Being Direct: Shared Cost Recovery through Direct Cost Allocation

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Introduction

Somewhere in America, a small community action agency (CAA) employs an executive director. She oversees the organization and performs various tasks at different times for the three programs that the agency provides to the community. Each program is funded by different federal and state funding sources, and the levels of funding provided fluctuate from year to year. The time she dedicates to each program varies from week to week. She also supports the agency's board of directors, oversees its financial management, and develops the new organization-wide strategic plan, all to the benefit of the entire agency. The CAA rents office space, leases a vehicle, and purchases office equipment and supplies that staff use for each program. As a small agency, the CAA seeks to operate efficiently and to stretch each dollar as far as possible to better serve its community. To do so, it must recover not only those costs that are easy to identify with a specific funding source but also those that are not as easily identifiable, i.e., shared costs. These are the costs, like those associated with the executive director role, that span multiple programs and funding awards, and for which the benefits each program or award receives from them is difficult to discern. How then does a CAA accurately and fairly allocate these shared costs?

The shared cost recovery conundrum is one that all federally funded organizations wrestle with. It's also one that has more than one allowable answer. Depending on an organization's size, resources, experience, staffing, or preference, the method it chooses to recover shared costs may vary. This resource explores one of those options for an organization's shared cost recovery: direct cost allocation.

Direct cost allocation is the process of assigning a cost incurred to a cost objective (a grouping of costs related to achieving a specific purpose) so that it may be tracked and charged to the organization's funding awards. Decisions around cost allocation and the processes involved in doing it correctly are far from simple. For many organizations, cost allocation remains a source of great confusion and complexity given how they incur costs, the number of funding awards they typically receive, and the rules that apply related to proper accounting and allowability.

This resource aims to cut through the complexity and guide organizations as they consider this approach to shared cost recovery. It discusses factors to weigh when deciding whether to fully recover costs using direct cost allocation principles; how to recover costs using a cost allocation plan; and allowable and unallowable cost allocation methods. It also includes a sample cost allocation plan and examples.

The Uniform Guidance

The Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (the "Uniform Guidance") serves as the main legal framework for the different approaches to recovering costs from federal grants, including direct cost allocation. The part of the Uniform Guidance that specifically addresses these approaches is the Cost Principles.

Unfortunately, the Uniform Guidance is not as "uniform" as was originally intended. While most federal agencies adopted the Office of Management and Budget (OMB) codification of the Uniform Guidance, 2 C.F.R. Part 200, in its entirety with a few funding-specific changes, the Department of Health and Human Services (HHS) adopted its own version, 45 C.F.R. Part 75. The HHS version largely resembles the regulations in 2 C.F.R. Part 200, however, it does contain some notable differences. As of this writing, HHS has yet to adopt the set of revisions to the Uniform Guidance that OMB codified in 2020 in 2 C.F.R. Part 200.

For purposes of consistency, this resource references the most recent version of the Uniform Guidance at 2 C.F.R. Part 200.

Overview of Cost Recovery Options

Organizations exploring options for shared cost recovery should note that a key purpose of the Cost Principles in the Uniform Guidance is that Federal awards bear their fair share of allowable costs. 2 C.F.R. § 200.100(c). Fairness requires that where an award receives a benefit from a cost incurred by an organization, that award should pay for it.

Shared costs are costs incurred by an organization that benefit multiple cost objectives (i.e., program, activity, or award). Under the Uniform Guidance, organizations may recover shared costs in four ways.

One way is the subject of this resource, direct cost allocation, where an organization assigns a cost or certain percentage of a cost directly to a cost objective for recovery from its awards. See 2 C.F.R. § 200.405(d); 2 C.F.R. § 200.332(a)(4)(ii). Under the Uniform Guidance, "direct costs" are:

> [T]hose costs that can be identified specifically with a particular final cost objective, such as a Federal award, or other internally or externally funded activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy.

2 C.F.R. § 200.413(a). The direct cost allocation principles in the Uniform Guidance establish how an organization recovers direct costs when the benefit received by a funding source is easy to discern as well as when it is not. See 2 C.F.R. § 200.405(d).

The other three ways are different methods by which organizations may obtain an indirect cost rate for the recovery of shared costs under the Uniform Guidance. While not the subject of this resource, understanding these three ways will help organizations make informed decisions about the better option for their organizations. The Uniform Guidance defines "indirect (facilities & administrative (F&A)) costs" as:

> [C]osts incurred for a common or joint purpose benefitting more than one cost objective, and not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved. To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect (F&A) costs. Indirect (F&A) cost pools must be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of relative benefits derived.

2 C.F.R. § 200.1. An organization may obtain an indirect cost rate in one of the following three ways:

Negotiate with a federal agency for an indirect cost rate

Only organizations that receive funding directly from a federal agency may obtain a federally negotiated indirect cost rate. An organization negotiates the rate with its cognizant agency (the agency from which it receives the largest direct federal award, unless different arrangements are agreed to by the federal agencies concerned). The process involves grouping the organization's allowable indirect costs together into an indirect cost pool and dividing the total amount in the indirect cost pool by a direct cost base. The Uniform Guidance provides multiple choices for how the direct cost base may be defined.[1] Once an organization obtains a federally negotiated indirect cost rate, the rate must be recognized by each of the organization's federal funding awarding agencies and pass-through entities and consistently applied. 2 C.F.R. § 200.414(c), (d).

Negotiate with a pass-through entity for an indirect cost rate

An organization may negotiate an indirect cost rate with one of its pass-through entities if the organization does not receive direct federal funding. 2 C.F.R. § 200.332(a)(4)(i)(A); 2 C.F.R. § 200.414(d).

