

THE ART OF COST ALLOCATIONS FOR BETTER MANAGEMENT

Catholic Charities USA Annual Gathering
Finance, Risk and Compliance Institute
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AGENDA

- 1 Introductions
- 2 3 allocation types
- 3 Functional allocations
- 4 Indirect rate allocations
- 5 “Fully-loaded” allocations
- 6 Case study
- 7 Conclusion & discussion

INTRODUCTIONS



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3 ALLOCATION TYPES

Functional, Indirect Rate, and Fully-Loaded



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3 ALLOCATION TYPES



FUNCTIONAL

- Required by accounting standards
- Included in audit and 990 and specifically identified on Guidestar
- Used by donors, charity watchdogs, etc.



INDIRECT COST RATE

- Required for those with federal contracts
- Specific direction given through OMB A-122
- Used by the Federal Government and tested in single audits



FULLY-LOADED

- Optional
- Allocates all expenses to programs to identify true resource requirements
- Used for management and board decision-making

3 ALLOCATION TYPES



FUNCTIONAL

- Required by accounting standards
- Included in audit and 990 and specifically identified on Guidestar
- Used by donors, charity watchdogs, etc.

- All expenses are identified within three categories:
 - Program
 - Fundraising
 - Management and Administration
- IRS requires only that a nonprofit uses a reasonable basis for allocating expenses into these 3 categories
- Many organizations use employee time as a key driver of overhead cost allocation

3 ALLOCATION TYPES



INDIRECT COST RATE

- Required for those with federal contracts
- Specific direction given through OMB A-122
- Used by the Federal Government and tested in single audits

- Used for cost reimbursable grants, contracts, and other agreements awarded by the Federal Government
- The purpose is to identify what proportion of indirect cost each program should bear
- The rate is a ratio between total indirect expenses and some direct cost base

3 ALLOCATION TYPES



FULLY-LOADED

- Optional
- Allocates all expenses to programs to identify true resource requirements
- Used for management and board decision-making

- Theoretically assumes that a program cannot run without administrative and fundraising support; likewise it assumes that the administration and fundraising components would not exist other than for the support of programs
- Allows management and boards to identify the “true” cost of each program in order to make more well-informed decisions about program expansion, contraction, elimination, or subsidies

3 ALLOCATION TYPES

- Allocations are not mutually exclusive
- Your organization may use one, two, or all three types of allocations for different purposes
- You may be able to use the information gathered for one type of allocation, organized in a new way, to depict another type of allocation

NOTE: If you are/want to use multiple allocations, it is helpful to call them something other than “allocations” around the office – they are easily confused!



EXTERNAL FUNCTIONAL ALLOCATIONS

Functional allocations for external reporting

PRESENTATION REQUIREMENTS

Voluntary Health and Welfare organizations (like Catholic Charities) = Statement of Functional Expense

Others = At a minimum, either on the Statement of Activities or in a footnote

990 = All 501(c)(3) and 501(c)(4) organizations

*Financial Reporting Executive Committee now **recommends** that all nonprofits that are supported by the general public (20-30% or more of total revenue) present a Statement of Functional Expenses.*

WHY?

Donors and watchdogs use to judge organization effectiveness.

Discussion:

How has your Statement of Functional Expense or 990 been used by the public?

CATEGORIES

- Program
- Supporting Activities
 - Management and General (Administration)
 - Fundraising

PROGRAM COSTS

- Costs associated with direct mission work
- Number of programs detailed out varies by entity

MANAGEMENT AND GENERAL COSTS

- Costs of administering the organization
- Examples
 - Business management
 - Accounting/recordkeeping
 - Budgeting
 - Soliciting funds other than contributions, including for exchange transactions (even if program related)
 - Informing the public about the entity's stewardship of contributions
 - All administration except for direct conduct of program services or fundraising

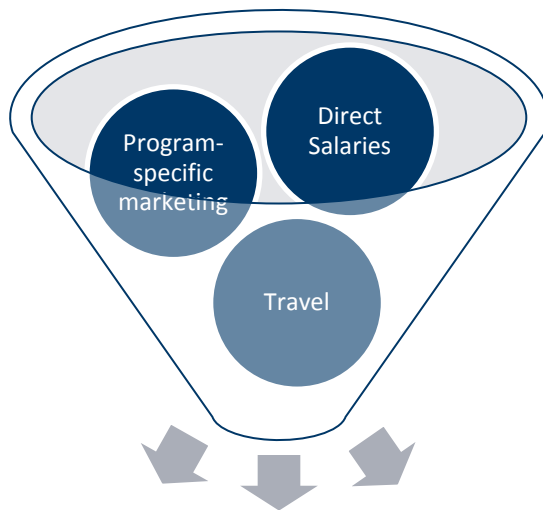
FUNDRAISING COSTS

- Working with potential donors to solicit contributions (cash, services, in-kinds, other assets)

