

**FRANCIS LAUER YOUTH SERVICES
CERRO GORDO COUNTY, IOWA**

An Analysis of the County Decision to Privatize The Agency

Prepared for

Francis Lauer Youth Services

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THE PRIVATIZATION OF THE FRANCIS LAUER
HOME AND SHELTER: ANALYSIS AND PLAN

I. INTRODUCTION

A. Background

Francis Lauer Youth Services is a Cerro Gordo County agency providing short term shelter for infants, children and teenagers facing emergencies in their lives, and longer term residential treatment for those requiring it. Young people come to Francis Lauer out of a variety of circumstances. Some are abused children of abusing parents; some are runaways. Still others are from homes where, for one reason or another, their parents are simply not able to care for them properly. Some walk in and ask for help, and some are delivered by social welfare or law enforcement officers.

Francis Lauer has two facilities. The first is the Shelter. The need for a shelter to provide short term care for children facing crises in their lives crystallized in 1983. After two years of planning with participation of city and county leaders at all levels, the Francis Lauer Youth Shelter opened its doors in August 1985. The Shelter is located on a floor of the old YWCA in downtown Mason City and is licensed to accommodate a maximum of 13 young people.

The second facility is the Youth Home, a separate building located on the grounds of the old County Home. The Home is a licensed Comprehensive Residential Treatment Facility designed to handle up to fourteen emotionally disturbed teenagers. The Home provides not only residential care for these young people but also a full educational program in lieu of public school in its own facility. Both the Shelter and the Home provide in-house psychological counseling.

A total of 43 employees staff the two facilities. These include five management professionals, and thirty eight hourly staffers. The annual payroll for the overall operation is in the \$500-600,000 range, with all other costs boosting the total budget of the operation to approximately \$589,129 for the (somewhat atypical) fiscal year ending June 30, 1987. Table 1 presents a tabulation of the revenues by source for the agency.

The Shelter has been able to offset the overhead costs of providing these services to Cerro County by taking in young people referred to Francis Lauer (and paid for) by surrounding counties. In addition, as is evident from Table 1, the state of Iowa offsets a substantial share of the overall cost of operation.

Both the Home, since 1968, and the Shelter, since 1985, have been Cerro Gordo County agencies. Over the course of those years the Home has provided long term treatment for well over 200 young people, while the Shelter, since its opening in August 1985, has provided care for approximately 220. Both facilities have been successful in fulfilling their service functions, both to the Cerro Gordo and northern Iowa community in general, and in particular to the young people directly served. Law enforcement professionals, the judiciary, community services professionals, and the community at large, have all indicated satisfaction with the services provided, and relief that these facilities are in fact available to provide quality care for these young people.

TABLE 1
SOURCE OF FUNDS
FY 1987
Total Agency

Source	Amount	Percent of Total
=====		
Cerro Gordo County		
Equivalent Unit Charges:	\$18,942	0.035
Net Budget Allocation:	28,058	0.051
Other Counties:	16,542	0.030
State (POS):	447,386	0.816

Grants:	21,200	0.039
United Way:	8,005	0.015
Other Donations:	7,401	0.014

Total:	\$547,534	1.000
=====		

Source: Francis Lauer Youth Services

B. The Decision to Eliminate Francis Lauer Youth Services As a County Agency

With the inception of the County's FY 1988 budget process in December 1986 there were strong indications that the Board of Supervisors were inclined toward a policy of closing Francis Lauer Youth Services as a County agency and reopening it as a private non-profit corporation. At a meeting between Francis Lauer director Bruce Hoffmaster and the Board of Supervisors in January (1987), the Board indicated that study and preparation was in order for the transfer of Francis Lauer out of County agency ranks.

At a meeting between the Board of Supervisors and the Francis Lauer Board of Directors on February 12, 1987, the Supervisors directed that plans be initiated to bring about the reorganization. The Francis Lauer Board of Directors, on the other hand, felt that the better course was first to study the financial feasibility and ramifications of the change and the potential impact on service provision before committing the agency to a major reorganization.

Twelve days later the Board of Supervisors resolved any remaining ambiguity in the situation by sending a letter to Francis Lauer saying:

"Our support for Francis Lauer Youth Services will remain as it is through the budget year ending June 30, 1988. At that time, you would have in place your private, non-profit corporation. The

county's involvement as an entity (sic) would cease at the end of that period."¹

The expectation of the Board of Supervisors was, at least implicitly, that the elimination of Francis Lauer as a county agency, and its re-establishment as a private entity providing much the same services, would reduce both the future dollar cost to the county of providing these services, as well as the county's tort liability exposure.

In response to the Supervisor's mandate, the Board of Directors of Francis Lauer have commissioned this study to serve two purposes. First, to provide a road map for the transition from public agency to non-profit provider; and second, to provide the Supervisors and the Francis Lauer Board of Directors with a comparison of the costs of public versus private provision. What follows is divided into four sections. Section II (after the Introduction) is a discussion of the economic development impact of Francis Lauer on the economies of both Mason City and Cerro Gordo County. Section III presents a financial history of Francis Lauer, and compares Francis Lauer with other similar services in Iowa. Section IV outlines a financial plan for the transition from county agency to private non-profit provider. Finally, section V furnishes an overview and summary of this report with a rough schedule for the transition.

II. THE ROLE OF FRANCIS LAUER IN THE CERRO GORDO ECONOMY

A. The Economic Benefits of Francis Lauer

Cerro Gordo County and Mason City are both vitally interested in economic development. Economic development means both jobs for residents and the direct and indirect beneficial impact of agency expenditures in the community. Agency employees add to the county's economic viability directly through their payroll expenditures on food, clothing, housing, recreation, vehicles, and through their local tax payments, and

¹ Robert Ermer to Bruce Hoffmaster letter of February 24, 1987.

indirectly through the income generating effect of their expenditures on the community.

An approximate measure of these favorable impacts can be provided through the use of Army Corps of Engineer data on the expenditure patterns for each county in the mid-west. This data base is maintained by the University of Illinois at Champaign-Urbana. Table 2 provides the income and employment multipliers for Cerro Gordo County.

The 2.1736 income multiplier figure indicates that for every \$100,000 in expenditures by Francis Lauer, the County economy can expect to benefit from \$217,360 in economic activity as the direct expenditures ramify through the economy.