Elect to use the de minimis rate

An organization that does not have a current[2] negotiated indirect cost rate may elect to charge a de minimis rate of 10% of its "modified total direct costs."[3] 2 C.F.R. § 200.414(f). It may use the de minimis rate indefinitely, and no documentation is required. As a result, an organization is not required to provide justification that the amount recovered via the de minimis rate equals the actual amount of indirect costs

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[1] Nonprofit organizations should review Appendix IV of the Uniform Guidance to understand their options for defining a direct cost base. Another option is to use the "modified total direct costs" base as defined in the Uniform Guidance. See 2 C.F.R. § 200.1.

[2] Because HHS has yet to adopt the 2020 updates to the Uniform Guidance, HHS funding is subject to the pre-2020 version of the Uniform Guidance rule on the de minimis rate, where a non-federal entity may only elect to use the de minimis rate if it never had a federally negotiated indirect cost rate in the past. See 45 C.F.R. § 75.414(f).

[3] The Uniform Guidance defines "modified total direct costs" as:

> [A]ll direct salaries and wages, applicable fringe benefits, materials and supplies, services, travel, and up to the first $25,000 of each subaward (regardless of the period of performance of the subawards under the award). MTDC excludes equipment, capital expenditures, charges for patient care, rental costs, tuition remission, scholarships and fellowships, participant support costs and the portion of each subaward in excess of $25,000. Other items may only be excluded when necessary to avoid a serious inequity in the distribution of indirect costs, and with the approval of the cognizant agency for indirect costs.

2 C.F.R. § 200.1

that it incurred. If an organization's actual indirect costs are less than what the rate allows it to recover, the organization may keep the surplus. The amount of indirect cost which may be charged to each award via the de minimis rate is determined by multiplying the "modified total direct costs" incurred in the specific award by 10%. Not all allowable award costs may be included in the "modified total direct costs" for that award, so the organization must understand and apply the rules for excluding those costs.

Even if an organization has an approved indirect cost rate, it is not required to recover all its shared costs through that rate. For example, while the requirements for negotiating a rate with a federal agency include a requirement to include all agencywide administrative costs (e.g., agencywide financial management, human resources, and board support) in the indirect cost pool, organizations may exclude other shared costs, such as telephone, internet, or supplies, from the indirect cost pool and allocate them directly.[4] Thus, organizations with indirect cost rates often have cost allocation plans as well.

For additional information on shared cost recovery using an indirect cost rate, please reference CAPLAW's indirect cost resources.[5]

Deciding Whether to Directly Allocate Shared Costs

Because each organization's operations and funding vary, it will need to weigh multiple factors to determine its preferred cost recovery option. Common considerations include:

Frequency of funding award changes. When an organization that directly allocates shared costs adds or terminates an award, it must recalculate its cost allocation formulas. While the cost allocation methods remain constant – at least until the cost allocation plan is modified – the actual allocation formulas applied to various costs will have to be recalculated to reflect the current mix of awards. The effort required to directly allocate shared costs in this environment can overwhelm even well-staffed financial departments, especially those without a strategy for adjusting allocations to reflect changing cost objectives that benefit from shared or allocated costs. Alternatively, organizations with indirect cost rates are permitted to continue using their approved indirect cost rate when they lose and gain awards.

Funding award changes may also impact the final indirect cost rate an organization can charge, so organizations may need to plan for rate adjustments. When an organization loses or gains awards, its direct cost base expands or contracts. As a result, its actual indirect cost rate may change, getting larger as direct costs shrink and smaller as direct costs grow. Most organizations work with an indirect cost rate determination process that requires the submission of actual year-end financial information before the provisional indirect cost rate is finalized. While they are permitted to charge their provisional rate to awards throughout the period covered by it, the final rate will be determined after review of the audited financial statements. The cognizant agency's determination of the final rate may result in the need to adjust the indirect costs charged to each award to match the actual final rate as determined by the federal cognizant agency.

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[4] Most federally negotiated indirect cost rate proposals require inclusion of a cost allocation plan that describes the costs that have been included in the indirect cost pool and will be recovered via the indirect cost rate, and the other shared costs that will be allocated according to methods described in the plan.

[5] See CAPLAW's FAQ on Recovering Shared and Indirect Costs and Indirect Cost Webinar Series Q&A.

Availability of a negotiated indirect cost rate. Only organizations that receive funding directly from a federal awarding agency, such as Head Start funding from HHS, may obtain a federally negotiated indirect cost rate. See Appendix IV to Part 200 – Indirect (F&A) Costs Identification and Assignment, and Rate Determination for Nonprofit Organizations. Organizations that solely receive federal funds, like the Community Services Block Grant (CSBG), via a pass-through entity, like a state or local government, are ineligible for a federally negotiated indirect cost rate. While organizations that are ineligible for a federally negotiated indirect cost rate may negotiate an indirect cost rate with their pass-through entity, pass-through entities may not have the expertise or ability to do so.

Fiscal capacity of the organization. Direct cost allocation requires significant, ongoing investments of staff time and resources to perform key tasks, such as developing and managing multiple cost allocation methods, as well as reviewing and revising cost allocation formulas and methods as funding awards change. Alternatively, negotiating a rate can result in significant up-front costs. The process is often extensive and requires a level of expertise that may only be available via a consultant. As such, the fiscal capacity of an organization may factor into its decision to choose one method of shared cost recovery over another. Factors to flesh out and weigh when deciding whether to directly allocate shared costs include overall size and complexity of the organization; number of fiscal staff; time constraints on fiscal staff; costs of employing fiscal staff; existing fiscal and operational (e.g., time tracking) systems in place to assist with cost allocation; and, an analysis of the comparative ease and burden of obtaining an indirect cost rate.

Acceptance and predictability of the organization's approach. The Uniform Guidance requires that federally negotiated indirect cost rates be honored by all federal agencies and pass-through entities. This leads to more predictable cost recovery for organizations. No similar requirement exists for cost allocation plans, which can trigger funding sources to question the different methods used to allocate costs. For example, financial professionals disagree about the proper way to recover agencywide administrative costs.

