NEW JERSEY HUMAN SERVICES:
COST PRINCIPLES & ACCOUNTING FOR
ALLOCATION OF COSTS & INDIRECT/GENERAL
& ADMINISTRATIVE COSTS

Presented By:
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COST PRINCIPLES

State of New Jersey, Department of Human Services, Contract Reimbursement Manual (“CRM”)

Section 4 - Principles for Determining Costs (MUST read for allowability of Program Costs)
COST PRINCIPLES

Basic Elements of the Cost Principles:
- Reasonableness and Allocability (CRM Sect. 4.2)

Reasonableness - “A cost is reasonable if, in it is nature or amount, it does not exceed that which would be incurred by an ordinary prudent person….”

So who is this “prudent person”?
“The model of all legal behavior and always exercises due care.”

In addition CRM 4.2: “The action of the prudent person would take in the circumstances, considering responsibilities to the public at large, the government, provider agency employees, clients, shareholders or members, and the fulfillment of the purposes for which the provider agency was organized.”
COST PRINCIPLES

Allocability - A cost is allocable if:

1. Incurred for the contract

2. It benefits the contract & other non-contract activities & is distributed in a reasonable proportion to the benefits received.

3. Is necessary to the operation of the Agency.
Allowable Items of Cost:

- Compensation for Personal Services
  Charges to contracts, whether treated as direct or indirect costs, are determined and supported as required in this Section.

(Be careful about “accrued vacation pay” more than 52 weeks of compensation - cannot be charged to the contract)
COST PRINCIPLES

• **Incentive Compensation** - Allowable, but:

  ➢ Is part of overall compensation (Refer to Policy Circular P2.01-Section 5.16 “Salary Compensation Limitations”)

  ➢ Paid or accrued pursuant to:
    1. An agreement with the employee
    2. Established written plan
Support for Salaries and Wages:

- Reports reflecting the distribution of activity of each employee must be maintained for all staff members...whose compensation is charged, in whole or in part, directly to the contract. Reports maintained to satisfy these requirements must meet the following standards:
  - The reports must reflect an after-the-fact determination of the actual activity of each employee. *Budget estimates* (i.e., estimates determined before the services are performed) do not qualify as support for contract charges.
  - The reports must be prepared at least monthly and must coincide with one of more pay periods.
COST PRINCIPLES

Depreciation and use Allowances:
• For assets utilized in a NJ HS program, and had not been reimbursed by NJ HS (or any other governmental agency) as a contract charge. (Normally for a building).
• Use either depreciation or a use allowance.
• Depreciation:
  ➢ Useful life and straight line method is presumed (unless another method has been approved).
COST PRINCIPLES

• Depreciation:
  - If asset is fully depreciated and still in use, negotiate a use allowance with NJ HS.

• Use allowance:
  - Computed at an annual rate not exceeding two% of the acquisition cost for buildings and improvements.
  - Six and two-thirds % for equipment of the acquisition cost.
COST PRINCIPLES

• **Rental Costs** - “Rental costs under less-than-arm’s length leases are allowable only up to the amount that would be allowed had title to the property vested in the provider agency.”

• **Unallowable Items of Cost (Section 4.7 of CRM)**
Unallowable as a direct cost and as a Indirect/General & Administrative Cost.
COST PRINCIPLES

So how to make sure that you adhere to the requirements of Contract Reimbursement Manual?

Have someone, either on the program side or in the accounting department, that is well versed in the CRM and that person signs off on the allowability of contract expenditures.
THE DOWNFALL OF MOST ALLOCATION PLANS IS?
ALLOCATION OF COSTS

USING THE ALLOCATION BASES/PERCENTAGES THAT WERE SPECIFIED IN THE BUDGET!!

THAT WAS AN ESTIMATE!!!!

NOT AFTER-THE-FACT DOCUMENTATION
70%
DIRECT COSTS TO BE ALLOCATED

- Costs that traditionally require special accounting methodology and associated adequate supporting documentation:
  - Personnel Costs:
    - Salaries and Wages (BIGGEST problem)
    - Fringe benefits (Usually based on % of S&W)
  - Non-Personnel Costs:
    - Facility Costs
    - Other non-personnel costs (not assigned to the indirect/general and administrative cost pool)
DIRECT COSTS TO BE ALLOCATED

For all costs to be allocated, the Agency should have a written plan that specifies the methodology utilized in the allocation of the costs for each cost to be allocated. So for instance, as an example, i.e.:

- Salaries and wages are allocated based upon time sheets prepared for each employee which specify the hours worked by activity for each day during the payroll period.
- Rent and other facility costs are allocated upon the square footage attributable to each program’s activity and the space occupied by employee.
SUPPORT FOR ALLOCATIONS

- Why do we need to support the allocations?
  - “Necessary and reasonable”
  - “Allocable to the award”
  - “Actually incurred”
SUPPORT FOR ALLOCATIONS

No matter what allocation methodology that you utilize, the first thing you should do is prepare a written document that delineates/explains the various methods the agency has in place to allocate costs. This document would contain, as a minimum, what is the basis of allocation for:

1. Salaries and wages and fringe benefits.
2. Non-personnel costs.

This document will become a permanent part of your accounting procedures and would only be updated at such a point when an allocation basis would change.
Support for Salaries and Wages:

• Reports reflecting the distribution of activity of each employee **must** be maintained for all staff members...whose compensation is charged, in whole or in part, directly to the contract. Reports maintained to satisfy these requirements must meet the following standards:
  
  ▪ The reports must reflect an after-the-fact determination of the actual activity of each employee. **Budget estimates** (i.e., estimates determined before the services are performed) **do not qualify as support for contract charges**.
  
