



## Division of Disability and Aging Cost Allocation Guidelines

### Introduction

Agency providers must attach a Cost Allocation Plan to their cost reports to identify and explain how expenses are allocated to each cost center. At a minimum, the Cost Allocation Plan must allocate expenses recorded on the general ledger in the following ways:

1. **Allocation of a direct expense to an individual service line when the expense is specific to the service.**
2. **Allocation of an indirect expense to more than one service and/or other program service.** The expense is booked in an account where expenses for multiple services are recorded. The Cost Allocation Plan must indicate how charges in that account are allocated to each service.
3. **Allocation of an indirect expense to all services that the agency provides.** The expense is booked in a General & Administrative account. The cost allocation plan must indicate the proportion of each expense that is applicable to each service.

The following guidelines are intended to offer agency providers recommended methodologies for allocating the indirect expenses described above in items two and three. These guidelines are not intended to be a prescriptive list of methodologies from which agency providers must choose. While agency providers are required to base their allocation plans on generally accepted accounting principles (GAAP), DDA is committed to working with agency providers to determine what allocation methodology best reflects each provider's operations.

These recommendations were developed following a review of federal standards and best practices employed by multiple state and municipal governments, including Iowa, Maryland, Ohio, South Dakota, Wyoming, and New York City.

### Direct and Indirect Costs

**Direct Costs:** Costs accrued directly through the provision of a service. Some examples include hourly compensation paid to an employee for the time the employee is providing the service and cost of materials used to provide the service.

**Indirect Costs:** Expenses that are not directly tied to the provision of a service but still contribute to the agency provider's ability to provide services. Common examples include administrative salaries and overhead.

\*\*\*It is important to note that indirect and direct costs must be treated as mutually exclusive on a general ledger. A direct cost cannot also be double counted as an indirect cost. \*\*\*

## Cost Allocation

Why is it necessary to allocate indirect costs?

While indirect costs are not accrued during the provision of a single service, they still contribute to an agency provider's ability to provide that service and therefore must be considered when determining the service's total cost and profitability. Accurately allocating indirect costs allows an agency's management to understand the true cost of providing a service, which DDA relies upon to set fair and equitable reimbursement rates that permit agency providers to continue to serve the needs of their participants.

- Allocation of indirect costs across multiple services permits management to understand the total costs of providing an individual service.
- Selecting the correct allocation methodology and allocation base is essential to ensuring costs are accurately reflected.

## Allocation Methods

Ensuring costs are accurately reflected depends on a provider's ability to select the correct allocation methodology and base(s). These decisions must reflect the provider's business operations and should be explained in its Cost Allocation Plan.

### Simplified v Multiple

The agency provider should first decide between using a single or multiple allocation base(s) when allocating expenses as explained below:

**Simplified Allocation Method:** Total indirect costs are allocated by a single, equitable cost rate across all services. This method should be used when all services benefit from the indirect costs by approximately the same degree.

**Multiple Allocation Base Method:** When indirect costs benefit major services to a varying degree, such costs can be organized into separate cost groupings. The indirect costs in each grouping can subsequently be allocated to each service by a rate reflective of the benefit of that grouping to each service. As the name suggests, a different allocation base should be used to determine the appropriate allocation rate for each grouping.

## Types of Allocation Bases

After determining whether its operations require a single or multiple bases, the agency provider must similarly decide which base(s) to use when allocating expenses. As previously mentioned, all decisions must be justified in the Cost Allocation Plan.

Examples of common allocation bases include, but are not limited to:

### **1. Total Revenue**

A total revenue allocation base will allocate indirect costs according to each cost center's share of revenue earned. This may be helpful when the proportion of revenue reflects the each services relative level of activity and use of shared resources. In cases where certain services enjoy disproportionately high payment rates, an alternative base may be preferable.

### **2. Total Direct Costs:**

A total direct cost allocation base will allocate indirect costs according to each cost center's share of direct costs. This may be helpful when the proportion of direct costs also reflects each service's relative use of shared resources. In cases where, for example, high material or travel costs increases a service's share of direct costs, but not its use of shared resources, an alternative base may be preferable.