Some argue that a certain portion of agencywide administrative costs do not benefit the programs or awards, but rather some type of agency survival or corporate interest, and thus cannot be completely allocated to programs or awards. Others believe high-level administrative staff should track and record as much of their time as possible to specific program cost centers and any time remaining must be covered through unrestricted funds. Others argue that having high-level administrative staff track time to specific cost centers is a waste of time and resources, and almost always inaccurate. As this resource reflects and many financial professionals including auditors agree, it is reasonable to apply the percentages of all staff time allocated to each cost objective to the agencywide administrative cost center and allocate accordingly to each funding award. Doing so reasonably reflects their agencywide administrative burden. Organizations should be prepared to show that these costs are integral to the award project or activity charged because they ensure effective oversight and management of the project or activity within the context of a well-governed and well-run corporate entity, without which the project or activity would not be possible. See 2 C.F.R. § 200.413(c).

Another challenge with the direct cost allocation approach is the differing opinions among finance professionals as to whether costs specifically identified as indirect in the Uniform Guidance may only be recovered with an indirect cost rate. OMB added language in its 2020 revision that recognized the direct cost allocation approach as an option for all types of cost, including indirect, that a subgrantee incurs. See 2 CFR 200.332(a)(4)(ii).[6] However, the lack of OMB guidance regarding this addition has led to various, inconsistent interpretations of the language by funding sources.

Level of shared cost recovery. An organization may determine that it can recover more of its shared costs through direct cost allocation than it can through an indirect cost rate. This is a complicated comparison to make between a negotiated indirect cost rate and direct cost allocation, as it depends on how an organization defines its direct cost base and what it includes in its indirect cost pool. However, the comparison is more straightforward in relation to the 10% de minimis rate. Any organization with agencywide administrative costs greater than 10% of its modified total direct costs will recover more through direct cost allocation than via the de minimis rate.

To determine whether the 10% de minimis rate will allow an organization to fully recover its agencywide administrative costs, the organization calculates what 10% of the modified total direct costs for each of its cost objectives would be and compares the total of those amounts to the organization's total agencywide administrative costs. The organization must also consider whether its non-federal funding sources will allow it to use the de minimis rate to recover a fair share of agencywide administrative costs from those funds. If the organization incurs a substantial portion of its total direct costs in programs that are funded by sources that will not honor the de minimis rate, it may decide against using it, as that would limit the amount of costs it may recover.

How to Recover Shared Costs Through a Cost Allocation Plan

An organization that wants to directly allocate shared costs must develop and adopt a written cost allocation plan, which guides its fiscal staff's decisions about how to allocate each individual shared cost.

What is a Cost Allocation Plan?
A cost allocation plan is a written document that describes the methods an organization will use to allocate direct costs to various programs or awards, including how the organization will equitably apportion the shared costs which benefit the entire organization to each of its awards.

How Does a Cost Allocation Plan Guide the Allocation of Costs?
An organization's cost allocation plan defines how to allocate its costs directly to the awards that benefit from them. It must also identify the "cost objectives" that will be used to track all costs. The Uniform Guidance defines "cost objective" as:

> [A] program, function, activity, award, organizational subdivision, contract, or work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capital projects, etc. A cost objective may be a major function of the non-Federal entity, a particular service or project, a Federal award, or an indirect (Facilities & Administrative (F&A)) cost activity.

2 C.F.R. § 200.1.

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[6] Because HHS has yet to adopt the 2020 updates to the Uniform Guidance, HHS funding is subject to the pre-2020 version of the Uniform Guidance rule, which does not include this revision. See 45 C.F.R. § 75.352(a)(4).

Essentially, a cost objective is a center of costs and is sometimes called a cost center. Some think of it as a bucket where all the costs associated with a specific program, project, or award are assigned or placed, including the allocated portion of a shared cost. An organization has discretion to decide how it defines its cost objectives. It can define them as programs, projects, functions, or awards, but whatever it chooses, it must use them consistently. 2 C.F.R. § 200.403(d).

A nonprofit organization typically chooses to structure its overall cost objective system in one of two ways, by function or by funding award. With either format, the organization must still distinguish between costs incurred for program purposes and those incurred for administrative, management, or fundraising purposes, to meet IRS and GAAP accounting requirements.[7]

Under the ***functional cost objective*** format, an organization defines its cost objectives as major programs and functions. For example, costs could be pooled by an agency's programs, such as Early Childhood Programs, Emergency Services Programs, and Energy Assistance Programs, and by its functions, including Administrative, Management, and Fundraising. Many of these programs and functions are supported through multiple grants and contracts (for example, Early Childhood Programs may be funded through a Head Start award, an Early Head Start award, a state preschool award, etc.). As such, an organization using this format would also include sub-cost centers or funding source codes to track what award will be charged for each cost. When using this format, an organization will typically establish an "administrative" function cost center and then use the methods described in its cost allocation plan to allocate a fair share of the total administrative costs to each cost objective, including both programmatic cost objectives, and fund raising or other non-program cost objectives.

Under the ***funding award cost objective*** format, each cost objective corresponds to a funding award that the organization receives. For example, an organization that uses this format would pool its costs by separate CSBG, Head Start, and Weatherization awards. Organizations using this format could account for administrative and management costs either by using cost allocation to determine each funding award's share of an administrative cost, or by establishing a separate cost objective for administrative costs and allocating those administrative costs to its various funding awards according to its cost allocation plan. Costs that are generally unallowable to be charged to federal awards, such as fundraising costs, would require a separate fundraising cost objective under this format.

Once an organization structures its cost objectives, it can implement its system for allocating costs using its general ledger accounting system. This will involve populating the system with the organization's cost objectives so that information about revenue and expenses associated with each cost objective may be recorded. An organization will include its funding awards in the system, either as specific cost objectives, codes, or otherwise so that the amounts charged to each award can be substantiated. The organization must provide a description for how shared expenditures within the major cost objectives will be allocated and recorded in the organization's accounting system.

