

Understanding Cost Allocation Principles

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The views expressed in this presentation are those of Mr. Clark. Official positions of SCDDSN and other bodies referenced in these materials are reached by them after specific situational deliberation and due process.

Objectives of This Training

- Understand why it really matters how we account for our costs
- Outline various regulations defining cost principles
- Define direct and indirect costs
- Discuss the requirements to have a cost allocation plan and the use of the step-down method
- Discuss a variety of cost pools available for use and related allocation bases
- Discuss a variety of costs that are commonly incorrectly accounted for in the administrative cost pool
- Share other pointers related to proper allocation of costs
- Identify resources to be used after you leave here today

October 10, 2017 Presentation - DSN Board Administrative Costs

Administrative Costs (Indirect Costs)

25

Local DSN Board Administrative allocations vary:

- **Less than \$5M budget - 10.92 % average**
 - **Ranging from 7.65 % - 14.06 %**
- **Between \$5M and \$15M budget – 7.46 % average**
 - **Ranging from 5.85 % - 13.43 %**
- **Over \$15M budget – 7.57 % average**
 - **Ranging from 3.84 % - 10.25 %**

Comparing Board Administrative Percentages

<u>Budget Size</u>	<u>Spread %</u>	<u>High vs Low</u>	<u>Spending on Services</u>
Less than \$5 million	6.41%	184%	89.8% vs. 96.2%
\$5 to \$15 million	7.58%	230%	86.6% vs. 94.2%
Over \$15 million	6.41%	267%	85.9% vs. 92.4%

Audit Disallowances Cost Millions

- “SC Claimed Some Unallowable Room and Board Costs Under the Intellectual and Related Disabilities Waiver” – Office of Inspector General September 2012 reviewing 2007, 2008, and 2009 cost reports
 - “The State agency claimed Medicaid reimbursement of \$5,176,347 (\$3,726,112 federal share) for unallowable room and board costs under the Waiver program that the Department operated.”
- “SC Claimed Some Unallowable Room and Board Costs Under the Intellectual and Related Disabilities Waiver” – Office of Inspector General April 2015 reviewing 2010 cost reports
 - “The State agency claimed Medicaid reimbursement of \$1,293,893 (\$1,029,033 federal share) for unallowable room and board costs under the Waiver program that the Department operated.”

ACTION STEP!

- Why is there such a drastic variance?
 - Where your Agency in this range?
- Are you accounting for your administrative costs properly?
- What we do and why we do it is very important to understand.
 - Your books become our books!

Sample Step Down Cost Allocation and Reconciliation



Microsoft Excel
17-2003 Worksheet

Sample Cost Allocation Plan



Microsoft Word
Document

Proper Reflection of Allocated Costs in TB



Microsoft Word
Document

How are you performing your cost allocation?

- Are you using Excel spreadsheets?
- Does your software complete the allocation for you?
- Is the cost allocation functioning properly and being updated based on changes in your Agency?
- Are you using automation to the extent possible to increase efficiency and accuracy? Exporting and importing data.
- Are you maintaining your statistics properly?

Regulations Over Cost Allocations

- SCDDSN Directive 250-05-DD “Cost Principles for Contracts and Grants with Community Providers”
- Provider Reimbursement Manual/State Medicaid Plan
- [Title 2 of the Code of Federal Regulations \(2 CFR\), part 200](#)
 - Governments, Non-profits, and Higher Education – pay attention to section you need to use
 - All entities – Subpart E – Cost Principles
 - All entities – Parts 200.412 – 200.415 – Direct and Indirect (F&A) Costs
 - All entities – 200.416 – Cost Allocation Plans and Indirect Cost Proposals
 - Governments – Appendices V and VII
 - Non-profits – Appendices IV and VIII

Allocation Method to be Used

Per SCDDSN Directive 250-05-DD

- When a provider operates Medicaid-funded programs, the step-down allocation method must be used. Providers without Medicaid-funded programs may use this method if it will make a significant difference in allocation of indirect costs.
- The step-down method in a nutshell
 - Determine the order of the allocations
 - Each intermediate cost pool should be allocated to other benefitting pools whether they are another intermediate cost center or a final cost center using an established base
 - Once allocated an intermediate cost center should not receive further allocations from other pools later in the allocation

SCDDSN Directive 250-05-DD

- The directive requires the following:
 - Each Provider (includes contract QPL providers) shall maintain a cost allocation plan in accordance with the principles stated in this directive.
 - The plan must include adequate narratives and schedules to explain the methodology used to distribute shared costs.
 - The plan must include a detailed budget for all costs that are allocated.
 - Any changes to cost allocation plans must be approved in advance by DDSN.

