet the requirements of all pertinent legislation, including OMB Circular A-87. We believe that Red Oak offers an appropriate blend of financial and managerial skills that can properly allocate costs to appropriate cost centers. Our proposed project personnel were chosen to specifically meet the City's needs in completing this cost allocation study. Brief experience summaries for our team members are presented below.

#### **John Mastracchio, CFA – Project Manager**

Mr. Mastracchio has more than a decade of experience as a project manager and senior financial analyst on various municipal financial projects. His experience includes financial planning, revenue and cost studies, rate setting, valuations, bond feasibility, and government consolidation. He has testified before several state public service commissions as an expert witness in financial and cost matters, is a contributing author of industry publications pertaining to capital financing and utility management. Mr. Mastracchio has lead numerous cost allocation and financial studies including cost allocation studies for the Hudson River Black River Regulating District, NY, the City of Virginia Beach, VA, Wayne County, MI, and Lee County, FL. Mr. Mastracchio holds a Masters of Business Administration degree from Cornell University and has earned the Chartered Financial Analyst designation.

#### **Pat Walker – Technical Advisor**

With more than 30 years of experience in local government management and operations, Ms. Walker has provided a broad array of management and financial planning services to one of Arizona's most financially stable cities, Chandler, for 23 years. As the city's Management Services Director she has developed numerous budgets and capital financing plans, prepared feasibility studies, overseen the city's human resources, accounting division, purchasing, information management, sales tax and utilities, risk management, environmental services and fleet operations in addition to the development and maintenance of numerous financial models. Ms. Walker is also well versed in municipal regulations issues, having drafted financial policies for Chandler as well as numerous citywide policies that impact every aspect of city management.

#### **Michael Francis – Financial Analyst**

Mr. Francis is a financial analyst with a focus on municipalities and public utilities. He



has completed many financial projects including cost allocation studies, financial planning studies, and rate and fee studies. Mr. Francis has worked extensively in the southeastern U.S., including throughout Florida and Georgia. Mr. Francis holds a Bachelors degree from the University of Central Florida.

### **RELEVANT EXPERIENCE AND CLIENT REFERENCES**

The Red Oak team has completed cost allocation and other related studies for numerous municipalities across the United States. The following are key references that we invite the City of Key West to call upon to obtain direct feedback on our performance.

#### **City of Huntington Beach Cost Allocation Plan**

Red Oak was retained by the City of Huntington Beach to provide professional consulting services for a City-wide cost allocation study. Red Oak reviewed Huntington Beach's existing Cost Allocation Plan and ascertained whether costs within the City's Public Works Department were being allocated in accordance with industry standards, including OMB Circular A-87, and the requirements of California's Proposition 218.

The review of the existing Cost Allocation Plan found that it largely met industry standards and that minor improvements could be made to optimize the allocation of costs within the department. Red Oak developed an Excel™-based model that extracted pertinent data from the City's Cost Allocation Plan and reallocated certain costs within the Public Works Department, without disturbing how costs should be allocated within other City departments. The quantitative findings of the model were summarized and provided in a report, which has been provided as an attachment to this proposal.

#### *Client Reference:*

Mr. Howard Johnson  
19001 Huntington Street  
P.O. Box 190  
Huntington Beach, CA 92648  
(714) 375-5055

#### **Indio Water Authority Cost Allocation Plan and User Fee Study**

Red Oak developed a cost allocation plan and comprehensive schedule of user fees for the Indio Water Authority in Southern California. This work was completed in accordance with applicable local laws, including California Proposition 218 and AB 1600. The project included four major elements:

- Development of a cost allocation plan specific to the Indio Water Authority to develop "fully burdened hourly rates" for all employees. These rates ensured that the Authority's overhead costs were properly reflected in user fees.
- Review of the Authority's user fee schedule, examination of the Authority's



operational practices to identify new potential fees, and a benchmarking survey of the fees charged by peer agencies.

- Estimation of the average labor time associated with each identified service/fee.
- Development of a user-friendly Excel™-based model to calculate the “maximum justifiable” fees for the comprehensive list of new user fees.

