

Which One Should I Choose?

Cost Allocation Methods

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With You Today



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Learning Objectives

1

Identify the various cost allocation methodologies

2

Determine how to use a cost allocation method

3

Analyze how effective cost allocations leads to understanding true cost of activities

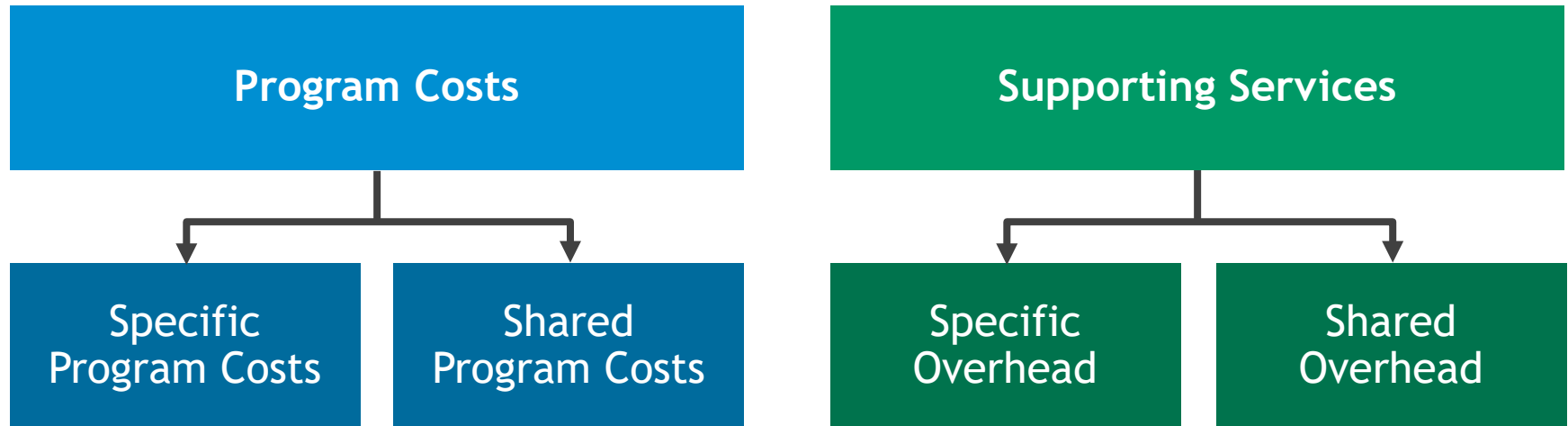


Reflection

Why Allocate Costs?

