

Chapter 6

Cost Allocation and Cost Pooling

INTRODUCTION

This chapter provides general guidance on cost allocation principles, methods of allocating costs, the use of cost pools, development of cost allocation plans (CAPs), and allocation of personnel services costs to ensure that WtW costs are properly and equitably distributed to the benefitting cost objectives. It contains the following sections:

- Requirements for Financial Management Systems
- Elements of Cost and Their Allocability
- Treatment of Costs
- Cost Pools
- Allocating Personnel Services Costs
- Allocation Bases
- Cost Allocation Plans
- U.S. Department of Education (DOE) Standards on Statistical Sampling.

Allocability is one of the basic cost principles (discussed in Chapter 5, *Cost Principles and Allowable Costs*) used in determining whether costs are allowable to WtW. Allocability is a measure of the extent to which a cost benefits the WtW program in general and its cost objectives in particular. To the extent that a cost does not benefit the program, the cost cannot be charged to WtW.

The total cost of a grant program is comprised of the allowable direct costs incident to its performance, plus the allocable portion of allowable indirect costs, less applicable credits. Direct costs are readily identified with and directly charged to a specific cost objective.

Costs that are not readily chargeable to a final cost objective are often aggregated into intermediate cost objectives, usually called cost pools, and are periodically allocated to final cost objectives using an appropriate allocation methodology. Cost pools can be established for any type of cost when it is beneficial or necessary to pool costs. All pooled costs must ultimately be allocated to the final cost objectives in proportion to the relative benefits received by each cost objective. This chapter provides guidance on the allocation of direct, pooled, and indirect costs to the WtW program.

REQUIREMENTS FOR FINANCIAL MANAGEMENT SYSTEMS

Sections 29 CFR 97.20(a) and 95.21(b) set the requirements for financial management systems. They require that organizations follow the cost principles written in the applicable OMB circular. These cost principles require, in general, that, to be allowable, a cost shall be necessary and reasonable for the proper and efficient administration of the program; be allocable to the program; and, except as provided in the case of governmental recipients/subrecipients, not be a general expense required to carry out the overall responsibilities of the Governor or a governmental subrecipient. Each of these conditions is defined in the circulars and the DOL regulations.

Whether a cost is charged as a direct cost or as an indirect cost shall be determined in accordance with the descriptions of direct and indirect costs contained in the cost principles identified in DOL's regulations at 29 CFR 97.22(b) and 95.27.

For nonprofits, the cost principles are contained in OMB Circular A-122; for educational institutions, A-21; and for State and local governments, A-87. For commercial organizations, the cost principles are found at 48 CFR Part 31.

ELEMENTS OF COST AND THEIR ALLOCABILITY

The regulations at 20 CFR 645.230(c) direct WtW organizations to follow the cost principles contained in the appropriate OMB circular, as identified at 29 CFR 97.22(b) and 95.27. The circulars include guidance on distinguishing between direct and indirect costs. Beyond the general guidance provided in the circulars, there is no universal rule for classifying certain costs as either direct or indirect under every accounting system.

Costs are normally classified as direct or indirect based on their relationship to a particular cost objective. Generally, a direct cost can be traced to a particular cost objective, whereas an indirect cost is incurred for multiple cost objectives and is charged to an intermediate cost objective pending allocation. A cost may be direct with respect to some specific service or function, but indirect with respect to the grant or ultimate cost objective.

This guide groups costs into three categories for purposes of discussing cost allocation and cost pooling. Direct costs are classified as direct, while indirect costs are classified as being either shared indirect costs, or general indirect costs, commonly referred to as administrative overhead or general and administrative (G&A) costs. A brief description of each of these categories follows.

Direct Costs

Direct costs may be specifically identified with and assigned to a final cost objective, such as a WtW cost category. Direct costs are charged directly to a final cost objective such as a cost category or the WtW grant and do not require any further allocation or breakdown by funding source or cost category.

Example. The salary cost of a staff person performing case management duties only for WtW participants is directly assignable to the cost category of Intake, Assessment, Eligibility Determination, and Case Management. It is fully chargeable to WtW because the case manager is serving only WtW participants.

Example. The staff person in the above example performed case management duties for both WtW participants and WIA participants and documented the hours spent on each program on a time sheet. The salary costs would be a direct charge to WtW and a direct cost to the Workforce Investment Act (WIA) based on the documented time sheet hours.

Indirect Costs

Indirect costs are costs incurred for a common or joint purpose benefitting more than one cost objective; they are not readily assignable to the cost objectives specifically benefitted without effort disproportionate to the results achieved. This guide groups indirect costs into two categories for purposes of discussing cost pooling and cost allocation. These costs are shared indirect costs and general indirect (overhead/G&A) costs. Each of these types of indirect costs is defined below and an example of each type is provided.

