

# REPORT TO THE LEGISLATURE

## CHILD SUPPORT ADMINISTRATIVE COST RATIO STUDY



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## **EXECUTIVE SUMMARY**

In 2005, Supplemental Report Language directed the California Department of Child Support Services (DCSS) to conduct a study in consultation with: the Child Support Directors Association of California; local child support agency directors (or their designees) from at least one small, medium, large, and regional local child support agency; the Department of Finance; the Legislative Analyst's Office; and legislative staff from both caucuses of the Senate and Assembly. The study was to determine how local child support agency costs should be classified as direct program administration costs or overhead administrative costs, to examine the feasibility of imposing a cap on overhead administrative expenses for the State Fiscal Year (SFY) 2006-07 budget based on the new definitions of administrative costs, and to report to the Legislature by January 10, 2006. This report presents the findings and recommendations of that study.

This review of administrative costs among counties shows a reasonably consistent administrative cost ratio (i.e. the ratio of direct program administration costs and overhead administrative costs) across counties taking into account expected variables due to size. Current reporting of administrative costs is limited by the particular ways that counties provide their administrative services, and can result in differences in reported costs where no true differences exist.

The workgroup reviewed the various cost review mechanisms that are in place to ensure the appropriateness of LCSA expenditures and concluded that these mechanisms ensure appropriate program oversight. The workgroup also concluded that placing a limit on administrative overhead costs is not necessary at this point in time based on the revised definitions of administrative costs and data collected and analyzed for this report. The DCSS' goal is to ensure the LCSAs consistently and accurately report expenditures according to the definitions discussed in this report and the DCSS may conduct periodic reviews of LCSA expenditure reporting to ensure compliance with these definitions.

## I. PREFACE

In reviewing the proposed budget of the California Department of Child Support Services (DCSS) for SFY 2005/06, the Legislative Analyst's Office (LAO) recommended reducing the amount of state funding for local child support agencies (LCSA) by capping administrative costs in the Child Support Program because there were unexplained variations in administrative cost rates among LCSAs. The LAO raised a concern that LCSA administrative costs were too high, using as its basis findings in the AB 1752 Budget Allocation Workgroup Report that DCSS submitted to the Legislature in May 2004.

During budget hearings the issue was discussed further and it became clear that there was variation among the counties in the way that administrative costs are classified and reported. It was agreed to provide further information about how these costs should be classified. As a result, Supplemental Report Language was adopted, as follows:

**Classification of Administration and Program Costs.** The Department of Child Support Services shall report to the Legislature on *how local child support agency costs should be classified as program costs or administrative costs*. In developing this report, the department should consult with stakeholders including, but not limited to, the Child Support Directors Association of California; local child support agency directors (or their designees) from at least one small, medium, large, and regional local child support agency; the Department of Finance; the Legislative Analyst's Office; and legislative staff from both caucuses of the Senate and the Assembly. The report should *examine the feasibility of imposing a cap on administrative expenses for the 2006-07 budget based on the new definitions of administrative costs*. To the extent that counties provide sufficient information, *the report should include a county-by-county listing of program and administrative expenditures for each county based on the definitions contained in the report*. The report shall be submitted to the Legislature no later than January 10, 2006. (Emphasis added.)

In developing this report, DCSS consulted with stakeholders, including the Child Support Directors Association (CSDA), LCSA directors (or their designees) from small, medium, large and regionalized LCSAs, the California Health and Human Services Agency, the Department of Finance (DOF), the LAO, and legislative staff from both caucuses of the Senate and the Assembly. This report examines the categories and definitions of administrative costs, the explanation of variances in administrative costs between counties, and the feasibility of imposing a cap on administrative expenses for the 2006/07 budget based on new definitions of administrative costs. It also contains a listing of program and administrative expenditures for each LCSA that participated in the study, based on the definitions identified in this report.

