Real Costs ➔ Realistic Strategies
Calculating, Analyzing, & Communicating the Full Cost of Your Programs
WCSAP Webinar

March 16, 2016

Discussion Leader: Kay Sohl

Kay Sohl Consulting
Training and Consulting Services
Housekeeping

- Webinar is being recorded
- The slides and recording of this webinar will be sent to all registrants 24-48 hours after the webinar
- Phones are currently muted
- Need Technical Help?

- We will be taking questions throughout the webinar as well as at the end.
- Please type your question in to the chat column on the left-hand side of your screen.
- Please note your organization name and the city in which you are located.

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Discussion Leader

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kay@kaysohlconsulting.net

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Why Overhead?

- Understanding how to allocate shared costs allows you to manage allocations to maximize recovery of the full costs from funders.

- Understanding “fully loaded” costs of various activities gives you the financial info you need for strategic decision-making.
Why now?

• OMB Uniform Guidance creates new opportunities for nonprofits to recover their administrative/overhead costs in contracts with state, local, & federal government

• National conversation about Starvation Cycle and new support for nonprofit sustainability

• Need to counteract the influence of the online charity raters which rely heavily on “overhead rates” as a proxy for excellence

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How do you decide between a Starbucks latte and a latte from a local café?
The myth about nonprofit overhead

• Overhead rates are a good indicator of whether a nonprofit is effective

• Lower overhead = good nonprofit

• Higher overhead = bad nonprofit

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The myth about nonprofit overhead

- Overhead rates are a good indicator of whether a nonprofit is effective.
  - Lower overhead = good nonprofit
  - Higher overhead = bad nonprofit
Must Know Real Costs

• Set prices
• Choose mix of products
• Pick locations
• Evaluate future investments
Why does it matter what a program really costs?

- Key factor in setting “price”
- If market price is lower than actual cost, must find subsidy to close the gap
- If no source to close the gap between price we are paid and full cost of providing services, nonprofit dies
Closing the gap between full costs and price…

• Funders and donors
• Third-party payers
• Low wage staff
• Clients and communities
• Customers willing to pay more than cost
Real Costs ➔ Realistic Strategies

- Determining the **full cost** of providing services allows:
  - Clarity for *decision-making*
  - Investment in *infrastructure*
  - Reality-based *communications*
Language Reality

We (nonprofits, funders, others):

• Call the **same costs by different names**
• Call **different costs by the same name**
• **Confuse & deceive** ourselves and others
Confusion of Terms

Which *one* of the following terms would you consider the closest in meaning to “*indirect costs*”?

<table>
<thead>
<tr>
<th></th>
<th>Grantmakers</th>
<th>Nonprofit Organizations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overhead</td>
<td>58%</td>
<td>37%</td>
</tr>
<tr>
<td>Supporting Costs (Contrasted with Program Costs)</td>
<td>21%</td>
<td>25%</td>
</tr>
<tr>
<td>Administrative Costs</td>
<td>16%</td>
<td>26%</td>
</tr>
<tr>
<td>Joint or Shared Costs</td>
<td>5%</td>
<td>17%</td>
</tr>
</tbody>
</table>
Frameworks for expenses:

- **Form 990**: program, management & general, fundraising
- **Direct costs and indirect costs**
- **Direct program costs, shared costs, admin costs and fundraising costs**
Form 990 classification of expenses:

- Program
- Management & General
- Fundraising

---

<table>
<thead>
<tr>
<th></th>
<th>Total expenses</th>
<th>Program service expenses</th>
<th>Management and general expenses</th>
<th>Fundraising expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Grants and other assistance to domestic organizations and domestic governments. See Part IV, line 21</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Grants and other assistance to domestic individuals. See Part IV, line 22</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Grants and other assistance to foreign organizations, foreign governments, and foreign</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Direct Costs & Indirect Costs

Directly associated with a function

- Lunches for the senior lunch program
- Tree scientist for tree planting program

Not directly associated with a function

- Benefits more than one function
- A fair share needs to be allocated to each function

- Rent
- IT expenses
- Audit costs
Both Direct & Indirect Costs are legitimate components of:

- Administrative functions
- Fundraising functions
- Program functions
Administrative Functions

- Board support
- Financial management
- HR management
- IT management
Administrative Costs