Shared Indirect Costs. Shared indirect costs are costs that cannot be readily assigned to a final cost objective, but which are directly charged to an intermediate cost objective or cost pool and subsequently allocated to final cost objectives. These costs are incurred for a common or joint purpose benefitting more than one cost objective. These costs are similar to the general indirect costs in that it is easier to assign or allocate them based on some measure of benefit received than to assign them directly to final cost objectives.

Example. Three staff members provide case management services to participants in the WtW program without regard to whether the participants are Required Beneficiaries or Other Eligible participants, and it is difficult to identify time spent by participant. The case managers' costs are directly assigned to the cost category of Intake, Assessment, Eligibility Determination, and Case Management but are not readily assignable by type of participant. The case managers' costs could be directly charged to a cost pool established to accumulate such costs and later distributed to the appropriate category using an appropriate allocation method, such as the relative number of participants enrolled.

General Indirect (Overhead/G&A) Costs. These costs may originate in the recipient's or subrecipient's own organization or in other departments that supply goods, services, and facilities to the WtW program. Most often, however, indirect costs are administrative costs that are incurred to support the overall operation of the organization, and for which a direct relationship to WtW cannot be shown without effort disproportionate to the results achieved. Indirect costs are charged back to WtW using an indirect cost plan or rate. The development of indirect cost plans is contained in Attachments C and E of OMB Circular A-87 and Attachment A of OMB Circular A-122 and is discussed in further detail later in this chapter.

Example. The grantee is a department within the city, and the city treasurer processes WtW and other department vouchers for payment. Staff in the treasurer's office cannot readily identify the time and other costs associated with processing WtW vouchers. Rather, the city's approved indirect cost plan is used to charge WtW its share of the processing costs at least quarterly, using transaction counts as the basis for allocation.

TREATMENT OF COSTS

Intermediate and Final Cost Objectives

A cost objective is an activity for which separate cost measurement is performed. A further distinction is made between intermediate and final cost objectives.

An *intermediate* cost objective can be a cost pool, center, or area established for the accumulation of costs, assigned to such dissimilar categories as organizational units, functions, objects, or items of expense. *Final* cost objectives include specific funding sources, cost categories, grants, program activities, projects, contracts, and/or other activities.

The final cost objectives discussed here are limited to the WtW grant and the cost categories/activities as identified in the regulations at 20 CFR 645.211, 645.220, and 645.235(a) and (c). These are the minimum number of final cost objectives that WtW entities must establish to meet the Federal reporting requirements. A discussion of the reporting requirements is contained in Chapter 8 of this TAG. Cost classification is discussed in contained in Chapter 7.

WtW entities may choose or be required to establish additional final cost objectives for internal reporting or other non-Federal purposes, such as reporting costs by individual participant/program activities or by contract budget line items. The basic guidelines on cost allocation apply to these additional cost objectives as well.

Measuring Benefit

Measuring benefit is the critical requirement and central task to be performed in allocating costs. Throughout this chapter the requirement is stressed that costs are allocable to a particular cost objective to the extent of benefits received by that cost objective. Likewise, costs that do not benefit a particular cost objective are not allocable to and cannot be charged to that cost objective.

For a direct cost to be assignable to a particular cost objective, it is clear that the cost objective must receive the full benefit from the goods, services, activities, or effort that make up that cost. In this instance, measuring benefit entails no more than identifying the full cost of the activity and assigning it to the correct cost objective.

Example. The staff costs associated with performing WtW intake functions are directly assignable to the cost category of Intake, Assessment, Eligibility

Determination, and Case Management. That cost objective receives the full benefit of the cost of the intake activity.

Very often, however, a cost benefits more than one cost objective, so that any single cost objective receives only partial benefit from the cost incurred. Thus, the relative benefit received by each cost objective must be measured.

Example. If the intake staff in the above example also performed duties related to data collection at the same time, the costs would benefit more than one cost category and, therefore, must be prorated among the benefitting cost categories. To determine each category's share of the cost, an allocation method must be identified that measures each category's share of the total benefit.

It is possible and preferable in some cases to directly assign the correct portion of shared costs to each cost objective. For example, the intake staff in the above example could record the time spent performing each function and distribute the costs accordingly.

However, it may require disproportionate effort to directly assign each segment of the total cost to the benefitting cost objective. When the direct measurement of benefit cannot be done efficiently and effectively, then it is appropriate to pool the costs for later distribution. The allocation base is the mechanism used to allocate the pooled costs to final cost objectives and is discussed later in this chapter. Using the above example on intake staff costs, instead of staff recording time spent by activity, the organization could use the relative number enrolled by program or some other equitable basis for measuring benefit to each program. Care should be taken to ensure that the basis chosen does not distort the results and that the basis is appropriate to the cost objectives receiving the costs.