In terms of jobs, the 2.1736 multiplier means that in addition to the 43 direct staff jobs provided by Francis Lauer, an additional 50 jobs are created indirectly in the county, for a total beneficial impact of 93 jobs overall.

TABLE 2
INCOME AND EMPLOYMENT MULTIPLIERS
FOR CERRO GORDO COUNTY

=====

Income Multiplier	2.1736
Employment Multiplier	2.3318

=====

Source: Environmental Technical Information System
CONSTRUCTION ENGINEERING RESEARCH LABORATORY
Champaign, Illinois.

The availability of the Francis Lauer services also adds significantly to an attractive environment for new business concerned about the quality of schools and other services, crimes rates, and the overall quality of the general community. Francis Lauer is a significant player in each of these areas. The services provided by

Francis Lauer in a socially responsible and dignified way act to minimize the societal impact of family disruption, homelessness, and young people in need of care and counseling. The presence of such services is a significant element in making middle American cities attractive places to live, work, and do business.

B. The Cost of Providing Alternative Services:

An Efficiency Rating for Francis Lauer

One of the reasons that Francis Lauer was established initially in Cerro Gordo county was to provide a significantly less expensive way to furnish youth home and shelter services, compared to the existing alternatives.

Tables 3 and 4 compare the cost to the county of providing care at Francis Lauer versus the cost of the same care at facilities in neighboring counties.

Tables 3 and 4 show that for both the Home and the Shelter the facilities provided by Francis Lauer are significantly less expensive for Cerro Gordo County when compared to nearby alternatives. Part of this cost advantage arises out of the costs involved in transporting young people to distant facilities, and part, in the case of shelters, relates to

TABLE 3

COST TO CERRO GORDO COUNTY OF PROVIDING YOUTH CARE

VIA FACILITIES IN NEIGHBORING COUNTIES

RESIDENTIAL CARE FACILITY

	Francis Lauer	Hillcrest ²
Direct Charge Per Day ³	0	0
Mileage at \$0.205	0	\$67.24
Time for Personnel & Equipment Out of Service at \$30/hr. ⁴	\$30.00	\$226.80
Total Differential Cost:		\$264.04

Source: Mileage figure from Francis Lauer. \$30 per hour for personnel and equipment is the author's rough estimate for illustrative purposes.

² Hillcrest, in Dubuque, is used simply to illustrate, in dollars, that the cost of using alternate facilities were Francis Lauer no longer available would be the cost of mileage to the alternative facility, plus the cost of vehicle and personnel out of service for the time necessary to effectuate delivery and return.

³ The direct charge per day is the total cost of providing one unit of service (one young person for one day) less the amount of the state reimbursement.

⁴ Assuming an average of one hour average time to check in the young person involved.

TABLE 4
 COST TO CERRO GORDO COUNTY OF PROVIDING CARE
 VIA FACILITIES IN NEIGHBORING COUNTIES
 YOUTH SHELTER

	Waterloo	Fort Dodge	Francis Lauer
Net Direct Charge Per Day	\$26.50	\$20.00	\$16.82
Mileage at \$0.205	32.39	44.28	0
Time for Personnel & Equipment Out of Service at \$30/hr.	124.80	159.60	30.00
Totals:	\$183.69	\$223.88	\$46.82

Sources: Net Direct Charges from the Shelters listed. Mileage rate from Francis Lauer. Time for Personnel and Equipment out of service assumed fifty miles per hour, and one hour average at the agency making the transfer.

Francis Lauer's lower FY1986 cost of service.

Table 5a provides a comparison of wage rates for typical providers of similar services in Iowa. The Waterloo Shelter is public, while the Fort Dodge and Hillcrest facilities are operated by private, non-profit entities. For the basic personnel category of Youth Worker Francis Lauer's wage rates are 16% to 36% lower than at the comparison facilities. For the Social Worker category Francis Lauer is in the middle of the range of the others; Francis Lauer's Office Manager wage rate ranks substantially below the other two facilities reporting a similar position.

As is evident from the tables, wage rates vary a great deal as do the qualifications for the positions. The pressure on Shelter and Home finances, given the large fraction of the total cost of operation necessarily going to wages and benefits, has been translated into pressure on wage rates. The position of the Department of Human Services seems to be notably unsympathetic on this point; if the operation is having a difficult time getting by at the state POS rate, then the solution is, according to them, to cut costs, which given the character of the service can only mean cutting wages.

Since the task of dealing with disturbed young people in a residential care or shelter environment is a job for professionals and mature and well prepared hourly workers, the pressure to cut wages is destructive of quality care. Many positions which ought to require bachelor's level preparation were downgraded to require only a high school degree, and then further downgraded to require only a GED. Thus, it is now possible, at least theoretically, to have 18 year old high school graduates supervising 17 year old shelter and home clients.

As wage rates fall toward the \$4.50 per hour level, the difficulty of recruiting adequately trained staff gets more severe. In addition, even if the pool of available workers is currently adequate due to the depressed state of Iowa's economy, the turnover rate is going to be high, as these wage levels are hardly adequate to keep quality staff other than on a temporary basis.

For those skeptical of claims of long term, unquantifiable declines in service quality, it should be noted that poorly trained staff, with low morale, and high turnover rates, are much more likely to cause liability

problems than well paid, highly professional, permanent staff with high morale.

Table 5b presents the results of our review of wages paid to agency directors at several levels of responsibility. Quality directors are, of course, pivotal to the successful operation of quality services with maximum positive impact on the community. To attract and keep high level professional management, salaries have to be paid which are adequate relative to national norms, and which embody reasonable incentives for high level performance. Opportunities for professional development and creative growth are also necessary for high management performance levels over time.

With this in mind, the director's current salary level at Francis Lauer (see Table 5b) is toward the lower end of the competitive range and will need to be adjusted upward in the near future.

TABLE 5A
 COMPARATIVE WAGE RATES
 (STARTING WAGES ON AN HOURLY BASIS)

Position	Waterloo	Ft. Dodge	FLYS	Hillcrest
Youth Worker ⁵	\$7.00	\$6.00	\$4.50	\$5.36
Social Worker ⁶	8.75	7.00	8.00	7.50
Office Manager ⁷	n/a	8.50	6.50	7.50

⁵ Includes the titles of Residence Counselor, Youth Worker, and Child Care Worker.