RESOURCE UTILIZATION

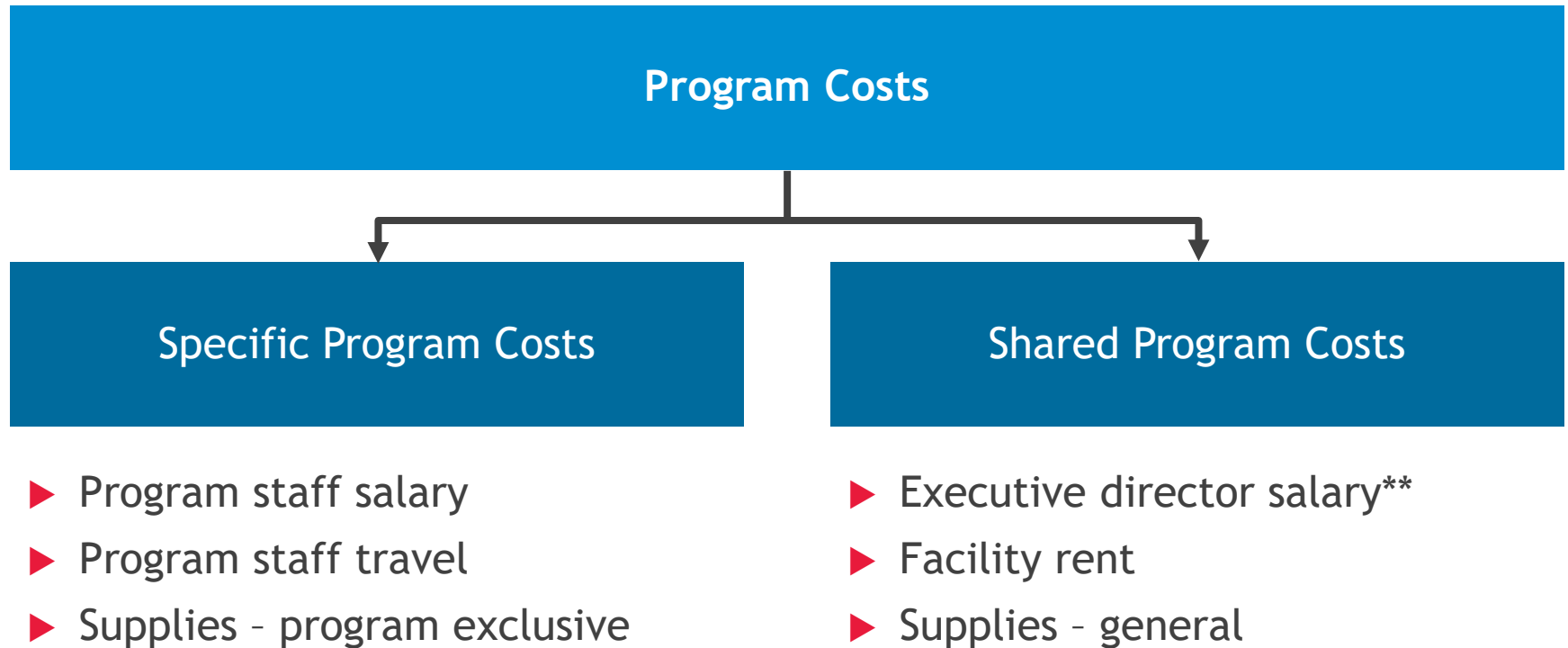
Reality of Costs



In accordance with GAAP, expenses that benefit more than one function/activity should be allocated

RESOURCE UTILIZATION

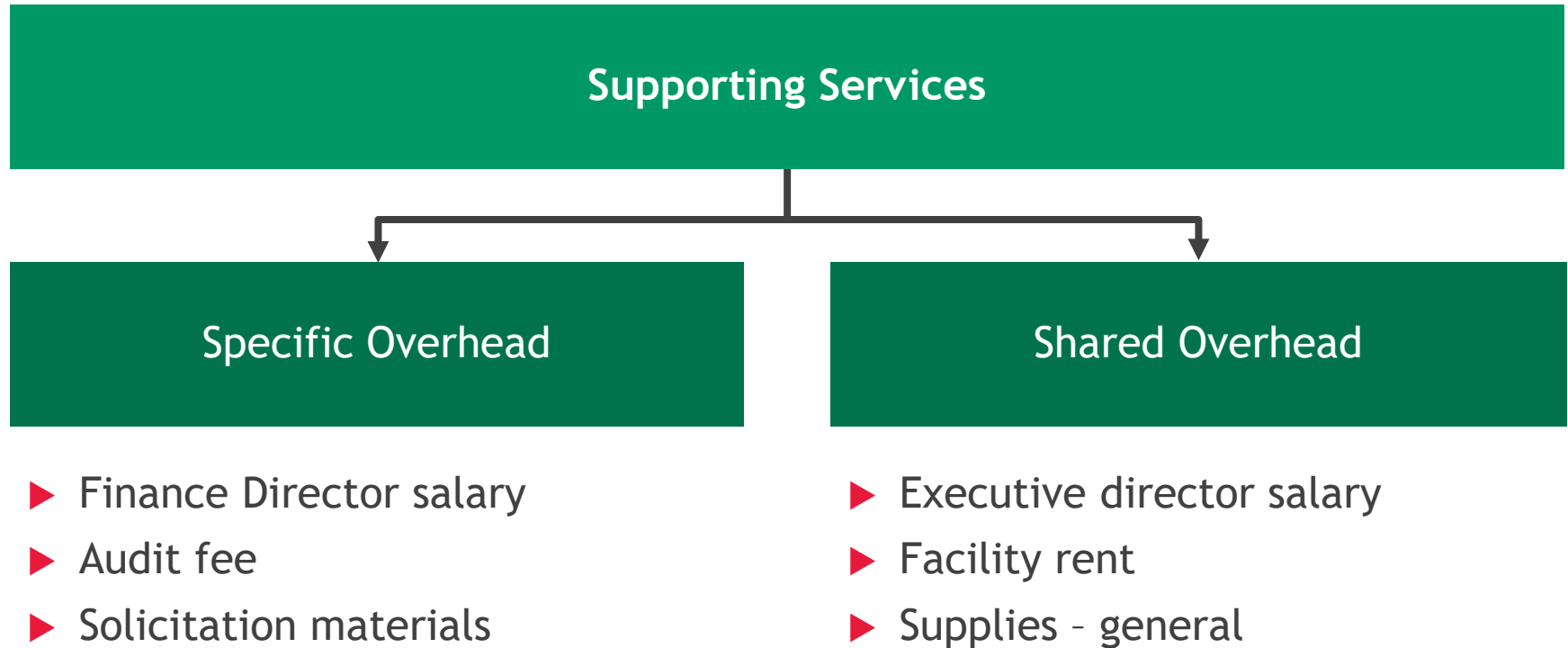
Reality of Costs



*** Activities that represent direct conduct of direct supervision or program services are program costs. (FASB ASC 958-720-45-2)*