FUNCTIONAL ALLOCATIONS

Step 1: Separate Direct from Indirect Expenses

DIRECT EXPENSES

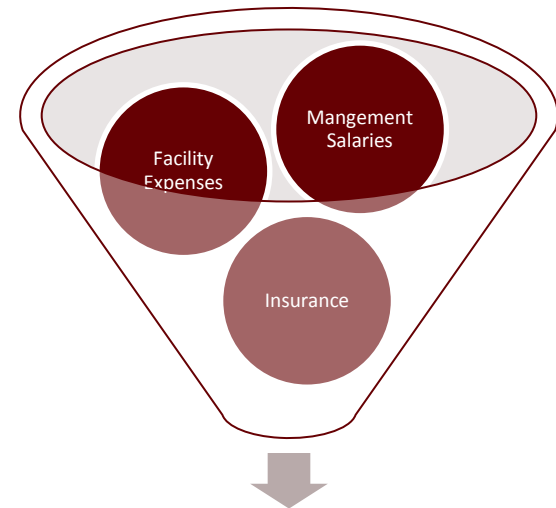


Program A

Program B

Program C

INDIRECT EXPENSES



Allocate

FUNCTIONAL ALLOCATIONS

Step 2: Identify Allocation Methods for Indirect Expenses

Staff Time

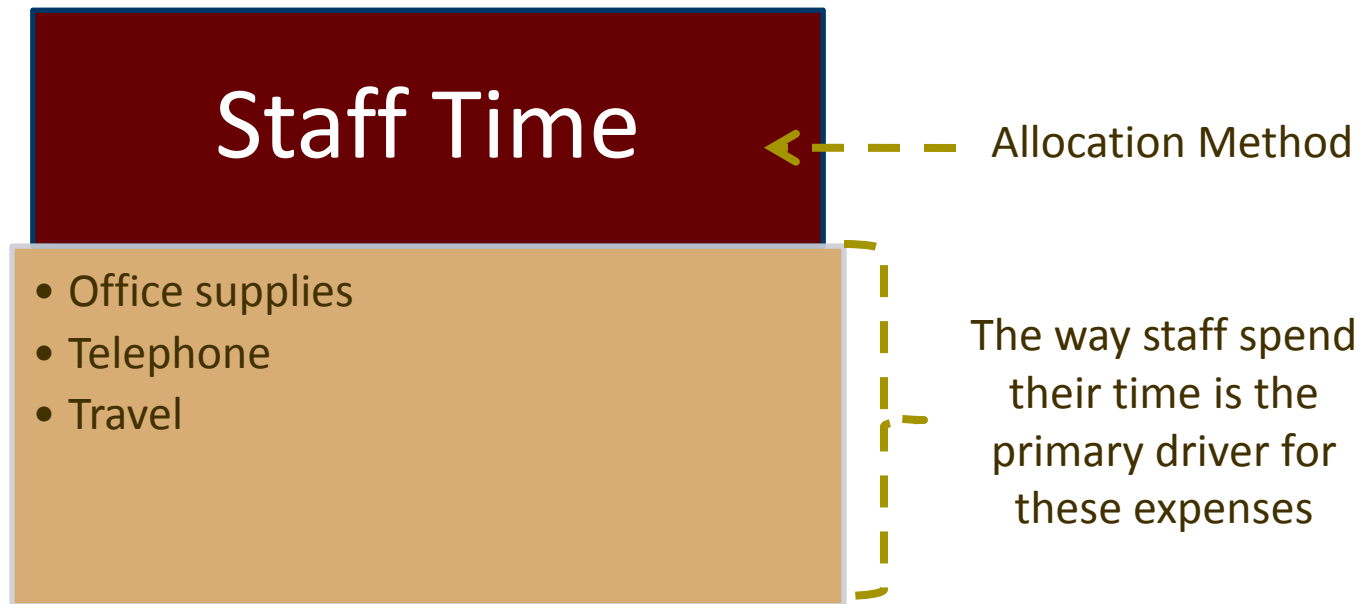
- Full Time Equivalents
- Total Salary

Square Footage

Functional allocations are an estimate. Use your best judgment.