SCDDSN Directive 275-04-DD

- This is the Provider Audit Policy issued annually (note 275-06-DD does not contain these same requirements)
- It outlines requirements of your Agency and your auditor that overlays all other audit requirements established that must also be followed.
- It states “All DSN Boards are required to submit cost allocation plans to DDSN. The Auditor should determine if the cost allocation plan submitted by the DSN Board is appropriate and complies with DDSN Directive 250-05-DD. The Auditor should also review the cost allocation plan to determine that it has been updated for any additions or deletions to the basis used to allocate costs and that the current year cost allocations are materially correct. The Auditor should review the DSN Board’s cost allocation plan to determine that costs charged to the administrative and general cost center do not include program costs in accordance with requirements of DDSN Directive 250-09-DD in conjunction with guidance issued by DDSN.”

What is the difference between direct and indirect costs?

- Direct costs are
 - costs that are readily identifiable to a specific department or consumer
 - costs are charged directly to a department budget/trial balance
- Indirect costs are
 - costs that are not readily identifiable to a specific operational department or consumer and benefit multiple departments
 - costs are charged to a cost pool and then allocated to departments using an allocation method
- Intermediate cost centers (indirect) vs. final cost centers (direct)

Indirect (facilities and administrative) costs

2 CFR Part 200, Section 200.56

Indirect F&A costs means those costs incurred for a common or joint purpose benefitting more than one cost objective, and not readily assignable to the cost objective specifically benefitted, without effort disproportionate to the results achieved. To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect F&A costs. Indirect F&A cost pools should be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of the relative benefits derived.

SCDDSN Directive 250-05-DD – indirect cost

Because of diverse characteristics and accounting practices of provider organizations, it is not possible to specify the types of costs which may be classified as indirect costs in all situations. However, typical examples of indirect costs for provider organizations may include:

- the costs of operating and maintaining shared facilities
- general and administrative costs for executive directors, financial officers and shared secretarial staff, including salaries, fringe benefits, and support costs.

SCDDSN Directive 250-05-DD – direct costs

Any direct cost of a minor amount (this is not defined in the directive) may be treated as an indirect cost for reasons of practicality when the accounting treatment for such cost is consistently applied to all final cost objectives. For these minor cost areas, the accounting effort in charging costs directly is not commensurate to the results achieved.

Administration vs. Program Administration

- Understand the distinction
- These are not interchangeable terms
- Program Administration entails management and oversight of programs operated by the Agency - examples
 - Residential directors
 - Day program directors
 - Operational directors
 - Quality Assurance
 - Training/Staff Development
 - Some IT Services

Indirect Cost vs. Administrative Costs

- Understand the distinction
- These are not interchangeable terms
- Administrative Costs can be direct and indirect - examples
 - Accounting
 - Budgeting
 - Human Resources
 - Payroll
 - Procurement
 - Oversight of Organization
- Indirect costs can be administration, program activities, program administration, shared facilities, transportation, maintenance, or other non-admin cost pools

ACTION STEP!

- Do you have a cost allocation plan developed and properly documented?
- Have you submitted a cost allocation plan?
- Has it been approved?
- Have you made changes since you last submitted?

Example Intermediate Cost Pools

Type of Pool

- Administration
- Information Technology
- Maintenance
- Transportation
- Shared Facility
- Residential Management
- ICF, CRCF, CTH Management
- Fringe Benefits
- Lawn Maintenance

Example Allocation Bases – others may be more appropriate

- Total Modified Total Direct Cost
- Number of PCs managed
- Work Orders, Work Order hours, effort factor
- Mileage
- FTEs or heated square footage
- Number of beds, effort factor
- Number of beds, effort factor
- Salaries
- Effort factor

Determination of MTDC

- Modified Direct Total Cost is the base to be used when allocating by expenses – commonly used to allocate administrative costs
- MTDC is determined as follows:
 - Total full accrual basis expenses (note not using expenditures)
 - Less contracts in excess of \$25,000 (other distorting items – See OMB implementation guide)
 - Less pass-through funds
 - = MTDC

What is an effort factor?

