“Is Your Organization Healthy?”: Cost Allocation, Invoices and Personnel (Payroll and Timesheets)

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CompassPoint intensifies the impact of fellow nonprofit leaders, organizations, and networks as we achieve social equity together.

Our integrated practice offers the strongest teaching, coaching, consulting, and peer learning – all grounded in deep nonprofit leadership experience.
Welcome

• 9:00 am – 3:00 pm. 1 hour lunch around noon. A break in the morning.
• Sign in & logistics
• Silence mobile phones
• Questions
• Introductions:
  • Name, organization, and role
Learning Objectives

• To develop and implement a comprehensive allocation process
• To identify the hallmarks of an effective timekeeping system
• To understand the importance of accurate, well-supported invoices
Why Allocate Expenses?

- Business Analysis
- Cost Recovery
- It’s Easier!
• **Reasonable**: Ordinary and necessary to accomplish the purpose of the contract and comparable to market prices.
• **Allowable**: As per the circular. Those costs for fundraising activities are not allowed by the government.
• **Allocable**: They must benefit the cost objective.
• **Consistently applied**: You cannot switch methods to generate more revenue or treat one cost as direct for one contract and indirect for another government contract.
• **Documented**: The methodology for allocating costs should be documented. This includes time studies and functional time sheets.
Compliance Form Box: 1B

1B. Cost Allocation Procedures

a. Process for cost allocation procedures and plan for shared costs is documented in a written narrative or in the footnotes of the current approved agency-wide budget

b. Process for allocating shared program costs is consistent and reasonable

c. Process for cost allocation procedures and plan for indirect costs is documented in a written narrative or in the footnotes of the current approved agency-wide budget

d. Process for allocating indirect costs is consistent and reasonable
The Allocation Process

1. Categorize expenses
2. Choose an allocation basis
3. Allocate shared costs
4. Allocate administrative/overhead costs
5. Calculate indirect rate
### Organizational Costs: Definitions

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative/Overhead</td>
<td>Those not identifiable with a single program, fundraising, or membership development AND indispensable to the organization’s existence such as finance, accounting, legal, and board-related expenses [Note: Also includes cost of negotiating exchange transactions and/or government contracts]</td>
</tr>
<tr>
<td>Fundraising</td>
<td>Cost associated with soliciting contributions from individuals, foundations, and corporations.</td>
</tr>
<tr>
<td>Program</td>
<td>Costs resulting in distributing goods and services to clients and fulfilling the mission of the organization</td>
</tr>
<tr>
<td>Common/Shared</td>
<td>Costs not easily identified with a specific program or supporting activity which are allocated and borne by all activities</td>
</tr>
</tbody>
</table>
## Cost Categorization: Language Matters

<table>
<thead>
<tr>
<th>Cost Categorization</th>
<th>Possible Audience</th>
</tr>
</thead>
</table>
| Program vs. Supporting  | IRS / Audited Financials
|                         | Watchdog Agencies
|                         | Donors                                                |
| Specific vs. Shared     | Internal management
|                         | Auditors                                              |
| Direct vs. Indirect     | Funders: Foundations and Government
|                         | contracts                                             |
Cost Categorization: Language Matters

- Program Specific/Direct
- Overhead/Indirect
- Common/Shared
Direct Costs vs. Shared Costs vs. Indirect Costs

Direct Costs
- Costs that are clearly and easily attributable to a specific program or activity (or specific programs or activities, e.g. when a staff person’s time is clearly allocated to multiple programs)

Shared Costs
- Costs that are necessary to the operation of all programs or activities
- Costs without which the programs or activities could not function
- Costs which can be prorated using a basis which reasonably measures the benefits provided to each activity

Indirect Costs
- Costs that are necessary to the overall operation of an organization, but the benefits can’t be traced to a particular program, for example, finance and executive activities

For the City and County of San Francisco and other funders, there are only two types of costs in Contractor budgets: Direct and Indirect. The direct costs may include items that the nonprofit would define as “shared costs” as well as their definition of “direct costs”. The indirect costs would most likely include items that the nonprofit defines as “shared costs” as well.
Cost Definitions: OMB A-122

- **Direct costs** are those that can be identified specifically with a particular final cost objective, i.e., a particular award, project, service, or other direct activity of an organization.

