Cost Allocation Plans

FGFOA Webinar Series

August 16, 2018

2:00pm – 3:40pm

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Agenda

- Why Perform Cost Allocation?
- Terminology & Definitions
- Types of Cost Allocation Plans
- Cost Allocation Process
- Types of Indirect Cost Rates
- Indirect Cost Recoveries
- Submission Requirements
- Questions & Answers

Why Perform Cost Allocation?

Why Perform Cost Allocation?

Reasons for Performing Cost Allocation:

- Charge indirect costs to special revenue, internal service, and enterprise funds.
- Recover indirect costs from federal or state funding.
- Provides indirect cost analysis, which when combined with direct costs, is useful in determining fees-for-services.
- Useful in determining the full cost of services when considering outsourcing options.
- Useful as management tool (recognize cost drivers & benchmarking).
- Useful in identifying service levels and service usage/consumption.

Terminology & Definitions

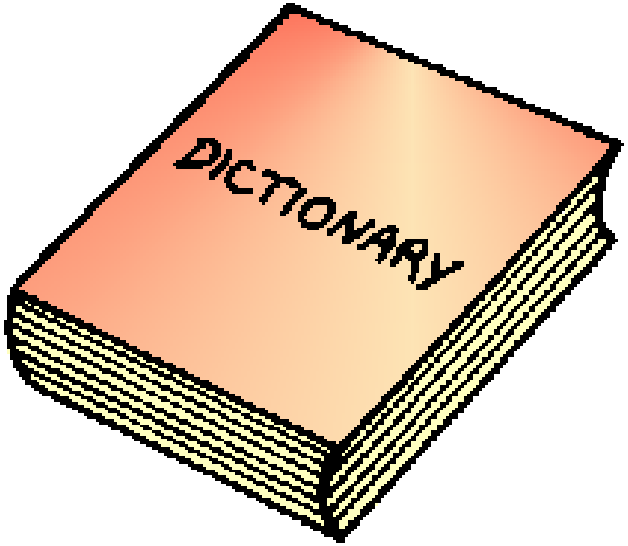
Terminology & Definitions

Indirect Costs:

Overhead or administrative costs incurred for joint purposes that may not be identified with a single use without effort out of proportion to the benefit of that analysis. Indirect Costs must be allocated using an “allocation basis”.

Direct Costs:

Costs that can be specifically identified with a particular final cost objective (i.e. 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.



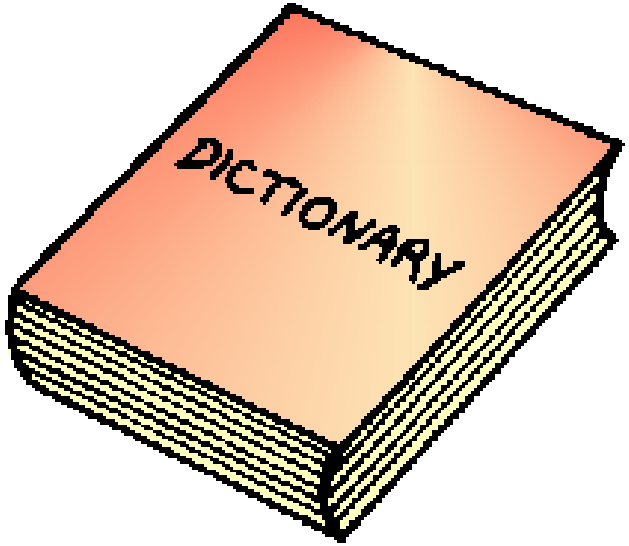
Terminology & Definitions

Central Service Department:

Organization(s) within an entity that primarily exist to provide support services to operating departments. The expenditures of central service departments are used to develop the allocable costs pools (i.e., “indirect costs”).