⁶ Converted from yearly rates using a factor of 2,000 hours per year. Since practice in the industry appears to be to work more hours than this in practice, these figures will tend to overstate the hourly equivalent wage.

⁷ Actual wage.

=====
 Source: Conversations with agency directors.

Francis Lauer also has Youth Counselor Supervisors

who start at \$7.75/hr.

In sum, the Francis Lauer operation operates on lower than average wages, has a lower cost of operation for the Shelter, and provides both Home and Shelter care at overall costs (including reasonable transportation charges) which are significantly lower than the costs Cerro Gordo County would incur were Francis Lauer not available.

TABLE 5B
 SURVEY OF DIRECTOR SALARY LEVELS
 FOR MIDDLE MANAGEMENT AND CEO LEVEL DIRECTORS

Survey or Entity	Middle Mgmt	CEO	Salary Range
Waterloo Shelter (Public)	X		\$22,000
Ft. Dodge Shelter (Private)		X	\$29,000
Hillcrest Shelter + Home (Private)	X		\$30-40,000
Francis Lauer Shelter + Home		X	\$32,400
CWLA Research Center 1985 Survey: Median Director's Pay ⁸			\$48,483

⁸ Botsko & Jones, Annual Salary Study and Survey of Selected Personnel Issues 1985: A

CFCS Survey⁹ \$25,992-\$39,253
=====

Source: The agencies listed for the agency figures, and the surveys listed.

III. FINANCIAL OVERVIEW

A. Public Agency Costs and

The Economics of Shared Overhead

There are a number of ways that a county could provide for the provision of Youth Home and Shelter services. Organizational alternatives range all the way from independent private for-profit corporations to public "combined-service" organizations. Since we live in a world where markets do not conform to the fantasy world of economists, where state and federal taxes have a substantial impact on the viability of certain organizational forms, and where the overhead cost structure of the service to be provided is significant, the choice of organizational form can have a considerable impact of the cost of providing the service.

It is worth investigating, then, how the cost effectiveness of various organizational alternatives are affected by their relationship to these factors. Table 6 lists seven different types or organizational alternatives currently in use, or which could be used, for the provision of these services. Listed horizontally

Report on Administrative and Professional Staff and Salaries in CWLA Member Agencies. New York. Child Welfare League of America, 1985. Figures have been adjusted upward for inflation at 3% to provide a reasonable comparison.

⁹ CFCS, Salary Survey. Des Moines. Coalition for Family and Childrens' Services; December 1984. The stated figures are for agencies in the budget range of \$500,000 to \$1 million. The figures given in the survey are adjusted for inflation at 3% to make them commensurate with current salary levels quoted for the agencies in the table.

across the top of the table are five variables which can have a material impact on the cost and financial performance of the seven alternatives relative to the county and its residents.

The obligation of profitmaking entities to pay state and federal income taxes will mean, for example, that other things equal, private for-profit services will be more costly to the county picking up the bill. On the other hand, since non-profit and public entities are not required to pay income taxes, other things equal, they are able to provide these services at lower cost.

Tax exempt financing is of similar significance. While public agencies have access to debt financing at low tax exempt rates, private corporations don't generally have access to tax exempt bond financing (certainly not very low interest general obligation bond financing), and even those areas where tax exempt revenue bond financing has been available in the past were substantially circumscribed by Congress in the 1986 Tax Simplification Act.

Since revenue bonds, again other things equal, bear lower interest rates than non-exempt bonds, and general obligation bonds lower rates than either, public entities, especially those with general obligation bond financing, will have a more or less significant advantage over entities without such access.

The power to tax is perhaps significant in a way that is not obvious. Good youth services programs create positive externalities for the county and county residents. The existence of these externalities is indicated by the fact that in most places residents are willing to pay to have high quality youth services available, even though those services never touch them directly in any outright manner.

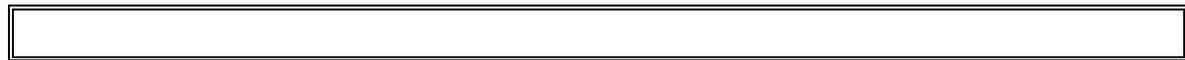


TABLE 6
STRUCTURAL COMPARISON OF ORGANIZATIONAL ALTERNATIVES

Form	Pay Federal Taxes?	Access to Tax Exempt Financing?	Taxing Power?	Direct Shared Overhead?	Indirect Shared Overhead?
Private, Independent, For-Profit	Yes	No	No	No	No
Private, Independent, Non-Profit	No	Revenue Bonds(?)	No	No	No
Private, Affiliated, For-Profit	Yes	No	No	Possible	Possible
Private, Affiliated, Non-Profit	No	Revenue Bonds (?)	No	Possible	Possible
Public, Independent	No	Revenue Bonds	Sometimes	No	No
Public, Combined	No	Revenue Bonds & Gen. Oblig.	Yes	Yes	Yes

Direct Shared Overhead refers to situations where the entity serves two functions with the same personnel, for example where the fire department uses firemen to staff an emergency ambulance service.

Indirect Shared Overhead refers to situations where the entity is able to share in centrally provided services like billing, accounting, payroll, etc.

The ability to tap these "external" benefits to residents¹⁰ through the tax system, such that those who benefit have an opportunity to contribute, may well mean the difference between a mediocre service of small direct benefit to the young people in need of assistance, and minimal "external" benefits to County residents, and a robust service fully justifying direct and tax expenditures.

It is significant to note that both the County and the State have been cognizant of the importance of these services to the quality of life and business climate in the County. Whereas the State has traditionally carried a significant share of the burden of funding youth related services, the legislature has also recognized the important role the Counties can play in section 232.141 (Iowa Code 1985).

Though each of the variables just described is significant with respect to cost effectiveness, the ability to share overhead between services is of special significance for entities like Francis Lauer where the ratio of overhead costs (fixed costs) to variable costs, i.e. costs which vary in the short run with the number of young people, is weighted substantially in favor of the fixed costs for each service.

So, for example, a private enterprise operating a Youth Shelter facility would have

¹⁰ Such benefits include knowing that there is a safe place for abused children to stay away from their abusers; the availability of a facility for teenagers who may be hovering on the edge of criminal activity through parental neglect or psychological disturbance, etc.

to provide for accounting, payroll, bill collection, financial planning, auditing, and legal functions for the entity. It will normally be more costly per unit of youth service provided to do this for a small entity than for a larger entity, or for several entities sharing services, given the relatively large minimum cost effective size of the units of provision of these service.