- **Indirect costs** are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective.
Cost Definitions: Human Services Agency

Indirect Costs are classified within two broad categories: Facilities and Administration.

- **Facilities type indirect costs** are defined as depreciation and use allowances on buildings, equipment, capital improvements, operations and maintenance expenses and interest on debt associated with certain buildings, that do not relate solely to any major function of the organization.

- **Administration type indirect costs** are defined as general administration and general expenses such as central offices, director’s office, office of finance or accounting, budget and planning, personnel and safety, general counsel, management information systems, and all other expenses of a general nature that do not relate solely to any major function of the organization.
Cost Definitions: Department of Children, Youth and Their Families

Administrative cost include items such as prorated cost of audit, insurance, bookkeeper and/or accounting services, the executive director or other administrative staff salaries. Grantee may also include a percentage of rent, equipment lease, utilities, communication cost such as postage and phones, internet cost, etc. DCYF allows Grantees a total of 15% of total budget for administrative cost. If subcontractors have administrative cost in their budgets, the allowable 15% should include those amounts as well.
Organizational Costs: Examples

- **Direct or Program:**
  - Program staff salaries
  - Materials and supplies for programs
  - Consultants’ fees

**OTHER EXAMPLES?**
Organizational Costs: Examples

- Indirect or Overhead/Administrative:
  - Portion of Executive Director’s salary
  - Finance staff salary
  - From HSA: central offices, director’s office, office of finance or accounting, budget and planning, personnel and safety, general counsel, management information systems
  - From DCYF: prorated cost of audit, insurance, bookkeeper and/or accounting services, the executive director or other administrative staff salaries. Grantee may also include a percentage of rent, equipment lease, utilities, communication cost such as postage and phones, internet cost, etc

OTHER EXAMPLES?
Organizational Costs: Examples

• Shared or Common:
  – Office manager’s salary
  – Rent
  – Telephone
  – Postage

OTHER EXAMPLES?
## Estimating Costs: Roles & Responsibilities

<table>
<thead>
<tr>
<th>Personnel</th>
<th>Salaries &amp; FTE</th>
<th>Management Team</th>
</tr>
</thead>
<tbody>
<tr>
<td>Program</td>
<td>Specific costs</td>
<td>Program Staff</td>
</tr>
<tr>
<td>Full costs</td>
<td>Specific plus allocated costs</td>
<td>Finance Staff</td>
</tr>
<tr>
<td>Capital</td>
<td>Fixed assets</td>
<td>Finance Staff/Management Team</td>
</tr>
</tbody>
</table>
Cost Allocation: The Basics

What is Cost Allocation?

Cost allocation is the process by which a nonprofit allocates indirect and shared costs across programs and administration. Cost allocation is important because it helps a nonprofit to capture the true cost of their activities and fairly allocate overhead costs. The City’s cost allocation guidelines for nonprofit contractors largely follow those described by Generally Accepted Accounting Principles (GAAP) and in Federal OMB Circular A-122.

Key Attributes of Cost Allocation: Consistent, Reasonable, and Documented

- **Consistent** - Is the allocation plan or process used consistently throughout the fiscal year and within all of the agency’s functions?
- **Reasonable** - Are the particular costs ordinary and necessary and comparable to market prices?
- **Documented** - Is the methodology for allocating the cost documented? For example, are there
Allocation Bases: OMB A-122

Actual conditions shall be taken into account in selecting the base to be used in allocating the expenses in each grouping to benefitting functions. The essential consideration in selecting a method or a base is that it is the one best suited for assigning the pool of costs to cost objectives in accordance with benefits derived; a traceable cause and effect relationship; or logic and reason, where neither the cause nor the effect of the relationship is determinable. When an allocation can be made by assignment of a cost grouping directly to the function benefited, the allocation shall be made in that manner. When the expenses in a cost grouping are more general in nature, the allocation shall be made through the use of a selected base which produces results that are equitable.
Possible Allocation Methodologies