Some example of central service departments are:

- Facilities Maintenance
- Information Technology
- Finance
- Accounting
- Purchasing
- Legal
- Internal Audit
- Human Resources
- Payroll



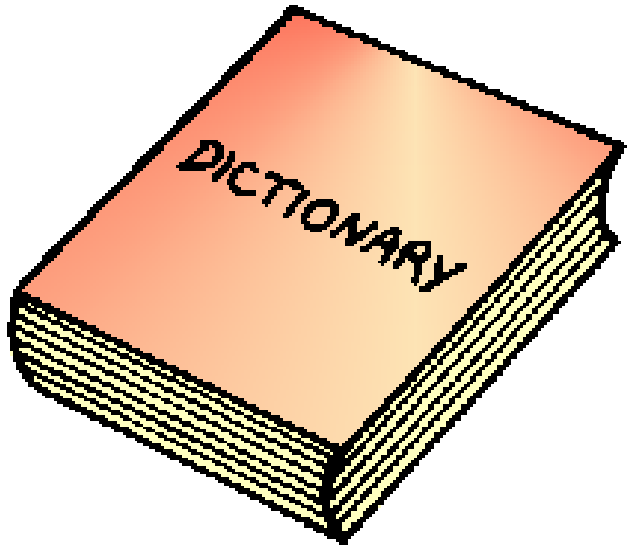
Terminology & Definitions

Grantee Department:

Organization(s) within an entity that primarily exist to provide services directly to the public. The expenditures of grantee departments are used to develop the direct cost base. Any organization not classified as a Central Service department is a Grantee Department.

Some example of grantee departments are:

- Health & Social Services
- Fire
- Police
- Community Development
- Airport
- Public Transportation
- Libraries
- Parks & Recreation
- Water & Sewer
- Solid Waste



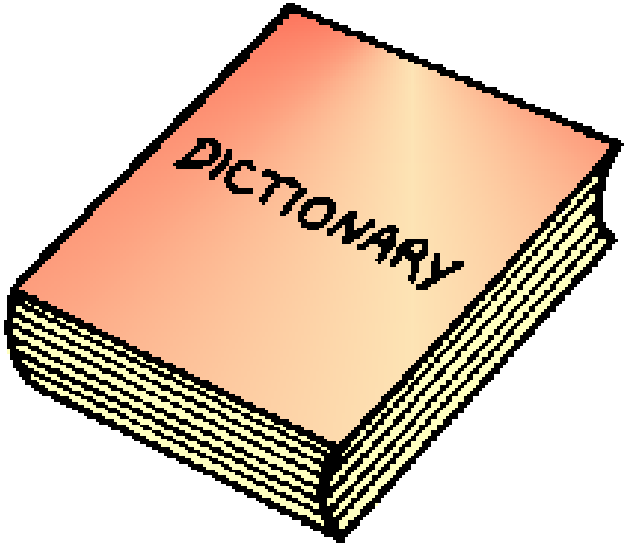
Terminology & Definitions

Cost Objective:

A fund, department, organization, function, contract, grant or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost.

Cost Allocation:

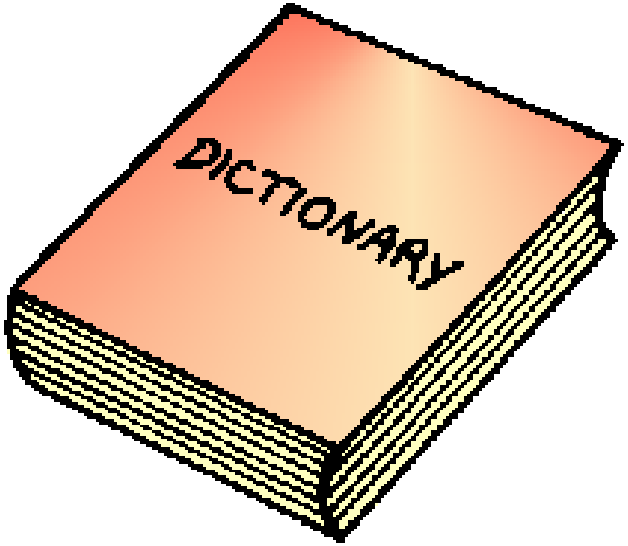
The process of distribution or apportioning "indirect costs" to a benefiting "cost objective".