Caution: For pooled costs, the cost elements that make up the pool must be scrutinized to ensure that all costs are allowable to WtW. Costs that are not allowable must be removed from the pool before the pooled costs are allocated to WtW cost objectives.

Example. A nonprofit organization charges costs of the director to an administrative pool. Part of the director's duties are fund-raising, which is an unallowable cost under the cost principles of A-122, Attachment B. That portion of the director's salary attributable to fund-raising activities would have to be excluded from the pool prior to allocation to the WtW program. In this example, the pool would need to be allocated twice and care taken that all funding sources receive their fair share of the pooled costs.

When WtW does not use or derives no benefit from the cost of an activity, service, product, or effort, then the associated cost cannot be charged to any WtW cost objective. A cost must benefit (be allocable to) a WtW cost objective to be an allowable cost under the WtW program.

Consistent Treatment

For a cost to be allocable to a particular cost objective, it must be treated consistently with other costs incurred for the same purpose in like circumstances. A cost may not be assigned to an

award as a direct cost if any other cost incurred for the same purpose, in like circumstances, has been allocated to an award as an indirect cost. Costs identified specifically with awards are direct costs of the awards and are to be assigned accordingly. Costs identified specifically with other final cost objectives of the organization are direct costs of those cost objectives and are not to be assigned to other awards directly or indirectly.

Example. A director has responsibility for WtW and non-WtW programs and also spends four hours a week teaching a class to WtW participants on work skills. For the 36 hours of general administrative time, it would not meet the standard of consistent treatment to simultaneously charge a portion of the director's time as a direct cost to WtW and as an indirect cost to the non-WtW program, since the same type of cost (the administrative cost of the director) should be treated the same in both programs. However, the four hours of teaching time can be charged directly to WtW regardless of how the administrative costs were charged, since the training costs were not incurred for the same purpose as the administrative costs.

Any cost allocable to a particular grant or other cost objective under these principles may not be shifted to other Federal grants to overcome funding deficiencies, to avoid restrictions imposed by law or grant agreement, or for other reasons. [OMB Circular A-87]

COST POOLS

Many types of cost pools are acceptable if established and managed properly in the entity's accounting system. Examples include:

- Indirect cost pools
- Intake cost pools
- Administrative cost pools
- Pools for supplies expense
- Other combinations of costs that are similar in nature and are shared among several cost objectives.

Consider the following when developing cost pools:

- # **Written Cost Allocation Plan.** The cost pool should be described and documented in a written CAP that is used in allocating all allocable direct costs within the WtW program to the appropriate program activity and cost category. CAPs are discussed in a later section of this chapter.
- # **Combined Administrative Costs.** Shared indirect administrative costs can be combined with any general indirect administrative costs and allocated using an appropriate allocation methodology or base.

- # **Personnel Services.** Personnel services costs (salary and fringe benefits) of internal staff who spend a portion of their time in administrative and a portion of their time in allowable participant services functions can be individually distributed among the respective cost categories using staff time records or other verifiable means. A supporting time record that prorates the time between two or more functions is recommended. Time records should include hours spent on each cost objective. A position description alone is insufficient documentation.

- # **Nonpersonnel Services.** Nonpersonnel service costs that benefit more than one cost objective can be allocated to more than one cost objective. Such allocations must be based on an appropriate allocation methodology.

Caution: Costs that may be pooled are limited to shared indirect and general indirect costs. Direct costs should not be pooled, but rather should be directly charged to the benefitting cost objective. Only actual, not budgeted, costs may be pooled and distributed to the various funding titles. Costs incurred based on an indirect cost rate may be included in the appropriate administrative cost pools for allocation.

The allocation of cost pools based on benefits received should not be burdensome once the methodology is developed. Where a cost pool is used, the expenditures must be distributed among the various funding sources for reporting purposes. The method of allocation should be consistent with the guidelines addressed in other sections of this guide.

Types of Pools

Administrative Cost Pools. One of the benefits of an administrative cost pool is that very often administrative costs benefit multiple programs and the effort of directly classifying portions of a cost to a number of programs is onerous. However, care should be taken that the allocation methodology chosen fairly distributes the costs to all affected funding sources. The allocation of administrative costs or any other pooled costs based on fund availability or percentage of funding source administrative dollars (contribution method) is generally not allowable. The allocation of pooled administrative costs based on each program's share of direct costs is the best method. In addition, the WtW requirement for the expenditure of funds by participant eligibility category must be included in whatever methodology is chosen to allocate administrative costs. The agency auditor should be contacted for technical assistance and concurrence on any methodology developed.