- A percentage determined by dividing the number of FTEs of each activity by the total number of FTEs from all the activities (excluding any whose salaries are treated as common costs).
- A percentage determined by dividing the amount of the payroll expenses of each activity by the payroll expenses of all the activities (excluding common).
- A percentage determined by dividing the square footage used by each activity by the total agency square footage.
- A percentage determined by dividing the amount of the specific expenses of each activity by the total specific expenses of the organization.
## SAMPLE UNRESTRICTED BUDGET WITH SHARED COSTS ALLOCATED

2009-10 Budget: First Draft (summarized)

As for May 29, 2009

<table>
<thead>
<tr>
<th>Program Activities</th>
<th>Supporting Activities</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Shelter Services Admin- Support Groups Fundraising Costs</td>
<td>2008-09</td>
<td>2007-08</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contributions - Fundraising events - net</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>80,000</td>
<td>-</td>
<td>80,000</td>
<td>58,000</td>
<td></td>
</tr>
<tr>
<td>Foundation grants</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>135,000</td>
<td>-</td>
<td>135,000</td>
<td>125,000</td>
<td></td>
</tr>
<tr>
<td>Total support</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>125,000</td>
<td>-</td>
<td>125,000</td>
<td>115,000</td>
<td></td>
</tr>
<tr>
<td>Government contracts</td>
<td>815,009</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>815,009</td>
<td>770,467</td>
<td></td>
</tr>
<tr>
<td>Interest and dividends</td>
<td>-</td>
<td>-</td>
<td>10,000</td>
<td>-</td>
<td>-</td>
<td>10,000</td>
<td>5,750</td>
<td></td>
</tr>
<tr>
<td>Unrealized gain (loss) on investments</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Total revenue</td>
<td>815,009</td>
<td>-</td>
<td>10,000</td>
<td>-</td>
<td>-</td>
<td>825,009</td>
<td>776,217</td>
<td></td>
</tr>
<tr>
<td>Net assets released from restriction</td>
<td>-</td>
<td>445,000</td>
<td>-</td>
<td>5,000</td>
<td>-</td>
<td>450,000</td>
<td>453,000</td>
<td></td>
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<tr>
<td>Total income</td>
<td>815,009</td>
<td>445,000</td>
<td>10,000</td>
<td>345,000</td>
<td>-</td>
<td>1,615,009</td>
<td>1,527,217</td>
<td></td>
</tr>
<tr>
<td>Personnel expenses</td>
<td>329,852</td>
<td>214,881</td>
<td>117,365</td>
<td>127,339</td>
<td>179,161</td>
<td>968,598</td>
<td>973,204</td>
<td></td>
</tr>
<tr>
<td>Non-personnel expenses</td>
<td>416,750</td>
<td>129,300</td>
<td>28,100</td>
<td>44,750</td>
<td>224,113</td>
<td>843,013</td>
<td>505,507</td>
<td></td>
</tr>
<tr>
<td>Total specific costs</td>
<td>746,602</td>
<td>344,181</td>
<td>145,465</td>
<td>172,089</td>
<td>(403,274)</td>
<td>1,811,611</td>
<td>1,478,711</td>
<td></td>
</tr>
</tbody>
</table>

**See 1 Note Below**

| Allocation of shared costs | 181,473 | 125,015 | 44,360 | 52,426 | (403,274) | - | - |
| Expenses before overhead/indirect | 928,075 | 469,196 | 189,825 | 224,514 | - | 1,811,611 | 1,478,711 |

| Change before overhead/indirect | (113,066) | (24,196) | (179,825) | 120,486 | - | (196,602) | 48,507 |
| % of direct costs See Note 2 Below | 57% | 29% | -100% | 14% | 0% | (0) | - |
| Allocation of indirect costs | 108,200 | 55,049 | (189,825) | 26,576 | - | (0) | - |
| Total expenses | 1,036,275 | 524,245 | - | 251,090 | - | 1,811,610 | 1,478,710 |

| Change in net assets | (221,266) | (79,245) | 10,000 | 93,910 | - | (196,601) | 48,507 |
Cost Allocation Plan: A Sample