## II. THE ADMINISTRATIVE COST RATIO STUDY

The DCSS conducted a study of direct program and overhead administrative costs of selected counties using actual expenditures of the LCSAs participating in the study for SFY 2004/05.<sup>1</sup> (See Appendix.) A cross representation of LCSAs was chosen to participate in the study: Alameda, Central Sierra, Contra Costa, Los Angeles, Napa, San Francisco, San Mateo, Santa Barbara, Santa Cruz/San Benito, Sierra/Nevada and Tuolumne. These counties represent large, medium, small and regionalized LCSAs.

The purpose of this report is to review the classification of costs in the LCSAs as direct program and overhead administrative and determine the ratio for the sampling of LCSAs, based on a more consistent application of one definition of administrative costs across the counties. The findings also explore the reasons for the administrative cost ratio variance among LCSAs and consider the feasibility of imposing a cap on the LCSAs' administrative expense ratios for the 2006-07 budget. This report is presented in three parts. The first part describes the parameters used in the study; the second part presents findings as to the causes of ACR variance among LCSAs; and the conclusion represents the recommendation of the DCSS regarding the feasibility of imposing a cap on LCSAs' administrative expense ratios.

DCSS used the following general definitions for program and administrative costs:

**Direct Program:** includes all costs incurred by an LCSA that are directly attributable to providing child support program services (child support program specific).

**Overhead Administrative:** includes all costs incurred by an LCSA that are supportive in nature and necessary to operate the program generally.

**Administrative Cost Ratio:** a mathematical comparison of both direct program and overhead administrative costs to total costs.

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<sup>1</sup> The original AB 1752 Workgroup findings used budgeted figures and not actual expenditures.

### **III. PARAMETERS OF THE STUDY**

DCSS and CSDA convened an Administrative Cost Ratio Workgroup, comprised of representatives from DCSS, CSDA, and representatives from small, medium, large and regional LCSAs (six LCSAs in total) to undertake the review required by the Supplemental Report Language. The workgroup began by examining what makes up overhead administrative costs as compared to direct program administration costs. The group identified uniform definitions of costs in the child support program. The group then determined whether each type of cost defined should be classified as overhead administrative or direct program administration costs, or whether the cost could be allocated between both functions.

Many costs in the child support program are incurred for direct program services, although these same costs are typically considered overhead administration in other state or local programs. Therefore, postage has been classified as an overhead administrative cost for purposes of this study. Although many issues impact the ACR, postage is the most significant factor. The reason postage costs are high in the child support program is due to the volume of mailings the LCSAs must make in order to effectively establish and enforce child support cases and to distribute collections made on behalf of those cases. If the cost of postage were classified as a direct program expense, it would result in an administrative cost ratio that is lower than that found in other human service programs.

In addition, the workgroup was concerned that using budgeted costs did not accurately reflect their actual administrative costs. The AB 1752 Budget Allocation Workgroup Report administrative cost ratio findings were based on LCSA budgeted funding levels for FY 03-04 not actual expenditures. Therefore, each LCSA participating in the workgroup completed mock claim worksheets using their actual SFY 2004/05 expenditures following the revised definitions and classification established by the group. The mock claim figures were compiled in spreadsheets using an allocation method based on the percentage of administrative salaries as compared to total LCSA expenditures. This administrative percentage was used to allocate certain common costs and other overhead costs between the overhead administrative and direct program functions for the LCSAs. DCSS compiled the results from this allocation model for each LCSA participating in the workgroup and an additional group of five LCSAs, and determined that the ACRs for these LCSAs were significantly less than what had been previously identified in the AB 1752 Workgroup Report. Table I sets forth the results using this allocation methodology.

**TABLE I**  
**Administrative Cost Ratio Using**  
**Participating LCSAs SFY 2004/05 Actual Expenditures**

<u>County Size</u>	<u>County</u>	AB 1752	ACR
		<u>SFY 03/04 Budgeted</u>	<u>SFY 04/05 Actual</u>
Very Large	Los Angeles	31.31%	24.57%
Large	Alameda	23.13%	19.97%
Large	Contra Costa	18.84%	20.32%
Large	San Francisco	25.63%	21.62%
Medium	Santa Barbara	24.78%	25.04%
Medium	San Mateo	23.47%	22.62%
Small	Napa	26.81%	26.59%
Very Small	Tuolumne	32.57%	25.66%
Medium (Regionalized)	Santa Cruz/San Benito	24.74%	32.12%
Small (Regionalized)	Sierra/Nevada	28.11%	27.98%
Very Small (Regionalized)	Central Sierra	25.22%	32.12%

Variations between the budgeted and actual administrative cost ratios resulted from a number of things including changes in A-87 Countywide Cost Allocation plan charges, changes in the way LCSAs identified costs based on the revised definitions, and changes in staffing levels.