Other Cost Pools. Cost pools other than administrative can be established for any types of common costs when it is more practical or necessary to pool such costs. The following example illustrates when cost pools could be established for other than administrative costs.

Example. A local area grantee has frontline intake staff that conduct the initial intake for the WtW and other programs. An intake manager is responsible for overseeing and managing the client flow process, supervising the intake workers, and reporting to the deputy director.

All costs are unassignable, initially pooled, and charged temporarily to an intake-related cost pool account. These costs include the salary and fringe benefits of the line staff and the intake manager, materials, phones, and other related costs required to carry out the intake function.

Then, based on an approved formula that distributes costs based on benefits received by each program (such as the number of eligibility determinations completed for each program or the number of persons enrolled during the period), the costs are charged back to the appropriate programs.

Cost Pool Management

Cost pools reduce some of the burden of tracking expenditures because they are a vehicle for temporarily accumulating unassignable direct and indirect costs that later will be allocated to a particular program. As costs accrue, a formula based on the benefits received by each program dictates how these costs will be distributed and reported by program title/subtitle or cost category. This eliminates trying to assign all staff time and every expenditure by grant or title at the time it is incurred.

ALLOCATING PERSONNEL SERVICES COSTS

Amounts charged to WtW programs for personnel services, regardless of whether treated as direct or indirect costs, should be based on payrolls documented and approved in accordance with the established practice of the employing entity. Payrolls should be supported by time and attendance or equivalent records for individual employees.

In general, time distribution records or other verifiable means will be used to document how personnel services costs are charged to cost objectives. Time sheets and/or time and attendance records alone, however, do not necessarily satisfy the time distribution requirements. The method used to charge these costs to cost objectives, and the documentation needed to support the allocation of the costs, will vary by type of cost and how that cost is treated in the accounting system.

Daily Time Distribution Records

A time distribution system is a formal method for accumulating labor costs associated with specific programs. Time distribution can be documented in a variety of ways. The most commonly accepted method is to record actual time spent on each cost objective during each working day. Other methods are also discussed below. The most appropriate method to use will depend on the circumstances in each case.

Direct Costs. When the personnel services cost of an individual or group of individuals is chargeable in full to a single cost objective, it is not necessary to maintain a daily time distribution record for that staff person. There should be other documentation available to support the claim that the person's activities and costs do not need to be allocated to more than one cost objective. Other documentation could include negative time distribution reporting, approved and written office policies and procedures, or other written forms of task assignment.

Example. The agency director's time is spent entirely on administrative activities and can be charged as a direct cost to the Administrative Cost category without daily time distribution records. The job description is a likely form of documentation in this instance. However, the allocation of the administrative cost across programs would have to be documented in a separate manner.

Shared Indirect Costs. Salaries and wages of many employees are chargeable to more than one grant or cost category. Daily time distribution records, or some acceptable method of time sampling as discussed below, are the most common forms of documentation used in this situation. The method used must accurately reflect the actual time spent on each activity by each employee. Budget estimates or other distributions determined before the services are performed cannot be used to support charges to a WtW program.

For staff who maintain daily time distribution records, there are periods during the day or within the pay period when it is difficult to associate time worked with a specific cost objective. This is the case when a person is attending a general staff meeting or is on sick or vacation leave. It is recommended that direct hours charged to each cost objective be used as the basis for allocating the other time that is spent on general activities, provided that there are a sufficient number of direct hours to establish an adequate base.

Example. During the 80-hour, two-week pay period, a staff person worked 35 hours on intake and case management activities (ICM), 35 hours on administrative activities (ADM), and took 10 hours of leave. The 10 hours of leave can be allocated among the cost categories as follows:

	ICM	ADM	General	Total
Hours charged	35	35	10	80
Hours worked	35	35	0	70
% of total hours worked	50	50	0	-
Share of general hours	5	5	-	-
Total hours allocated	40	40	0	80

Nonpersonnel Services Costs

Nonpersonnel services costs, when directly associated with time worked by the recipient's or subrecipient's staff, may also be allocated to the benefitting cost objectives based on documented distributions of actual time worked. These costs could include space costs, utilities, building maintenance, supplies, and other such costs correlated with staff usage. To use time distribution as the basis for allocation of nonpersonnel services cost, time worked must be an equitable measure of the benefit derived from nonpersonnel services costs.

Example. Desktop supplies are stored centrally and used by all staff in performing their jobs. It is reasonable to conclude that the supplies are used in the same manner and for the same purpose as the time spent by staff while using the supplies. It is acceptable to use time distribution as the basis for allocating the cost of desktop supplies to various cost categories.