Terminology & Definitions

Allocation Basis:

The methodology or statistical measure by which indirect costs are distributed to a benefiting cost objective. Allocation bases should be objective, measurable, and a relationship should exist between the indirect cost allocated and the benefit derived for the service.



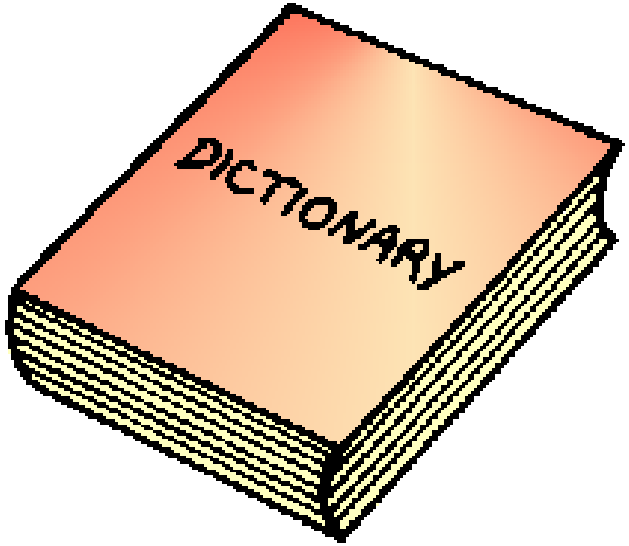
Examples of Allocation Basis:

- Number of Active Employees
- Number of Positions
- Number of Full Time Equivalent (FTE) Employees
- Number of Purchase Orders
- Number of Transactions Processed
- Number of Hours Worked
- Square Footage Occupied
- Number of Devices Maintained
- Work Order Costs
- System Usage

Terminology & Definitions

Indirect Cost Rate:

A device for determining in a reasonable manner the proportion of indirect costs each program should bear. It is the ratio (expressed as a percentage) of the indirect costs to a “direct cost base”. A separate indirect cost rate is usually necessary for each department or agency of the governmental unit claiming indirect costs under Federal awards.



Indirect Cost Rate Proposal:

The documentation prepared by non-Federal entities to substantiate its request for the establishment of an indirect cost rate.

Indirect Cost Rate Negotiation Agreement:

A document that formalizes the indirect cost rate negotiation process. The agreement contains:

- The type of rate negotiated
- Effective period
- Location / Program to which rate is applied
- Direct Cost Base
- Signatures of authorized individuals

Types of Cost Allocation Plans

Types of Cost Allocation Plans

1. Central Services Cost Allocation Plan
   - Full Cost Allocation Plan
   - Federal Cost Allocation Plan
     - "OMB" Plan
     - Appendix V to 2 CFR Part 200 ("Uniform Guidance")
2. Department Cost Allocation Plan/Indirect Cost Rate Proposal (ICRP)
     - Appendix VII to 2 CFR Part 200

Types of Cost Allocation Plans

Central Services Cost Allocation Plan

The documentation prepared by an organization to identify, accumulate and allocate costs of services provided on a centralized basis to its departments and agencies. The cost of these services may be allocated or billed to users.

Types of Cost Allocation Plans

Department Cost Allocation Plan

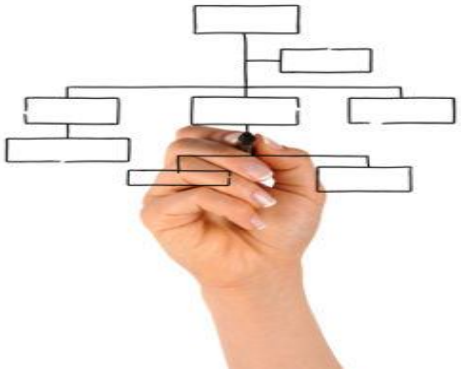
The documentation prepared by an organization to identify, accumulate and allocate costs of services defined within the department.

