



# COST ALLOCATIONS AND PROGRAM PROFITABILITY

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# Agenda

- 1 Learning objectives
- 2 3 allocation types
- 3 Case study & program strategic analysis
- 4 Conclusion



# Learning Objectives

- Identify different methods of allocating costs to programs to meet external and internal reporting needs
- Measure impact and profitability to identify the value of a program to an organization
- Discuss ideas on how to best incorporate program analysis into strategic decision making





## 3 Allocation Types

Functional, Indirect Rate, and Fully-Loaded

## 3 Allocation Types

How many of you utilize the following methods of cost allocation:

- ❖ Functional
- ❖ Indirect Cost Rate
- ❖ Fully-Loaded



# 3 Allocation Types



## FUNCTIONAL

- Required by accounting standards
- Included in audit and 990 and specifically identified on Guidestar
- Used by donors, charity watchdogs, etc.



## INDIRECT COST RATE

- Required for those with federal contracts
- Specific direction given through Uniform Grant Guidance
- Used by the Federal Government and tested in single audits



## FULLY-LOADED

- Optional
- Allocates all expenses to programs to identify true resource requirements
- Used for management and board decision-making



# 3 Allocation Types



## FUNCTIONAL

- Required by accounting standards
- Included in audit and 990 and specifically identified on Guidestar
- Used by donors, charity watchdogs, etc.

- All expenses are identified within three categories:
  - Program
  - Fundraising
  - Management and Administration
- IRS requires only that a nonprofit uses a reasonable basis for allocating expenses into these 3 categories
- Many organizations use employee time as a key driver of overhead cost allocation



# 3 Allocation Types



## INDIRECT COST RATE

- Required for those with federal contracts
- Specific direction given through Uniform Grant Guidance
- Used by the Federal Government and tested in single audits

- Used for cost reimbursable grants, contracts, and other agreements awarded by the Federal Government
- The purpose is to identify what proportion of indirect cost each program should bear
- The rate is a ratio between total indirect expenses and some direct cost base





# 3 Allocation Types



## FULLY-LOADED

- Optional
- Allocates all expenses to programs to identify true resource requirements
- Used for management and board decision-making

→ Theoretically assumes that a program cannot run without administrative and fundraising support; likewise it assumes that the administration and fundraising components would not exist other than for the support of programs

→ Allows management and boards to identify the “true” cost of each program in order to make more well-informed decisions about program expansion, contraction, elimination, or subsidies



## Discussion

For those of you that prepare a fully-loaded calculation, what method do you use to accomplish?



\*See Appendix A





# Case Study

Strategic Analysis

# Case Study – Strategic Analysis

## Activity

- Using the grid below analyze 3 to 5 of your current programs to determine which type of program they would be categorized as. Type of program can be found in the table on the slide following the grid.

## Discussion:

- How many organizations had the majority of their programs in each of the program types? Why do you think that is the case?
- How can you best use this tool in your organization?



# Case Study 2

Program	Impact (High or Low)	Profitable (Yes or No)	Type of Program (From table on next slide)
Program 1			
Program 2			
Program 3			
Program 4			
Program 5			



## Case Study 2 – Program Table

Impact (High or Low)	Profitable (Yes or No)	Type of Program
High Impact	Yes	Investing Program
Low Impact	Yes	Supporting Program
High Impact	No	Mission Program
Low Impact	No	Reevaluate Program



# Investing Program

- High impact
- Profitable
- Social enterprise model
- Should have high strategic importance as it's a mission related activity that can generate funds for future investment
- Strategy for programs in this category should be to invest and grow the program



# Supporting Program

- Low impact
- Profitable
- Common supporting programs are:
  - Fundraising
  - Endowments (spending)
  - Rents
  - Royalties
- Used to support mission programs or to grow investing programs
- Strategy is to grow profitability to support other programs





# Mission Program

- High impact
- Not Profitable
- These programs are important to the organization as they meet the mission
- Need to control losses on these types of programs
- Strategy is to mitigate losses to what your organization can afford
- Need to consider how much overhead the program absorbs. Could have strategic importance if it absorbs a large amount of general & administrative costs

