Strategic Cost Allocation

Understanding What it Takes to Advance Community Health

Nonprofit Finance Fund (NFF) has worked with community-based organizations (CBOs) across the country to understand and accelerate partnerships with healthcare payors and providers to improve **community health**. Our decades of work with CBOs has demonstrated to us that fair and ample funding is critical to growing and sustaining these types of partnerships. But to know what is "fair and ample" requires a firm understanding of costs. It can be difficult to calculate what it truly takes to deliver effective services. This article introduces core concepts and guiding questions to help nonprofit leaders understand costs and explore the connection between costs and mission goals.

Calculate for Compliance and Strategy

Knowing what it truly costs to deliver services may sound straightforward, but complex funding restrictions and chronic underfunding force organizations to cobble together revenue streams, leaving many CBOs and networks without a strategic view of costs. With their often-limited resources, most CBOs must first focus on a compliance view of costs, slicing and dicing (or allocating) costs to meet contract requirements and funding structures. They are experts at "contract math" to make sure shared costs are correctly allocated across programs. (For example, one contract might allow for 10 percent of a staff worker's salary and 5 percent of rent, while another allows for 7.5 percent of salary and 10 percent of rent, even though it takes less office space, so that's how CBOs allocate expenses.) Given the difficulty of managing expenses in this way, CBOs are left with little time to focus on what it actually costs them to deliver on their mission.

Cost Allocation for Compliance

- What is allowable or billable?
- What is an acceptable "overhead rate"?
- What will they fund?

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Cost Allocation for Strategy

- What does this program *actually* cost to deliver?
- What is the gap between what it actually costs and revenues intended to cover that cost? How can we raise what we need to fill the gap?
- When should we say "no" because a "yes" stretches limited, flexible funding so far it jeopardizes our ability to deliver mission?

In a perfect world, the costs that are calculated for compliance with a contract would match the actual costs of providing the service. But this is often not the case. CBOs are at a disadvantage when negotiating a fair price with a payor, because they aren't in the practice of analyzing and asking for a price that covers actual full costs.

Understand Costs to Inform Strategic Decision-Making

For a CBO or networks of CBOs considering a healthcare partnership, strategic cost allocation can be a powerful tool both for internal learning and management purposes and external negotiations.

Internal learning: Having a range of data from peers can also help network members better understand the particularities of their business. If a member's costs are higher, are there efficiencies or service models they could learn from peers? Or is there something about the location or population served that requires additional investment, and that would be valuable to point out in contract negotiations or grant applications? How do differences align with outcomes achieved? Once differences are understood, they can be brought to the negotiating table (e.g., this population needs a higher rate, this type of CBO needs a different contract structure, these outcomes require larger grants). Similarly, a single CBO can look at the true cost of discrete elements within a more comprehensive service or program, or what it costs to serve different kinds of clients, to better understand how to manage those costs.

External network negotiations: A network has more negotiating power if it can show data across all providers to back up the cost of services. When a group of providers in a network all request higher rates and have data showing why higher rates are necessary, it's harder for those they are negotiating with to deny the request – and easier for the network to feel comfortable saying no if the contract offer is simply too low. Ultimately, this leads to more appropriate funding of the work. It's also useful for broader advocacy in how members talk about the cost of their services. The same principals apply for a single CBO seeking a contract with healthcare.

Know the Three Layers of Cost

While strategic cost allocation is an important goal, we recognize it as a point on a continuum toward a "**full cost**" approach that encompasses what it takes to build strong, robust organizations while delivering programs. To determine the strategic and full cost of programs and services, an organization needs to think about the following:

	Layer 1: Compliance	Layer 2: Strategic	Layer 3: Full Cost View
What is it?	A **bare minimum** view of costs, with minimal allocations for shared costs (like rent, office supplies, accounting).	The **true cost of programs**, including the full portion of shared costs needed for mission delivery.	The true, fully loaded cost plus **expenses beyond the budget** necessary for a healthy organization now & tomorrow.
Important for:	**Reporting**	**Strategizing**	**Building**
What it means:	We can cover most program expenses. ***But if we stop here***, we are in a hand-to-mouth starvation cycle and fail to deliver our mission.	We can cover our budget. ***But if we stop here***, we will have a hard time saving up enough to reinvest in our business and strengthen our organization.	We are financially well-positioned to deliver our mission now and into the future.
Talking points for conversations with funders:	"This is the cost of our programs with minimal allocation for admin costs and **does not cover the cost of delivering programs**."	"This is how much it costs us to deliver our programs." True overhead rates are generally 20-40 percent, much higher than rates allowed in program-specific contracts.	"This is what our programs would cost if they carried the full costs of building an adaptable, sustainable organization."