An example of this might be the purchase of a computer and software to handle payroll and accounting for a small entity, where the smallest cost effective computer is still capable of handling much more work than the entity is able to generate. Two separate independent entities will often be found to have purchased two computers, and hired two separate people to operate them, when a combined agency could get by with one computer and fewer than two operators.

Francis Lauer, along with other entities providing services of this sort, has a high ratio of fixed overhead to variable costs. This means that the bulk of the costs of operating the two services do not vary with the number of resident young people in the short run. In any particular month, for example, the rent and insurance payments have to be made, salaries for full time staff plus benefits have to be forthcoming, and accounting, billing, and payroll functions have to go on. In a situation of this sort it is cost effective to share as much of these overhead functions among several entities as is possible.

In the case of Francis Lauer as a county agency much of this sharing is in place. The Youth Home and the Shelter are managed by a central management. Some billing and accounting functions are provided centrally, and some supplies are ordered centrally.

In addition to the central provision of some management services within the agency, some services are centralized in the county between several county agencies, or between all county agencies. These include legal services, the bulk of the billing and payroll function, employee health, unemployment, and worker's compensation insurance, pensions, and property and liability insurance.

In some areas county agency status has meant that certain costs are avoided altogether. Among these have been the cost of licenses for agency vehicles, sales, use, and gasoline taxes, the need for a contingency fund in case of emergencies, and the availability of beeper and emergency answering service via the county dispatcher.

Almost all the costs described in the last several paragraphs are in the category of overhead costs. All will be affected by the changeover from county agency status to independent private entity status. It is important to note that although increases in Francis Lauer's costs in these areas are liable to be substantial, spinning off Francis Lauer will not save the county from having to pay these increases.

To illustrate, consider the case of the licensing of agency vehicles. As a county agency those vehicles were exempt at the state level from annual license fees, use tax,

gasoline taxes, and title fees. The county did not have to pay these fees and neither did Francis Lauer, and so they did not show up in Francis Lauer's unit charges to the county. With the conversion of Francis Lauer to private agency status, however, Francis Lauer, Inc. will now be subject to all these fees, which will then be reflected in the Corporation's cost of doing business, and in the charges made to those utilizing corporate facilities, i.e. the county.

Similarly, whereas as a county agency Francis Lauer was exempt from the sales tax on its purchases of supplies and services (as well as the gasoline tax), as a private entity licensed under the "non-mentally retarded" provisions of chapter 237 (Iowa Code 1987)¹¹ it will no longer be exempt, and its resultant 4% higher cost for materials and supplies will be passed on to the county in the form of higher per unit charges, which would not have entered the picture otherwise.

In addition, the county's withdrawal of legal, auditing, payroll, accounting, and billing services to Francis Lauer will result in Francis Lauer, Inc. having to purchase legal and auditing services on the open market, and provide additional staff internally to

¹¹ The Shelter is currently licensed under Chapter 232 while the Home is licensed under chapter 237. The administrative rules provide, however, that private shelters may only be licensed under chapter 237. (Source: Hap Palmer, Department of Human Services).

handle payroll, accounting, and billing.¹² These additional costs of doing business will then, of course, need to be reflected in per unit charges.

Unfortunately, even though the county would no longer provide those services, it is unlikely to be able to reduce its own total cost of providing auditing, legal, payroll, accounting, and billing services by the same amount as Francis Lauer will have to increase its; it's simply not possible to lay off 5% of a computer; and the county is not likely to reduce a full time employee to 95% time.

In sum, Francis Lauer Youth Services more cost effectively provides youth services as a public agency than it is likely to be able to do as a private entity. Its financing costs are lower, many of the costs of operation are reduced because of its public agency status, it is able to participate in the group provision of certain services (payroll, etc.) which are more cost effectively provided to relatively small entities on a centralized basis, and it benefits from large group or public rates for insurance and pensions.

If Francis Lauer, Inc. is going to provide its services as a private provider, those

¹² Francis Lauer's outside CPA has estimated that the average annual additional audit cost will be approximately \$2,000. Legal costs will, of course, vary greatly from year to year, but his opinion, based on other similar private entities, was that approximately \$1,000 per annum on the average for legal fees would be reasonable. The cost of additional staff to handle payroll, billing, accounting, was estimated at one full time position at \$4.50 per hour with approximately 25% roll-up, for an annual increment over current cost of \$11,250.

that make use of the service are going to have to cover all the costs of operation above the level of the state subsidy. If these costs rise due to the higher cost environment of private operation compared to public agency operation, then the costs to the county as a user of the service will rise as well.

B. Francis Lauer: Financial Status

Tables 7, 8, and 9 provide an overview of the financial status of the Francis Lauer operation for the last two years. Tables 7a and 7b present Francis Lauer financial statements for FY1985-6. Table 7c presents Francis Lauer's FY 1987 financial statement adjusted in two ways. First, FY 1987 capital expenditures on items with multi-year lives were removed; and second, an estimated annual depreciation item was added based on the estimates in Table 7d. These adjustments were made in order to provide a better idea of a typical year's cost of operation.

Tables 8a, 8b, and 8c present a breakdown of sources of funds for FY1987 for the agency as a whole, and for the Home and the Shelter separately. Table 9 provides a breakdown of total cost per unit of service provided.

Table 7a
(hard copy spreadsheet)

Table 7b

Second sheet of 2 short sheets on fy86

TABLE 7C

FRANCIS LAUER YOUTH SERVICES
 ADJUSTED FINANCIAL STATEMENT
 FY 1987

Expenses	Shelter	Home	Total
Salaries	\$143,112	\$202,285	\$345,397
Payroll Taxes	11,267	13,437	24,704
Emp. Benefits	20,351	20,492	40,843
Professional Fees	723	723	1,446
Office Supplies	2,515	2,816	5,331
Recreational/Craft	2,848	4,092	6,940
Food	9,683	16,498	26,181
Other Supplies	3,069	5,982	9,051
Utilities	3,085	9,717	12,802
Program/Allowance	46	3,295	3,341
Other (Clothing)	31	3,614	3,645
Vehicle/Travel	2,942	5,111	8,053
Staff Development	330	431	761
Repairs/Sm. Equip	2,095	6,591	8,686
Miscellaneous	2,955	1,727	4,682
Depreciation	11,200	16,920	27,520
Rent	27,060	540	27,600
Total:	\$242,712	\$314,271	\$556,983

Note: The \$10,000 depreciation expense for vehicles has been assigned \$5,000 to the Shelter and \$5,000 to the Home.
Sources: Francis Lauer June 1987 Financial Statement and Table 7d (below).