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[7] The generally accepted accounting principles (GAAP)(ASC 958-720-45-2) requires organizations to distinguish between costs incurred for program purposes and those incurred for administrative, management, or fundraising purposes. An organization's determination of costs in accordance with the GAAP is a factor affecting the allowability of costs in the Uniform Guidance. 2 C.F.R. § 200.403(e). A nonprofit organization also must separately report program service, management and general, and fundraising expenses on its IRS Form 990s each year.

How is a Cost Allocation Plan Finalized and Maintained?
After an organization develops and approves its cost allocation plan, an authorized staff member should sign and date it, including an effective date, and the organization should keep it on file in a designated location. This practice helps an organization identify the final, approved version of its plan and avoid confusion.

While the Uniform Guidance does not require a nonprofit organization to submit its cost allocation plan to its funding sources, the organization should consider discussing its cost allocation methodologies with its funders in advance of charging costs to its awards. This proactive approach may help identify potential problems or disagreements over planned allocation of costs and reduce the risk of future disallowed costs.

Requirements of a Cost Allocation Plan for Shared Costs

An organization's cost allocation plan describes how the agency recovers shared costs through direct allocation. This description includes an explanation of the allowable methods the organization uses for recovering these costs. These methods for direct allocation of shared costs must be based on principles contained in the Uniform Guidance.

Direct Cost Allocation Principles for Shared Costs
The direct cost allocation principles of the Uniform Guidance provide the framework within which shared costs are recovered directly:

> If a cost benefits two or more projects or activities in proportions that can be determined without undue effort or cost, the cost must be allocated to the projects based on the proportional benefit. If a cost benefits two or more projects or activities in proportions that cannot be determined because of the interrelationship of the work involved, then, notwithstanding paragraph (c) of this section, the costs may be allocated or transferred to benefitted projects on any reasonable documented basis.

2 C.F.R. § 200.405(d).

An organization must allocate shared costs to each cost objective either according to the proportional benefit that the cost objective receives from that cost, or, if that cannot be determined because of the interrelationship of the work involved, by some reasonable, documented method.

Proportional Benefit
The proportional benefit language in the Uniform Guidance direct allocation principles is relatively straightforward. It should be used when there is an easily determined, measurable benefit to the project or activity. This would be the case when a shared cost is incurred, and on its face, an organization can determine what percentage of the cost to allocate to each cost objective (program, project or award) involved. For example, an organization easily determines the proportional benefit of the salary paid to a bus driver who drives for two programs, Head Start and Senior Services. She allocates her time to each program based on her time records, which indicate time spent driving for each program.

Reasonable Documented Basis

The benefits of shared costs do not always fall into neat proportions that can be easily allocated to cost objectives (programs, projects, awards). The benefits of shared costs can be amorphous. When an executive director is promoting the organization in the community, for example, presumably all programs or cost objectives benefit. The challenging question is what proportion of the total benefit does each receive? What if the executive director mentions two or three programs but not others? Should the finance department parse or count her words and track exactly how many references she makes to CSBG and Weatherization and LIHEAP and all the organization's other programs? Is that possible, and if so, would any organization really want to do that given the time and resources – and grammar – involved?

Of course not. Luckily, the Uniform Guidance direct cost allocation principles recognize that the benefit of a shared cost to an award is not always easy to quantify. They allow organizations to allocate shared costs by any reasonable, documented basis. When considering reasonableness, an organization should consider time, effort, resources, and cost of the method of allocation.[8] For example, it is unreasonable for an organization to employ a finance staff person to count the number of times the executive director publicly mentioned a program to determine if that program benefited from her outreach, and thus can be charged a portion of the costs associated with it.

Another common example involves counting pieces of paper. While it is possible to estimate the benefit a ream of copier paper provides to each cost objective by having a clerk keep track of the purpose for which each piece of paper is used, it is an unreasonably costly method. It requires investment in expensive staff time to gain greater precision about a relatively small cost item.

An organization must also document the basis it uses to allocate shared costs. As might be expected, this involves writing a cost allocation plan that documents the organization's cost objectives as well as the reasonable methods by which it will allocate shared costs.

Applying Allocation Methods Consistently

While it is permissible to use various allocation methods to allocate different types of costs, the method used for any one type of cost must be used consistently. 2 C.F.R. § 200.412. An organization could not, for example, allocate costs for shared office space using a square footage-based method one month and an employee headcount-based method another month.

Common Allowable Methods of Cost Allocation

Where the benefits of shared costs cannot be allocated based on the proportion of benefit received due to the interrelationship of the work involved, organizations may allocate them by any reasonable, documented basis. This section offers descriptions of common allowable methods of cost allocation.

Full-Time Equivalent (FTE)

Under the full-time equivalent (FTE) method, an organization bases its cost allocation on the percentage of total staff time devoted to each cost objective. It documents the staff time spent by an employee or a group of employees performing work that benefits a particular award.[9] It computes the portion of the

[8] The Uniform Guidance addresses the factors to consider when determining if a cost is reasonable, see 2 C.F.R. § 200.404.

[9] Remember, an organization using functional cost objectives (e.g., programs) would include sub-cost centers or funding source codes to track what award will be charged for each cost.

total time the employee (or employees) worked on a task that benefited a particular award and applies the resulting percentage to the total cost of employing the employee or employees (i.e., the total cost of employing an HR director). This process results in charging the award for the time spent benefiting it. This method assumes that the time employees spend on a particular award ends up benefiting that award.

Example 1

Best CAA requires employees to track and submit reports on the time they devote to different programs. A full-time employee is one who works 40 hours per week. At the end of a week, Best CAA determines that the total of all hours worked for Program A was 80 hours, which is the FTE of having 2 employees devoted full-time (40 hours) to Program A. It also determines that employees devoted 160 hours, or 4 FTE positions (160 hours/40 hours) to Program B. Based on the percentage total of FTEs reported (6 FTEs), Best CAA estimates that Program B has received twice as much benefit (4 FTEs/6 FTEs=66%) from the use of the telephone system or reception function as Program A (2 FTEs/6 FTEs=33%), and that Program B should be charged twice as large a share of the cost of the telephone system and reception function.