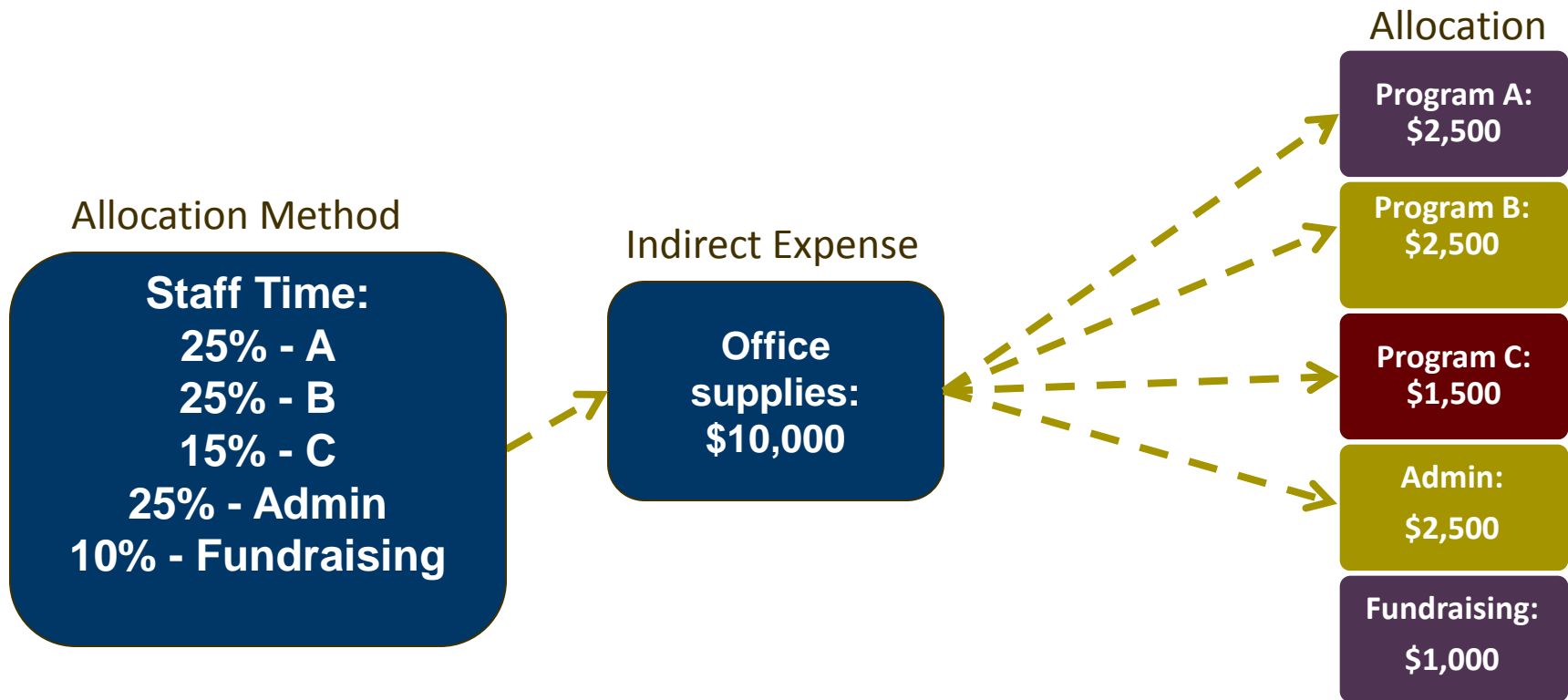
FUNCTIONAL ALLOCATIONS

Step 3: Determine Method for Each Expense



FUNCTIONAL ALLOCATIONS

Step 4: Apply Allocations to Indirect Expenses



FUNCTIONAL ALLOCATIONS

Step 5: Report and Defend

- Funders often judge an organization by their program percentage.

Discussion:

How can you change the focus away from just “the percentages”?



INDIRECT COST RATE

Allocations for federal grant reporting purposes

INDIRECT COST RATE ALLOCATIONS

How many of you currently use an indirect cost rate or are required to use an approved indirect cost rate?