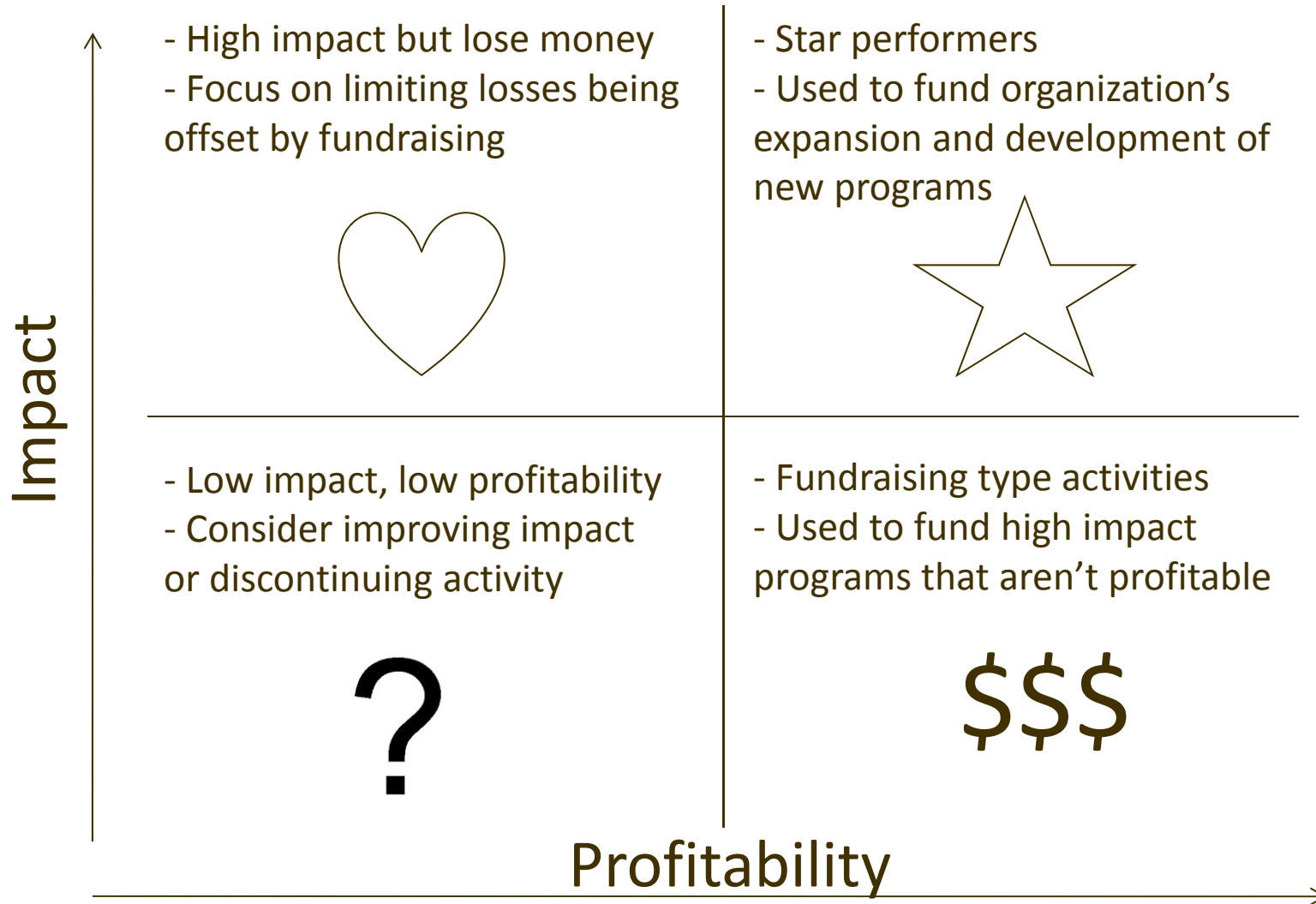


# Reevaluate Program

- Low impact
- Not Profitable
- Program needs to be reevaluated as it is losing money and not meeting the mission of the organization
- Often these are programs that were once investing or mission programs that have changed over time
- Strategies to consider are:
  - Elimination of program
  - Partnering with another organization
  - Changing scope to meet mission



