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Applicability: All DSN Boards, All Financial Managers, All Contracted Service Providers

I. PURPOSE

This directive establishes principles for determining costs of services provided under contracts, grants and other agreements between the South Carolina Department of Disabilities and Special Needs (DDSN) and Disabilities and Special Needs Boards, Financial Managers, and other community service providers hereafter referred to collectively as “providers”. The principles are designed so that the state and federal governments bear their fair shares of costs except where restricted or prohibited by law. The principles do not attempt to prescribe the extent of funding for contracts, grants, or other agreements. Provisions for profit or other increments above cost are outside the scope of this directive.

II. APPLICABILITY

These principles shall be used in determining the costs of work performed by providers under contracts, grants, and other agreements issued by DDSN. All of these instruments are hereafter referred to as “awards.”

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III. GENERAL PRINCIPLES

A. Basic Considerations

1. Composition of Total Cost

The total cost of a service is the sum of the allowable direct and allocable indirect costs less any applicable credits. Applicable credits would include cost reductions such as purchase discounts, rebates or allowances, insurance recoveries, and adjustments of overpayments.

2. Allowable Costs

To be allowable under an award, costs must meet all of the following general criteria. They must:

- a. Be reasonable for the performance of the award and be allocable thereto under these principles.
- b. Conform to any limitations or exclusions in the award or as stated in Attachment 1.
- c. Be consistent with policies and procedures that apply uniformly to both state and federally financed/other activities of the organization.
- d. Be accorded consistent treatment.
- e. Be determined in accordance with generally accepted accounting principles.
- f. Be adequately documented.
- g. In the case of Medicaid (Title XIX, Social Security Act) funded programs, be consistent with applicable federal regulations and guidelines set forth in the Health Care Financing Administration's Provider Reimbursement Manual and the South Carolina State Medicaid Plan. For Intermediate Care Facilities for the Mentally Retarded (ICFs/MR) contracts with DDSN, the federal regulations for ICFs/MR shall take precedence over the State Medicaid Plan, as interpreted by DDSN.

3. Reasonable Costs

A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the prevailing circumstances at the time the decision was made to incur the cost. Reasonable costs would be those required to be incurred by standards set by DDSN and program requirements established by the federal government for Medicaid-funded programs, as interpreted by DDSN. In

determining the reasonableness of a given cost, consideration should be given to:

- a. Whether the cost is of a type recognized in standards, regulations, and other guidelines as ordinary and necessary for the operation of the organization or the performance of the award.
- b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms-length bargaining, federal and state laws and regulations, and terms and conditions of the award.
- c. Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees and consumers, the public at large, and the government.
- d. Significant deviations from the established practices of the organization which may unjustifiably increase the award costs.

4. Allocable Costs

- a. A cost is allocable or assignable to an award in accordance with the relative benefits received. A cost is allocable to a DDSN award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if:
 - i. It is incurred specifically for the award, or
 - ii. It benefits both the award and other work and can be distributed in reasonable proportion to the benefits received, or
 - iii. It is necessary to the overall operation of the organization, although a direct relationship to any particular award cannot be shown.
- b. Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other DDSN awards to overcome funding deficiencies or to avoid restrictions imposed by law or by the terms of the award.

B. Direct Costs

1. Direct costs are costs that can be identified specifically with a particular award.
2. Any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality when the accounting treatment for such cost is

consistently applied to all final cost objectives. For these minor cost areas, the accounting effort in charging costs directly is not commensurate to the results achieved.

C. Indirect Costs

1. Indirect (overhead) costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular award or other final cost objective. Direct costs of minor amounts may be treated as indirect costs under the conditions described in paragraph B. 2 above. After direct costs have been determined and assigned directly to awards or other work as appropriate, indirect costs are those remaining to be allocated to benefiting awards. A cost may not be allocated to an award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to an award as a direct cost.
2. Because of the diverse characteristics and accounting practices of provider organizations, it is not possible to specify the types of costs which may be classified as indirect costs in all situations. However, typical examples of indirect costs for provider organizations may include the costs of operating and maintaining shared facilities and general administrative costs for executive directors, financial officers and shared secretarial staff, including salaries, fringe benefits and support costs.

IV. COST ALLOCATION PROCEDURES

A. Definitions

1. Cost Allocation Plan

A cost allocation plan is a document explaining the system used by a provider to measure and assign costs to awards and other cost objectives. When indirect costs are distributed among two or more programs, the plan must explain methodology used to distribute these costs.

2. Cost Center

A cost center is a separate accounting unit to which costs are charged for an organization. A cost center may be established for each award or for each indirect cost center which needs to be allocated. A final cost center is one established for an award; the costs charged there are not further charged or allocated. An intermediate cost center is an accounting unit whose costs are further allocated to other cost centers. For example, if operational and maintenance costs for a shared building are to be allocated

or charged out, the separate cost center established for these costs is known as “intermediate.”

