Cost Allocations
KLR Not-for-Profit Services Group
October 2012
Functional Classification of Expenses

General Purpose financial statements report on the following functions:

- Program Services
- Administrative services (Management and General)
- Fund-raising

Functional classifications used by most organizations include specific “Program Services” or specialized activities and “Supporting Services” under which management and general (sometimes referred to as Administration, General Administration, General Expenses, Overhead, General and Administrative) expenses and fund-raising costs are shown as separate items on the financial statements.

Program Services

This function includes the expenses related to the activities of the organization for which it was organized. Examples of program expenses include:

- The salaries of direct program workers
- The salaries (or portion thereof) of administrators that are responsible for program activities (Program Director). Other expenses that directly benefit the program activity.

Fund-Raising

This function includes all expenses related to fund-raising, which encompasses more than the solicitation of contributions. Other expenditures that should be charged to this function include costs of transmitting appeals to the public (postage, etc.) and the salaries of personnel connected with the activity. This includes the time and the related salaries of regular administrative and program staff that devote time to record keeping for fund-raising activities.

Administration (Management & General)

Administration costs include expenditures for the overall direction of the organization, including:

- Salaries and Expenses of the CEO and his or her staff
- General Record Keeping
- Business and Office Management
- Corporate Legal Services
- Personnel Procurement
- General Board Activities
- Publication of appointments
- Accounting, Auditing and Budgeting
- Internal and External Financial Reporting
Administration (Management and General) should not be confused with administrative expenses. Administrative expenses are business expenses that may directly or indirectly benefit a program, whereas administration (Management and General) includes revenues and expenses that may only indirectly benefit a program.

Administrative expenses include the same type of expenditures that could be classified as administration except they may directly or indirectly benefit program services.

Administration (Management and General) costs must be reported separately and may not be charged or allocated to program services or fund-raising in the basic financial statements.

Cost Allocation Plan

What is a cost allocation plan?

A cost allocation plan is a method by which you attempt to allocate expenses that are not directly identifiable to a particular activity or allocate expenses that benefit more than one activity, to a specific program on a consistent, fair and equitable basis.

I. Reasons for allocating costs

A. It is required by governmental agencies, the American Institute for Certified Public Accountants, various voluntary health and welfare publications and most funding sources.

B. To ensure that all programs receive their fair and equitable share of all costs associated with providing a particular service. One of the goals of not-for-profit financial reporting is to inform the community of the (true) costs of providing various services so that the community can continually assess the cost/benefit of making the expenditure.

II. Development of a cost allocation plan

A. Prepare an agency-wide budget displaying a breakdown of revenues and expenses by activity. An activity is defined as program services, fund-raising, or administration.

B. Identify all program-specific costs, fund-raising costs, and management and general costs.

C. Identify all costs that belong strictly to a single activity.

D. Develop techniques that will provide verifiable bases upon which expenses may be related to program or supporting service activities.
III. Implementation of a Cost Allocation Plan

A. Personnel costs generally include salaries, payroll taxes, and fringe benefits. In the majority of non-profit organizations, personnel cost account for 50% to 70% of total expenses.

1. At the time of preparing the annual budget for the organization, identify the employees and the programs/activity to which they relate.

2. Information should be developed outlining the duties of employees, the functional classification of work to be done, and the approximate amount of time to be spent on each activity for the projected year.

3. Budgeted allocations should be prepared based on the above review.

4. Employees involved in more than one activity need to complete time reports detailing: work performed, time spent, and functional classification. The time reports should be completed continuously or at various times throughout the year to reflect any seasonal patterns in work assignments.

5. Staff training should be conducted to insure that all time reports are being completed properly.

6. Each completed time report should be reviewed by a supervisor and signed as evidence of their review and approval.

7. A summary of the time sheets should be completed and compared with the predetermined estimated percentages. Where significant variations exist, a review should be made to determine the reasons.

8. Where applicable, the revised percentages based on the time studies should be used in making the final allocations for the financial statements.

B. Similar studies should be conducted on other shared costs.

IV. Allocation of Administrative Costs

A. Based on the same time study and usage reports used to determine the functional allocation of expenditures above.

B. If the time studies and usage reports are not feasible, then you may use one of the following:

1. An allocation percentage previously established for expenses that benefit all programs: *e.g.,* Centralized Telephone System.

2. A basis that utilizes experience levels established for similar costs; *e.g.,* Percentages based on each program’s direct salaries to total direct salaries could be used to allocate administrative salaries.

3. Allocation methods approved by the Federal government or other funding source for indirect costs associated with federal assistance.
V. What auditors do to review your cost allocation methods

A. Obtain a copy of the organization’s cost allocation plan.

B. Review the studies done by the organization for allocating expenses and employee time sheets and job descriptions.

C. Review the instructions given to the employees for completing the time reports and usage studies.

D. Examine expenditures (on a test basis) to determine that the allocation methods were followed.

E.Ascertain that the allocation and classification methods used were consistent with those of the prior year.