INDIRECT COST RATE ALLOCATIONS

A device for determining fairly and conveniently within the boundaries of sound administrative principles, what proportion of indirect cost each program should bear:

- Provisional or billing rate: temporary indirect cost rate applicable to a specified period used for funding and reimbursement, and reporting indirect costs on awards pending the establishment of a final rate for the period
- Final rate: indirect cost rate applicable to a specified past period which is based on the actual costs of the period (not subject to adjustment)
- Predetermined rate: permanent rate established for a specified current or future period and not subject to adjustment. May also be used on awards where there is reasonable assurance that the rate is not likely to exceed a rate based on the organization's actual costs

INDIRECT COST RATE ALLOCATIONS

Simplified

Multiple Rate

Direct
Allocation

← Three Basic Methods for Non Profits →

Note: See OMB Circular A-122 for computation instructions, as well as the conditions in when to use each method

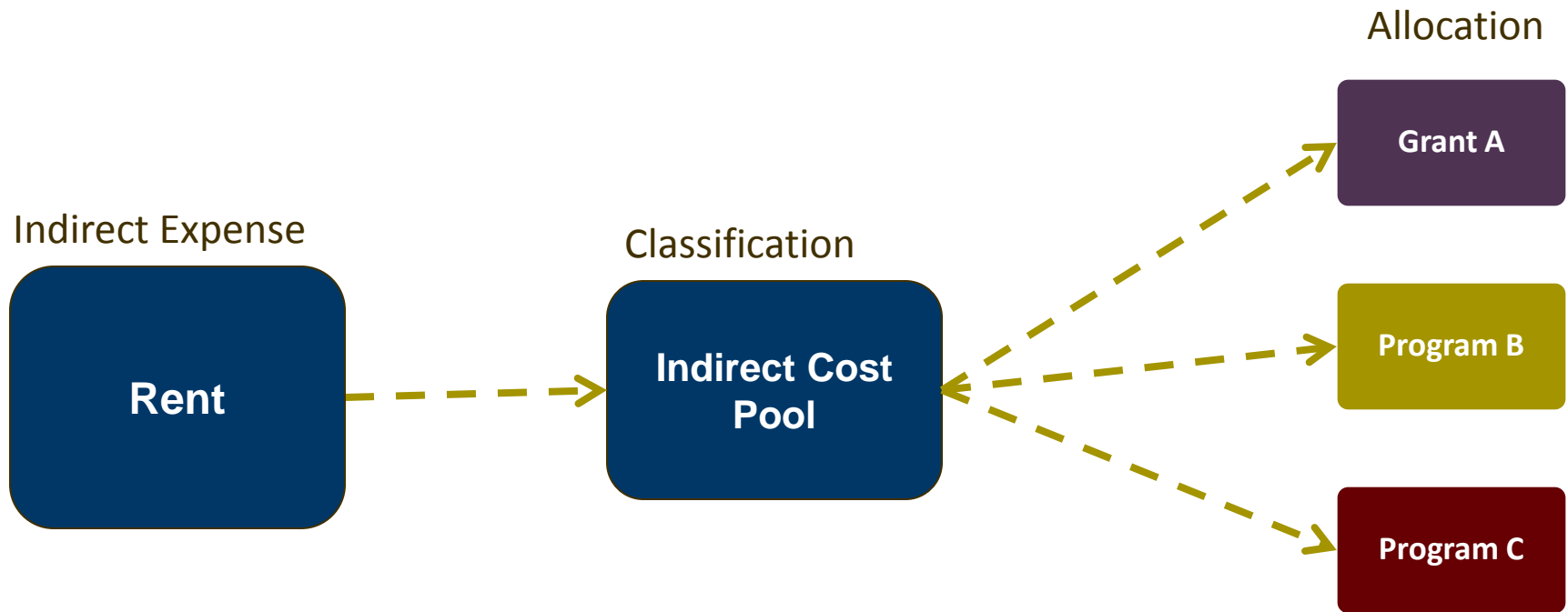
INDIRECT COST RATE ALLOCATIONS

SIMPLIFIED ALLOCATION METHOD

- Used whenever the major functions of an organization benefit from its indirect costs to approximately the same degree
- Allocation of indirect costs may be accomplished by:
 1. Classifying the total cost for the base period (usually the organization's fiscal year) as either direct or indirect
 2. Dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base.
- Indirect cost rate is used to distribute indirect costs to individual Federal financial assistance programs and contracts
- Both direct and indirect costs exclude capital expenditures and unallowable costs, but these are included in direct cost base.