The project included multiple workshops, interviews, and presentations. A copy of the final report has been provided as an attachment to this proposal.

*Client Reference:*

Ms. Kelly Smith  
100 Civic Center Mall  
P.O. Box 1480  
Indio, CA 92201  
(760) 391-4184

**Example Reports**

Example reports from our Huntington Beach and Indio Water Authority projects have been provided as attachments to this proposal submittal.

**Additional Clients**

Below is a list of some of the Florida clients to whom the Red Oak team has provided financial consulting services, demonstrating our proven ability to successfully deliver financial consulting projects to municipal clients of all sizes throughout the state.

- City of Daytona Beach, FL
- City of Fort Myers, FL
- City of Hollywood, FL
- City of North Miami Beach, FL
- City of Sarasota, FL
- City of Venice, FL
- Broward County, FL
- Collier County, FL
- Emerald Coast Utilities Authority, FL
- Lee County, FL
- Miami-Dade County, FL
- Palm Beach County, FL
- Polk County, FL

**PROPOSED SCOPE OF WORK AND APPROACH**

Red Oak proposes the following scope of work to complete the cost analysis and develop a cost allocation plan for the City of Key West. Our project approach includes four major tasks, each of which is described below in more detail.

Task 1 - Kickoff Meeting

Task 2 - Information Gathering and Review, including Interviews



Task 3 - Cost Allocation Plan

Task 4 - Cost Allocation Plan Report

### **Task 1 - Kickoff Meeting**

Red Oak will meet with the City staff for a Kickoff Meeting at the City's offices to confirm the scope, schedule, and approach outlined in this proposal. The purpose, uses, and goals for the Cost Allocation Plan will be discussed to ensure that the project meets the City's current and future needs. During this meeting, we will clarify any implications that OMB Circular A-87 might have on the project methodology and discuss the best approach to meeting its requirements. We will also discuss Red Oak's data needs, which will be provided in memorandum format prior to the meeting. Finally, we will coordinate the project schedule with City staff schedules in order to ensure that key milestone dates are met, as well as confirm our respective team members' roles and responsibilities and communication needs/protocols throughout the assignment.

#### *Task 1 Deliverables:*

Kickoff Meeting minutes  
Data request memorandum.

#### *Task 1 Meeting:*

Kickoff meeting lasting two hours, and data gathering.

#### *Task 1 City Staff Resource Commitments:*

Attend Kickoff meeting  
Provide requested data, as available.

### **Task 2- Information Gathering and Review, including Interviews**

Following the kickoff meeting, and upon receipt of the requested data, Red Oak will review the City's financial records (e.g. budget, salaries paid to existing positions, benefit costs) in order to determine existing and potential cost centers and cost allocation approaches. Other useful documents will include organizational charts and organizational/program descriptions. The document review will be completed to understand the City's current practices related to direct and indirect cost allocation.

Red Oak will then schedule and facilitate group and one-on-one interviews with selected personnel in order to further our understanding of current operational and direct and indirect cost allocation practices, in order to select the most appropriate cost allocation approach to utilize for each General Fund function.

As part of our information gathering and review, we will hold approximately 12 interviews with key City employees in order to understand the services, both direct and



indirect that are provided by the City's General Fund. These interviews are anticipated to be held with the following City employees:

- Assistant City Manager
- City Clerk
- Finance representative
- Human Resources representative
- Information Technology representative
- City Attorney
- Planning Department representative
- Community Service employee representative
- General Services representative
- Building Services representative
- Code Compliance representative
- Port Operations representative

*Task 2 Deliverables:*

List of interview questions.

*Task 2 Meetings:*

Twelve interviews and approximately 24 hours of group or one-one-one interviews with selected personnel.

*Task 2 City Staff Resource Commitments:*

Attend and assist in scheduling interviews.

Provide requested data, as available.

### **Task 3- Cost Allocation Plan**

Red Oak will develop an Excel™-based model that will be the basis for the City's Cost Allocation Plan. Ultimately this plan will identify the cost allocation method used to allocate indirect General Fund costs to the various enterprise, special revenue and internal services funds, and the costs resulting from such allocation.