Both **direct & indirect** costs of performing administrative functions:

- Admin costs that benefit whole agency function as **indirect** costs

- Administrative costs that benefit a single cost objective may be treated as **direct costs** *(program management costs)*
Fundraising Functions

• Preparing & making unsolicited requests for contributions
• Soliciting donors, businesses, foundations
• Generally does not include submitting requests to government
Fundraising Costs

• **Direct Costs:** cost directly associated with soliciting contributions &

• **Shared Costs:** costs associated with performing multiple functions for which the benefit to fund raising efforts must be estimated through allocation
Program Functions

Providing services or activities designed to achieve your mission

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Program Costs

- **Direct Costs**: cost directly associated with delivering a program

- **Shared Costs**: costs associated with performing multiple functions for which the benefit to a specific program must be estimated through allocation
Differing Definitions of Overhead Costs

• Agency-wide administration
• Agency-wide administration plus facilities and other shared costs
• Any cost that cannot be directly attributed to delivery of a specific service
Real Costs = Full Costs

Direct costs
+ Fair allocation of shared costs
+ Fair allocation of admin costs

= Full Cost
### Exhibit 1

**Organization A - Shared cost rate of 7.1%**

<table>
<thead>
<tr>
<th>Programs</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>Admin.</th>
<th>Shared</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Expenses:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and wages</td>
<td>$100,000</td>
<td>140,000</td>
<td>70,000</td>
<td>30,000</td>
<td>20,000</td>
<td>360,000</td>
</tr>
<tr>
<td>Employee benefits</td>
<td>15,000</td>
<td>21,000</td>
<td>10,500</td>
<td>4,500</td>
<td>3,000</td>
<td>54,000</td>
</tr>
<tr>
<td>Materials and supplies</td>
<td>5,000</td>
<td>9,000</td>
<td>5,000</td>
<td>1,000</td>
<td>-</td>
<td>20,000</td>
</tr>
<tr>
<td>Postage and shipping</td>
<td>1,000</td>
<td>2,000</td>
<td>1,000</td>
<td>1,000</td>
<td>5,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Printing and publications</td>
<td>2,000</td>
<td>1,500</td>
<td>1,000</td>
<td>500</td>
<td>5,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Occupancy</td>
<td>12,000</td>
<td>11,000</td>
<td>10,000</td>
<td>10,000</td>
<td>-</td>
<td>43,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>500</td>
<td>200</td>
<td>500</td>
<td>1,800</td>
<td>-</td>
<td>3,000</td>
</tr>
<tr>
<td><strong>Total direct expenses</strong></td>
<td>135,500</td>
<td>184,700</td>
<td>98,000</td>
<td>48,800</td>
<td>33,000</td>
<td>500,000</td>
</tr>
<tr>
<td><strong>Allocation of shared costs</strong></td>
<td>9,574</td>
<td>13,051</td>
<td>6,925</td>
<td>3,450</td>
<td>(33,000)</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$145,074</td>
<td>197,751</td>
<td>104,925</td>
<td>52,250</td>
<td>-</td>
<td>500,000</td>
</tr>
</tbody>
</table>

1. The effective shared cost rate = .071 [(33,000)/(500,000 - 33,000)].
2. The administrative rate = 11.6 [(52,250)/(500,000 - 52,250)].
3. Shared costs are allocated by applying the shared cost rate (7.1%) to each cost center's total direct expenses. e.g., Program A: 7.1% x $135,500 = $9,574.
### Organization B - Shared cost rate of 39.45%

<table>
<thead>
<tr>
<th>Programs</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>Admin.</th>
<th>Shared</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and wages</td>
<td>$88,000</td>
<td>115,000</td>
<td>64,000</td>
<td>30,000</td>
<td>63,000</td>
<td>360,000</td>
</tr>
<tr>
<td>Employee benefits</td>
<td>13,200</td>
<td>17,250</td>
<td>9,600</td>
<td>4,500</td>
<td>9,450</td>
<td>54,000</td>
</tr>
<tr>
<td>Materials and supplies</td>
<td>2,500</td>
<td>9,500</td>
<td>500</td>
<td>1,000</td>
<td>6,500</td>
<td>20,000</td>
</tr>
<tr>
<td>Postage and shipping</td>
<td>500</td>
<td>100</td>
<td>400</td>
<td>1,000</td>
<td>8,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Printing and publications</td>
<td>400</td>
<td>500</td>
<td>100</td>
<td>500</td>
<td>8,500</td>
<td>10,000</td>
</tr>
<tr>
<td>Occupancy</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>43,000</td>
<td>43,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>3,000</td>
<td>3,000</td>
</tr>
<tr>
<td>Total direct expenses</td>
<td>104,600</td>
<td>142,350</td>
<td>74,600</td>
<td>37,000</td>
<td>141,450</td>
<td>500,000</td>
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<tr>
<td>Allocation of shared costs</td>
<td>41,265</td>
<td>56,157</td>
<td>29,430</td>
<td>14,599</td>
<td>(141,450)</td>
<td>–</td>
</tr>
</tbody>
</table>