# Analysis – Grid Format

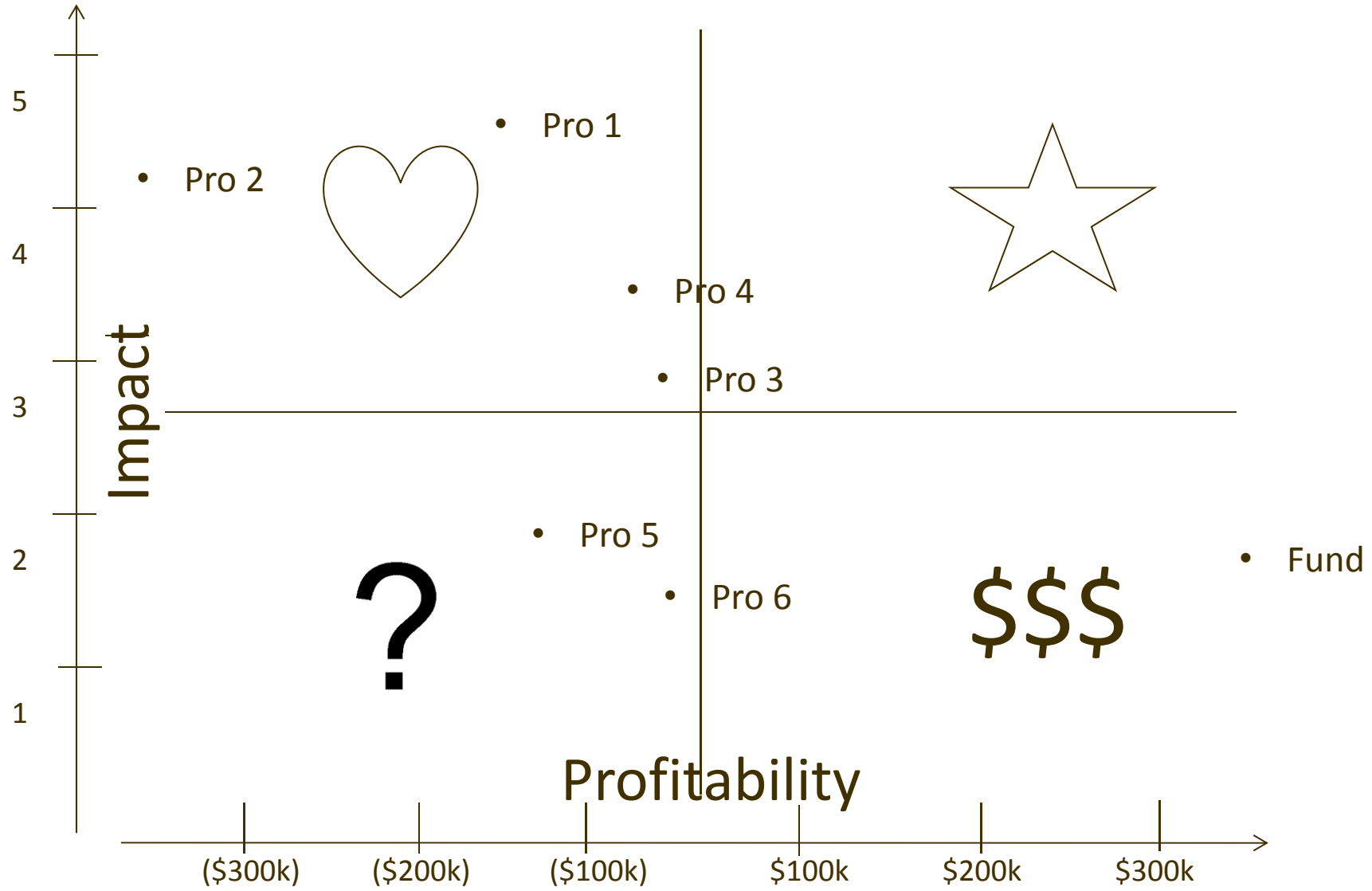


# Program Profitability

Sample Nonprofit Organization	Program 1	Program 2	Program 3	Program 4	Program 5	Program 6	Fundraising
<b>Income</b>	(631,844)	(756,936)	(36,065)	(17,365)	(275,455)	(48,288)	(515,324)
<b>Direct Expenses</b>	46,628	277,251	26,327	55,229	269,070	50,797	102,523
<b>Utilities</b>	105,157	125,976	6,002				
<b>Other Indirect Overhead</b>	122,866	147,190	7,013				
<b>Admin Payroll</b>	248,330	297,494	14,174	6,825	108,261	18,978	0
<b>Other Admin Overhead</b>	57,217	68,545	3,266	1,573	24,944	4,373	46,666
<b>(Profit) Loss before depreciation</b>	(51,645)	159,522	20,718	46,261	126,820	25,860	(366,135)
<b>Depreciation</b>	197,202	234,210	11,256	2,034			
<b>(Profit) Loss</b>	145,557	393,732	31,974	48,295	126,820	25,860	(366,135)



# Sample Grid

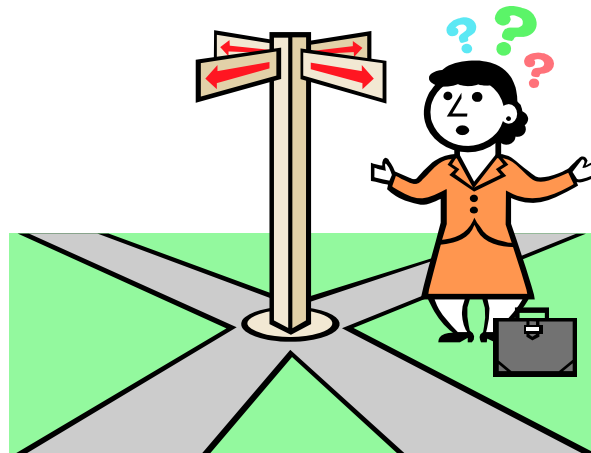


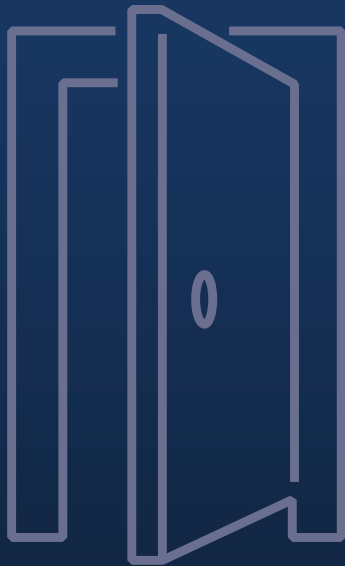