Other Methods of Directly Charging Time

This section discusses two methods of directly charging time as possible alternatives to continuous time distribution. They fall into the general categories of time sampling systems and non-time-based measures.

Time Sampling. A variety of work sampling and work measurement techniques is explained in greater detail in Appendix D, including:

- Random Time Sampling
- Systematic Work Sampling
- Stratified Work Sampling
- Worker Self-Recorded Work Sampling
- Work Measurement–Time Log Systems.

Additional guidance on standards for time sampling systems is provided in OMB Circular A-87, which contains the Federal cost principles for governmental organizations. The standard critical to each time sampling system is that the sampling method used must be statistically valid.

Measures of Effort Other Than Time. In some limited situations and for certain types of staff work, the cost of staff time can be allocated on a basis other than time distribution.

This is most often done when some quantitative measure, such as units of work performed, direct expenditures, or participants served, provides an equitable basis for allocating staff time and related costs. The methods (such as transaction counts or units of work) used to allocate costs should be documented and maintained to support the basis of the allocation.

A common example is when personnel services costs are combined with other costs from the same cost category into a larger pool of costs, which is then allocated to final cost objectives based on direct expenditures or another basis other than time. This approach is often used for administrative cost pools.

Another application is when staff time and related costs associated with processing vouchers for payment are allocated based on a transaction count.

ALLOCATION BASES

When costs are pooled instead of being directly assigned to a final cost objective, the ability to directly assign benefit for each item of cost is lost. Instead, the pool contains a group of common costs to be allocated by using an indirect or approximate measure of benefit. The approximate measure of benefit is the allocation base. An allocation base is the method of documentation used to measure the extent of benefits received when allocating joint costs among multiple cost objectives.

Many different types of bases can be used in allocating costs. The most appropriate base will vary with the circumstances prevailing in each instance. An organization is likely to use several different bases for allocating different types of costs. Acceptable methods for distributing pooled costs may vary by type of organization, functional units or levels within an organization, types of cost to be allocated, and cost category. The basis used to allocate a particular type of cost should be used consistently over time and be described in the CAP. The development of CAPs is discussed further in this chapter.

Acceptable Allocation Bases

An allocation base is acceptable if it represents a fair measure of cost generation or cost benefit, and if it results in an equitable distribution of the costs of services rendered or goods provided. Each base should be considered on its own merits as to the purpose for using it and the degree of equity it will achieve in allocating joint costs. In selecting a method, consider the additional effort and expense required to achieve a greater degree of accuracy. General criteria that should be used in selecting an allocation base include the following:

- **Minimal Distortion.** The base should distribute costs in a fair and equitable manner without distorting the results. This requires that the base be as causally related as possible to the types of costs being allocated so that benefit can be measured as accurately as possible.

Example. It is appropriate to allocate pooled intake costs on the basis of the proportionate number of eligible applicants per program since there is a direct relationship between incurring intake costs and determining eligibility. It also is appropriate to use the number of new enrollments by program as the basis for allocating intake costs when enrollments provide an equitable measure of effort, and since the benefit of intake is the eventual enrollment of participants into the programs.

By contrast, it is much less appropriate to use post-employment services costs as the basis for allocating pooled intake costs since there is a very limited relationship, and no causal relationship, between the base and the type of costs in the pool. The results are likely to be distorted when using this base for allocating this type of costs.

- **General Acceptability.** The base should be generally accepted and in conformance with GAAP. For example, it should be consistently applied over time. The base should also be drawn from the same period in which the costs to be allocated have been incurred.

Example. It is not appropriate to change the base for allocating pooled administrative costs from quarter to quarter, such as using direct program expenditures in the first quarter, number of participants served in the second quarter, and time distribution in the third quarter. It is also not appropriate to use last year's participant data as the basis for allocating this year's expenditures.

- **Represents Actual Cost or Effort Expended.** The base should be a measure of actual cost or actual effort expended. It should not be based solely on a plan, budget, job description, or other estimates of planned activity.

Example. Pooled administrative costs may not be allocated to participant type on the basis of the proportionate amount of funds to each type. It is generally not appropriate to use the relative amount of funds required to be spent as the basis for allocating this pool of costs since budgets are not a measure of actual activity or effort.

- **Timely Management Control.** The base should be within management's ability to control on a timely basis. The base should produce reliable and fairly predictable results. If the base is erratic and unpredictable, beyond management's ability to control, or not timely, it is likely to produce unacceptable results.

Example. If an organization uses lower-tier subrecipient expenditure or participant data as the base for allocating some of its organization-wide costs, it risks having the data used for allocation skewed by a poorly performing subrecipient. The organization also becomes dependent on timely reporting by its subrecipients to allocate some of its own costs. It would be better for the

organization to use a base that is within the direct control of the organization's management.