  ▪ The reports **must** be prepared at least monthly and **must** coincide with one of more pay periods.
Why so much emphasis of the allocation and support for salaries and wages?

- In most instances the largest $$$$$$.
- Basis of other allocations (fringe benefits and many non-personnel costs).
- Based upon experience the area most entities do not “adequately document.”
Allocations within and without the NJ HS contract must adhere to Contract Reimbursement Manual.

Employees that are generally considered administrative personnel, those salaries generally are 100% classified as General and Administrative ("G&A") expenses.

Can a G&A employee have a direct cost for salaries and wages? Maybe, but it has to be documented on the time record the direct service performed. (For example the G&A employee performed a “direct program service” and not in a supervisory or administrative role).
You could for example:

1. If the individual is a Program Coordinator or Manager then you could use the number of clients for each program as a % of the total clients served.

2. If the number of clients does not work for a reasonable allocation then you could use the total direct salaries for the various programs.
SALARIES AND WAGES - ALLOCATION

So how do we start, prepare the following:

• Prepare a written document that explains how you are allocating salaries and wages. What employees will satisfy the requirement by time and effort reporting on a time sheet, and what employees are allocated on some other basis (these are the employees that have one job function but they are allocated to two or more activities, therefore they cannot delineate their time on a time sheet, need to determine another method of allocation).

• Prepare a “Employee Designation Schedule” on each employee to determine if they need to have a document to support the allocation of their salary. (See next page for a suggested format).

• Then have employees who need to have their time allocated prepare a time sheet that designates hours worked by each program activity.
# Salaries and Wages - Allocation

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<th>Job Position</th>
<th>G&amp;A Employee</th>
<th>Fulltime</th>
<th>Part-Time</th>
<th>Not Allocated</th>
<th>Allocated - Time Sheet</th>
<th>Allocated - Other Basis</th>
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<td>Jill Lang</td>
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### Sample Time Sheet

**Employee:** James Friendly  
**Time and Effort Reporting - 9/1/11 to 9/15/11**

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**Summary**

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<td>Vacation</td>
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<tr>
<td></td>
<td>104</td>
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</tbody>
</table>

Employee Signature_________________________  Supervisory Signature_________________________
So what is the allocation % for James Friendly?

Is it based upon the 104 hours or not?
SALARIES AND WAGES - ALLOCATION

No, it is based upon 88 hours (45 + 43). The vacation and holiday do not factor in on the computation (allocations are based upon hours worked). Therefore, 51% (45/88) of the salaries and wages for this pay period will be allocated to DAS and 49% (43/88) to Project Mobile.

What happens if James was on vacation for a whole pay period, how do we allocate the salaries for that pay period?
The allocation for that pay period should be based upon the average allocation of prior pay periods.
So what about those employees that need to be allocated, but due to their job position (they only perform one job function), however their salaries are allocated to different activates and their salary is therefore paid out of two different grants or contracts.

- One method to allocate is after all employee salaries that are directly 100% chargeable & employee salaries that were allocated by the time & effort reporting, then allocate the remaining employee(s) based upon the percentage of salaries for each activity to the total of all salaries and wages. (This would not include G&A salaries).
What about other allocation methods:

• You could use the number of clients for a particular program activity as a % of the total clients served for all program services.

(Just make sure than the units of service are comparable between the programs. If one unit of service for a program is a daily encounter and the other unit of service is by hours provided, then the units would not be appropriate, since the service delivery in hours would/could be drastically different).
Final thought
What if the Agency utilizes an electronic timekeeping system. Is this adequate?

Probably not, since it would only track/record the employee coming to work, taking a break from work and going to lunch, and then leaving at the end of the day. It would not reflect the hours worked on more than one program/project. Therefore, for all employees that need to document his or her time on a particular activity/project they would have to prepare a written paper time sheet to record their hours for each program/project.
SALARIES AND WAGES - ALLOCATION

As a tip of advice, for those Not-For-Profits, if you receive Federal grants/contracts (either directly or as a pass-through), you must still have adequate time and effort reporting. This is a requirement of Office of Management and Budget Circular A-122, Attachment B, Item 8, Section M, which has the exact documentation requirements as the Contract Reimbursement Manual.
OTHER DIRECT COST ALLOCATIONS

• All non-personnel costs that can be charged directly to a program, project or activity will be charged so.