Example 2

Best CAA runs a number of different programs and uses an allocating percentage based on the FTE method to allocate shared costs. Employees track and submit reports on the time they devote to different cost centers. A full-time employee is one who works 40 hours per week. The agency has clusters of 2 or 3 programs within which shared administrative costs of supervisory personnel mostly benefit the programs in a cluster (i.e., oversight and administration of the programs and awards in a cluster). At the end of a workweek, Best CAA wants to determine how much of a Program Manager's FTE to assign to each of the programs she has worked on. Best CAA's time tracking reports indicate the Manager worked a total of 40 hours (1 FTE) during the workweek. 10 of those hours were devoted to Program A, 10 hours to Program B, 15 hours to Program C, and 5 hours to administrative functions. Best CAA divides the hours worked for each program or administrative functions performed by 40 hours to determine the Manager's FTE division for the workweek. The results are .25 FTEs (10/40 hours) each to Programs A and B, and .375 FTEs (15/40 hours) to Program C. It also determines that the Manager devoted .125 FTEs (5/40 hours) to administrative functions. It uses these percentages to allocate the cost of her employment for the week (salary, employer taxes, and employer paid fringe benefits) to the appropriate program or administrative cost objective. Because the Manager's administrative FTEs were spent performing administrative functions for the Program A, B, and C cluster, the agency can allocate the administrative FTEs based on the percentages of Program FTEs determined for that workweek.

Example 3

Best CAA runs three different programs and uses an allocating percentage based on the FTE method to allocate shared costs. Employees track and submit reports on the time they devote to different cost centers. Best CAA's cost objectives are funding award-based, and a full-time employee is one who works 40 hours per week. At the end of a workweek, Best CAA wants to determine how to charge its awards for the CFO's salary, which it defines as an agencywide administrative cost. The agency consults its time tracking reports and determines that altogether, Best CAA staff worked a total of 1,000 hours for its three Awards. That is equivalent to 25 total FTEs (1,000/40 hours). Staff worked 300 hours (7.5 FTEs) for Award A, 100 hours (2.5 FTEs) for Award B, and 600 hours (15 FTEs) for Award C. Best CAA divides each employee's hours worked on an award by the 1,000-hour total. It determines that Award A receives 30% of the benefit of its FTEs (300/1,000 hours), Award B receives 10% (100/1000 hours), and Award C receives 60% (600/1,000 hours). It can now charge the CFO's salary in one of two ways. The first way is to place the CFO's salary cost into an agencywide administrative cost objective along with its other agencywide administrative costs (e.g., CEO salary, board support). Best CAA then can allocate that entire cost objective 30% to Award A, 10% to Award B, and 60% to Award C. Best CAA's second way to allocate the CFO's salary is to not group it with other costs, but allocate it by itself to each Award cost objective, 30% to Award A, 10% to Award B, and 60% to Award C.

Units of Service

Under the units of service method, an organization allocates shared costs based on the number of units of service delivered by each cost objective. This requires tracking the actual number of transactions involved in a service, rather than allocating based on budgeted or planned percentages, to determine the actual percentage of benefit a particular cost objective or award received from the transactions. For example, the IT department assigns "tickets" for each request for support and then the agency allocates IT costs based on the percentage of tickets assigned to each cost objective.

For some recipients, the units of service method may be challenging because the nature of the services provided in their various programs is quite different, with services in some programs being delivered in less than an hour and services delivered in other programs requiring several days. In this situation, the percentage of total units of service would not be a reasonable basis for estimating the benefit received from shared costs.

Example 4

Best CAA operates a client intake center that provides information and intake services to the community on all the programs Best CAA operates. Center staff track new applicants and enrollees for the agency's programs in a database. Best CAA allocates its intake center staff costs for a month using the number of new enrollees entered in its database for that month. It determines that Program A enrolled 10 new clients during the month, Program B enrolled 10, and Program C enrolled 20. It uses these units of service to determine that Programs A and B each received 25% (10/40 enrollees each) of the benefit of the intake center, and Program C received 50% (20/40 enrollees). It allocates 25% of that month's intake center staff costs each to Programs A and B, and 50% of the costs to Program C.

Square Footage

Square footage is a common allowable method for allocating costs associated with an organization's shared facilities, such as rent, utilities, and janitorial services. This method involves determining the total amount of square footage in a shared facility, and then mapping out the use of square footage by each cost objective on a floor plan, as well as the square footage considered to be common space, such as restrooms, meeting rooms, and shared reception areas. Common space is measured separately because each cost objective in the facility benefits from it. Excluding common space allows an organization to determine the percentage of dedicated space each cost objective uses in a facility, which is a reasonable reflection of the benefit a cost objective receives from that facility's common space.

The organization determines the percentage of square footage used by each cost objective by dividing each cost objective's square footage by the total square footage in the facility, excluding the common space from the total. Facilities costs, including the common space, are then allocated based on those percentages.

This method requires calculating the percentage of actual square footage used, not a budgeted use. An organization may base this calculation on planned use, but only if it is certain no changes will be made to the use of space. This can be an important distinction for recipients who experience major shifts in how space is used during the year, for example, mid-year growth in a specific program, frequent staff turnover and reassignment, or alteration of office space. In these situations, it could be difficult to track actual, up-to-date assigned square footage and repeatedly recalculate accurate percentages of actual square footage used by each cost objective.

This method must also account for office space used by program staff that work on multiple programs and by administrative and executive level staff that perform activities that benefit multiple cost objectives. For agencywide administrative and executive level staff, the organization would calculate their percentage of space used and allocate that percentage of facilities' costs to the agencywide administrative cost objective. The organization would then allocate these costs via its method for agencywide administrative costs. For program staff, the organization must calculate the portions of these staff members' offices devoted to each cost objective that benefits from their work. Program needs differ, so it may be impractical to determine how much of the space used in an employee's office benefits each program. Given this complexity, many organizations prefer to use the FTE method as the basis for allocating facilities costs.