$145,865                     | 198,507    | 104,030    | 51,599     | –          | 500,000    |

1. The effective shared cost rate = 39.45%  
   [($141,450/($500,000 - $141,450)].
2. The administrative rate = 11.51%  
   [($51,599/($500,000 - 51599)].
3. Shared costs are allocated by applying the shared cost rate (39.45%) to each cost center’s total direct expenses  
   e.g., Program A: 39.45% x $104,600 = $41,265
### Organization C - Shared cost rate of 0%

<table>
<thead>
<tr>
<th>Programs</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>Admin.</th>
<th>Shared</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Expenses:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and wages</td>
<td>$100,000</td>
<td>140,000</td>
<td>80,000</td>
<td>40,000</td>
<td>40,000</td>
<td>360,000</td>
</tr>
<tr>
<td>Employee benefits</td>
<td>15,000</td>
<td>21,000</td>
<td>12,000</td>
<td>6,000</td>
<td>6,000</td>
<td>54,000</td>
</tr>
<tr>
<td>Materials and supplies</td>
<td>5,000</td>
<td>9,000</td>
<td>5,000</td>
<td>1,000</td>
<td>1,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Postage and shipping</td>
<td>2,000</td>
<td>3,000</td>
<td>2,000</td>
<td>3,000</td>
<td>3,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Printing and publications</td>
<td>3,000</td>
<td>2,500</td>
<td>3,000</td>
<td>1,500</td>
<td>1,500</td>
<td>10,000</td>
</tr>
<tr>
<td>Occupancy</td>
<td>12,000</td>
<td>11,000</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
<td>43,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>500</td>
<td>200</td>
<td>500</td>
<td>1,800</td>
<td>1,800</td>
<td>3,000</td>
</tr>
<tr>
<td><strong>Total direct expenses</strong></td>
<td>137,500</td>
<td>186,700</td>
<td>112,500</td>
<td>63,300</td>
<td>63,300</td>
<td>500,000</td>
</tr>
</tbody>
</table>

Allocation of shared costs

<table>
<thead>
<tr>
<th>Programs</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>Admin.</th>
<th>Shared</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>137,500</td>
<td>186,700</td>
<td>112,500</td>
<td>63,300</td>
<td>63,300</td>
<td>500,000</td>
</tr>
</tbody>
</table>

1. The shared cost rate = 0%. No shared cost allocation mechanism is used; all expenses are charged directly.
2. The administrative rate = 14.5% \([\$63,000/(\$500,000-63,000)]\).
### Exhibit 4

**Organization A - Combined Shared and Administrative Cost Rate of 19.56% of Direct Costs**

<table>
<thead>
<tr>
<th>Expenses</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>Admin.</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries and wages</td>
<td>$100,000</td>
<td>140,000</td>
<td>70,000</td>
<td>50,000</td>
<td>360,000</td>
</tr>
<tr>
<td>Employee benefits</td>
<td>15,000</td>
<td>21,000</td>
<td>10,500</td>
<td>7,500</td>
<td>54,000</td>
</tr>
<tr>
<td>Materials and supplies</td>
<td>5,000</td>
<td>9,000</td>
<td>5,000</td>
<td>1,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Postage and shipping</td>
<td>1,000</td>
<td>2,000</td>
<td>1,000</td>
<td>6,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Printing and publications</td>
<td>2,000</td>
<td>1,500</td>
<td>1,000</td>
<td>5,500</td>
<td>10,000</td>
</tr>
<tr>
<td>Occupancy</td>
<td>12,000</td>
<td>11,000</td>
<td>10,000</td>
<td>10,000</td>
<td>43,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>500</td>
<td>200</td>
<td>500</td>
<td>1,800</td>
<td>3,000</td>
</tr>
<tr>
<td><strong>Total direct expenses</strong></td>
<td>135,500</td>
<td>184,700</td>
<td>98,000</td>
<td>81,800</td>
<td>500,000</td>
</tr>
<tr>
<td>Allocated shared &amp; admin costs</td>
<td>26,504</td>
<td>36,127</td>
<td>19,169</td>
<td>(81,800)</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$162,004</td>
<td>220,827</td>
<td>117,169</td>
<td>-</td>
<td>500,000</td>
</tr>
</tbody>
</table>