### **3. Labor Costs**

A labor cost allocation base reflects the labor intensity of each cost center by allocating indirect costs according to each service's share of total direct labor costs. An agency provider must specify what costs comprise its direct labor costs. Some examples include a combination of the following:

- Direct salaries and wages including (or excluding) all fringe benefits
- Vacation, holiday, sick pay, and other paid absences
- Fringe benefits
- Contracted labor (not to include consultants)

### **4. Total Cost Less Facility Cost**

Allocation based on total cost less facility cost is often used when a provider performs mixed services, some being labor intensive and others having a residential building component. Using this methodology will help to remove the distorting influence of facility fees that may not have a significant impact on a service's use of other shared resources.

### **5. Square Footage**

A square footage allocation base is most appropriate to allocate a building's overhead costs when the building is shared by multiple services, but the use is separate and distinct for each service. The allocation of such costs would be based upon the square footage used by each service.

### **6. Time Sheets/Time Study**

Time sheet/time study allocation can be the most accurate way to allocate expenses, but also the most time consuming. Allocation based on time sheets requires tracking the hours each employee spends performing each unique function, for each service, daily. For employees who spread their time across multiple services, their time sheets must clearly demark the time spent performing each function and service, in order for indirect costs to be allocated according the ratio of employee time devoted to each service

compared to the total time. The agency provider must utilize a sufficiently large sample time period to ensure data accuracy and should include a description of the sample time period as part of its Cost Allocation Plan.

## Calculating indirect cost rate/allocation base

After selecting the appropriate allocation base, calculating the allocation rate is a matter of simple arithmetic, but can be done multiple ways. While the formulas below use total direct costs for the allocation base for illustrative purposes, the arithmetic remains the same regardless of the base used.

### ***Using a Single Indirect Cost Rate***

$$\text{Indirect Cost Rate} = \text{Total Indirect Costs} / \text{Total Direct Costs}$$

$$\text{Indirect Cost Rate} = \frac{\text{Total Indirect Costs}}{\text{Total Direct Costs}}$$

$$(\text{Total Direct Costs} = \text{Total Costs} - \text{Total Indirect Costs})$$

$$\text{Service Specific Indirect Cost Allocation Amount} = \text{Indirect Cost Rate} * \text{Service Specific Direct Cost}$$

**OR**

### ***Using Service Specific Rate***

$$\text{Service Specific Allocation Rate} = \frac{\text{Service Specific Direct Costs}}{\text{Total Direct Costs}}$$

$$\text{Service Specific Indirect Cost Allocation Amount}$$

$$= \text{Service Specific Cost Allocation Rate} * \text{Total Indirect Costs}$$

Please Refer to Appendix 1 for basic cost allocation examples

## Appendix 1 – Indirect Cost Allocation Examples

| Simplified Method                            |                    |                    |                    |                    |                   |                   |                     |
|----------------------------------------------|--------------------|--------------------|--------------------|--------------------|-------------------|-------------------|---------------------|
|                                              | Service 1          | Service 2          | Service 3          | DDA Non-<br>Waiver | Non-DDA           | Fund<br>Raising   | Total               |
| <b>Expenses</b>                              |                    |                    |                    |                    |                   |                   |                     |
| Indirect Cost Allocation ( <i>Total Cost</i> | \$2,681            | \$13,013           | \$6,483            | \$1,331            | \$257             | \$1,236           | \$25,000            |
| <i>Allocation Base)</i>                      |                    |                    |                    |                    |                   |                   |                     |
| Wages                                        | \$10,000           | \$50,000           | \$25,000           | \$5,000            | \$1,000           | \$5,000           | \$96,000            |
| ERE                                          | \$1,000            | \$5,000            | \$2,500            | \$500              | \$100             | \$500             | \$9,600             |
| Program Support                              | \$2,000            | \$10,000           | \$5,000            | \$1,000            | \$200             | \$1,000           | \$19,200            |
| Other                                        | \$800              | \$3,200            | \$1,200            | \$500              | \$50              |                   | \$5,750             |
| Non-Allowable                                | \$300              | \$250              | \$400              |                    |                   |                   | \$950               |
| <b>Total w/o indirect</b>                    | <b>\$14,100</b>    | <b>\$68,450</b>    | <b>\$34,100</b>    | <b>\$7,000</b>     | <b>\$1,350</b>    | <b>\$6,500</b>    | <b>\$131,500</b>    |
| Total w/ indirect                            | \$16,781           | \$81,463           | \$40,583           | \$8,331            | \$1,607           | \$7,736           | \$156,500           |
| Indirect %                                   | 16%                | 16%                | 16%                | 16%                | 16%               | 16%               | 16%                 |
| <b>Revenue</b>                               | <b>\$18,000.00</b> | <b>\$80,000.00</b> | <b>\$39,000.00</b> | <b>\$9,000.00</b>  | <b>\$1,500.00</b> | <b>\$8,000.00</b> | <b>\$155,500.00</b> |
| <b>Profit/Loss</b>                           | <b>\$1,219</b>     | <b>(\$1,463)</b>   | <b>(\$1,583)</b>   | <b>\$669</b>       | <b>(\$107)</b>    | <b>\$264</b>      | <b>(\$1,000)</b>    |
| Margin                                       | 7%                 | -2%                | -4%                | 7%                 | -7%               | 3%                | -1%                 |