- It is a factor that is derived to measure effort to determine costs to be allocated to a particular program.
- For example, for maintenance you may use an effort factor comprised of a variety of components that are consistently applied to each department.
 - Time Study
 - Size of facility
 - Distance of facility from Agency's Central Office
 - Painted exterior vs. brick vs. siding
 - Age of home
 - Consumer abuse of home
- Consider mid-year changes

Example Effort for Facility Allocation

Any County DSN Board													
Facility Usage Statistics - Main Administrative Office													
FY 2018													
	FTE's												
Program	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	March	April	May	June	Avg
Case Management	3	3	3	3	3	3	3	4	4	4	4	4	3.42
Early Intervention	2	2	2	2	2	2	2	2	2	2	2	3	2.08
Residential Admin	3	3	3	3	3	3	3	3	3	3	3	3	3.00
Administration	5	5	5	5	5	5	5	5	5	5	5	4	4.92
Staff Development	1	1	1	1	1	1	1	1	1	1	1	1	1.00
Waiver Respite Coordinator	1	1	1	1	1	1	1	1	1	1	1	1	1.00
Total	15	16	16	16	16	16	15.42						

ACTION STEP!

- What cost pools are you using?
- How are you distributing the costs to departments?
- Is it a fair method of allocation?
- Are you including costs in your base that you should not include?
- Do you need more pools to generate efficiencies or to improve accounting accuracy?

Costs Commonly Found in Administration that Should not be in Administration

- Salaries of the following positions:
 - Maintenance personnel
 - Quality Assurance personnel
 - Employee Health Nurse
 - Management of Consumer Funds accounts personnel
 - Management of Trust personnel
 - Foundation or other fundraisers
 - Residential directors
 - Day program directors
 - Non-dedicated clerical personnel

Costs Commonly Found in Administration that Should not be in Administration (cont)

- Worker's compensation total premium – allocate by salaries in each department in each classification
- Cost report preparation fees
- Total GASB 45/75 or GASB 68 accrued expense – allocate by % salaries
- Tort insurance total premiums – allocate by FTE in each category
- Bonuses for all staff
- Facility costs – often all charged to admin or adult day
- IT consultant when bill identifies specific department
- Shared vehicles

Costs Commonly Found in Administration that Should not be in Administration (cont)

- Janitorial services
- Lawn maintenance services
- Property insurance – vehicle and/or buildings
- Fidelity bond covering consumer funds
- Advertising for positions
- SLED checks, TB tests, physicals, and other hiring costs if practical to charge departments or other intermediate cost center
- Office supplies not specifically for Admin staff
- Legal fees involving cases for other department matters
- Retiree health insurance premiums paid

ACTION STEP!

- Complete a Detailed and Critical Review of all Costs Coded to Admin – Accounts Payable and Payroll
- Look at your FTE report and critically review all personnel charged to your administrative cost pool.
- Pull a general ledger of your administrative cost pool and critically review all invoices and journal entries posted to expense in this cost pool.
- Consider efficiencies that can be gained by creating new cost pools to allocate costs in total instead of allocating costs on a per transaction basis.
- Consider the need for a general fund or board fund to capture non-allowable costs.

Intermediate Cost Pools and Best Practices

- Intermediate cost pools should be allocated monthly so that accurate costs are shared with management and the Board of Directors
- If you use budgeted allocated costs during the year to simplify cost allocation entries, then you should consider truing this up at least quarterly using actual figures.
- Cost pools should zero out when the allocation is completed (sometimes they should not zero out – discussed later)
- Cost pools are ideally allocated using year-to-date figures instead of monthly figures since the year-end allocation typically uses annual figures. Discrepancies can be significant when using monthly figures instead of year-to-date.
- Statistics should be updated monthly considering changes (new beds, new residential facilities/programs, changes in facility usage, etc)

Intermediate Cost Pools and Best Practices (Cont)

