

**Do You Know What  
Your REAL Costs Are?**



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**Why Cost Accounting?**

- You can't manage without costing
- Keep costs aligned with strategic plan
- Maintain improved consistency for measurement purposes
- Aid in satisfying grant obligations

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**Cost and Cost Concepts**

- Cost object – Any item or purpose for which costs need to be measured
- Direct cost – A cost that can be clearly identified with a single cost object
- Indirect cost – A cost that cannot be clearly identified with a single cost object

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## Cost and Cost Concepts



- Common cost – A cost related to two or more cost objects
- Joint cost – A cost related to two or more cost objects

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## Cost Accounting Terms



- Cost recording – Entering the cost in the accounts
- Cost accumulation – Collecting all costs of a specific activity
- Cost assignment – Tracing direct costs to a cost object or purpose
- Cost allocation – Relating indirect costs to cost objects or purposes

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## External Financial Reporting Costs



- Expense
- Functional expense
- Loss
- Natural expense
- Product cost
- Period cost

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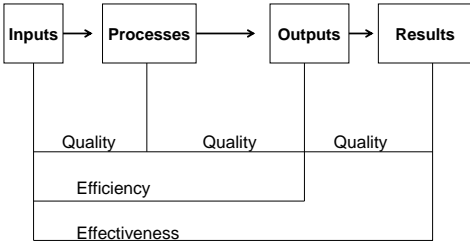
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## Service Efforts and Accomplishments Framework



Service Efforts                      Service Accomplishments



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## Costs of Activities



*Can be used to*

- Establish accountability by organizational element
- Reports on activities, processes, or organizational elements
- Compare budget to actual expenses

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## Costs of Activities



*Do not show*

- Costs of outputs
- Efficiency
- Effectiveness

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## Functional Expense Reporting



- Program services
- Supporting services
  - Management and general
  - Fund-raising
  - Membership development

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## Cost Allocation Criteria



3-2

- Cause and effect
- Benefits received
- Equity
- Ability to bear

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## Allocation Methods



3-3

- Stand-alone method
- Relative sales value (direct cost) method
- Physical units method

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3-5

## Direct Cost Method

Cost Objective	Total Direct Costs	Relative Share	Indirect Costs	Allocated Costs	Total Costs
Activity A:	2,500,000	$\frac{2,500}{3,000}$	x 750,000	= \$625,000	3,125,000
Activity B:	300,000	$\frac{300}{3,000}$	x 750,000	= 75,000	375,000
Activity C:	<u>200,000</u>	$\frac{200}{3,000}$	x 750,000	= <u>50,000</u>	<u>250,000</u>
	<b>\$3,000,000</b>			<b>\$750,000</b>	<b>\$3,750,000</b>

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3-6

## Cost Determination

- Reason(s) for cost information
- Cost objects or purposes
- Types of relevant costs
- Assign direct costs to cost objects
- Select allocation base(s) or cost drivers
- Allocate indirect costs
- Ensure appropriateness