- **Consistency with Variations in Funding.** The base must be able to accommodate and withstand changes in funding during the year and from year to year. If the base excludes factors that are affected by variations in funding, it will produce distorted results.

Example. It is not appropriate to allocate costs using a basis that does not include all funding received during the year. If an organization operates a State-funded summer work experience program, then the basis for allocating case management costs would need to reflect changes in the mix of activities during the summer period or the distribution of costs may not be equitable.

- **Materiality of Costs Involved.** The complexity of the base should be commensurate with the materiality of the costs to be allocated. In other words, the grantee should not spend more on obtaining the information needed to allocate pooled costs than the dollars in the pool warrant. The base should be sufficiently detailed to provide the most equitable and accurate allocation possible. At the same time, the base should be simple enough to be efficient while still attaining a fair distribution of costs.

Example. On the other hand, it is not appropriate to either fold a larger pool of costs, such as administrative staff costs, into another unrelated pool of costs, or to distribute staff costs equally among the programs. For pooled administrative staff costs, a base should be used that more accurately measures benefit to each program, such as direct time charges per program.

- **Practicality and Cost of Using the Base.** The base should be as efficient as possible in terms of the cost or effort in developing it. Thus, wherever possible, a data base that already exists in the financial or participant record keeping and reporting systems should be used rather than create a separate data base to be used only for allocating costs.

Example. It is appropriate and more efficient, without unduly sacrificing accuracy, to allocate participant transportation costs using current enrollment data that is already available, rather than creating a separate data base on the exact number of participants receiving transportation assistance by type of participant.

What Is the Best Base?

There is no single answer to that question. The answer varies by type of organization, levels within an organization, organizational structure, method of program delivery, accounting and participant reporting systems, types of costs included in the pool, and availability of other types of data to use as a base. The general guidelines presented here can be used to help with decision-making.

When choosing among available bases, the base should be chosen that is more directly related to, and the better measure of, the costs being allocated and the benefits being received.

Example. Using the number of vouchers processed as the basis for allocating the costs of financial services is preferable to using the dollar value of those vouchers. The work performed in processing each voucher is fairly standard for each unit of work, regardless of the dollar value of the vouchers. As a result, the cost/benefit of the service is a function of the quantity of work units performed.

Subrecipients are encouraged to develop and use appropriate expenditure bases (such as salaries and fringe benefits, and total direct costs) and participant bases (such as number of participants enrolled) to allocate joint costs. Where a subrecipient conducts several human services programs with multiple funding sources and uses an automated accounting system, an appropriate expenditure base is usually one which reflects time spent or participants served. This is also a more easily managed base.

Suggested Bases for Allocation

Some suggested bases for allocation are shown on the chart on the following page. These are suggested bases only and grantees are cautioned to review these bases for applicability to their programs.

Suggested Bases For Allocation

Accounting	—Number of transactions; direct labor hours; allowable Survey methods
Auditing	—Direct audit hours; expenditures audited
Budgeting	—Direct labor hours
Consumable supplies	—Total direct costs; direct labor hours
Counselor	—Direct labor hours; number of participants counseled
Data processing	—System usage; direct labor hours
Disbursing service	—Number of checks issued; direct labor hours
Fidelity bond	—Number of bonded employees
Freight	—Number of items shipped; cost of goods
Health services	—Number of employees
Intake	—Number of eligibles; current period enrollments
Legal services	—Direct hours
Motor pool costs	—Miles driven; days used
Office machines and equipment maintenance	—Direct machine hours; direct labor hours
Office space	—Square feet of space occupied; staff salary distribution
Payroll services	—Number of employees
Personnel services	—Number of employees
Postage	—Direct usage; acceptable survey methods
Printing/reproduction	—Direct labor hours; job basis; pages printed
Procurement service	—Number of transactions processed; direct hours of purchasing agent's time
Retirement system administration	Payroll; number of employees contributing
Telephone	Number of instruments; staff salary distribution
Travel	Mileage; Actual expenses; Direct labor hours
Utilities	Square feet of space occupied; Staff salary distribution

Unacceptable Allocation Bases

In general, unacceptable allocation bases are those that do not meet the general guidelines discussed above. Unacceptable bases are those that:

- Distort the final results
- Do not represent actual effort or actual expenditures
- Are not used consistently over time and with variations in funding
- Do not have an integral relationship to the types of costs being allocated.

Some commonly used bases that fall into this unacceptable category include the use of:

- Relative funds available to allocate unassigned direct costs
- Job descriptions to allocate staff costs
- Fixed or predetermined number of staff hours assigned to an activity to allocate staff costs
- Planned participant levels to allocate participant-related costs
- Results from prior periods to allocate current period costs.