| Multiple Allocation Base Method                                          |                    |                    |                    |                   |                   |                   |                     |
|--------------------------------------------------------------------------|--------------------|--------------------|--------------------|-------------------|-------------------|-------------------|---------------------|
|                                                                          | Service 1          | Service 2          | Service 3          | DDA<br>NonWaiver  | Non-DDA           | Fund<br>Raising   | Total               |
| <b>Square Footage</b>                                                    | 500                | 1500               | 1000               | 400               | 0                 | 300               | 3700                |
| <b>Expenses</b>                                                          |                    |                    |                    |                   |                   |                   |                     |
| Indirect Cost<br>Group 1                                                 |                    |                    |                    |                   |                   |                   |                     |
| Allocation ( <i>Wages</i><br><i>Allocation Base</i> )                    | \$1,041.67         | \$5,208.33         | \$2,604.17         | \$520.83          | \$104.17          | \$520.83          | \$10,000            |
| Indirect Cost<br>Group 2                                                 |                    |                    |                    |                   |                   |                   |                     |
| Allocation ( <i>Square</i><br><i>Footage Allocation</i><br><i>Base</i> ) | \$10,000           | \$50,000           | \$25,000           | \$5,000           | \$1,000           | \$5,000           | \$96,000            |
| Wages                                                                    |                    |                    |                    |                   |                   |                   |                     |
| ERE                                                                      | \$1,000            | \$5,000            | \$2,500            | \$500             | \$100             | \$500             | \$9,600             |
| Program Support                                                          | \$2,000            | \$10,000           | \$5,000            | \$1,000           | \$200             | \$1,000           | \$19,200            |
| Other                                                                    | \$800              | \$3,200            | \$1,200            | \$500             | \$50              |                   | \$5,750             |
| Non-Allowable                                                            | \$300              | \$250              | \$400              |                   |                   |                   | \$950               |
| <b>Total w/o indirect<br/>costs</b>                                      | <b>\$14,100</b>    | <b>\$68,450</b>    | <b>\$34,100</b>    | <b>\$7,000</b>    | <b>\$1,350</b>    | <b>\$6,500</b>    | <b>\$131,500</b>    |
| Total w/ indirect<br>cost                                                | \$17,169           | \$79,739           | \$40,758           | \$9,142           | \$1,454           | \$8,237           | \$156,500           |
| Indirect Cost<br>Group 1 %                                               | 6%                 | 7%                 | 6%                 | 6%                | 7%                | 6%                | 6%                  |
| Indirect Cost<br>Group 2 %                                               | 12%                | 8%                 | 10%                | 18%               | 0%                | 15%               | 10%                 |
| <b>Revenue</b>                                                           | <b>\$18,000.00</b> | <b>\$80,000.00</b> | <b>\$39,000.00</b> | <b>\$9,000.00</b> | <b>\$1,500.00</b> | <b>\$8,000.00</b> | <b>\$155,500.00</b> |
| <b>Profit/Loss</b>                                                       | <b>\$831</b>       | <b>\$261</b>       | <b>(\$1,758)</b>   | <b>(\$142)</b>    | <b>\$46</b>       |                   | <b>(\$1,000)</b>    |
| Margin                                                                   | 5%                 | 0%                 | -5%                | -2%               | 3%                | -3%               | -1%                 |