Cost Allocation Process

Cost Allocation Process

Steps to Preparing a Cost Allocation Plan:

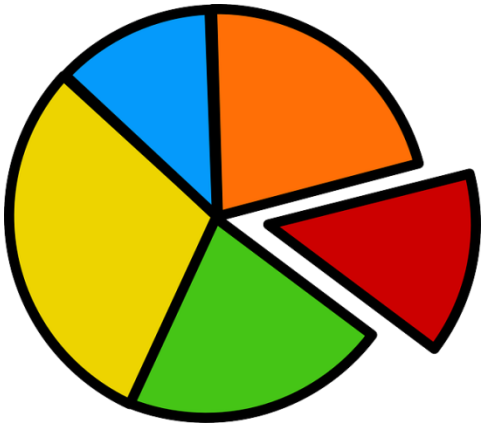
1. Review the Organization Chart
2. Determine Central Service Departments and Grantee Departments
3. Define the Cost Basis (i.e., actual, budgeted or projected)
4. Develop the Central Service Cost Pools
5. Define the Services or Activities Performed by each Central Service



Cost Allocation Process

Steps to Preparing a Cost Allocation Plan:

6. For each Service or Activity, Determine what Statistical Data or Metrics are Available to Quantify the Level of Service Provided to each Department that Uses or Benefits from the Service (“Allocation Basis”)
7. Allocate each Central Service Cost Pool using the Allocation Basis developed for that Service
8. Summarize the Allocated Costs by Grantee Department



Cost Allocation Process

Allocation Basis Example

Centralized Copier that Three Divisions Utilize

Division A – 12 Staff

Division B – 6 Staff

Division C – 22 Staff

40 Staff Total

Cost Allocation Process

How should the copier costs get allocated?

	Equal Distribution	Number of Staff
Division A	1/3	30%
Division B	1/3	15%
Division C	1/3	55%
	100%	100%

How about user codes?

- Measures actual usage

	User Codes
Division A	15%
Division B	75%
Division C	10%
	100%

Cost Allocation Process

Examples of Allocation Bases:

1. Accounting
    - Number of Transactions Processed
2. Budget
    - Number of Budgeted Accounts
    - Total Budgets
3. Commission/Council/Clerk
    - Number of Agenda Items
4. County/City Manager
    - Number of Employees
    - Number of Departments

Cost Allocation Process

Examples of Allocation Bases:

5. Facilities Maintenance
    - Work Order Costs (Labor Hours and Materials)
    - Total Square Footage Occupied
6. Fleet Maintenance
    - Work Order Costs (Labor Hours and Materials)
    - Number of Vehicles
7. Human Resources/Personnel
    - Number of Positions
    - Number of Full-Time Equivalent (FTE) Employees
    - Number of Applications Processed
    - Number of Training Hours

Cost Allocation Process

Examples of Allocation Bases:

8. Information Technology Services
    - Number of Tickets/Hours
    - Number of Accounts
    - Number of Applications/Hours
    - Number of Computers/Devices
    - Application/License Cost
9. Legal
    - Number of Hours
10. Payroll
    - Number of Payroll Transactions Processed
    - Number of Active Employees

Cost Allocation Process

General Criteria for an Allocation Basis:

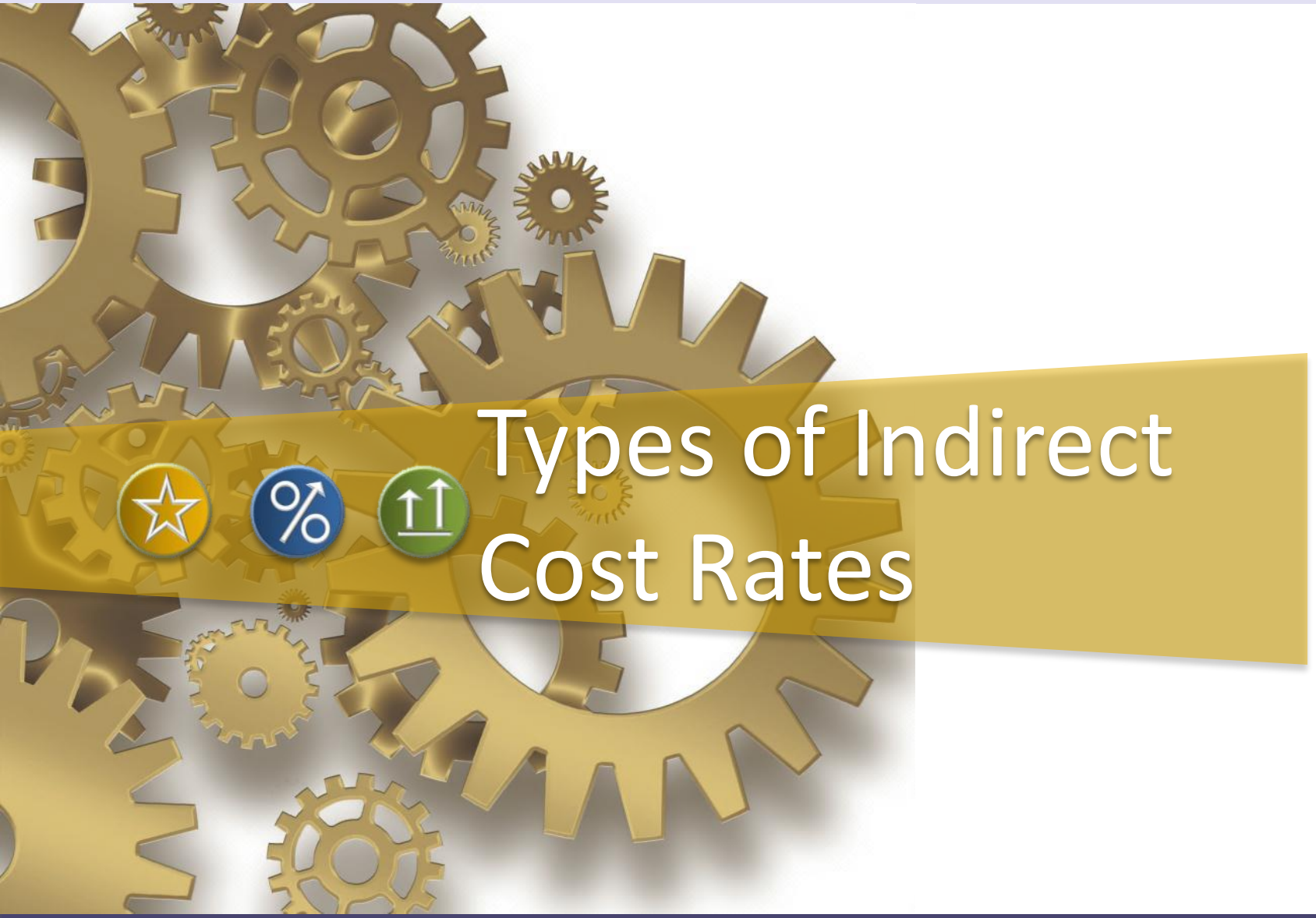
- Objective
- Measurable
- Identifies Units of Service to the Departments Using or Benefiting from the Service
- Relationship Exists Between the Indirect Cost being Allocated and the Benefit Derived for the Service

In general, any method of allocation may be used which will produce an equitable distribution of cost. In selecting one method over another, consideration should be given to the additional effort that would be required to achieve a greater degree of accuracy.