Example 5

Best CAA looks at its facility's floor plan. The facility is 10,000 square feet in total. In the facility, Best CAA determines that 2,000 square feet is dedicated to staff working on Program A, 5,000 square feet is dedicated to staff working on Program B, 2,000 square feet is common space used by all staff, and 1,000 square feet is used by agencywide administrative staff. Best CAA excludes the common space so that it can accurately calculate the percentage of benefit that Programs A and B, and administrative staff receive from the use of the facility. It divides 2,000/8,000 square feet and 5,000/8,000 square feet and finds that Program A receives 25% of the benefit and Program B receives 62.5% of the benefit. It also divides 1,000/8,000 square feet and finds that administrative staff receive 12.5% of the benefit of the facility. Best CAA uses those percentages to allocate facilities costs for the entire facility, including common spaces, to its Programs A and B, and agencywide administrative cost objectives.

Cost Shifting

Each funding award that benefits from a shared cost must pay for that benefit, i.e., pay its own way. See 2 C.F.R. § 200.100(c). While it might seem reasonable for one program or award to foot the bill for a shared cost until the other receives a fresh injection of funds, the Uniform Guidance prohibits this approach except in limited circumstance:

> Any cost allocable to a particular Federal award under the principles provided for in this part may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by Federal statutes, regulations, or terms and conditions of the Federal awards, or for other reasons. However, this prohibition would not preclude the non-Federal entity from shifting costs that are allowable under two or more Federal awards in accordance with existing Federal statutes, regulations, or the terms and conditions of the Federal awards.

2 C.F.R. § 200.405(c).

Unless funding source rules specifically permit it, organizations cannot engage in the practice commonly known as cost shifting, whether that be because of availability, or lack thereof, of funding, or because another program or award might have a significantly higher budget and be better placed to cover a disproportionate share of the cost.

Example 6

Foggy CAA had several awards that placed limitations on the amount of administrative costs that could be charged to the award. Foggy charged only the allowable amount of administrative costs to these awards and then divided the remaining administrative costs among programs funded by awards that did not impose specific limitations on the amount of administrative costs which could be charged. Foggy believed that because the other funding sources had approved budgets for their awards that were based on this approach to allocation, that the allocation method had been approved. Unfortunately, Foggy's auditor determined that this practice was in violation of the Uniform Guidance because Foggy was charging some funding awards to overcome funding deficiencies caused by limitations on others, and funding source rules did not allow the funds to be used in this way.

CAPLAW

Kay Sohl Consulting
Training and Consulting Services

This resource is part of the Community Services Block Grant (CSBG) Legal Training and Technical Assistance (T/TA) Center. It was created by Community Action Program Legal Services, Inc. (CAPLAW) in the performance of the U.S. Department of Health and Human Services, Administration for Children and Families, Office of Community Services Cooperative Agreement – Award Number 90ET0482-03. Any opinion, findings, and conclusions, or recommendations expressed in this material are those of the author(s) and do not necessarily reflect the views of the U.S. Department of Health and Human Services, Administration for Children and Families.

This Sample Cost Allocation Plan was developed by Kay Sohl Consulting. It is an example of how an organization may structure its plan to allocate costs directly. The language and methods contained herein are illustrative, and each organization reviewing this Sample should use it to help inform the development of its own cost allocation plan. Each organization must make its own decisions about how to allocate costs, including how to define its cost objectives and what are its reasonable bases for allocating shared costs. This Sample includes highlighted text in brackets to help clarify and explain where decisions by different organizations may vary.

SAMPLE
COST ALLOCATION PLAN

Date adopted

SAMPLE is a 501(c)(3) non-profit corporation. SAMPLE administers grants in compliance with Federal regulations listed in 2 C.F.R. Part 200 "Uniform Guidance". SAMPLE is a multi-funded organization operating numerous public and privately funded programs.

This Cost Allocation Plan describes the methods which SAMPLE uses to allocate costs which benefit multiple cost objectives (programs, projects, grants, and contracts) in accordance with 2 C.F.R. § 200.405(d). The Plan also describes the methods SAMPLE utilizes to ensure that costs which benefit a single cost objective are charged appropriately to that cost center. In compliance with 2 C.F.R. § 200.405(d), the Cost Allocation Plan describes the methods SAMPLE utilizes to allocate and charge allowable costs which benefit more than one cost center or cost objective to federal and state grants. It also describes the methods used to determine the allowability of all costs and ensure that only allowable costs are charged to federal, state, or other governmental awards.

SAMPLE's use of this Cost Allocation Plan is based on the requirements of 2 C.F.R. § 200.405(d) to establish the reasonable bases and methods used for recovering costs by allocating them fairly and directly charging them to cost centers (programs, projects, awards) that benefit from the cost. The Plan does not involve the use of an Indirect Cost Rate and consequently is not subject to the requirements specified in Appendix IV to Part 200 - Indirect (F&A) Costs Identification and Assignment, and Rate Determination for Nonprofit Organizations.

Attachments to the Plan include information useful in understanding SAMPLE's current programs, funding sources, and services, current administrative organization, and current organization-wide budget. Attachments include:

Attachment 1: SAMPLE current Programs, Funding Sources, and Services
Attachment 2: SAMPLE current Administrative Organization Chart

Attachment 3: SAMPLE Organization-Wide Budget for (insert fiscal year)

(Note: budget amounts are estimates and subject to change)

SAMPLE Cost Allocation Policy Overview

SAMPLE has established a cost center structure which identifies the programs, projects, grants, or contracts for which the organization incurs expenses. For each funding award, an appropriate set of general ledger accounts (or account segments) shall be established in the chart of accounts to reflect the categories of allowable costs identified in the award or the award budget.

Each cost incurred by SAMPLE is charged to the cost center or cost centers which benefit from the cost. SAMPLE ensures that all costs charged to cost centers supported with federal or state funds are reasonable, allowable, and allocable.