- Adult Day Program expenses should be combined with Work Activity Expenses net of revenue
- Adult Day Program allocations to ICF/ID residential programs should ensure total expenses are reduced for the following:
 - All vehicle expenses – insurance, fuel, repairs, depreciation, etc.
 - All driver salaries and benefits
 - Local revenues
 - Miscellaneous revenues
 - State Funded Community Supports revenues **earned** (SFCS units attended x the rate paid by the State for these services (\$27.50 per half day unit for FY 2020))
- If you have a transportation pool and ICF/IDs, then allocate transportation costs so that they do not end up in Adult Day Program per diem that is allocated to the ICFs
- Adult Day Program expenses should be allocated to ICF/IDs only. ICF/IDs include day program services in the definition of residential habilitation whereas Waiver funded programs reflect day habilitation as a separate service.

Other Special Items to Consider

- Depreciation on all assets (whether grant funded or not) should be included in costs to be allocated and in MTDC.
- Capital grant revenues should not be used to offset costs being allocated which means you may end up with a surplus in a cost pool.
- You should not allocate non-allowable costs which means you may end up with a deficit in a cost pool representing the non-allowable cost.
- Allocated costs should be reflected in their own section of your trial balance and should not be shown as contractual services.
- Revenues from allocated costs should be reflected as a negative expense. GAAP requires this treatment or you end up with grossed up expense and revenue figures.
- Costs should not be allocated on Waiver direct billed, Medicare Pt D, Regional Respite, or Self-directed expenses since they have a distorting affect.
- Total allocated costs must zero – all expense accounts less the credit to the cost pool must zero.

Other Special Items to Consider (Cont)

- Be mindful of room and board costs that are allocated through intermediate pools and your inability to identify these in your room and board calculation.
- Include maintenance cost center allocations as part of your room and board calculation.
- Do not use the administrative cost pool as a dumping ground for things that are difficult to correctly allocate. For example, special grants received recently from DDSN have been reflected in administrative costs at many places, but these should have been given their own cost center to account for all costs.
- Do not account for the SCRS/PORS 1% credit as a reduction in administrative retirement expense or as a revenue for administration.

Other Special Items to Consider (Cont)

- Lawn maintenance and other internally provided services should be based on the lower of the amount charged or the cost customarily charged. In other words, if you charge \$100 internally for cutting a lawn of one of the facilities, but your cost is only \$55 you can only claim the \$55 on your cost report as an allowable expense.
- Charges by related parties must be based on the costs and cannot generate a profit to the related entity.
- HUD management fees, bookkeeping fees, and maintenance fees should offset expenses allocated. Should ensure fees charged are adequate to at least cover your cost.
- Interest income should be reflected in administration and offset allocated costs.
- Meals served in Day Program should be considered for allocation – room and board costs.
- If you have a transportation pool, then consider direct charging certain expenses to final cost centers such as those due to negligence/accidents/vehicle damage.

Various Resources for your perusal

- South Carolina Comptroller General's Office Disbursement Regulations (subsistence) - http://www.cg.sc.gov/guidanceandformsforstateagencies/Documents/CGsAPP/12-31-17/Disbursement_Regulations_12-31-17.pdf
- General Services Administration (lodging rates by locale) - <https://www.gsa.gov/travel/plan-book/per-diem-rates>
- Internal Revenue Service Employer Resources - <https://www.irs.gov/publications>
- SC Medicaid Plan - <https://www.scdhhs.gov/site-page/state-plan-under-title-xix-social-security-act-medical-assistance-program>
- SCDDSN Directive 250-05-DD - [http://www.ddsn.sc.gov/about/directives-standards/Documents/currentdirectives/250-05-DD%20-%20Revised%20\(110316\).pdf](http://www.ddsn.sc.gov/about/directives-standards/Documents/currentdirectives/250-05-DD%20-%20Revised%20(110316).pdf)
- Provider Reimbursement Manual - <https://www.cms.gov/Regulations-and-Guidance/Guidance/Manuals/Paper-Based-Manuals-Items/CMS021929.html>
- US Chief Financial Officers' Council COFAR resources - <https://cfo.gov/grants/grants-resources/>
- US Chief Financial Officers' Council Uniform Guidance - <https://cfo.gov//grants/uniform-guidance/>
- US Health and Human Services Cost Allocation Services - <https://rates.psc.gov/>

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