TABLE 7D

FRANCIS LAUER YOUTH SERVICES
ESTIMATED ANNUAL DEPRECIATION CHARGE

Item	Value ¹³	Depreciation Rate	Charge
Home:			
Office Furniture	\$5,000	0.14	\$700
Other Equipment	53,000	0.14	7,420
Building	60,000	0.04	2,400
Additions	10,000	0.14	1,400
Shelter:			
Equipment	40,000	0.14	5,600
General:			
Vehicles	50,000	0.20	10,000
Total	\$218,000	****	\$27,520

¹³ Estimated values are on an original cost basis.

Source: Francis Lauer.

TABLE 8A
SOURCES OF FUNDS
FY 1987

SHELTER

Source	Amount	Percentage
Cerro Gordo County:		
Equivalent Unit Charges:	\$18,942	0.077
Net Budget Allocation:	28,058 ¹⁴	0.114
Other Counties:	16,542	0.067
State (POS):	152,162	0.615
Grants:	18,100	0.073
Other Donations:	5,339	0.022
United Way:	8,005	0.032
Total:	\$247,148	1.000
Source: Francis Lauer Youth Services		

¹⁴ Budget allocation of \$47,000 less the \$18,942 in imputed unit charges.

TABLE 8B
SOURCES OF FUNDS
FY 1987

HOME

Source	Amount	Percentage
=====		
Cerro Gordo County:		
Equivalent Unit Charges:	0	0
Net Budget Allocations:	0	0
Other Counties:	0	0
State (POS):	\$295,224	0.983
Grants:	3,100	0.010
Other Donations:	2,062	0.007
United Way:	0	0
=====		
Total	\$300,386	1.000
=====		
Source: Francis Lauer Youth Services		

TABLE 8C
SOURCES OF FUNDS
FY 1987

TOTAL AGENCY

Source	Amount	Percent of Total
Cerro Gordo County		
Equivalent Unit Charges:	\$18,942	0.035
Net Budget Allocation:	28,058	0.051
Other Counties:	16,542	0.030
State (POS):	447,386	0.816
Grants:	21,200	0.039
United Way:	8,005	0.015
Other Donations:	7,401	0.014
Total:	\$547,534	1.000

Source: Francis Lauer Youth Services.

Note: This table is a reproduction of Table 1 for the convenience of the reader.

TABLE 9

BREAKDOWN OF TOTAL COST PER UNIT
FY 1987

	Shelter	Home
Total Units Served	2,156	4,629
Total Cost ¹⁵	\$242,712	\$314,271
Total Cost Per Unit	112.58	67.89

Source: Previous tables.

TABLE 10

LICENSED CAPACITY FIGURES
FY 1988

Facility	License	Maximum Annual Units
Shelter	13	4,745
Home	14	5,110

¹⁵ Half the depreciation charge for vehicles was arbitrarily assigned to the Home and the Shelter for the purposes of this table.

=====
Source: Francis Lauer

IV. THE FINANCIAL PLAN

A. The Task at hand

The task of reorganizing Francis Lauer Youth Services into Francis Lauer Youth Services, Inc. on a sound financial footing involves two problems. The first relates to the successful management of the transition so that the corporation gets off to a reasonably felicitous start. Having successfully weathered the storms of transition, the focus then shifts to the longer term issue of how best to arrange the financial affairs of the corporation to assure financial stability over the long haul.

In order to help focus the financial discussion it's useful to look at a simple model of the financial problem presented. Basically, the operation needs to generate at least as much by way of revenues as it does costs. For the Shelter operation, for example, revenues are of three general types: the \$64.36 per unit provided by the State; contributions from counties to off-set the difference in cost between the state-provided \$64.36 and the actual cost of providing a unit of care; and other grants and contributions, either of a governmental or eleemosynary nature.

Costs come in two broad categories. The first is fixed costs, i.e. costs which do not vary with the number of units provided in the short run; and variable costs, i.e. those costs which do vary in the short run with the number of units provided. In order to reach the financial breakeven point total revenues have to at least equal total

costs. If total revenues exceed total costs, then the entity will have a surplus; while if total costs exceed total revenues, the entity will show a deficit.

There are two other relationships which it is important to note before going on with the analysis. The first relates to the earlier discussion of entities which have the bulk of their total costs in the fixed cost category as distinguished from the variable cost category. Discussions with agency staff indicate that of the total budget for the shelter less than 10% is comprised of variable costs, with the remaining 90% or more being fixed costs.

For the sake of illustration, let's assume that the annual fixed cost of running the shelter was approximately \$220,000, and that the variable cost per unit was \$15. Table 11 shows the impact on the average cost per unit of various levels of units served up, to a legal maximum for the year of 3,650 units (assuming a facility licensed to provide service to a maximum of ten young people).

Tables 11b, 11c, 11d, and 11e, provide a simulation of the impact on average cost per unit at various service levels for variations in fixed and variable costs.

Several conclusions may be reached based on these simulations. The first, and obvious, one is that for every dollar that Francis Lauer trims the variable cost per unit, the average cost per unit will fall by one dollar. Similarly, for every dollar that variable cost per unit rises, without a compensating rise in revenues, Francis Lauer will

be one dollar worse off in terms of average cost.

TABLE 11A
 AVERAGE COST PER UNIT SERVED

Units Served	Total Cost For All Units	Average Cost Per Unit
1,000	\$220,000+1,000(\$15) = \$235,000	\$235
1,500	\$220,000+1,500(\$15) =\$242,500	\$162
2,000	\$220,000+2,000(\$15) =\$250,000	\$125
2,500	\$220,000+2,500(\$15) =\$257,500	\$103
3,000	\$220,000+3,000(\$15) =\$265,000	\$88
3,650	\$220,000+3,650(\$15) =\$274,750	\$75

Source: Hypothetical

The second lesson relates to fixed costs. These costs can be expected to rise over

the next several years significantly. Table 11 shows average costs when fixed costs are at \$220,000 (holding variable costs constant at \$15.00), table 11b when fixed cost are lowered to \$190,000, and table 11c when fixed costs are raised to \$250,000. At the 2,500 unit utilization level this results in an average cost spread from \$91.00 to \$115.00, or \$24.00 per unit. At full utilization the spread is only \$16, while at a utilization level of 1,500 units the spread is \$40 per unit (\$181.67 - \$141.67). This means that the lower the utilization level the more increases in fixed cost are going to raise average costs per unit. The lesson from this is that rising fixed costs can be mitigated by increasing utilization levels, and conversely, that falling utilization levels with rising fixed costs will compound the problem.