*Allocation Criteria*

Red Oak will work with the City in determining service provisions and cost categories for current City programs in order to develop the cost allocation plan. Red Oak will also



develop allocation criteria to distribute costs among the City's departments. Red Oak will use our previous experience as well as work directly with the City to determine those criteria (for example, the criteria used to allocate IT costs may be based on the number of computers or servers in each department).

This will ultimately result in developing formulas that will be used in the model to distribute General Fund indirect costs. These formulas will be used for internal, inter-fund, enterprise, special revenue, and external billing and/or costing processes. The cost allocation criteria will also consider approaches such as payment-in-lieu-of-taxes (PILOT) payments for police and fire service, as well as service fees for the use of City rights of way.

#### *Two-step Methodology*

Red Oak will use a two-step allocation methodology in developing the cost allocation plan, in accordance with industry standards. The first step identifies all General Fund and categorizes them into direct and indirect cost categories. These costs are then allocated proportionately to any department that benefit from the services. The second step isolates the costs that were allocated to any central department and proportionately reallocates those costs to the remaining operating departments. The purpose of this approach is to appropriately allocate costs to the City's operating departments.

#### *Cost Allocation Model Specifications*

The cost allocation model will allow for the addition or removal of direct and overhead costs so that the allocation of costs can be easily modified by the City as necessary in the future. The model will also have the ability to adjust the cost allocation based on the increase or decrease in future General Fund direct or indirect costs, and evaluate hypothetical future service enhancements and the ability to calculate the estimated costs of providing these future services.

#### *Task 3 Deliverables:*

Draft Cost Allocation Plan (provided under Task 4)  
Copy of the Draft Cost Allocation Model (provided under Task 4)

#### *Task 3 Meetings:*

Up to four (3) one-hour conference calls, as needed to review and discuss questions and comments pertaining to the development of the preliminary cost allocation plan.

#### *Task 3 City Staff Resource Commitments:*

Participate in conference calls as necessary





#### **Task 4 - Cost Allocation Plan Report**

Red Oak will develop a written draft Cost Allocation Plan and based on the results of the cost allocation model, and provide the draft plan and model to the City for review. The report will include a thorough description of the cost allocation methodology, the rationale behind allocation criteria used, a summary of the finding, and recommendations including alternatives where applicable. The draft plan will provide an executive summary of all the major findings and graphic summarizations wherever applicable. The Cost Allocation Plan will include formulas for distributing indirect costs to operating departments.

Red Oak will submit a draft Cost Allocation Plan to City Staff for one round of review and comment. Red Oak will incorporate all comments received by staff regarding the draft Cost Allocation Plan. Once all comments have been addressed, a final report will be prepared and provide to the City.

##### *Task 4 Deliverables:*

Draft Cost Allocation Plan

Final Cost Allocation Plan (up to 10 hard copies + electronic version)

Cost Allocation model (electronic version)

##### *Task 5 City Staff Resource Commitments:*

Review and comment on draft Cost Allocation Plan

#### **PROJECT SCHEDULE**

Red Oak will commence work immediately upon the notice to proceed from the City. It is anticipated that this cost allocation study will take approximately three months to complete, assuming that the necessary information to complete the study is received from the City in a timely manner.

#### **PROJECT COST**

Red Oak proposes to provide this scope of services on a lump sum basis for a fee of \$49,000. The return on the investment that the City can anticipate from engaging Red Oak in this project will result from our extensive experience and expertise in developing cost justified, fair and equitable cost allocation plans and financial studies for municipalities across the County. This successful track record will provide the City with a tangible return on investment as the City more equitably recovers its General Fund costs from the departments that benefit from its services.



Red Oak appreciates the opportunity to work with the City on this important and strategic project. Should you have any questions regarding our proposal, or require additional information, please do not hesitate to contact me at (518) 250-7353.

Very Truly Yours,

**RED OAK CONSULTING**  
A Division of Malcolm Pirnie, Inc.



John M. Mastracchio, CFA  
Senior Associate



ATTACHMENT A - EXAMPLE COST ALLOCATION STUDY REPORTS