- Organization uses a bottom-line allocation for shared costs
- Shared cost allocation methodology: # of Department FTEs/Total # of FTEs in Organization
- Indirect cost allocation methodology: Allocated Administrative costs + Allocated Shared Costs/Total Specific Costs
Calculating Indirect Rate

\[
\text{Indirect Rate} = \frac{\text{Allocated Administrative Costs} + \text{Allocated Shared Costs}}{\text{Specific Costs}}
\]
Sample Indirect Rates and/or Policies

- **Department of Public Health**: The indirect cost charged by agencies contracting with the Sections noted above should not exceed 15 percent of the direct costs of the contract. Requests to increase the indirect cost rate above 15 percent must be approved by the Department’s Chief Financial Officer and Director of Public Health. Where applicable, grant guidelines will dictate the maximum indirect cost rate that an agency may charge; however indirect cost rates for contractual services exceeding 15 percent must still be approved by the Department’s Chief Financial Officer and Director of Public Health.

- **Human Services Agency**: Historically, the Agency has allowed Contractors to allocate Indirect Costs as an additive of direct costs in a variety of formats not too exceed 15% of direct costs as established by the Human Services Commission. The Adult and Aging Services Commission have historically allowed an indirect rate capped at 8%. This revised policy is intended to provide an equitable rate for all Human Service Agency Contractors.

- **Mayor’s Office of Housing**: Our indirect costs are short and succinct. As organizations are preparing their annual budgets, we ask that they follow these guidelines when using the indirect cost line item. Maximum allowed is 15% of total grant amount. Describe how indirect cost was arrived at and what this amount will pay for. If choosing to use this line item, there should be no administrative expenses elsewhere in the budget (including administrative salary for Executive Director or other management) and all other budget line items should represent only program-related costs.

- **First 5**: For Commission-funded programs, total Administrative Costs must not exceed 15% of the total grant budget. The 15% administrative cap also applies to all subcontractors. A lower threshold of 1 – 10% will apply to contracts with pass-through items such as stipends, reimbursements and subcontracts, with the percentage depending on the dollar amount of the pass-through.
Common Cost Allocation Challenges

• “Um, we don’t have a cost allocation plan.”
• “Aren’t we supposed to allocate all of the executive director’s salary to overhead?
• “We have to use different allocation methodologies – we have lots of different types of expenses. There is no ‘one-size-fits-all’ methodology!”
• “Different funders have different limits on the amount of indirect or shared costs that can be allocated to grants; what are we supposed to do?”
Compliance Form Box: 1H

1H. Payroll

a. State (DE6) and federal (941) payroll tax returns were filed by the end of the month following the end of the quarter for monitoring months under review
b. Employees paid with City funds listed on invoices checked in Section 1G above are listed on the DE6 for the quarter(s) that includes the monitoring months under review
c. Payroll taxes due were actually paid

Timesheets:
d. If employee time is paid by more than one source, it is recorded by funding source or program on timesheets
e. Employee & supervisor signatures on timesheets in ink
f. All changes to timesheet are initialed by supervisor in ink
g. Employees and hours charged to City contracts agree to timesheets and to payroll journals
Timesheets: What to Look Out For

- Time spent on activity is accurately reflected, including breaks
- Activity is clearly defined
- Time is recorded by program or funding source
- Employee’s and supervisor’s signatures
- Any changes are initialed by supervisor
Different Ways to Track Time

- Daily timesheets
- Weekly timesheets
- Time studies
Great Organization Timesheet