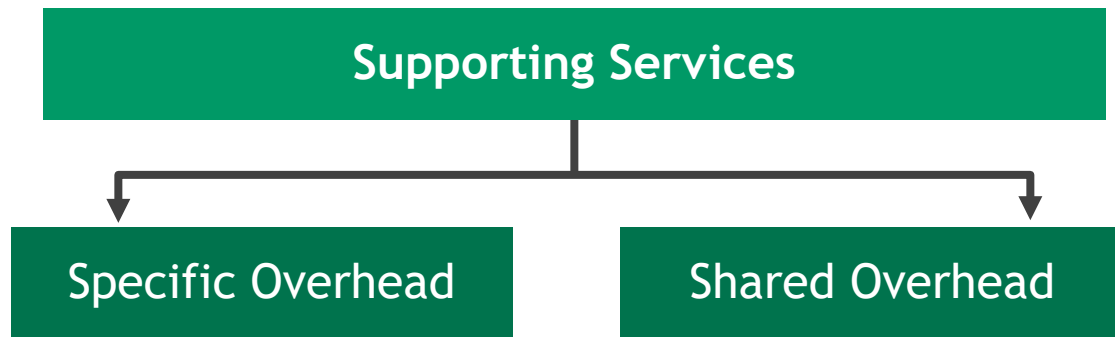
RESOURCE UTILIZATION

Reality of Costs



RESOURCE UTILIZATION

Reality of Costs



Knowledge Spotlight:

Overhead costs
Vs.
Indirect costs

*These are two different
concepts.*

*Indirect costs are related to
funder-defined terms and
are often NOT the same as
the true cost of overhead.*

Cost Allocations

Some shared costs are more easily coded to applicable areas

Shared Expense

Identifying Split

Payroll

Timesheets

Supplies

Analysis of invoice (i.e., manual breakdown of costs)

Insurance

Broker's policy breakdown



What If It's Not That Easy?
Allocate Using the Selected Method.

Cost Allocations



Cost allocation methods are

- ▶ Designed to efficiently spread shared costs
- ▶ Intended to code costs to reflect resource utilization, within the applicable accounting guidance
- ▶ Should be reasonable based on facts and circumstances and consistently applied

How precise are cost allocations designed to be?

Allocation Methods

| Method | Shared costs coded... |
|---------------------------------|-------------------------------------|
| Full Time Equivalent (FTE) | where staff spend time |
| % of Payroll Dollars | where salary dollars are coded |
| Per Participant (or other unit) | based on level of activity |
| Square Footage | based on predetermined facility map |
| Space Usage | based on usage of shared space |

Which One Do I Choose?



USING PAYROLL AS THE BASIS FOR ALLOCATION

FTE Method

- ▶ Payroll and fringe coded to the activities where staff spend time (level of effort)
- ▶ Use same percentages to spread non-payroll shared costs

| | Prgm A | Prgm B | M&G | Dev. | Total |
|-----------|--------|--------|------|------|-------|
| Executive | | | | | |
| Director | 15% | 15% | 40% | 30% | 100% |
| Program | | | | | |
| Director | 50% | 50% | | | 100% |
| Case | | | | | |
| Manager | 100% | | | | 100% |
| Case | | | | | |
| Manager | | 100% | | | 100% |
| Case | | | | | |
| Manager | 50% | 50% | | | 100% |
| Business | | | | | |
| Manager | | | 100% | | 100% |
| | 215% | 215% | 140% | 30% | 600% |
| | 36% | 36% | 23% | 5% | 100% |

