Cost Allocation: Correcting Common Deficiencies

As most Workforce Development professionals well-know, the Federal awards provided to their agencies for social and job training services do not come without strings. That's because the awarding agencies want to ensure that only those costs associated with carrying out the purpose of the federal awards are incurred. Therefore, cost principles for governmental and non-profit agencies were developed to ensure accountability for the use of federal funds.

Cost Allocation in Principle

The cost principles that ensure accountability are incorporated in 2 CFR 225 (OMB Circular A-87) for governmental and 2 CFR 230 (OMB Circular A-122) for non-profit agencies. These principles provide guidelines for determining allocation methodologies while at the same time allowing for flexibility in doing so. As a result, individual agencies can develop and tailor cost allocation plans and methodologies that fit their specific, unique needs.

Before a cost can be allocated to a federal grant, certain requirements must be met. A cost is allocable to a federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it is one of the following:

- Direct – incurred specifically for the award
- Shared – benefits more than one award and can be distributed in reasonable proportion to the benefits received
- Indirect – necessary to the overall operation of the organization, although a direct relationship to any particular award cannot be shown/substantiated

For shared and indirect costs, a reasonable allocation base must be determined. When selecting a base, it is essential to adopt the one best suited for assigning the pool of costs to cost objectives/awards in accordance with benefits derived—in other words, one that best establishes a traceable cause-and-effect relationship. Once the appropriate base is determined, agencies need to ensure methodologies are consistently applied and properly supported. The importance of substantiating, and properly documenting, the methodologies and bases utilized to charge costs to federal awards cannot be stressed enough. The reality is that costs may be questioned, and even disallowed, if costs are not allocated in compliance with applicable rules and regulations.

Cost Allocation in Practice

The One-Stop system includes many different programs and partnering agencies that are co-located and share costs to deliver a full array of services to customers in an efficient and effective manner. As a result, shared costs, such as rent, equipment, telecommunications, etc., have to be allocated to the programs and partners in an equitable manner.

These costs have to be identified, defined, and grouped into like categories. When identifying costs, each agency has the responsibility of determining the allowability of costs under its own program requirements. Then, equitable allocation methodologies and bases have to be developed, negotiated, and approved by the participating partner programs. Methodologies developed can vary depending on the types of costs being allocated. For example, facility costs may be allocated based on the amount of/percentage of square feet utilized by each agency, while supply costs may be allocated based on the number of full-time equivalents (FTE's). Once the appropriate allocation base has been applied to actual costs, each agency has to pay the amount determined to be their proportionate share. This can be done by providing resources, such as staff or equipment, or paying cash.

For most Workforce Development organizations, FTE's are the main basis for allocating costs. The premise of the FTE is that actual time worked can be translated into a unit of effort, with all staff being equal. The FTE is substantiated by a personnel activity report (PAR), commonly referred to as a timesheet, which is completed by staff in order to capture time by/according to funding source or activity/function. Time directly chargeable is treated as such; however, a basis for charging time specified by activity/function, which can vary based on individual staff duties, needs to be determined. For example, for some staff, customer case loads or customers served could be the best basis for the allocation, while staff supervised may be the most appropriate base for others. As a whole, a summary of all FTE's can provide an allocation base for costs benefiting all programs over which the organization has control. One thing is certain: an organization needs to ensure that all methodologies can be substantiated and are in compliance with cost principles.

Another important role of cost allocation is its impact on the budgeting process. Budgets are designed to be used as a benchmark against which results are measured; they must be prepared by funding source and adapted as needed to accommodate changes in funding and anticipated expenditures. The same cost allocation methodologies to be used in practice must be applied to planned expenditures. Thus, a budget prepared by funding source becomes a useful tool for monitoring expenditure levels and determining whether cost allocation methodologies are appropriate and provide the best results.

Correcting Common Deficiencies

The Workforce Development environment has been changing over the past number of years, as new programs are developed and others are being modified. Many organizations may be applying old/outdated cost allocation methodologies and bases; as a result, they may be unaware that deficiencies exist. Some examples of cost allocation deficiencies/issues include:

- Allocation percentages utilized are based on budget/planned percentages rather than a measure of actual efforts/results. This is specifically not allowable per cost principles.
- Allocation bases cannot be substantiated due to improperly maintained supporting documents (e.g., customer database queries were not printed and could not subsequently be recreated).
- Problematic Personnel Activity Reports (PAR's)
  - PAR's do not designate time by funding source or activities but rather contain only hours worked (e.g., 80 hours worked vs. designating 40 hours for/to TANF and 40 hours for/to Wagner-Peyser, totaling 80 hours worked).
  - Directly charging all time per PAR's for certain staff whose hours are very difficult, or impossible, to correlate with specific programs (e.g., receptionist, One-Stop manager).
  - For Workforce Development Board staff, PAR's do not designate time as administration or program. As a result, allocation of payroll costs to administration and/or program are not substantiated (e.g., payroll costs are charged 50% to the administration pool and 50% to the program pool; however, the timesheet does not designate time as administration or program).
- The organization's allocation needs are not properly assessed, resulting in:
  - inadequate allocation methodologies/bases (e.g., using customer data as an allocation base when customers served does not provide an reasonable representation of resources utilized).
  - lack of appropriate allocation methodologies/bases (e.g., only having a single One-Stop Center allocation when multiple One-Stop Centers exist that vary in the services provided).
- Inefficient cost allocation processes (i.e., the time required to compile documentation exceeds the benefit received).
- Allocation bases are not consistently applied to similar costs (e.g., rent costs being allocated utilizing a different allocation base than utility costs for the same location).
- Allocation bases are not appropriately updated on a periodic basis; therefore, allocations are not based on/do not reflect current efforts/results (e.g., failure to update cost allocation bases monthly as specified in the agency's cost allocation plan).

Outside review is particularly helpful in identifying many of these types of deficiencies in cost allocation methodologies and documentation. Such reviews are among the continuing services provided by TLHW, which has assisted several Workforce Boards in this way, helping each organization to develop, refine, and monitor its cost allocation methodologies and processes.

Taylor, Lombardi, Hall & Wydra, P.A., is a firm of independent Certified Public Accountants, located in the Orlando-area. For the past 15 years, TLHW has provided monitoring, continuous improvement, and technical assistance services to Workforce Boards and non-profit organizations—including conducting various process reviews for Workforce Boards. For more information about TLHW, please contact us at (407) 539-2066 or visit www.tlh-cpa.com.