1. The effective combined shared and administrative cost rate = 19.56% \([81,800/(500,000 - 81,800)]\).
2. Combined Shared and Admin costs are allocated by applying the combined rate (19.56%) to each cost center's total direct expenses (e.g. Program A: 19.56% \(\times 135,500 = 26,504\).
Exhibit 5

Organization A - "Fully loaded" cost model

<table>
<thead>
<tr>
<th>Programs</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>Admin.</th>
<th>Shared</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries and wages</td>
<td>$100,000</td>
<td>140,000</td>
<td>70,000</td>
<td>30,000</td>
<td>20,000</td>
<td>360,000</td>
</tr>
<tr>
<td>Employee benefits</td>
<td>15,000</td>
<td>21,000</td>
<td>10,500</td>
<td>4,500</td>
<td>3,000</td>
<td>54,000</td>
</tr>
<tr>
<td>Materials and supplies</td>
<td>5,000</td>
<td>9,000</td>
<td>5,000</td>
<td>1,000</td>
<td>-</td>
<td>20,000</td>
</tr>
<tr>
<td>Postage and shipping</td>
<td>1,000</td>
<td>2,000</td>
<td>1,000</td>
<td>1,000</td>
<td>5,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Printing and publications</td>
<td>2,000</td>
<td>1,500</td>
<td>1,000</td>
<td>500</td>
<td>5,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Occupancy</td>
<td>12,000</td>
<td>11,000</td>
<td>10,000</td>
<td>10,000</td>
<td>-</td>
<td>43,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>500</td>
<td>200</td>
<td>500</td>
<td>1,800</td>
<td>-</td>
<td>3,000</td>
</tr>
<tr>
<td><strong>Total direct expenses</strong></td>
<td><strong>135,500</strong></td>
<td><strong>184,700</strong></td>
<td><strong>98,000</strong></td>
<td><strong>48,800</strong></td>
<td><strong>33,000</strong></td>
<td><strong>500,000</strong></td>
</tr>
<tr>
<td>Allocation of shared costs</td>
<td>9,574</td>
<td>13,051</td>
<td>6,925</td>
<td>3,450</td>
<td>(33,000)</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total direct and shared costs</strong></td>
<td><strong>145,074</strong></td>
<td><strong>197,751</strong></td>
<td><strong>104,925</strong></td>
<td><strong>52,250</strong></td>
<td>-</td>
<td><strong>500,000</strong></td>
</tr>
<tr>
<td>Allocation of admin. costs</td>
<td>16,930</td>
<td>23,076</td>
<td>12,245</td>
<td>(52,250)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Fully loaded costs</strong></td>
<td><strong>$162,005</strong></td>
<td><strong>220,826</strong></td>
<td><strong>117,169</strong></td>
<td>-</td>
<td>-</td>
<td><strong>500,000</strong></td>
</tr>
</tbody>
</table>

1. The effective shared cost rate = .071 [($33,000/($500,000 - $33,000)].
2. The administrative rate = 11.67% [$52,250/($500,000 - 52,250)].
3. Shared costs are allocated by applying the shared cost rate (7.1%) to each cost center’s total direct expenses.
   e.g., Program A: 7.1% x $135,500 = $9,574.
4. Administrative costs are allocated by applying the administrative cost rate (11.67%) to the sum of each cost center’s
Bases for allocation of shared and indirect costs

- Proportionate to total direct costs
- Proportionate to direct personnel costs
- Proportionate to specific measures (square footage use, copier counts)
- Other
Impact of Caps on Shared Costs