The calculated administrative cost ratio in any particular county is sensitive to the kinds of costs that are classified as overhead administrative costs. Overhead administrative costs are distinguished from direct program costs as being cost items that support but do not directly provide program services. It is not always clear what cost should be included in overhead administrative costs as opposed to direct program costs. For example, if the definition of overhead administrative costs in Table I were changed to include direct program costs, such as postage and prorated shares of space costs and director's salaries (see 1. Scale of Operation on the following page), it would significantly affect the administrative cost ratio as shown in Table II for a subset of the counties.

**TABLE II**  
**Administrative Cost Ratio Using**  
**Cost Allocation Methodology**

<u>County</u>	<b>Administrative Cost Ratio</b>
Alameda	8.3%
Central Sierra	13.7%
Los Angeles	5.8%
San Mateo County	6.8%
Santa Cruz/San Benito	14.6%
Tuolumne	9.2%

## **IV. FINDINGS ON CAUSES OF VARIATIONS IN ADMINISTRATIVE COSTS**

The data reported in Table I shows considerable variation in the administrative cost rates among counties. Overall, this variation can be attributed to several different factors:

### **1. Scale of Operation**

Generally, the smaller counties have higher overhead administrative cost rates. This is, in part, due to the expected economies of scale that result in these kinds of fixed costs constituting a larger share of small county costs. One reason for this larger share is that overhead administrative cost elements come in units that cannot be divided into smaller parts. For example, each LCSA has a director whose salary costs are identified as overhead administrative costs and constitute a larger share of total salary costs in smaller counties. In many small counties, directors take on duties other than just program administration, and many of them include in their duties direct case management. Our survey and costs analysis did not take these direct case activities into account and did not share their time between direct program costs and overhead administrative costs.

### **2. Postage**

The child support program requires heavy use of the mail for communicating to clients, employers, and others. LCSAs are required to mail numerous documents including legal documents, postal and employer verification letters, correspondence to customers, correspondence to attorneys, monthly statements of accounts, and checks to custodial parents and other agencies. However, reporting of postage differs among counties depending on their particular arrangements for handling these mailings. Some counties have contracts that cover the cost of printing and mailing materials required by the program. Others do not separately identify the cost of mailing payments to families. Some of the variation in administrative costs among the counties is due to these differences in reporting.

### **3. Space Costs**

The creation of separate child support departments locally, resulted in many LCSAs which formerly occupied space with their county Offices of the District Attorney having to find other space for the new agency. Thus, space costs vary significantly depending on the solution available to the LCSAs at their time of transition to the new program. Space costs include rental and lease costs for privately-owned buildings; depreciation and use allowance for purchased buildings; alterations and renovations of buildings; and building maintenance. Some LCSAs incur higher rates of space cost due to the region of their location; however, all space costs are subject to review and approval by

the State Controller's Office. Some LCSAs now occupy space that costs more than their previous space did.

#### **4. Pay and Classification Differences**

Wages and classifications of employees differ throughout the state reflecting differences in local economic conditions. To some extent these costs will be reflected in differences in administrative costs.

#### **5. Limitations in Reporting**

The counties participating in this study attempted to report administrative costs as consistently as possible across the counties. Some variation in cost remains due to differences in how each county accounts for each of the particular cost elements that make up administrative costs.

## V. ENSURING REASONABLE COSTS

What mechanisms are in place to ensure that LCSAs do not expend an inappropriately large share of their budgets on overhead administrative costs?