An ominous sidelight to this is the financial snowball effect which arises when fixed costs rise. When fixed costs per unit rise, the natural tendency of the agency is to increase the per unit charge to the counties to offset the additional costs. Counties facing higher costs are going to have some tendency to respond to requests for higher per unit payments by (1) refusing to make the payments at all, or (2) making efforts to limit the number of young people referred to the agency.

The first of these courses will result in an increase in the agency's "bad debt" account, which will mean that the lost revenue will have to be made up via yet higher charges... The second response, fewer referrals, will mean that the agency's utilization

rate will fall. Falling utilization rates mean higher average costs. Higher average costs per unit, less the state's fixed contribution, mean higher residuals which have to be charged to counties, which will begin the cycle again.

TABLE 11B

AVERAGE COSTS PER UNIT SERVED
SECOND SCENARIO

Fixed Cost: \$190,000
Variable Cost: 15.00

Units Served	Total Cost for All Units	Average Cost Per Unit
1,000	\$205,000	\$205.00
1,500	212,500	141.67
2,000	220,000	110.00
2,500	227,500	91.00
3,000	235,000	78.33
3,650	244,750	67.05

TABLE 11C

AVERAGE COSTS PER UNIT SERVED
THIRD SCENARIO

Fixed Cost: \$250,000
Variable Cost: 15.00

Units Served	Total Cost for All Units	Average Cost Per Unit
1,000	\$265,000	\$265.00
1,500	272,500	181.67
2,000	280,000	140.00
2,500	287,500	115.00
3,000	295,000	98.33
3,650	304,750	83.49

TABLE 11D		
AVERAGE COSTS PER UNIT SERVED		
FOURTH SCENARIO		
Fixed Cost:	\$220,000	
Variable Cost:	10.00	
Units Served	Total Cost for All Units	Average Cost Per Unit
1,000	\$230,000	\$230.00
1,500	235,000	156.67
2,000	240,000	120.00
2,500	245,000	98.00

3,000	250,000	83.33
3,650	256,500	70.27

TABLE 11E		
AVERAGE COSTS PER UNIT SERVED		
FIFTH SCENARIO		
Fixed Cost: \$220,000		
Variable Cost: 20.00		
Units Served	Total Cost for All Units	Average Cost Per Unit
1,000	\$240,000	\$240.00
1,500	250,000	166.67
2,000	260,000	130.00
2,500	270,000	108.00
3,000	280,000	93.33
3,650	293,000	80.27

The other significant financial relationship for the agency relates to the sources of revenues. The per unit reimbursement from the state is "secure," the agency provides the unit of care, it is certain to get paid. For other grant money and most other sorts of

revenues (except for the county payments) once you've got it, generally you've got it (Title XIX money, for example). The county money is the cipher. Some counties pay, and some don't. Out-of-state kids are a problem as well, since all the agency is generally able to recoup is the state money.

Combining economics and finance in these circumstances leads to several other insights. First, counties that don't plan to pay their bills will generally place their kids where they encounter the least trouble and expense. Other things equal, they will send the kids to the closest shelter. If they find financial resistance in that shelter which becomes a problem or an embarrassment, they will go to the next closest shelter.

If Francis Lauer is the easiest to deal with and reasonably close, then Francis Lauer will find itself with a significant percentage of its units being from non-paying counties. This will increase the pressure on the paying counties which will provide them with an incentive to go elsewhere.

The ramification of this is that if a bed would otherwise go unused, then it makes financial sense to have even a non-paying county use it, since then at least the agency will receive the state money. This will be so as long as the \$64.36 state payment exceeds the variable cost of serving the unit.

The second insight, and corollary of the first, is that given a choice, the agency ought always to prefer to serve a unit sent from a paying county rather than from a

non-paying county. It is in the agency's interest to devise ways to do this as much as possible while still staying within the letter of the agreement with the state.

B. Planning the Transition

The transition entails several tasks. First, establishing the non-profit corporate shell. The county has indicated that the County Attorney would (probably) be available for this task. Second, an agreement needs to be made with the county for the transfer of assets, lease of county buildings, and related arrangements. These issues will be discussed in the next section.

Third, it is necessary to arrange for the creation of the necessary internal staff and mechanical apparatus for performing the functions that the county historically performed for the agency. These include billing, payroll, accounting, and miscellaneous other services which will be discussed in the section on special problems, below.

Fourth, arrangement will have to be made with the county with respect to per unit payments for county referrals. This issue will also be covered in the next section.

Finally, since Francis Lauer will no longer have the county as a source of financial reserves in case of emergency, thought will have to be given to the level of reserves necessary, and the sources of these funds.

C. The Agreement With the County

The agreement with the county is currently being pieced together. As questions arise commitments are being made. As of this writing the following issues have been resolved:

1) The county has agreed to lease the Youth Home facility to Francis Lauer for an annual payment equal to the insurance premium the county will pay for liability and property damage insurance on the building.

2) All the personal property currently being used by Francis Lauer will stay with Francis Lauer.

3) The revenues from the last three months of Fy 1988 will go to Francis Lauer.

4) The County Attorney will handle the legal work involved in setting up the corporation and another related arrangements.

5) The county will undertake to pay the same per unit charges levied against other counties in lieu of its annual appropriation to the agency; and,

6) Francis Lauer will be allowed to assume the county's lease of the shelter facility.

Items not yet resolved include:

A) The possibility of maintaining Francis Lauer's four vehicles as nominally county vehicles in order to avoid the licensing fees, use, and gasoline taxes. (This may be of only minor significance if Francis Lauer, Inc. qualifies as tax exempt under chapter 422

of the Iowa Code).

B) A related issue is whether Francis Lauer, Inc. will be sales tax exempt?

C) Is the county willing to continue to provide the following services?

