National Center on
Program Management and Fiscal Operations

Cost Allocation: Key Concepts and Vocabulary

Cost allocation is the process of assigning the shared costs of a resource, good, or service to the programs that benefit from that resource, good, or service. Head Start programs, through the Uniform Guidance (45 CFR §75.400(d)), require that all funds used to support program services must be able to be traced back to the funding source.

The Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance) in 45 CFR Part 75.415 Required Certifications describes the process by which grantees should develop and certify a cost allocation plan. A cost allocation plan is the method used to fairly and equitably divide the shared costs of an organization to each of its programs. It is essentially a budget – a prediction of how shared costs and services are expected to benefit more than one program in an agency. As with any budget, it should be carefully thought out. Cost allocation plans are rarely perfect, but they should reflect as correctly as possible how shared costs and services will be charged to various funding sources.

The cost allocation plan is expected to be a reasonable estimate of how an organization will use and charge shared costs and services. A written cost allocation plan is a clear best practice guide for effective fiscal management. As with any plan, cost allocation plans often change. It is not enough to just develop a plan at the beginning of the year and forget about it. Throughout the year, organizations should evaluate whether the plan has changed and whether costs need to be divided differently based on any significant changes.

Head Start programs use multiple terms to describe the funding sources they use and combine to achieve program goals and support community services. Although blended and braided funding are similar in nature, these three terms are still being used:

Blended – Blending refers to combining funds from two or more funding sources together to fund a specific part of a program or initiative. Remember that the Uniform Guidance (45 CFR §75.400(d)) requires grantees be able to trace all funds used to support services back to the funding source.

Braided – When funds are braided, two or more funding sources are used to support the total cost of a service while maintaining their separate identities. Revenues are divided and expenditures are tracked by different categories of funding sources. In braiding, cost allocation methods are required to make sure that there is no duplicate funding of service costs and that each funding source is charged its fair share across the partners.

Layered – This model introduces the concept of "supplement does not supplant." The concept of layering funds is used to guarantee that Early Head Start-Child Care Partnership funds will improve service quality without duplication or replacement of existing child care funding. Funding from different sources (e.g., Early Head Start program, Child Care Development Fund, and other early care funders) are "layered" to fund comprehensive services that meet the full-day, full-year needs of parents. Depending on the expense and the eligibility of the child receiving services, cost allocation might be required.

EXAMPLE 1:
ABC Child Development Center receives funding from the Early Head Start program, state funded child care, and foundation funding. ABC decides to use some of the funding from these separate streams to implement a strategy to improve health outcomes for children. The total cost of this improved health outcomes strategy is $250,000. ABC would be responsible for coordinating and carrying out the strategy and keeping each funding stream's connection with its original source. ABC would also maintain any constraints on the funds allocated. Expenses, management data, performance measures, and demographic and other reporting requirements would be tracked and attributed to the original funding streams based on the funds allocated and the benefits derived from the improved health outcomes strategy.

EXAMPLE 2:
ABC Child Development Center receives two separate funding streams to provide a child care program for 40 children and a Head Start program that serves 60 children. The agency's child development center has decided to build an outdoor play area that will be used equally by the children in each program. The cost to install the new playground is $200,000. Each program has agreed to pay their fair share of the costs for the purchase and installation of the playground. In this example, the ABC Child Care program would be responsible for $80,000 of the costs ($200,000 x 40% [number of children]). The ABC Head Start program would be responsible for $120,000 of the costs ($200,000 x 60% [number of children]).

Cost Allocation Considerations

1. Check with your auditor to identify costs that benefit only one program. These do not have to be allocated.
2. Identify costs shared between Head Start and other programs. These must be allocated in accordance with approved policies and procedures.
3. Make sure the allocation of staff time matches time sheets, payroll, and time and effort reporting.
4. The allocation plan needs to assign costs as accurately as possible in the most reasonable method to make sure funding streams are charged their fair share based on the benefit received.
5. Monitor cost allocation plans regularly to confirm proper allocation to funding resources. This process could be done through an automated accounting system.

For further information, see Cost Allocation Narrative posted on the ECLKC.