Cost Allocation Process

Examples of Allocation Bases:

11. Purchasing
    - Number of Purchase Orders Processed
    - Number of Bids/RFPs
    - Number of Contracts Managed
    - Number of P-Card Transactions
    - Number of Items on Asset Inventory
    - Number of Inventory Issues
12. Records Management
    - Number of Boxes Added/Retrieved/Destroyed
    - Number of Boxes Stores
    - Number of Records Scanned



Types of Indirect Cost Rates

Indirect Cost Rates

Basic Principle:

Cost principles of this part establishes principles for determining the allowable costs incurred by non-Federal entities under Federal awards. The principles are for the purpose of cost determination and are not intended to identify the circumstances or dictate the extent of Federal government participation in the financing of a particular program or project. The principles are designed to provide that Federal awards bear their *fair share* of cost recognized under these principles except where restricted or prohibited by statute.

(§200.100(c) to 2 CFR Part 200)

Indirect Cost Rates

Four Types of Indirect Cost Rates

- Predetermined rate
- Fixed rate
- Provisional rate
- Final

Which Rate to Use?

Indirect Cost Rates

Four Types of Indirect Cost Rates

Predetermined rate means an indirect cost rate, applicable to a specified current or future period, usually the governmental unit's fiscal year. This rate is based on an estimate of the costs to be incurred during the period. Except under very unusual circumstances, a predetermined rate is not subject to adjustment.

Predetermined rates may not be used by governmental units that have not submitted and negotiated the rate with the cognizant agency for indirect costs. Negotiation of predetermined rates for indirect costs for a period of two to four years should be the norm in those situations where the cost experience and other pertinent facts available are deemed sufficient to enable the parties involved to reach an informed judgment as to the probable level of indirect costs during the ensuing accounting periods.

Indirect Cost Rates

Four Types of Indirect Cost Rates

Fixed rate has the same characteristics as a predetermined rate, except that the difference between the estimated costs and the actual, allowable costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period.

Provisional rate means a temporary indirect cost rate applicable to a specified period which is used for funding, interim reimbursement, and reporting indirect costs on Federal awards pending the establishment of a “final” rate for that period.

Final rate means an indirect cost rate applicable to a specified past period which is based on the actual allowable costs of the period. A final audited rate is not subject to adjustment.

Indirect Cost Rates

10% De Minimis Rate

Section 200.414(f): any non federal entity that receives less than $35 million in direct federal funding and has never received a negotiated indirect cost rate may elect to charge a de minimis rate of 10% of modified total direct costs (MTDC) which may be used indefinitely.

One-Time Extension

Section 200.414(g): any non federal entity with a federally negotiated indirect cost rate may apply for a one-time extension of its current negotiated indirect cost rate(s) for a period of up to four years.

Indirect Cost Rates

Rate Methodology

The Simplified Method may be used where each of an agency's major functions benefit from its indirect costs to approximately the same degree

The Multiple Rate Method is more appropriate where each of an agency's major functions benefit from its indirect costs in varying degrees

Indirect Cost Rates

Rate Methodology

Multiple Rate Method

1. Classify departmental indirect costs into functional cost groupings ("cost pools") which benefit divisions in significantly different proportions
2. Select appropriate bases for distribution of each classified pool of indirect costs
3. Distribute each classified pool to benefiting divisions
4. Calculate an indirect cost rate for each division by relating the total indirect costs allocated to that division to that division's direct cost base

Indirect Cost Rates

Selection of Rate Methodology

- Amount of Federal Funding
- Size of the Organization
- Service Variances
- Availability of Allocation Statistics
- Types of Programs
- Cognizant Federal Agency

Indirect Cost Recoveries

Indirect Cost Recoveries

Indirect Cost Rate Proposal (ICRP)

The documentation prepared by an organization to substantiate its claim for the reimbursement of indirect costs. The proposal is the basis for establishing an **indirect cost rate** agreement

Should include *both* central service cost allocation plan and departmental administration indirect cost allocations

$$\text{Indirect Cost Rate (\%)} = \frac{\text{Total Indirect Costs = (CAP + Dept. Admin)}}{\text{Direct Cost Base}}$$

Indirect Cost Recoveries

An indirect cost rate must be applied to a direct cost base in order to determine the amount of indirect cost allocable to the award

Direct Cost Base:

Accumulated costs used to recover indirect costs from individual federal awards. The direct cost base selected should result in each award bearing a fair share of the indirect costs in reasonable relation to the benefits derived from those costs.