Costs for which the specific benefit provided to one or more cost centers can be determined without incurring unreasonable expense are charged directly to the cost center or centers which benefit. Cost for which the specific benefit provided to multiple cost centers cannot be determined without incurring unreasonable expense are allocated through application of the methods described in this plan to estimate the benefit provided to each cost center.

Costs incurred which provide benefit to the entire organization, including all of its activities (both those supported through federal or state funds and those supported through private and other sources) are allocated to all cost centers through the use of allocation methods described in this Plan. All allocation methods described in this plan are consistent with the requirements of 2 C.F.R. § 200.405(d) and are designed to provide a reasonable estimate of the benefit provided to each cost center.

Segregating Unallowable from Allowable Costs

Only allowable costs may be charged to federal and state grants. 2 C.F.R. Part 200 provides overarching guidance regarding the types of costs which are allowable uses of federal funds. Specific federal and state grant agreements may also provide additional limitations on the types of costs deemed allowable for the funds provided through specific funding agreements.

SAMPLE takes the following steps to ensure that no unallowable costs are charged to any cost center supported through federal or state funds:

1. SAMPLE staff review the grant or contract award agreement and budget for each award to determine which costs are deemed specifically allowable or unallowable under that agreement.

2. Staff receive training and are required to be familiar with the allowability of costs provisions of 2 C.F.R. Part 200 Uniform Guidance particularly:

   a. The list of specifically unallowable costs found in Part 200.420 (Selected Items of Cost), such as alcoholic beverages, bad debts, contributions, fines and penalties, lobbying, etc.

   b. Those costs requiring advance approval from Federal agencies in order to be allowable in accordance with 2 C.F.R. Part 200, such as foreign travel, equipment purchases, etc.

3. No costs shall be charged directly to any cost center supported by a Federal or state award until the cost has been determined to be allowable under the terms of the award and/or 2 C.F.R. Part 200 and the specific funding agreement.

4. All items of miscellaneous income or credits, including the subsequent write-offs of uncashed checks, rebates, refunds, and similar items, shall be reflected for grant accounting purposes as reductions in allowable expenditures if the credit relates to charges that were originally charged to a Federal or State award or to activity associated with a Federal award. The reduction in expenditures shall be reflected in the year in which the credit is received (i.e., if the purchase that results in the credit took place in a prior period, the prior period shall not be amended for the credit).

Criteria for Allowability

SAMPLE applies the following criteria to determine the allowability of all costs charged to federal or state grants or awards. Costs charged must meet the following criteria from 2 C.F.R. Part 200, in order to be treated as allowable direct or indirect costs under a Federal award.

1. The cost must be "reasonable" for the performance of the award, considering the following factors:

   a. Whether the cost is of a type that is generally considered as being necessary for the operation of the Organization or the performance of the award;

   b. Restraints imposed by such factors as generally accepted sound business practices, arm's length bargaining, Federal and state laws and regulations, and the terms and conditions of the award;

c. Whether the individuals concerned acted with prudence in the circumstances;

d. Consistency with established policies and procedures of the Organization, deviations from which could unjustifiably increase the costs of the award.

2. The cost must be "allocable" to an award by meeting one of the following criteria:

   a. The cost is incurred specifically for a specific award;

   b. The cost benefits both the specific award and other work, and can be distributed in reasonable proportion to the benefits received; or

   c. The cost is necessary to the overall operation of the Organization, except where a direct relationship to any particular program or group of programs cannot be demonstrated.

3. The cost must conform to any limitations or exclusions of 2 C.F.R. Part 200 or the funding award itself.

4. Treatment of costs must be consistent with policies and procedures that apply to both federally financed activities and other activities of the Organization.

5. Costs must be consistently treated over time.

6. The cost must be determined in accordance with generally accepted accounting principles.

7. Costs may not be included as a cost of any other federally or state financed program in the current or prior periods.

8. The cost must be adequately documented.

Direct Costs

Direct costs include those costs that are incurred to benefit one or more specific cost center, award, or function. SAMPLE identifies and charges these costs exclusively to the cost center tracking that award or program.

Invoices for items considered direct costs are coded with the appropriate account number for the cost center(s) for which the expenditure provides direct benefit. Invoices are approved by the [list the staff position(s) responsible for approving invoices].

Personnel costs relating to the work of employees whose work provides benefit to a specific cost center are coded to that cost center based upon the employee's record of the time they worked in activities which benefit that cost center. Employees record the use of their time each day on time sheets, recording the number of hours worked (or percentage of effort expended) and cost center for which their work directly benefited from the employees' effort. All timesheets are reviewed and approved by supervisors with knowledge of the employee's efforts. Approved employee time sheets serve as the basis for charging salaries directly to Federal or state awards and other functions.

Equipment purchased for exclusive use on a Federal or State award and reimbursed by a Federal or State organization shall be accounted for as a direct cost of that award (i.e., such equipment shall not be capitalized and depreciated). However, SAMPLE will track any purchase that meets the $5000 equipment threshold [this is a federal threshold. If SAMPLE has a different capitalization threshold for purchases funded by sources other than federal, an explanation should be inserted here] on a depreciation schedule and record annual adjustments as necessary.

Costs Benefitting More than One Cost Center

Costs for which the benefit to specific cost centers cannot be determined without incurring unreasonable expense are allocated to all cost centers benefiting from the expenditure based on the methods described below.

Such costs will be allocated to all programs on an equitable basis regardless of any limits imposed by funding sources. Costs will be allocated to Federal and non-Federal functions based on the most meaningful measures. Treatment of costs shall be consistent with policies and procedures that apply to both federally financed activities and other activities of the Organization. Costs will be consistently treated over time.

The following allocation methods will be used: [these methods may vary by organization]

a. Administrative and Human Resource and Fiscal and Accounting related costs will be allocated based on the percentage of full-time equivalent employees (FTE) who work in each Program based on time worked. See detailed description below.

b. Facilities related costs will be allocated using the method most appropriate to estimate the benefit provided to each cost center which utilizes the facility. See detailed description of Facilities Cost Allocation methods below.

c. Program-related costs which benefit more than one program or cost center will be allocated based on relevant activity measures.