# Conclusion

# Conclusion

- Consider which allocation methodology best fits your organization for external and internal reporting purposes
- Implement or adjust cost allocations to understand the full costs of each of your programs/activities
- Utilize the strategic analysis grid to categorize your programs to determine the best strategic course for that program





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# Appendix A – Fully Loaded Cost Allocation

The ideal setup for completing and using a fully-loaded allocation at your organization includes:

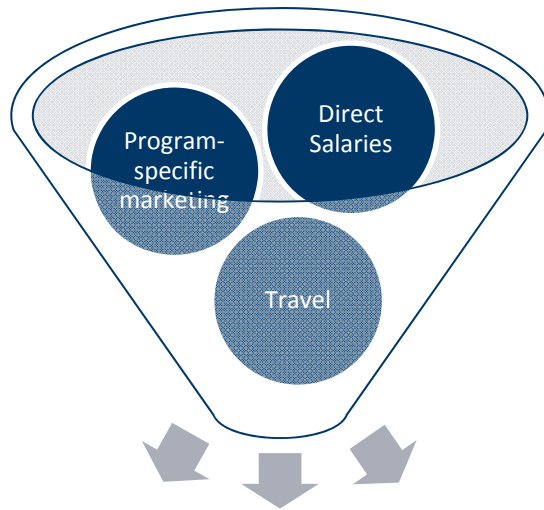
- Accounting and reporting system that delineates profit centers from the cost center(s)
- Ability to identify or estimate Management and Administrative staff time spent supporting each program
- Willingness by staff and board to evaluate financial results in new ways