(1) Beeper

(2) Answering service

(3) Sewer service and snow removal at the Home.

D) Will the county be responsible for replacement of items like furnaces, water heaters, and other major fixtures at the home?

E) Will Francis Lauer, Inc. be eligible for tax exempt revenue bond financing should it ever wish to build or acquire new or additional facilities or equipment? (Again a question for the County Attorney).

D. Special Problem Areas

Moving from county agency status means that certain aspects of the operation heretofore managed by the county will now have to be undertaken by the corporation. Important areas where the scope of management will have to be expanded are insurance and risk management generally, pensions, and billing, payroll and accounting. Within the accounting function new challenges must be met in the areas of working capital, the creation of a contingency fund, and the creation of a depreciation/amortization plan for

the replacement of vehicles and other expensive multi-year equipment items.

The sections below briefly set forth the plan as it currently stands for dealing with each problem area.

1. Pensions

The transition from county agency to corporate status will mean that on-going employees of Francis Lauer, Inc. will no longer be eligible for membership in Iowa's Public Employee Retirement System¹⁶. Francis Lauer is currently considering four options. The first would entail the corporation providing employees with a retirement plan of approximately the same cost to the corporation as the PERS affiliation was to the agency. The second option would allow the employees to go into the market and choose their own plan, which the corporation would then contribute to in approximately the same amount as previously. The third option is for the corporation simply to raise wages by the equivalent amount of the PERS contribution, thereby giving the employees the freedom of investing in a pension or using the additional money in some other fashion.¹⁷

The amount of the overall employee benefit contribution (pension contributions per se

¹⁶ Individuals with vested pensions with PERS will, of course, maintain those vested rights.

¹⁷ Though this might entail additional current federal and state income tax liability.

are not broken out on the Financial Statement) as a share of the average cost of providing a unit of care is \$9.44 for the Shelter and \$4.43 for the Home based on FY 1987 figures (see Tables 12 and 13). Any one of these options would appear to be financially feasible, assuming that whichever option is selected costs the corporation no more than would the corresponding PERS contribution.

2. Unemployment Insurance

Investigation by agency staff has led to the conclusion that the corporation would not pay significantly more for unemployment insurance than did the county. This needs to be verified; as a new private entity the corporation may be interpreted as having no track record, may be subject to a higher initial rate than the county had.

3. Workmen's Compensation

The new workmen's compensation insurance rate will be \$680.

4. Vehicle Liability and Collision Insurance

The staff has received estimates in the \$1,100 p/a range.

5. Other Types of Insurance

The cost estimates compiled by the Francis Lauer staff are presented in Table 14.

6. Working Capital

Agency management has indicated that a working capital fund equivalent to three months of agency operation is in order. Based on estimated FY1988 figures this would be

roughly \$145,000.¹⁸ The county has agreed to turn over the last three months of operating revenues from FY 1988 to the Corporation. This amount may or may not be sufficient to establish an adequate reserve for start-up in FY 1989.

E. Establishment of a Fund for the
Replacement of Assets With Multi-Year Lives

The corporation will need to provide for the accumulation of funds for the orderly replacement of buildings and equipment with multi-year lives, e.g. vehicles, typewriters, computers, furnaces, buildings. However, since Francis Lauer, Inc. will begin operation with facilities and a great deal of equipment with working lives which are already partially exhausted, it is necessary that Francis Lauer, Inc. begin operation with an adequately capitalized depreciation reserve so that the prospective demise of already overage equipment¹⁹ does not result in a disproportionate impact on any single year's operation in the start-up period.

¹⁸ The adjusted FY 1987 operating cost for the total operation was \$556,983. Add a 4% inflation adjustment for this for FY1988 to give \$579,262. At this annual rate three months working capital would come to approximately \$145,000.

¹⁹ For example, one of the agency's four vehicles is a 1978 van, well beyond its effective life expectancy, which will cost approximately \$15 to 20 thousand to replace. Such a large unplanned for expense in an early year of private operation could be a serious matter.

TABLE 12
 AVERAGE COST PER UNIT
 DISAGGREGATED BY COST CATEGORY
 SHELTER

Cost Category	\$ Cost as Share of AC/U	Percent
Salaries	\$66.38	0.590
Payroll Taxes	5.23	0.046
Emp. Benefits	9.44	0.084
Professional Fees	0.34	0.003
Office Supplies	1.17	0.010
Recreational/Craft	1.32	0.012
Food	4.49	0.040
Other Supplies	1.42	0.013
Utilities	1.43	0.013
Program/Allowance	0.02	0.000
Other (Clothing)	0.01	0.000
Vehicle/Travel	1.36	0.012
Staff Development	0.15	0.001
Repairs/Sm. Equip	0.97	0.009
Miscellaneous	1.37	0.012
Depreciation ²⁰	4.92	0.044
Rent	12.55	0.111

²⁰ Assigning \$5,000 of the general depreciation expense for vehicles to the Shelter and another \$5,000 to the Home.

TABLE 13

AVERAGE COST PER UNIT
DISAGGREGATED BY COST CATEGORY

HOME

Cost Category	\$ Cost per AC/U	Percent
Salaries	\$43.69	0.646
Payroll Taxes	2.90	0.043
Emp. Benefits	4.43	0.065
Professional Fees	0.16	0.002
Office Supplies	0.61	0.009
Recreational/Craft	0.88	0.013
Food	3.56	0.052
Other Supplies	1.29	0.019
Utilities	2.10	0.031
Program/Allowance	0.71	0.010
Other (Clothing)	0.78	0.011
Vehicle/Travel	1.10	0.016
Staff Development	0.09	0.001
Repairs/Sm. Equip	1.42	0.021
Miscellaneous	0.37	0.005
Depreciation ²¹	3.65	0.054
Rent	0.12	0.002

²¹ Assigning \$5,000 of the general depreciation expense for vehicles to the Shelter and another \$5,000 to the Home.

Table 14
Insurance Cost Estimates

Type of Insurance	Cost Estimate
Bonding	\$140 p/a
Professional Liability:	\$1,874 + 25% = \$2,343
Property Liability	\$1,052 + 25% = \$1,315
Employee Health:	
Single	\$65/mo.
Family	\$105/mo.
Life Insurance	30 cents/\$1,000 21 full time @ \$10,000 each = \$63/mo.