1. **Organization-wide Management, HR Costs, Accounting and Fiscal costs**
   Organization-wide Management, HR, Accounting, and Fiscal costs include both personnel costs for staff performing such functions and the portion of Organization-wide non-personnel costs (such as facilities costs, supplies, and other costs) which are necessary for such staff to perform their duties.

   Organization-wide Management, HR, Accounting, and Fiscal functions are performed by staff holding the following positions:

   - List the positions that perform these functions

   Employees in these positions record the use of their time on a daily basis on timesheets. Employees code the time they spend performing duties for which the benefit provided to specific cost centers cannot be determined without unreasonable expense as Organization-wide Management. Some employees in these positions also perform duties for which the benefit to specific cost centers can be determined without unreasonable expense. In such cases, the employee will code the hours spent to benefit specific cost centers to the cost center(s) which benefit and code the hours spent performing functions which benefit overall organization management as Organization-wide Management.

   Employee's daily time records are used to calculate the percentage of the overall hours they worked which were coded to specific cost centers and the percentage which was coded to the overall organization and management functions. The percentages calculated are applied to all personnel costs related to that employee including: salary, employer payroll taxes, and fringe benefits, including accrued leave and accrued retirement benefits.

   Because the entire organization, including all cost centers, benefits from the overall Organization-wide Management staff effort, but the specific benefit provided to each cost center cannot be determined without incurring unreasonable costs, the personnel costs associated with the Organization-wide Management and HR functions must be allocated among all cost centers.

   SAMPLE allocates Organization-wide Management costs among all organization cost centers based upon the distribution of all non-Organization-wide Management hours among the various costs centers. The calculation of the percentage of Organization-wide Management cost to be allocated to each cost center is determined by calculating the percentage of all non-Organization-wide Management hours worked attributed to each cost center. This method, commonly referred to as the percentage of FTE (full-time equivalent) positions method, results in the allocation of Organization-wide Management personnel costs to all other cost centers based on each cost center's share of total non-Organization-wide Management hours.

2. **Facilities-Related Costs**
   Facilities costs include rent, depreciation, utilities, maintenance supplies, repairs and other costs associated with the use of facilities for SAMPLE operations. The following methods are used to allocate facilities costs incurred in the various types of facilities which SAMPLE utilizes for its operations. SAMPLE allocates facilities related cost based on the percentage of FTE positions providing benefit to each cost center.

3. **Direct Allocation of Shared Expenses**
   In addition to the costs for Organization-wide Management costs and Facilities costs described above, SAMPLE incurs a variety of expenses for items that benefit multiple cost centers for which the specific amount of benefit provided to each cost center cannot be determined without incurring unreasonable expense.

   This section describes how such shared expenses are directly allocated to the cost centers which benefit from them.

   a. Property and General liability insurance: is considered a Facilities Cost and is allocated using the methods described above.

   b. Directors and Officers insurance: is considered an Organization-wide Management function expense and is allocated using the method described above.

   c. Annual financial audit expense: is allocated based on the percentage of total expenditures for each program as indicated in the audit.

   d. 401(k) audit: is treated as an Organization-wide Management expense and allocated using the method described above. [include only if you have a 401k audit]

   e. Consumable supplies are determined to be either facilities supplies or Organization-wide Management supplies. All supplies that directly benefit a program are billed directly to the program it benefits.

   f. Telephone expenses: are allocated to cost centers based on the number of extensions designated to each program and location. If the extension benefits multiple programs, the cost is then allocated in a two-step process based on the secondary allocation method of program-related costs.

g. Postage expense: is based on meter readings for postage usage attributed to each cost center. [this can also be based on percentage of FTE if that's more straightforward]

h. Computer hardware, software, upgrades and maintenance costs which are directly related to specific cost centers will be charged to the cost center that benefits from their use. Such technology-related costs which benefit multiple programs will be allocated using the method described for Management function costs.

i. Other costs which cannot be directly attributed to specific cost centers will be allocated by the most reasonable and cost-effective method available.

4. **<u>Allocation Procedures</u>** [this section should be revised to reflect an organization's actual procedures]

1. At the end of each month, the costs described in Sections 1, 2, and 3 above are directly allocated to the programs by expense line item based on the allocation method described above for each type of cost. No costs that is charged directly to a cost center, grant fund or non-Federal function may also be allocated. The costs allocated each month are based on actual current allocation period staff time records or square footage utilization records and are not based on budget projections. The basis used allows for fair and equitable distribution of costs to all programs.

Employee Time Records used for allocating and charging cost centers [this section should be revised to reflect an organization's actual procedures]

1. Daily time records:

   Employees are required to submit daily time records documenting their use of work time. Employees who perform activities which benefit more than one cost center are required to record the time they have worked for each cost center each day based on actual time spent performing work that benefits each cost center. Each employee's time record is reviewed and approved or revised by a supervisor with knowledge of the employee's work.

2. Allocation of employee time and personnel costs when one program is funded by multiple sources:

   In some programs, multiple funding agreements provide support for essentially similar activities. For example, the personnel costs for an employee carrying out Weatherization program functions may be allowable under several different funding agreements. In such situations, the allocation of the employee's personnel costs will be based on the percentage of labor and materials that are charged to each of the allowable funding sources. This allocation based on percentage of labor and materials will result in the employee's personnel cost for the function being allocated to the various cost centers used to track the multiple funding sources supporting the program.

3. Accrued Leave Expense and Employer Pension Expense:

   SAMPLE records the amount of paid leave time each employee earns each pay period based on the SAMPLE employment policies. The resulting accrued leave expense for each employee each pay period will be allocated to cost centers based on the employee's record of the use of work time for the pay period. Actual hours worked will be utilized to compute the percentage of all employment costs for each employee and that percentage will be used to allocate cost for paid leave expense for each employees.