B. Plan Preparation Requirements

Each provider shall maintain a cost allocation plan in accordance with the principles stated in this directive. The plan must include adequate narratives and schedules to explain the methodology used to distribute shared costs. The plan must include a detailed budget for all costs that are allocated. Any changes in methodology to cost allocation plans must be approved in advance by DDSN.

C. Allocation Methods

1. Simplified Allocation Method

a. Applicability:

When a provider does not operate Medicaid-funded programs, the simplified allocation method may be used.

b. Procedure for Charging Joint Costs:

Under this method all costs of the organization are treated as direct costs with the exception of general administrative costs. Joint shared costs such as rent, operation and maintenance of facilities, and telephone costs are prorated individually as direct costs to each award using the base most appropriate to the particular cost being prorated. Examples of allocation bases are listed in Attachment 2 to this directive.

c. Treatment of Indirect Costs:

Under the simplified method, indirect costs include only general administrative costs including costs of the executive director's office, accounting and clerical services, audit costs, and other costs not readily assignable to awards. These indirect costs are allocated to awards on the basis of total direct costs of the awards.

d. Plan Preparation Steps:

The following steps should be followed in preparing a cost allocation plan using the simplified method.

i. Establish clearly definable cost centers with the advice of auditors.

- ii. Identify cost centers as either final or intermediate. Final cost centers are client service programs usually with separate contracts or grants. Charges to intermediate cost centers (for example: administration) must be further spread through the cost allocation plan.
- iii. Estimate the total annual costs for all cost centers based on prior year actual figures or the current year budget. For contracts based on standardized award amounts, direct program costs – not DDSN established payment levels – should be used for the purpose of cost allocation.
- iv. Determine the most reasonable allocation basis for each intermediate cost center. The bases chosen should closely reflect benefits received from service areas and also be feasible in terms of data collection. For allocating administrative and general management costs, including costs of DSN board executive director offices, total direct costs should generally be used. A list of possible allocation bases can be found in Attachment 2 to this directive.
- v. Allocate all intermediate cost centers to all final cost centers that they benefit.
- vi. Total the costs for all final cost centers. The totals represent the estimated full costs of operating the service programs.

2. Step-Down Allocation Method

a. Applicability:

When a provider operates Medicaid-funded facilities, the step down allocation method must be used. Providers without Medicaid-funded programs may use this method if it will make a significant difference in the allocation of indirect costs.

b. Overview of Plan Preparation:

Under this method of plan preparation, joint shared costs are pooled into intermediate cost centers. A separate intermediate cost center should be established for each cost area to be separately allocated. Typical intermediate cost centers for DSN Boards include but are not limited to the following: administration, transportation, facility costs including rent, utilities, and maintenance, and day program costs when the day program serves the residential facilities funded by Medicaid. Each intermediate cost center should be allocated to all other benefiting cost centers whether they are final or intermediate.

Three basic rules govern the allocation process:

- i. Allocate first the cost centers benefiting the greatest number of other cost centers.
 - ii. A cost center should not be allocated back to itself.
 - iii. Once an intermediate cost center is allocated, it should receive no further allocations.
- c. Plan Preparation Steps:

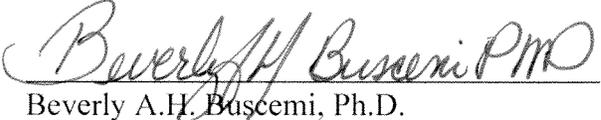
The following steps should be followed in preparing a cost allocation plan using the step-down method.

- i. Establish clearly definable cost centers with the advice of auditors.
- ii. Identify cost centers as either final or intermediate. Final cost centers are client service programs usually with separate contracts. Charges to intermediate cost centers must be further spread through the cost allocation plan.
- iii. Estimate the total annual costs for all cost centers, based on prior year actual figures or the current year budget. For contracts based on standardized award amounts, direct program costs – not DDSN established payment levels – should be used for the purpose of cost allocation.
- iv. Determine the order in which the intermediate cost centers should be allocated. Those centers that benefit the greatest number of other cost centers should generally be allocated first.
- v. Determine the most reasonable allocation basis for each intermediate cost center. The bases chosen should closely reflect benefits received from service areas and also be feasible in terms of data collection. For allocating administrative and general management costs (home office costs), total direct costs must be used for Medicaid purposes when the organization provides a variety of services in addition to residential programs. A list of possible allocation bases can be found in Attachment 2 to this directive.
- vi. Begin with the first intermediate cost center and allocate its cost to all other cost centers including intermediate and final. The costs of the cost center should not be allocated back to itself.
- vii. Allocate, in succession, each of the other intermediate cost centers to all other cost centers except for centers that have already been allocated. Each cost center allocated is “closed out” and receives no further allocations. Continue the process until the costs of all intermediate cost centers are allocated to final cost centers.

- viii. Total the costs for all final cost centers. The totals represent the estimated full costs of operating the service programs.



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To access the following attachments, please see the agency website page "Attachments to Directives" under this directive number.

ATTACHMENTS:

- A. LIMITATIONS ON COSTS FOR AWARDS WITH DDSN
- B. SAMPLE ALLOCATION BASES FOR SHARED COST AREAS