USING PAYROLL AS THE BASIS FOR ALLOCATION

% Salary Dollars

- ▶ Payroll and fringe coded to the activities where staff spend time (level of effort)
- ▶ Spread non-payroll shared costs proportionate to coding of payroll dollars

| | Prgm A | Prgm B | M&G | Dev. | Total |
|--------------------|---------|---------|---------|--------|---------|
| Executive Director | 18,750 | 18,750 | 50,000 | 37,500 | 125,000 |
| Program Director | 30,000 | 30,000 | | | 60,000 |
| Case Manager | 50,000 | | | | 50,000 |
| Case Manager | | 50,000 | | | 50,000 |
| Case Manager | 25,000 | 25,000 | | | 50,000 |
| Business Manager | | | 60,000 | | 60,000 |
| | 123,750 | 123,750 | 110,000 | 37,500 | 395,000 |
| | 31% | 31% | 28% | 9% | 100% |

USING PAYROLL AS THE BASIS FOR ALLOCATION

Comparison

Staff are spending their time the same way, so why are the %'s different?

| | | | | | |
|------------------|-----|-----|-----|----|------|
| FTE Method | 36% | 36% | 23% | 5% | 100% |
| % Salary Dollars | 31% | 31% | 28% | 9% | 100% |

Because our example has a relatively small # of staff (6 total), % of salary dollars is skewed towards where the ED dollars are coded based on the higher individual compensation.

Using Units as the Basis for Allocation



Each unit receive same prorata share of cost.

Examples

- ▶ Per student cost
- ▶ Per classroom cost
- ▶ Per camper cost

Using Physical Space as the Basis for Allocation



Square Footage

- ▶ % of space utilized

Facility Use

- ▶ Amount of time space is utilized (typically related to a common area or shared facility).

Both assume space utilization relates to resource utilization

What Costs Do We Typically Allocate?



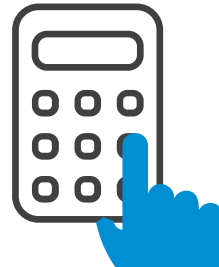
COST ALLOCATIONS

Considerations



EFFICIENCY

How many different methods should one organization use?



EASE OF CALCULATION

Is there a simple way to calculate allocation that yields the same/similar result?



REALITY OF RESOURCE UTILIZATION

Which method best approximates how resources are used?

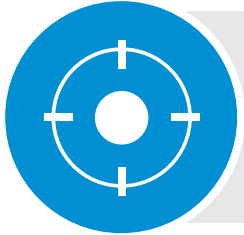
COST ALLOCATIONS

Putting It All Together

| Expense | Allocation Method | Prgm A | | Prgm B | | M&G | | Development | | Total |
|-------------------|------------------------------|------------------|--------|-----------|--------|-----------|--------|-------------|--------|-----------|
| | | Specific | Shared | Specific | Shared | Specific | Shared | Specific | Shared | |
| Salaries & Fringe | <i>n/a (level of effort)</i> | 154,688 | | 154,688 | | 137,500 | | 46,875 | | 493,750 |
| Professional Fees | <i>n/a</i> | 75,000 | | 95,000 | | 15,500 | | 5,000 | | 190,500 |
| Supplies | <i>% salary dollars</i> | 3,000 | 4,699 | 3,750 | 4,699 | 750 | 4,177 | 2,500 | 1,424 | 25,000 |
| Occupancy | <i>square footage</i> | | 24,000 | | 24,000 | | 6,000 | | 6,000 | 60,000 |
| Interest | <i>n/a</i> | 4,200 | | | | | | | | 4,200 |
| Depreciation | <i>square footage</i> | 7,500 | 12,000 | 4,000 | 12,000 | | 3,000 | | 3,000 | 41,500 |
| | | 244,388 | 40,699 | 257,438 | 40,699 | 153,750 | 13,177 | 54,375 | 10,424 | 814,950 |
| | | \$285,087 | | \$298,137 | | \$166,927 | | \$64,799 | | \$814,950 |

COST ALLOCATIONS

Final Thoughts



What costs to allocate using which method?



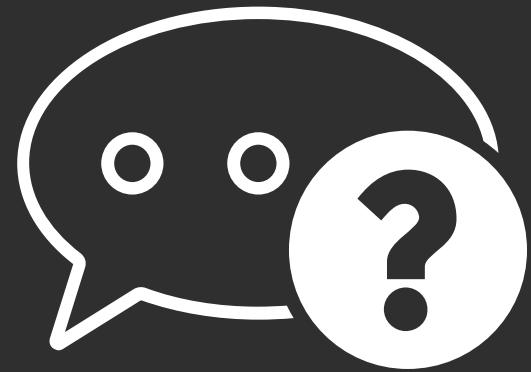
Any considerations affecting donor-funded activities?



How to “crunch the numbers” (i.e., any good tools out there)?



Discussion



Thank You



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