Although LCSAs are given discretion in determining how to organize and deliver services, they must still follow the federal and state laws and regulations governing the Child Support Program which dictate the activities LCSAs must fund with their administrative allocations. Further, the majority of administrative allocation funding is expended on program specific activities, whether or not these activities are officially classified as direct program costs. LCSA expenditures and performance are monitored by DCSS' Regional Administrators and through the Quality Assurance and Program Improvement (QAPI) process. In addition, there are many systems in place to ensure that the investments by all levels of government in the administration of the Child Support Program are reasonable. These include the following:

### **Allowable Costs:**

Overall administrative costs are controlled by federal cost principles under Office of Management and Budget (OMB) Circular A-87, in conjunction with federal regulations, which specifically define the overhead administrative and program costs allowable for federal reimbursement. These costs must be necessary and reasonable for the proper and efficient administration of the program. The State Controller's Office (SCO) annually reviews county centralized services to ensure that costs meet these requirements.

### **Space Costs:**

Space costs are also controlled under the authority of Circular A-87 by the Office of the State Controller, which in California has been delegated the authority to act for the federal government. Under this delegation the Controller has issued specific guidelines for LCSAs to follow when acquiring space, and under certain circumstances must approve the method of claiming space before reimbursement. A key element of this control is that space costs, no matter how acquired by a LCSA, must be within prevailing market rates to be reimbursable.

### **Budget Limits Control:**

Due to the ongoing budget constraints, LCSAs have received level funding over the last three state fiscal years. Level funding has required that LCSAs institute cost control measures within their agencies to live within their budgets.

**Claims Review:**

The Department of Finance conducts fiscal audits of LCSAs on behalf of the DCSS. These audits scrutinize expenditures by LCSAs in comparison to state and federal laws and regulations and ensure that LCSAs are following specified claiming procedures in reporting allowable costs. These audits also assist LCSAs in reporting costs accurately in order to maximize federal reimbursement.

## **VI. CONCLUSION AND RECOMMENDATION**

This review of administrative costs among counties shows a reasonably consistent administrative cost ratio across counties taking into account expected variables due to size. Current reporting of administrative costs is limited by the particular ways that counties provide their administrative services, and can result in differences in reported costs where no true differences exist.

The workgroup reviewed the various cost review mechanisms that are in place to ensure the appropriateness of LCSA expenditures and concluded that these mechanisms ensure appropriate program oversight. The workgroup also concluded that placing a limit on administrative overhead costs is not necessary at this point in time based on the revised definitions of administrative costs and data collected and analyzed for this report. The DCSS' goal is to ensure the LCSAs consistently and accurately report expenditures according to the definitions discussed in this report and the DCSS may conduct periodic reviews of LCSA expenditure reporting to ensure compliance with these definitions.

**Participating LCSAs**  
**SFY 2004/05 Actual Expenditures by Program and Administrative**  
 (Dollars In Thousands)  
 (Source: CS 356<sup>2</sup>)

County Size	Program Expenditures	Administrative Expenditures	Total Expenditures	Administrative Cost Ratio
<b>Very Large</b>				
Los Angeles	\$ 109,735	\$ 39,753	\$ 145,488	24.57%
<b>Large</b>				
Alameda	21,097	5,264	26,361	19.97%
Contra Costa	17,566	4,480	22,046	20.32%
San Francisco	9,233	2,547	11,780	21.62%
<b>Medium</b>				
San Mateo	8,759	2,560	11,320	22.62%
Santa Barbara	6,146	2,053	8,199	25.04%
<b>Small</b>				
Napa	2,865	1,038	3,903	26.59%
<b>Very Small</b>				
Tuolumne	1,379	476	1,855	25.66%
<b>REGIONALIZED</b>				
<b>Medium</b>				
Santa Cruz/San Benito	5,730	2,712	8,442	32.12%
<b>Small</b>				
Sierra/Nevada	2,804	1,089	3,893	27.98%
<b>Very Small</b>				
Central Sierra	1,898	898	2,797	32.12%

<sup>2</sup> CS356 is the Administrative Expenditure Claim submitted by each LCSA each quarter.

## **ADMINISTRATIVE COST RATIO WORKGROUP PARTICIPANTS**

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