• Nonprofits need to know full cost of providing services
• Some funders set arbitrary limits on Admin and other Shared Costs
• Arbitrary limits by restricted funders result in need to use unrestricted funds to cover the gaps created by the funder limits
### Exhibit 7

**Organization A - 5% cap on Admin costs that can be charged to Program A**

<table>
<thead>
<tr>
<th>Expenses</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>Admin.</th>
<th>Shared</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries and wages</td>
<td>$100,000</td>
<td>140,000</td>
<td>70,000</td>
<td>30,000</td>
<td>20,000</td>
<td>360,000</td>
</tr>
<tr>
<td>Employee benefits</td>
<td>15,000</td>
<td>21,000</td>
<td>10,500</td>
<td>4,500</td>
<td>3,000</td>
<td>54,000</td>
</tr>
<tr>
<td>Materials and supplies</td>
<td>5,000</td>
<td>9,000</td>
<td>5,000</td>
<td>1,000</td>
<td>-</td>
<td>20,000</td>
</tr>
<tr>
<td>Postage and shipping</td>
<td>1,000</td>
<td>2,000</td>
<td>1,000</td>
<td>1,000</td>
<td>5,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Printing and publications</td>
<td>2,000</td>
<td>1,500</td>
<td>1,000</td>
<td>500</td>
<td>5,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Occupancy</td>
<td>12,000</td>
<td>11,000</td>
<td>10,000</td>
<td>10,000</td>
<td>-</td>
<td>43,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>500</td>
<td>200</td>
<td>500</td>
<td>1,800</td>
<td>-</td>
<td>3,000</td>
</tr>
</tbody>
</table>

**Total direct expenses**

- A: $135,500
- B: $184,700
- C: $98,000
- Admin: $48,800
- Shared: $33,000
- Total: $500,000

**Allocation of shared costs**

- A: $9,574
- B: $13,051
- C: $6,925
- Admin: $3,450
- Total: ($33,000 - )

**Total direct & shared costs**

- A: $145,074
- B: $197,751
- C: $104,925
- Admin: $52,250

**Allocation of Admin Costs**

- A: $16,930
- B: $23,076
- C: $12,245
- Total: ($52,250 - )

**Fully loaded costs**

- A: $162,005
- B: $220,826
- C: $117,169

**Chargeable to Prog A**

- $152,328

**Subsidy Required**

- $9,676

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1. Program 5% Admin Cap: Prog A total direct and shared costs $145,074 x .05 = $7,254
2. Amount chargeable to Prog A = Total direct and shared costs + 5% Admin Cap ($145,074 + $7254 = $152,328)
Tactics to improve cost recovery

• Make overhead costs **invisible** by converting all to direct costs

• Utilize a **strict definition** of overhead as only admin costs

• Benefit from **new OMB Uniform Guidance**

• **Educate** donors & funders

www.kaysohlconsulting.net
Develop strategies based on knowing full costs

- Set prices to cover costs of a program and/or know how much subsidy it will require
- Include full costs in grant proposals
- Make the case to government funders for higher than 10% indirect cost rate
- Based on knowing what surplus or deficit each program generates, make strategic decisions about where to subsidize, cut, invest

www.kaysohlconsulting.net
Overhead issue is:

1. Management issue
2. Nonprofit sector structural issue & norms
3. Government contracting issue
4. Messaging challenge
Your Next Steps

• Discuss your orgs’ definition of admin, overhead, indirect costs

• Determine the full cost of providing each service

• Explore potential to improve recovery of admin/indirect costs in grants and contracts

• Join us for WCSAP webinar to explore OMB Uniform Guidance – June 20th

www.kaysohlconsulting.net
Many more resources
www.calnonprofits.org/overhead

Discussing Nonprofit Overhead

- About the Nonprofit Overhead Project
- What is overhead?
- How much is too much overhead?
- How inordinately low overhead hurts nonprofits, foundations, and communities
- How to get involved
- Must-reads

www.kaysohlconsulting.net
Nonprofit Overhead Toolkit

- Accounting techniques for overhead and indirect costs
- Overhead and profitability
- Indirect costs in nonprofit contracts with government: OMB Uniform Guidance
- Indirect costs and foundation grants
- Raising the issue with your funders
- Messaging to the public about overhead
More Resources

• www.COFAR.org
• www.Caplaw.org