INDIRECT COST RATE ALLOCATIONS

SIMPLIFIED ALLOCATION EXAMPLE



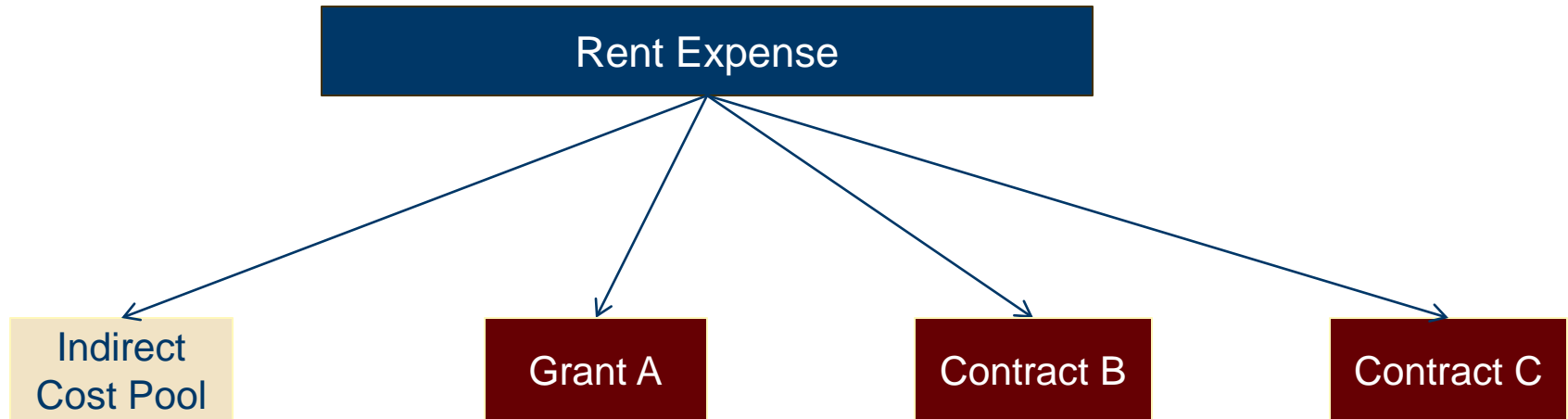
INDIRECT COST RATE ALLOCATIONS

DIRECT ALLOCATION METHOD

- Used by organizations that treat all costs as direct costs EXCEPT general administration and expenses
- Generally separate costs into three basic categories:
 1. General administration and expenses
 2. Fund raising
 3. Other direct functions (including projects performed under Federal awards)
- Joint costs (i.e depreciation, rent, maintenance, utilities) are prorated individually as direct costs to each category and to each award or other activity using a BASE most appropriate to the particular cost being prorated

INDIRECT COST RATE ALLOCATIONS

DIRECT ALLOCATION EXAMPLE



Note: Only rent expense allocated to the indirect pool is the indirect portion of rent expense as a whole

INDIRECT COST RATE ALLOCATIONS

DIRECT ALLOCATION BASES

The Allocation Base Selected by the Non Profit Organization Must Be:

- Reasonable and consistently applied to direct costs
- Supported by accurate and current data
- Appropriate to the particular cost being distributed, and
- One which results in an accurate measure of the benefits provided to each activity or the organization

INDIRECT COST RATE ALLOCATIONS

DIRECT ALLOCATION BASE SUGGESTIONS

Type of Service:

Legal service
Building lease & management
Accounting
Office space usage and related costs (utilities, janitorial)
Personnel administration
Employees retirement system administration

Suggested Allocation Base:

Direct hours
Number of leases
Number transactions processed
Square feet of space occupied
Number of employees
Number of employees contributing

INDIRECT COST RATE ALLOCATIONS

OTHER NOTES

An Organization that receives more than \$10 million in Federal funding of direct costs in a fiscal year must break out indirect costs into two components:

- **Facilities:** depreciation and use allowances on buildings, equipment and capital improvements; interest on debt associated with certain buildings, equipment and capital improvements; and operations and maintenance expenses
- **Administration:** general administration and general expenses such as the director's office, accounting, personnel, library expenses and all other types of expenditures not listed specifically under one of the subcategories of "Facilities"



FULLY-LOADED ALLOCATIONS

Internal allocations for better decision making



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FULLY-LOADED ALLOCATIONS

How many of you currently use a process where you allocate all of your costs to programs to identify the true costs of each program?

FULLY-LOADED ALLOCATIONS

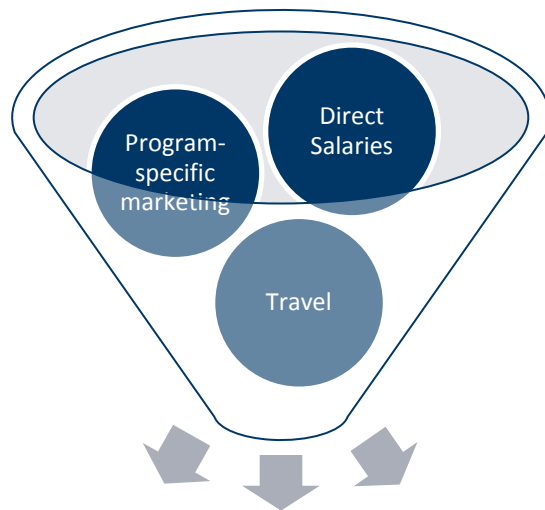
The ideal setup for completing and using a fully-loaded allocation at your organization includes:

- Accounting and reporting system that delineates profit centers from the cost center(s)
- Ability to identify or estimate Management and Administrative staff time spent supporting each program
- Willingness by staff and board to evaluate financial results in new ways

FULLY-LOADED ALLOCATIONS

Step 1: Record Expenses

DIRECT EXPENSES

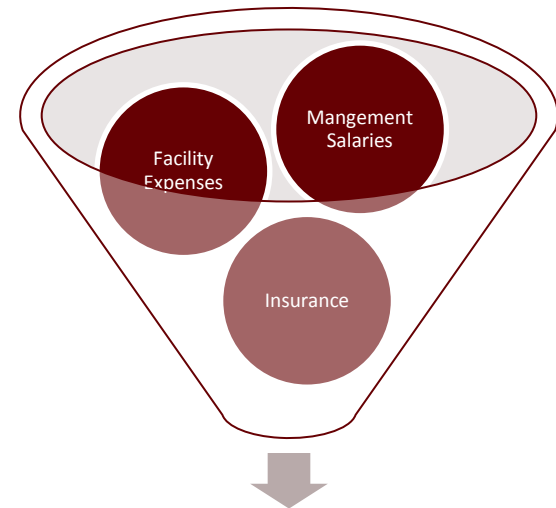


Program A

Program B

Program C

INDIRECT EXPENSES



Management & Administration

FULLY-LOADED ALLOCATIONS

Step 2: Identify Allocation Methods

Staff Time

Square
Footage

% Direct
Expenses

← Multi-Step Allocations →

FULLY-LOADED ALLOCATIONS

Step 3: Determine Method for Each Expense

Staff Time

- Administrative salaries
- Administrative benefits
- Travel
- Employee recognition

← Allocation Method

The way staff spend their time is the primary driver for these expenses

FULLY-LOADED ALLOCATIONS

Step 4: Apply Allocations to Indirect Expenses



FULLY-LOADED ALLOCATIONS

Step 5: Total and Report

- There are many options for how you can report the information
- Try to identify the most intuitive/logical reporting structure for your organization
- We recommend separating the direct and indirect expenses



CASE STUDY

A \$1M Swing



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Original Reporting Structure

(\$000's)	Total	1	2	3	PI
Operating Revenues					
Admissions	14,825	5,460	9,094	271	
Real Estate Rental Income	912	0	0	0	
Concession Income	1,130	0	93	200	
Advertising Income	250	0	250	0	
Contract Service Revenue	0	0	0	0	
Other Income	389	10	379	0	
Total Operating Revenue	17,506	5,470	10,653	471	
Operating Expenses					
Salaries/Gross Wages	4,628	405	3,733	490	
Stagehands & Usher Wages	1,181	420	721	40	
Musicians and Conductor Salaries	3,826	3,709	117	0	
Employee Benefits and Taxes	1,819	832	884	103	
Artist and Exhibit Fees	7,024	1,380	5,190	454	
Production and Operating	3,020	336	1,998	385	
Concession Cost of Goods Sold	578	0	474	104	
Marketing	1,844	489	1,217	134	
General and Administrative	1,019	1,389	(908)	473	
Interest Expense	282	0	0	0	
Depreciation	1,876	9	1,173	350	
Total Operating Expenses	27,019	8,069	14,599	2,530	
Operating Revenue minus Expenses	(9,513)	(3,499)	(3,946)	(2,059)	
Contributions and Investment Income and Gains					
Prior Year Contributions for Current Year	0	0	0	0	
Current Year Contributions	7,300	2,550	3,750	1,000	
Grants - Local, State, and Fed. Govt.	0	0	0	0	
Development Salaries & Expenses	(982)	(8)	(923)	(51)	
Total Contributions	6,318	2,542	2,827	949	
Operating Interest Income	6	0	6	0	
Endowment Draw (5%)	2,130	745	800	585	
Total Interest Income and Endowment Draw	2,136	745	806	585	
Total Contributions, Interest and Endowment Draw	8,454	3,287	3,633	1,534	
Surplus/(Deficit)	(1,059)	(212)	(313)	(525)	

Profit-center

Profit-center

Issue: combined profit-center & cost-center

Issue: unclear G&A allocation

Recommended Allocation Methods

A: Staff Time

B: % Direct

C: Multi-Step

Recommended Allocations

- Staff Time Allocation
 - Average estimated time split per division

Accounts	
Salaries/Gross Wages	403B Match
FICA Taxes	Employee Recognition
State Unemployment Taxes	Telephone
Long Term Disability	Training Expense
Short Term Disability	Travel Expense
Benefits- Health Insurance	Admin. Building Depreciation
Workers Compensation Insurance	