• After the above there generally will be non-personnel costs that are still open and need to be accounted for. These non-personnel costs should fall into two categories:
  1. Program costs
  2. General and Administrative Costs (G&A)
OTHER DIRECT COST ALLOCATIONS

For program costs that are not charged directly to a program, project or activity you will then have to determine the most reasonable basis to allocate. Whatever basis you need to document in the written plan previously discussed. One method to allocate these remaining direct program costs would utilize, as a basis, the salaries and wages already recorded to each program, project or activity as a percentage of total direct salaries and wages. This method is the most widely utilized/recognized acceptable allocation methodology.
OTHER DIRECT COST ALLOCATIONS

This method would follow the following accounting for salaries and wages (S&W) for each program, project or activity:

1. All direct employee S&W charged 100%.
2. All allocated S&W based upon a time sheet (or other allocation basis) that delineates that employees time and effort.

After the above is completed you would take the total of the S&W for each program/activity as a percentage of the total salaries and wages. Those percentages would then be applied to each non-personnel cost to be allocated.
Facility Costs - most times based upon square footage.

Remember the “common areas” are included in the square footage allocation. (Based upon the previously calculated allocated amount).

Allocation of facility costs based upon FTE. Be careful, may not be an appropriate basis of allocation. (Does each employee occupy the same square footage office space?)
OTHER DIRECT COST ALLOCATIONS

• **Other allocation bases:**
  - *Clients Served* - be cognizant of comparability of “service hours” for all services provided.
  - *Number of computer keystrokes.*
  - *Food costs* - number of meals served.
Why do we have Indirect/General & Administrative ("G&A") costs?

- Not practical or almost impossible to allocate direct costs.
- Federal, State or Local governments normally require it.
- Management needs to understand how much G&A they incur in operating their program services. (Many governmental agencies, potential donors, etc. look to this G&A rate as a barometer of how an agency expends "public dollars").
The requirements related to General & Administrative Expenses (G&A) are delineated in the NJ HS Contract Reimbursement Manual (CRM), Section 4.3 under the heading **Indirect Costs**. (In regard to this accounting for costs, G&A and Indirect Costs are interchangeable terminologies).
Some Key points in the CRM are:

- “An indirect cost is one which, because of its incurrence for common or joint objectives, is not readily subject to treatment as a direct cost.”
- “The overall objective is to allocate the indirect costs of the provider agency to its major activities or cost objectives in a reasonable proportion to the benefits provided.”
- “Indirect costs shall be accumulated by logical cost groupings with due consideration accorded to the reasons for incurring costs.”
Some Key points in the CRM are (Cont.):

- “When reporting costs, the provider agency must meet the following minimum requirements”:
  1. “The statistical base used to allocate each cost center must measure as accurately as possible the service rendered by that center to other cost centers.”
  2. “The statistics used must be auditable and maintained on a continuous basis.”
- “Both the direct costs and indirect costs shall exclude capital expenditures and unallowable costs.”
  (Remember to include unallowable costs on your Report of Expenditures as a cost activity.)
Some Key points in the CRM are (Cont.):

- “The distribution base may be total direct costs (excluding capital expenditures), direct salaries, or other base which results in an equitable distribution.”
The allocation of G&A expenses on NJ HS’s contract:

- G&A should capture all the G&A expenses of the Agency, not just the G&A of the program.
- If management personnel, normally 100% in G&A, performs direct service, then that portion of their compensation should be directly charged to the program’s direct expenses. (Time sheet must reflect the hours attributable to that direct service.)
- You should have a written plan as to how the G&A was derived and the plan basis.
When allocating G&A expenses, allocation could be based upon:

1. Total direct salaries and wages for each activity as a % of total direct salaries and wages costs for all activities (Including all funded NJ HS programs, non-funded programs [“Unallowable], fund raising, etc.).

2. Total Direct Costs. This would include ALL the total direct costs for each activity as a % of total direct costs for all activities, exclusive of equipment/renovations costs.
How does an entity start to prepare their G&A/indirect costs calculation?

- General ledger needs to capture General and Administrative costs.

- Analysis of G&A costs to determine if the costs contain any “unallowable costs” per the CRM regulations. (Cannot “back door” unallowable costs.)

- Make sure that all of the operations of the entity receive their fair share of the indirect costs.
**GENERAL AND ADMINISTRATIVE EXPENSES**

- **Determine what the G&A/indirect cost base will be.**
  - Salaries and Wages
  - Total direct costs, exclusive of equipment/renovations.

- **Prepare a calculation.**
Other “Tips of Advice”: 

1. Prepare a written document that explains the process and the methodologies the entity utilizes in the allocation of costs. (This would include how each type of cost is allocated, the basis of the allocation and the appropriate support.)

2. Meet with staff that will be involved and/or affected by the allocation of cost. May be necessary to explain to certain staff why that individual needs to prepare a “more detailed” time sheet, as opposed to another employee who does not have to delineate his or her time.
CONTACT INFORMATION

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