Source: Francis Lauer

F. The Need for Additional Staff to Handle the
New Accounting, Payroll, and Billing Functions

The need to perform in-house several of the functions heretofore provided centrally

by the county will entail substantial new expense. Three areas particularly need to be addressed at this point. Francis Lauer, Inc. will need to provide for legal services. A reasonable average annual figure would be in the \$1,000 range. Francis Lauer will also need to expand the activities of its CPA to include an annual audit; the cost for this will run in the range of \$2,000 p/a.

Finally, additional staff will be required to handle the new reassigned tasks in the areas of billing, accounting, payroll, and employee benefits. The agency's best estimate this will require at least a new low cost but full time position at \$4.50 per hour plus benefits, with total cost in the area of \$11,250 p/a.

V. OVERVIEW

Francis Lauer has, as a county agency, provided high quality Home and Shelter services to an appreciative community for a number of years. Via its operations, Francis Lauer has made Cerro Gordo County a more attractive place to work and do business. The community has been improved, not only because important social concerns have been attended to in a professional and dignified manner, but in addition, because the presence of the agency has meant 43 direct jobs for county residents and another 50 indirect jobs. Moreover, last year's agency expenditure of some \$581,000 has resulted in the generation of \$1,263,000 in additional income to county residents, businesses, and government.

In terms of efficiency of operation, Francis Lauer in fiscal years 1986 and 1987 was by far and away the least expensive provider of residential care and shelter services for Cerro Gordo county when compared to facilities elsewhere in Iowa. Wage rates at Francis Lauer are, on the average, substantially lower than at surrounding facilities, and though these low wage rates create problems of their own, they mean that the relative cost of operation at Francis Lauer, other things equal, is competitive or better.

As a generic matter, residential and shelter care facilities, regardless of who runs them, are labor intensive, and high fixed cost operations. This means that the bulk of the costs of operating both types of facilities do not vary substantially in the short run with the number of clients served. This poses a significant problem. In order to operate at a reasonable average cost per unit served, the facility has to be operated at as close to full capacity as possible. As utilization drifts away from the 100% utilization level, average costs per unit served rise. Since the state POS payment is fixed on a per unit served basis, any decrease in utilization will result in a rapid narrowing of the margin between revenues and costs. Further decreases in utilization due to disincentive effects of higher charges to counties, will mean yet higher average unit costs, and so forth. To avoid this, the alpha and omega of successful operation has to be high utilization of facilities.

The move on the part of the county supervisors to close the operation as a county

agency and reopen it as a private corporation is evidently rooted in a desire to reduce the payment by the county for the services provided, and reduce the county's potential tort liability for torts arising out of the operation of the agency. The supervisors, however, say that they wish to have the shelter and residential care services continued on an on-going basis, and so they have indicated a willingness to transfer county assets to the to-be-created Francis Lauer, Inc. on terms favorable to the Francis Lauer, Inc., and they have committed the county for the future to pay the same per unit charge charged to others.

Administratively, this is a perfectly acceptable arrangement, and there is no reason that it shouldn't work out satisfactorily based on the supervisors' commitment to pay the net difference between the full cost of shelter service and the state POS payment.

The only difficulty with this, and it is in fact no difficulty at all as long as the supervisors understand what they are getting the county into, is that the operation of the Shelter and Home as a County agency has certain substantial cost advantages over private operation.

Financially speaking, what the supervisors have in essence said, is that they wish to avoid future cost increases and the additional insurance cost of potential tort liability. These costs, however, will attend the Home and Shelter operations whether they are public or private. A private shelter operation will have to charge higher rates to

the counties in order to offset these cost increases. Cerro Gordo County, the primary user of the Shelter, has agreed to pay these higher costs under private operation. Under these circumstances, it's not clear just exactly what it is in terms of dollars that the county anticipates saving.

The fact that public residential and shelter care facilities have substantial cost advantages over private independent entities of the sort contemplated here poses another financial question. What additional costs is Francis Lauer, Inc. liable to be faced with solely for the reason that it will no longer be a county agency? These costs have been described in some detail above. Since county agencies are sales, use, gasoline, license, and titling fee tax exempt, but private non-profit corporations are not, there will be a pro-rata increase in the cost of operation when the agency moves to private provision, especially with respect to the use, sales, and gasoline taxes.

Secondly, Francis Lauer, Inc. will no longer have access to general obligation bond financing for major capital improvements. The most that will be available will be tax exempt revenue bonds which will bear a significantly higher rate of return for Francis Lauer, Inc. than would general obligation bonds issued for a county agency.

Third, many of the management services heretofore provided by the county as central services to a number of county agencies, for example, payroll, accounting, auditing, billing, employee benefits, and legal, will have to be provided as a new direct cost of

operation. The estimated annual cost for this in the first year of private operation is somewhere in the \$14,000 p/a range. Unfortunately, since there are economies of scale in the central provision of these services, the fact that the county is no longer providing these services to Francis Lauer will not result in a commensurate decrease in the county's cost of operation. However, since the County has agreed to pay the new unit charges from Francis Lauer, Inc., the County will, in essence, be paying about \$14,000 more p/a than it would under public operation for these items alone.

Finally, it will probably be the case that health and other forms of insurance will probably be more expensive for the agency given its small size, and the newness of the entity in its private form. These higher private costs will, of course, be reflected in the new unit charges to the county.

By way of providing a rough estimate of the aggregate increase in cost to the county due to the change over to private status alone, it is probably the case that private operation will wind-up increasing the cost to the county by somewhere in the neighborhood of \$20,000 per year over the equivalent per unit charges paid in FY 1987, not counting cost increases which would have occurred even as a county agency, and not counting the need to capitalize a depreciation reserve in order not to spin off the agency into immediate financial jeopardy.

One other issue needs to be addressed, and that is scheduling. The Supervisors have

directed that a non-profit corporation be created to take over at the closing of Francis Lauer as a county agency. Since the county attorney is evidently being designated by the Supervisors to handle the organization of the corporation, it is important that he be consulted about the time it takes to get IRS approval for a 501(C) corporation. Our best, non-authoritative, estimate so far is that a six to ten month lead time would be appropriate absent any special problems. If this is in fact the case, then now is not too soon to begin the process.

Other aspects of the transition would appear to fit well within the eleven month period yet remaining in the planning/organizational span set by the Supervisors in their letter of February 24th.