Types of Direct Cost Bases:

- Salaries & Wages
- Salaries & Wages and Fringe Benefits
- Modified Total Direct Cost Base

Modified Total Direct Cost Base is usually calculated to include salaries, wages, fringe benefits allowable operating expenditures and the first $25,000 of sub grants/sub awards (pass through funding).

Submission Requirements

Central Services Cost Allocation Plan

- Each **major local government** is required to submit a cost allocation plan to its Federal cognizant agency for indirect costs annually
  - *Major local government* means a local government that receives more than **$100 million in direct federal awards** subject to 2 CFR Part 200.
- All other local governments claiming central service costs **must develop a plan** in accordance with the requirements described in 2 CFR Part 200 and maintain the plan and related supporting documentation for audit.
- These local governments **are not required** to submit their plans for federal approval unless they are specifically requested to do so by the cognizant agency for indirect costs.
- Where a local government only receives funds as a sub recipient, the pass-through entity will be responsible for monitoring the sub recipient's plan.

Indirect Cost Rate Proposal

- A governmental department or agency unit that **receives more than $35 million in direct Federal funding must submit its indirect cost rate proposal to its cognizant agency** for indirect costs.
- Other governmental departments or agencies **are not required to submit their proposal unless specifically requested to do so by the federal cognizant agency** for indirect costs.
- Where a non-Federal entity only receives funds as a sub recipient, the pass through entity will be responsible for negotiating and/or monitoring the sub recipient's indirect costs.

Questions
& Answers

Cost Allocation Studies
How to Prepare For and Use the Report
August 16, 2018

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Budget Officer
City of Tampa

Presentation Topics

- Organizational Structure
- Costs to be Included
- Data Collection
- Managing and Communicating
- Conclusion & Questions

Organizational Structure

Cost Allocation Consultant Must Understand How Your Organization Operates:

- Organization Charts
- Charter
- Policies
- On-Site Visits

Organizations Change – Keep Them Abreast of the Changes

Costs to Be Included

Identify All Costs to be Recovered and Which Funds

- Organizations May Not Include all Allocations Into Their Plans
- Consolidate All Costs Into the Plan
  - Makes Defense Easier
  - Simplifies Monthly/Quarterly Inter-Fund Charges
- All Funds are Included in Calculating the Allocation of Costs – Even the General Fund
- Management Determines Which Funds are Charged Cost Allocation within the Annual Budgets
- Grants
  - Advises on the Rules
  - Defends the Cost Allocation Plan to the Cognizant Agency

Data Collection

Identify Data for the Report

- Number of FTEs (Budgeted or Actual)
- Department Budgets and/or Actual Expenses
- Number of Items Presented to Council/Commission
- Number of Accounting Transactions
- Square Footage of Buildings

Consistent Source and Methodology for Gathering the Data

Data Collection

Validate Data Year to Year

- Are their Major Variances?
- Any Major One-Year Swings?

Communicating Data with the Consultant

- Size of the Information
- Drop Box
- Thumb Drive
- CDs
- Coordinate with Your Technology Department

Managing and Communicating

Manage the Process

- Senior in Organization
- Understand Cost Principals
- Access to Managementment
- Don’t Keep it a Secret – Share with Administration & Directors

Understanding the Report

- Validate Costing Methodology
- Reasonable
- Serves as an Upper Limit for Each Fund

Managing and Communicating

Financial Sustainability of the Contributing Funds

- Know the Long-Term Forecast for Each Contributing Fund
- Do Not Want to Bankrupt a Fund Because of Cost Allocation
- Management Discretion
- Can Charge a Lesser Amount than Plan Recommends

Local Considerations

- Implementing Ordinances (e.g., Impact Fees)
- Policies and Practices
- Site Visits – Cost and Time Involved

Questions?