**Name:** Evelyn Employee  
**Time Period:** February 1 - February 14, 2012

<table>
<thead>
<tr>
<th>Program A</th>
<th>Activity</th>
<th>Program B</th>
<th>Activity</th>
<th>Administration</th>
<th>Activity</th>
<th>Fund Development</th>
<th>Activity</th>
<th>PTO/Leave</th>
<th>TOTAL HOURS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Led wellness support group</td>
<td>2</td>
<td>Delivered nutrition training to youth and family educators</td>
<td>2.5</td>
<td>Supervision meeting with Edwin Employee; submitted January timesheet</td>
<td>1.5</td>
<td>Drafted budget for proposal submission to The California Wellness Foundation</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>5-Feb</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>6-Feb</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>7-Feb</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>8-Feb</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<tr>
<td>9-Feb</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<tr>
<td>10-Feb</td>
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<td>0</td>
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<td>0</td>
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</tr>
<tr>
<td>11-Feb</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<td>0</td>
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<tr>
<td>12-Feb</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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</tr>
<tr>
<td>13-Feb</td>
<td>0</td>
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<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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</tr>
<tr>
<td>14-Feb</td>
<td>0</td>
<td>0</td>
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<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>TOTAL HOURS</strong></td>
<td><strong>2</strong></td>
<td><strong>2.5</strong></td>
<td><strong>1.5</strong></td>
<td><strong>2</strong></td>
<td><strong>0</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

TIP: List hours worked in the department or cost center columns. Hours can be captured in 15 minute, 30 minute, or 1 hour increments.

TIP: Any changes made to the timesheet should be initialed in ink by a supervisor.

TIP: Employees should describe what activities they performed in the "activity" columns.

TIP: Timesheet periods should correspond with the organization’s pay periods.

**Employee Signature**  
**Supervisor Signature**

TIP: Employee and supervisor signatures should be in ink.
Timesheet Practices

1. To the extent possible, timesheets should correlate with the systems used by the organization to track costs. In other words, hours should be recorded by department or cost center ("Administration," "Fund Development" or "Program Name") vs. individual projects or activities ("Supervision," "Professional Development" or "Support Groups").

2. E-timesheets are acceptable. To the extent possible, print out e-timesheets and have managers/supervisors sign these in ink. This requirement can be waived if an organization can explain internal controls for e-timesheet approval by a manager/supervisor.

3. All staff, including the Executive Director, should keep timesheets.

4. To the extent possible, a board member should sign the Executive Director's timesheet to ensure that all paid leave is properly recorded and accounted.
Compliance Form Box: 1G

1G. Invoices

Expenses:

a. Expenses tested on invoices have supporting documentation: credit card charges and/or petty cash expenditures are all documented with an original receipt and reasonably tie to the cost allocation plan.

b. Contractor follows its policies for writing checks, credit card use, petty cash use, and/or reimbursement for expenses tested on invoices

c. Tested expenses on invoices appear to be reasonably associated with the program budget

If Units of service contract (usually DPH contracts only):

d. Units of service provided are documented and agree with invoices

If payments to subcontractors are included on invoices:

e. Subcontractor authorized by contract

f. Contractor paid its subcontractors’ invoices per the schedule established in the subcontracting agreement and/or prior to receiving City reimbursement for the services delivered

g. Subcontractor invoices show basis for work billed as performed (units of service, hours, reimbursable costs)
Supporting Documentation for Invoices

- Payroll register for the months selected
- Paystubs
- Time sheets for the staff of interest to verify time worked on the program
- Fringe benefit documentation (e.g., bills from Kaiser for health benefits plan)
- Operating expenses (e.g., items that are either integral to the program, like participant stipends, subcontractor expenses, or any expense that is over $1,000 in a particular month)
- Bank statements
- Cancelled checks
- Petty cash vouchers
- Credit card statements
- Itemized bill
- Units of service support (*usually DPH contracts only*) e.g., sign-in sheets, intake forms, etc.
Other Resources . . .

- **Controller’s website**: [http://www.sfgov.org/controller/nonprofits](http://www.sfgov.org/controller/nonprofits)
- **CompassPoint Workshops**: [http://www.compasspoint.org/workshopspage](http://www.compasspoint.org/workshopspage)
- **CompassPoint Consulting Services**: [http://www.compasspoint.org/consulting](http://www.compasspoint.org/consulting)
- **Nonprofit Finance Fund**: [http://www.nonprofitfinancefund.org](http://www.nonprofitfinancefund.org)
- "Financial Leadership for Nonprofit Executives" by Jeanne Bell and Elizabeth Schaffer
Next Steps . . .

What next steps will you take as a result of what you learned today?
Contact Information

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