# Appendix A – Fully Loaded Cost Allocation

## Step 1: Record Expenses

### Direct Expenses

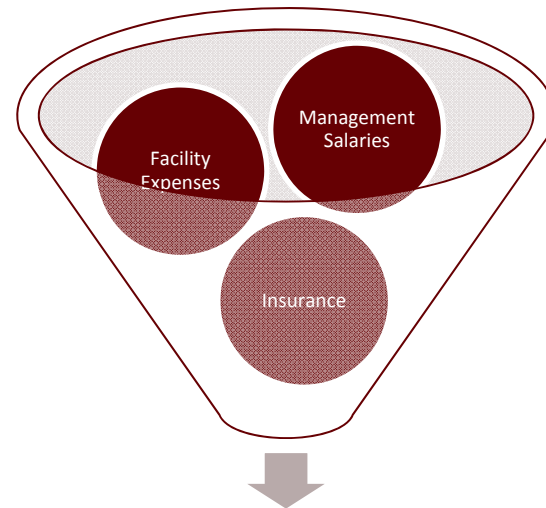


Program A

Program B

Program C

### Indirect Expenses



Management & Administration



# Appendix A – Fully Loaded Cost Allocation

## Step 2: Identify Allocation Methods

Staff Time

Square Footage

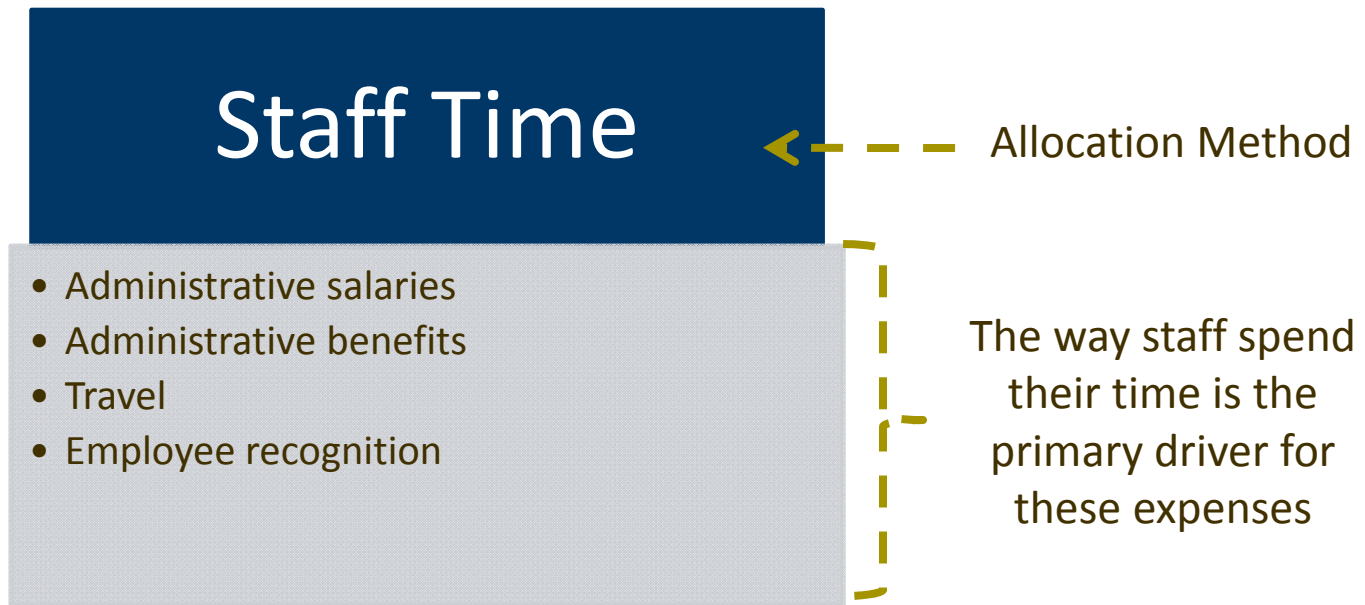
% Direct Expenses

← Multi-Step Allocations →



# Appendix A – Fully Loaded Cost Allocation

## Step 3: Determine Method for Each Expense



# Appendix A – Fully Loaded Cost Allocation

## Step 4: Apply Allocations to Indirect Expenses



# Appendix A – Fully Loaded Cost Allocation

## Step 5: Total and Report

- There are many options for how you can report the information
- Try to identify the most intuitive/logical reporting structure for your organization
- We recommend separating the direct and indirect expenses