Learning in Real Time

COST ALLOCATION WITH THE ENGAGEWELL NETWORK

EngageWell IPA is a coalition of community-based providers in New York City that offers comprehensive, integrated services to address complex medical and behavioral health needs and unmet social determinants of health, including food, housing, and economic insecurity. As part of the ARCH initiative, NFF and EngageWell IPA explored cost allocation for a cohort of harm-reduction providers. We wanted to understand how much it cost the cohort to provide certain harm-reduction services, with the goal of helping EngageWell negotiate a potential healthcare contract with fair reimbursements to the participating organizations. While we could analyze the cost of existing services for each member, it was challenging to analyze costs at the network level for several reasons:

- Providers had not determined which services might be included in new contracts.
- The potential healthcare payor and the cohort providers defined "harm reduction services" in very different ways, with the healthcare definition focused narrowly on what was Medicaid billable, and the providers focused more broadly on all the support needed to serve clients.
- Additional contract requirements (i.e., documentation, reporting, and quality assessment, etc.) had not yet been negotiated, all of which influence the full cost to providing services.

The big takeaway: It is easier to determine the true cost of predefined services that have already been established across members and that aren't likely to change based on patient population or healthcare demands. It is far more difficult to establish costs when programs are changing rapidly or are undefined. We recommend that network members build the "muscle" for doing this kind of costing analysis on already established programs or services, and then apply that understanding to approximate costs for new services that are still being defined.

COST ALLOCATION WITH UNITED NEIGHBORHOOD HOUSES

United Neighborhood Houses is a network of 44 settlement houses that serve more than 765,000 New Yorkers annually. Settlement houses are neighborhood-based social service organizations with strong connections to high-need communities, providing a variety of wraparound services focused on social determinants of health. NFF was initially brought to in help a cohort of settlement houses determine their full cost of providing critical social services as a step toward preparing for potential partnerships with healthcare. Considering new priorities due to the COVID-19 pandemic, NFF has refined our analysis to ask and answer questions related to costing that will help organizations manage their work today (e.g., what are non-billable expenses and how do those inform where staff are spending time and resources?). The processes put in place for analyzing current costs can be applied in the future.

The big takeaway: Even without the catalyst of a potential contract with healthcare partners, using costing to look at internal operations and to understand where and how resources are being spent can provide new insight into a program's bottom line.

Get Started

Moving beyond just compliance to strategic cost allocation is not easy, so we recommend beginning with a clear idea of the value this work will bring to your organization. Here are some steps to help you get started.

1. Define how strategic cost allocation will support and advance the work of your organization (or network). The analysis is time intensive but can be used to:
    - Negotiate for higher rates and more funds to support vital programs and services.
    - Better understand internal operations, which helps identify where full costs are not being covered, find efficiencies, and rethink how services are or might be resourced.
    - Educate funders about what it really takes to offer healthcare services and address social determinants of health. While there is **no guarantee that healthcare or other payors will pay for our full costs**, it is important funders know what those needs are.
2. Determine which programs or services to analyze; for networks, determine what will be compared across members. Even if data management and tracking systems aren't comparable, organizations can use what they have, recognizing the importance of stepping outside the narrow confines of reporting systems that reinforce the compliance mindset.
3. Find the right level of detail for analysis considering the data available. The goal is to have helpful information without an overly cumbersome process, so agree on what's "good enough."

NFF believes that looking at costs from a strategic view is **vital to an organization's ability to make data-informed decisions about programs and partnerships and to advocate for itself with payors and funders**. Funders will not often voluntarily change their rates or increase grant amounts; CBOs have to use their knowledge of their true costs, clarified with strategic analysis, to advocate for grants and contracts that fund what they actually need to achieve their missions.

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