A: Staff Time

B: % Direct

C: Multi-Step

Recommended Allocations

- Allocating expenses based on the portion of total direct division expenses

Accounts		
Public Relations	Director's & Officers Insurance	Postage
Development Signage	Key Man Life Insurance	Board Mtgs/Lunches
Receptions	Van/Fuel Service	Bank Charges
Advertising - Magazine	Audit & Tax Fees	Brokerage Charges
Advertising - Newspaper	Legal Fees	Other Expense
Advertising - Radio	Contract Labor	Recruiting Expense
Advertising - TV	Outside Services	Business Meals
Advertising - Other	Office Supplies	Dues & Subscriptions

A: Staff Time

B: % Direct

C: Multi-Step

Recommended Allocations

- Allocations requiring multiple steps
 - IT Services
 - ◇ Step 1: allocate to all 4 divisions based on number of users
 - ◇ Step 2: allocate G&A expense to profit-centers based on time allocation

Accounts
Computer Supplies
Software Support

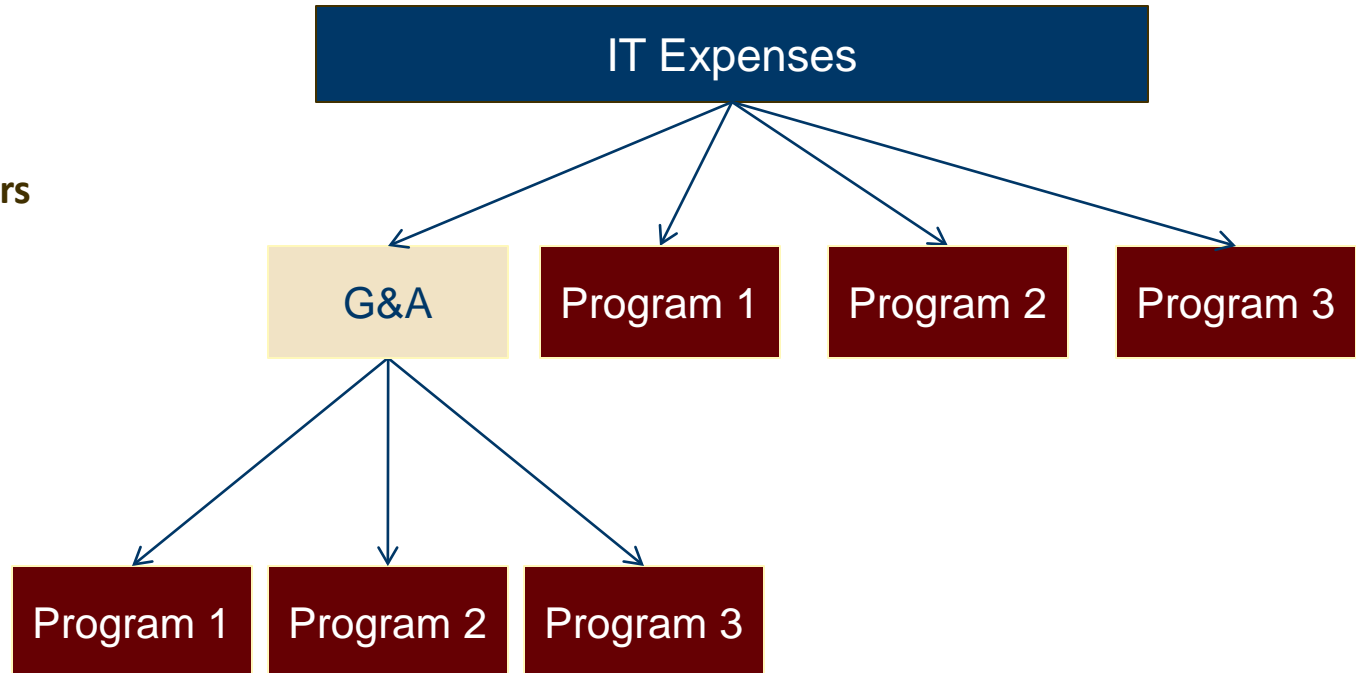
A: Staff Time

B: % Direct

C: Multi-Step

Recommended Allocations

Step 1:
Method: Number Users



Step 2:
Method: Staff Time

A: Staff Time

B: % Direct

C: Multi-Step

New Internal Financial Reporting Format

Revised Budget and Reporting

Profit-center
Profit-center
Profit-center
Cost-center

Organization Inc.
Income Statement by Program
Budget for the 12 Months Ended 6/30/2013