F. Compare actual expenditures with budgeted and/or prior year amounts and obtain explanations for significant variations.
Cost Allocation Plan For the Fiscal Year 20XX

XYZ Agency, Inc.
123 Main Street
Your City, ST  14313-6789
I. Time/Usage studies utilized

1. Employee time study:
   A. Determine employees’ actual job duties to establish a projected allocation among programs.
   B. Describe the frequency of the study to be conducted by employees throughout the year (e.g., one week per month).
   C. Describe the method for choosing the weeks to complete the time study (e.g., a different week of each month chosen on a rotating basis).

2. Telephone usage study:
   A. Describe the method used to establish a projected allocation among programs (number of employees per program).
   B. Describe how the usage study is to be conducted and the type of information to be recorded (log sheets by employee number, outgoing long distance calls, number of extensions, etc.).
   C. Frequency of the study (one week per month).
   D. Methodology for choosing the time period for the study. (A different week of each month chosen on a rotating basis.)

3. Postage Usage Study:
   A. Describe the method used to establish projected allocation among programs (prior year actual cost, anticipated bulk mailings, etc.).
   B. Describe how the usage study is to be conducted and the information to be recorded. (Staff to record on a log sheet which programs to charge and number of outgoing envelopes times postage rate).
   C. Frequency of the study.
   D. Methodology for choosing the time period of the study.

4. Copy machine Usage Study:
   A. Describe the method used to establish a projected allocation among programs.
   B. Describe how the usage study is to be conducted and the information to be recorded (employees fill out a log sheet detailing number of copies made per program).
   C. Frequency of study.
   D. Methodology for choosing the time period for the study (varied to account for monthly cyclical activities).
II. Basis For Allocating Costs

1. Employee Time
   - If most of an individual’s time is spent on one function, estimates of the time spent on each function may be appropriate. However, employee time reports will result in a more accurate determination of the costs attributed to each function. If such functions do not vary significantly during the year, a periodic time study (instead of continuously completing time sheets) might be sufficient.

2. Fringe Benefits
   - Allocated on the same basis as salaries.

3. Travel Costs
   - Expense reports of employee should allow for specific identification of program benefited by the expense.

4. Printed Materials
   - The use of the material as determined by the content, the reason for distribution, and the audience to whom it is addressed.

5. Telephone
   - Use of the extensions.
   - How the employee’s time is charged, after directly charging the toll calls.

6. Stationary, Supplies, Postage, Fax, Copier
   - By usage - have employees list the functions to be benefited.

7. Occupancy Costs (Rent, Utilities, Maintenance, Repairs, Cleaning)
   - A study of the function of the personnel using the space involved. Calculate the square footage used by the employee and apply the percentages determined in the time studies to allocate costs.

8. Depreciation, Maintenance and Repairs, Equipment Rental
   - Equipment usage otherwise charged to administration.

9. Professional Liability Insurance
   - Allocated on the same basis as salaries.

10. Property Insurance
    - Allocated on the same basis as occupancy costs.

11. Advertising
    - Direct invoicing if benefiting a specific program; otherwise, charge to administration.
III. Allocation Percentages

Salaries/Fringe Benefits, Telephone, and Professional Liability Insurance allocated based on a Time Study.

TIME STUDY

<table>
<thead>
<tr>
<th>Program</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Program #1</td>
<td>20%</td>
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<tr>
<td>Program #2</td>
<td>12%</td>
</tr>
<tr>
<td>Program #3</td>
<td>32%</td>
</tr>
<tr>
<td>Program #4</td>
<td>10%</td>
</tr>
<tr>
<td>Management &amp; General</td>
<td>21%</td>
</tr>
<tr>
<td>Fund - Raising</td>
<td>5%</td>
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</tbody>
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Rent, Utilities, Maintenance and Repairs, and Property Insurance allocated based on the Square Footage Study.

SQUARE FOOTAGE STUDY

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<th>Program</th>
<th>Percentage</th>
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</thead>
<tbody>
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<td>20%</td>
</tr>
<tr>
<td>Program #2</td>
<td>15%</td>
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<tr>
<td>Program #3</td>
<td>35%</td>
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<tr>
<td>Program #4</td>
<td>10%</td>
</tr>
<tr>
<td>Management &amp; General</td>
<td>20%</td>
</tr>
</tbody>
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Equipment Rental, Postage, and Equipment Maintenance allocated based on the Usage Study.

USAGE STUDY

<table>
<thead>
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<th>Percentage</th>
</tr>
</thead>
<tbody>
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<tr>
<td>Program #2</td>
<td>6%</td>
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<tr>
<td>Program #3</td>
<td>24%</td>
</tr>
<tr>
<td>Program #4</td>
<td>2%</td>
</tr>
<tr>
<td>Management &amp; General</td>
<td>40%</td>
</tr>
<tr>
<td>Fund - Raising</td>
<td>10%</td>
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</table>
IV. Methodology For Allocating Management and General Costs to Programs and Fund-Raising

- Same time studies and usage reports as above.
- Experience Levels
- Allocation methods approved by the Federal government or other funding source.

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