Bases developed from plans, budgets, or estimates usually cannot stand on their own as valid measures of benefit. They can be used only in very limited situations, especially when the results can be corroborated by, or later adjusted for, the results obtained by using an acceptable base. This requires that the base be verified as able to produce an equitable distribution of costs.

Example. A work experience program is jointly funded by the State and the WtW program. Each funding source plans to provide 10 participants. Start-up costs are incurred and billed to the funding sources before all participants are enrolled. It is appropriate to use planned activity levels as the basis for allocating these costs since full enrollment by both funding sources is expected. However, any deviation from the plan must later be adjusted using actual enrollment data.

Common Errors

A common error in choosing a base is to use a plan, budget, or other estimate of future effort or cost. In most circumstances, this type of base is not acceptable because it does not measure actual activity, effort, or cost, and too often later adjustments based on actual data are not made. In most instances, the most reliable measure of the amount of the cost incurred, the effort expended, and the benefit received can occur *only* when the activity is actually performed. Some grantees estimate (in their position descriptions, organizational charts, or other documents) the percentage of time their director or other staff members will be involved in the WtW program. This estimate is useful for planning purposes but must eventually be supported by documentation of actual involvement in the WtW program. Costs charged to the program based on the estimates will need to be adjusted to reflect actual time spent on WtW activities. It is also common for grantees to determine the percentage of time their staff will be involved in the WtW and other programs. Occasionally, this determination results in preassigned number of hours available for WtW activities. Staff are instructed to charge WtW and other programs according to the

established hours. Again, this predetermination is useful for budget purposes; however, any costs charged to the WtW program must be adjusted as necessary to reflect actual time spent on benefitting WtW activities.

We repeat the standard caution that a particular basis may work in some circumstances and not in others, and that the ultimate test of appropriateness is whether or not the basis used results in an equitable distribution of costs that reflects the level of effort or benefit received by the various cost objectives.

COST ALLOCATION PLANS

A Cost Allocation Plan (CAP) is a document that identifies, accumulates, and distributes allowable direct and indirect costs under (sub)grants and contracts, and identifies the allocation methods used for distributing the costs. A plan for allocating joint costs is required to support the distribution of those costs to the grant program. All costs included in the plan must be supported by formal accounting records to substantiate the propriety of the eventual charges.

Types of Allocation Plans

A distinction is made between two types of CAPs: the plans needed to allocate organization-wide and central services costs to individual departments within the organization (Indirect Cost Plan), and the plans needed to allocate costs within a department to grants and other final cost objectives (Cost Allocation Plan), as described below:

Indirect Cost Plan. The indirect cost plan identifies and distributes the costs of services provided by support organizations (such as personnel, treasury, security, legal) to departments or units administering Federal grants or contracts. At the State level it is referred to as the State-Wide Cost Allocation Plan (SWCAP). Indirect cost/central service CAPs are usually approved by a cognizant Federal agency. Similar types of indirect CAPs for central services are also common to local units of government and to larger nonprofit organizations. Indirect cost plans are discussed further in a later section.

Cost Allocation Plan of the Department/Entity Administering WtW. The second type of CAP distributes the administrative or other joint costs incurred within a performing (subrecipient or contractor) department or unit, together with the service costs allocated to it under the indirect cost proposal, to all work performed by that department or unit. This type of plan is developed by the unit that directly operates the WtW program to allocate costs between its WtW and non-WtW programs and between cost categories within WtW. This type of plan is commonly referred to as a CAP.

Contents of the Cost Allocation Plan

The CAP should include at least the following elements:

- Organization chart that identifies all departments, types of services provided, and WtW and non-WtW staff functions
- Description of the types of services provided and their relevance to WtW projects (generally called a Statement of Function and Benefit). This would include all WtW and non-WtW revenue sources and cost objectives.
- Copy of official financial statements or budgets
- Expense items included in the cost of the services. This would include all joint or pooled costs needing to be allocated (such as staff whose work benefits more than one cost objective, cost pools established for administrative costs and other types of pooled costs, and all other costs that cannot be readily assigned to a single cost objective).
- The methods used in distributing the expenses to benefitting cost objectives. This requires identifying the basis for allocating each type of joint or pooled cost, and the documentation for supporting each basis for allocation.
- Certification by an authorized (sub)recipient official that the plan has been prepared in accordance with the WtW Act and regulations and State or other applicable requirements.

For WtW entities that are charged indirect or central services costs, the CAP should also include:

- Identification of the departments rendering the service costs to benefitting departments (summary CAP)
- Summary schedule of the allocations of central service costs to operating departments.