	Program 1	Program 2	Program 3	G&A	Total
Revenue					
Admissions	5,442,084	9,093,967	270,942		14,806,993
Real Estate Rental Income	-	-	-		912,000
Advertising Income	-	250,000	-		250,000
Contract Service Revenue	-	929,842	200,000		1,129,842
Contributions and Grants	2,550,000	3,750,000	1,000,000		7,300,000
Processing Fees	-	350,000	-		
Other Income	27,600	33,840	-		62,180
Total Revenue	8,019,684	14,407,649	1,470,942	-	24,811,015

Revised Budget and Reporting

	Program 1	Program 2	Program 3	G&A	Total
Direct Expenses					
Salaries/Gross Wages	404,685	954,000	490,050	3,391,700	5,240,435
Stagehands & Usher Wages	420,408	721,060	40,456	-	1,181,924
Musicians & Conductor Salaries	3,708,686	116,645	-	-	3,825,331
Employee Benefits & Taxes	831,601	261,356	103,162	739,539	1,935,658
Artist & Exhibit Fees	1,380,034	4,754,951	458,059	-	6,593,044
Production & Operating	313,967	809,509	40,600	-	1,164,076
Concession COGS	-	474,323	103,700	-	578,023
Rent Expense	5,900	76,104	5,220	-	120,340
Marketing/PR	493,417	547,879	149,077	633,317	1,823,690
IT	1,350	600	2,330	169,536	180,260
Insurance	2,000	-	57,550	535,300	645,250
Maintenance	2,332	25,698	222,137	605,605	953,145
Professional Services	6,040	14,250	54,095	504,733	698,779
Travel and Training	7,510	33,145	36,030	124,120	200,805
Supplies	36,831	5,968	31,196	160,814	235,139
Credit Card Fees	-	8,500	8,705	345,000	362,205
Interest and Taxes	-	34,200	10,400	-	311,600
Depreciation	9,480	-	351,136	1,173,120	1,879,264
Other Expenses	2,000	550	20,000	49,450	72,000
Total Direct Expenses	7,626,241	8,838,738	2,183,903	8,432,234	28,000,968

All general and administrative expenses are reported in this division

Revised Budget and Reporting

G&A expenses are allocated to each profit-center based on the reflective cost-driver methods

	Program 1	Program 2	Program 3	G&A	Total
Indirect Expense Allocation					
Salaries/Gross Wages	841,647	1,899,225	650,828	(3,391,700)	-
Employee Benefits & Taxes	183,516	414,114	141,909	(739,539)	-
Marketing/PR	258,988	300,164	74,165	(633,317)	-
IT	40,024	88,740	40,772	(169,536)	-
Insurance	130,939	284,847	119,514	(535,300)	-
Maintenance	164,286	362,387	78,931	(605,605)	-
Professional Services	206,405	239,221	59,107	(504,733)	-
Travel and Training	39,553	64,821	19,746	(124,120)	-
Supplies	65,763	76,219	18,832	(160,814)	-
Credit Card Fees	-	345,000	-	(345,000)	-
Depreciation	284,245	628,359	260,516	(1,173,120)	-
Other Indirect Expenses	17,797	24,295	7,357	(49,450)	-
Total Indirect Allocation	2,233,162	4,727,393	1,471,679	(8,432,234)	-

Revised Budget and Reporting

	Program 1	Program 2	Program 3	G&A	Total
Total Indirect Allocation	2,233,162	4,727,393	1,471,679	(8,432,234)	-
Total Expenses	9,859,403	13,566,131	3,655,582	-	28,000,968
Operating Revenue less Total Expenses	(1,839,719)	841,518	(2,184,640)	-	(3,189,953)
Interest and Endowment					
Operating Interest Income	-	6,000	-	-	6,000
Endowment Draw	745,000	800,000	585,000	-	2,130,000
Total Interest & Endowment	745,000	806,000	585,000	-	2,136,000
Total Change in Net Assets	<u>(1,094,719)</u>	<u>1,647,518</u>	<u>(1,599,640)</u>	-	<u>(1,053,953)</u>

Original bottom line*:	(212,000)	(313,000)	(525,000)		(1,059)
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*Difference due to rounding.



CONCLUSION

CONCLUSION

- There are multiple types of allocations - each of which are required or used for and mean different things
- Fully-loaded allocations provide valuable information for decision-making
- Incorrect or out-dated allocations can dramatically impact how each of your programs appear to perform financially



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