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3-7

## Single Stage Allocation

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    graph LR
      subgraph Natural_Expense [Natural Expense]
        Labor[Labor]
        Rent[Rent]
      end
      subgraph Cost_Driver [Labor Hours Cost Driver]
        LHD[Labor Hours Cost Driver]
      end
      subgraph Purpose [Purpose]
        A[A]
        B[B]
        C[C]
      end
      Labor --> LHD
      Rent -.-> LHD
      LHD --> A
      LHD --> B
      LHD --> C
      CA[Cost Assignment Allocation] -.-> LHD
      style CA fill:none,stroke:none
  
```

Cost Assignment Allocation (Based on Labor Hours)

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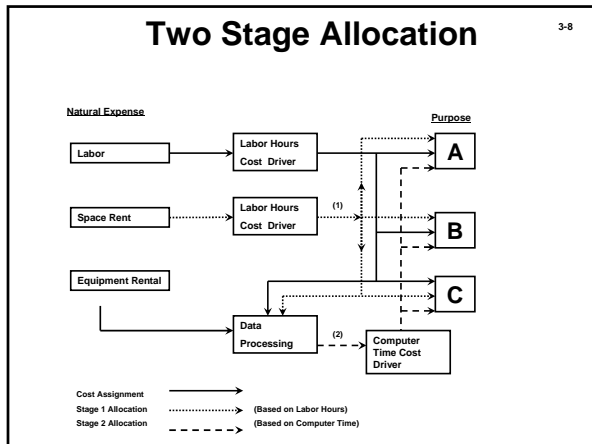
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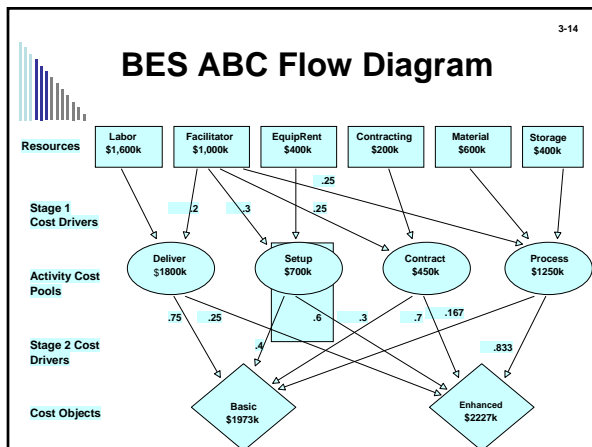
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### Functional Expense Reporting

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- Voluntary health and welfare organizations
  - Functional expenses
  - Natural expenses
  - Relationships between natural and functional expenses
- Other not-for-profit organizations
  - Functional expenses

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5-1

## SOP 98-2 Guidance

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- **Key terms:**
  - Joint activity
  - Joint costs
  - Costs of joint activities

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5-2

## Major Provisions

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- **Purpose criterion**
- **Audience criterion**
- **Content criterion**

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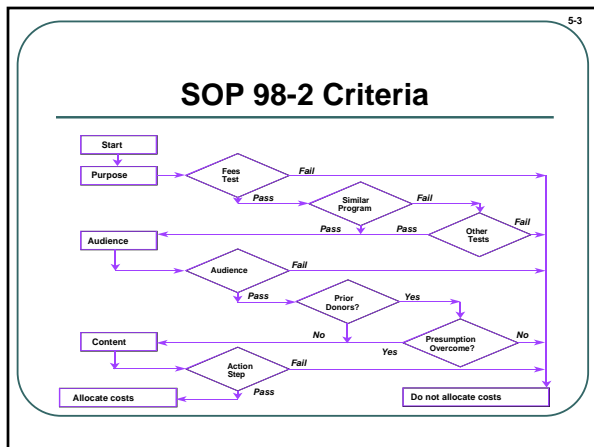
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5-4

### Information Packet for Direct Mail Campaign by Hypothetical Organization

<p><b>Letter Front</b></p> <table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td style="padding: 2px;">A 2 lines</td><td style="padding: 2px;">M&amp;G</td></tr> <tr><td style="padding: 2px;">B 21 lines</td><td style="padding: 2px;">Program</td></tr> <tr><td style="padding: 2px;">C 2 lines</td><td style="padding: 2px;">Agency</td></tr> <tr><td style="padding: 2px;">D 15 lines</td><td style="padding: 2px;">Program</td></tr> </table> <table border="1" style="width: 100%; border-collapse: collapse; margin-top: 5px;"> <tr><td style="padding: 2px;">1 Letter/Postcard Congressman</td></tr> <tr><td style="padding: 2px;">Program 5 Lines</td></tr> </table> <p style="text-align: center;">Total Lines = 45</p>	A 2 lines	M&G	B 21 lines	Program	C 2 lines	Agency	D 15 lines	Program	1 Letter/Postcard Congressman	Program 5 Lines	<p><b>Letter Back</b></p> <table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td style="padding: 2px;">E 8 Lines</td><td style="padding: 2px;">Program</td></tr> <tr><td style="padding: 2px;">F 4 Lines</td><td style="padding: 2px;">Agency</td></tr> <tr><td style="padding: 2px;">G 18 Lines</td><td style="padding: 2px;">Fund-raising</td></tr> <tr><td style="padding: 2px;">H 10 Lines</td><td style="padding: 2px;">Fund-raising</td></tr> </table> <table border="1" style="width: 100%; border-collapse: collapse; margin-top: 5px;"> <tr><td style="padding: 2px;">J Reply Envelope</td></tr> <tr><td style="padding: 2px;">Fund-raising</td></tr> </table> <table border="1" style="width: 100%; border-collapse: collapse; margin-top: 5px;"> <tr><td style="padding: 2px;">K Carrier Envelope</td></tr> <tr><td style="padding: 2px;">Joint Cost</td></tr> </table> <p style="text-align: center;">Total Lines = 40</p>	E 8 Lines	Program	F 4 Lines	Agency	G 18 Lines	Fund-raising	H 10 Lines	Fund-raising	J Reply Envelope	Fund-raising	K Carrier Envelope	Joint Cost
A 2 lines	M&G																						
B 21 lines	Program																						
C 2 lines	Agency																						
D 15 lines	Program																						
1 Letter/Postcard Congressman																							
Program 5 Lines																							
E 8 Lines	Program																						
F 4 Lines	Agency																						
G 18 Lines	Fund-raising																						
H 10 Lines	Fund-raising																						
J Reply Envelope																							
Fund-raising																							
K Carrier Envelope																							
Joint Cost																							

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6-1a

### Cost Allocation Do's

- Use a consistent method
- Charge as direct costs all expenses that can possibly be identified with specific activities. Reduce the pool of indirect costs as much as possible
- Maintain contemporaneous time records

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6-1b

### Cost Allocation Do's

- Use floor plans and leases for square-footage allocations
- Keep all work sheets and records used to develop cost allocations

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## Cost Allocation Do's 6-1c

- **Allocate appropriate expenses such as**
  - Interest expense on general purpose borrowing
  - Board of directors meeting expenses
  - Legal and accounting fees
  - Other consultant fees
  - Licenses and taxes

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## Cost Allocation Don'ts 6-2a

- **Allocate on ratio of gross income under most circumstances**
- **Allocate membership development/fund-raising costs**
- **Allocate legislative or lobbying costs**

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## Cost Allocation Don'ts 6-2b

- **Tie your future to an allocation method you would not want to see described in your local paper**

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## Allowable Costs

- ❑ Reasonable and allocable
- ❑ Conform to any limitations or exclusions
- ❑ Consistent with policies and procedures
- ❑ Accorded consistent treatment
- ❑ Determined in accordance with Generally Accepted Accounting Principles
- ❑ Not included as a cost or used to meet cost sharing or matching requirements
- ❑ Adequately documented

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## Allocable Costs

- ❑ Treated consistently with other costs incurred for the same purpose in like circumstances and
  - Is incurred specifically for the award
  - Benefits both the award and other work
  - Is necessary to the overall operation of the organization

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## Summary

- ❑ No costing = incorrect financials
- ❑ Service Sector must use costing to identify where costs are utilized
- ❑ Use common sense
- ❑ Use objective criteria
- ❑ Keep it simple

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