The following suggestions should also be considered when developing a CAP:

- # **Keep it Simple.** The simplest and least costly method possible, based on a measure of relative benefit received, that will produce an equitable allocation of costs to programs and cost categories, should be used.
- # **Make it Replicable.** The process that is developed must be able to be duplicated at any time, and with changes in the organization or funding levels.
- # **Simplify the Organizational Structure.** The organizational structure of the CAP should be made no more complicated than necessary to allocate costs.
- # **Consider What is Required.** The required structure and capabilities of the accounting system must be considered in designing an operable cost allocation process.
- # **Make Changes Prudently.** Changes in an organization's CAP that result in a retroactive redistribution of costs to the benefitting cost objective are allowable where the change

results in a more equitable distribution of costs. Such changes in allocation methodology should be rare, should receive the necessary prior approvals, and should be justified and well documented.

Value of Cost Allocation Plans

In addition to documenting the allocation of costs and prior approvals, the CAP has other benefits and advantages for the organization, as listed below:

- **As a management tool**, provides a clear and concise method to develop budgets and prepare plans
- **Obtains equitable sharing of indirect costs** from all programs and activities, beginning with their appropriate recognition in the budget process
- **Eliminates the arbitrary methods** sometimes used to account for all costs as direct costs in order to achieve full reimbursement
- **Establishes creditable fiscal accountability practices** that recognize indirect and shared direct costs as a necessary cost of program delivery
- **Establishes financial management standards and practices** that may be applied uniformly with all grantee agencies through the accounting and budgeting process
- **Creates financial management structures** that recognize that costs relative to programs or units of service consist of both direct and indirect costs
- **Promotes the use of up-to-date, integrated grantee accounting systems and procedures** within their organizational entities, so that shared direct and indirect costs can be identified and allocated across all programs and activities
- **Meets Federal cost principles and standards** when requiring approved plans as a prerequisite to claiming reimbursement of indirect costs
- **Uses CAPs as a management tool** to improve and standardize fiscal management policies and practices.

General Indirect Costs

General indirect, i.e., overhead/G&A, costs normally should be charged to the Administration Cost category, except that specific costs charged to an overhead or indirect cost pool that can be identified directly with a WtW cost objective/category other than Administration may be charged to the WtW cost objective/category directly benefitted, as described and justified in the CAP.

Governmental Grantees

Responsibility for approving the CAPs of most units of local government has been assigned by OMB to cognizant Federal agencies (primarily the Department of Health and Human Services (DHHS)). Some local area grantee administrative entities, especially those that are governmental agencies, have indirect cost rates that are already approved by a Federal agency. The State or the unit of local government should request an agency review of the indirect rate if questions arise on the application of the indirect rate to WtW.

Nonprofit Agencies

In some cases, agencies do not have indirect cost rates but wish to establish a rate to facilitate charging indirect costs to WtW awards. OMB Circular A-122, *Cost Principles for Nonprofit Organizations*, applies to determining indirect cost rates for nonprofit organizations. For assistance in preparing indirect cost rate proposals, nonprofit organizations should use the *Indirect Cost Determination Guide* published by the DOL Office of the Assistant Secretary for Administration and Management, Office of Cost Determination. Indirect cost rate proposals are required when a nonprofit organization has more than one source of funding and elects to recover indirect costs as well as the direct costs for meeting grant or contract obligations. Where a nonprofit subrecipient is required to obtain an indirect cost rate, the awarding agency should provide technical assistance and may wish to review and approve the indirect cost rate.

WtW Subrecipients

State and local governmental agencies that are not local area grantees but that operate WtW programs as subrecipients often have indirect cost rates already approved by a Federal agency. These rates should be reviewed by the awarding agency to determine their appropriateness for WtW. Any rate approved by the awarding agency should not exceed the rate approved by the Federal cognizant agency for Federal grants.

U.S. DEPARTMENT OF EDUCATION STANDARDS ON STATISTICAL SAMPLING

The DOE has issued guidelines to its grantees on alternative time allocation methods and statistical sampling standards. These guidelines are addressed at greater length in Appendix D to this guide and are summarized below.

Substitute systems may include random sampling, case counts, client counts, transaction counts, or other quantifiable measures of employee effort for a time period. Sampling and other measures should take into account relative effort and intensity of service provided to different categories of clients served. A substitute system must meet acceptable statistical sampling standards, including the following:

- # The universe from which a sample of employees is taken must include all of the employees whose salaries and wages are to be allocated by means of the sampling.

- # The entire time period for which salaries and wages are to be charged to a Federal grant involved must be covered.
- # The results must be statistically valid and applied only to the time period to which the sample may be validly extrapolated.
- # The results of the sampling system must be periodically updated to reflect changes in the measures used, such as case counts or client counts.
- # The recipient must use a valid and uniform system for converting the measure of employee effort (such as case counts, client counts) into time.