



Public Institutions: Methodologies for Allocating Depreciation, Operation and Maintenance of Plant, and Interest Expenses to Functional Expense Categories

Purpose

This Advisory Report provides preferred industry practice for public institutions completing Part C, “Expenses and Other Deductions,” of the Integrated Postsecondary Education Data System (IPEDS) Finance Survey. Part C of the Finance Survey was recently revised and adds columns that allow depreciation, operation and maintenance of plant (O&M), and interest expenses to be allocated to all other functional expense categories. Public institutions may use the revised Part C during the 2010 data collection period (for fiscal year 2009 financial information); however, the revised form becomes mandatory in the 2011 data collection period (for FY 2010 data).

Executive Summary

The Secretary of Education’s Commission on the Future of Higher Education completed its work in September 2006 with the release of its final report, *A Test of Leadership: Charting the Future of U.S. Higher Education*. One of six recommendations was greater accountability and transparency aided by a publicly available database with comparable higher education financial information.

In an effort to make financial data between public and independent institutions more comparable, IPEDS will require public and independent institutions to use similar definitions for functional expenses in the FY 2010 Finance Survey. Public institutions have the option of allocating depreciation, O&M, and interest expenses among all remaining functional expense categories in the expenses section (Part C) of the FY 2009 Finance Survey (submitted in 2010). Public institutions are required to perform the allocation in the expenses section (Part C) of the FY 2010 Finance Survey (submitted in 2011).

Public institutions must follow the functional expense definitions as defined by NACUBO in its *Financial Accounting and Reporting Manual (FARM)* and included in Appendix B of this Advisory Report. A functional classification is a method of grouping expenses according to the purpose for which the costs are incurred. To assist public institutions with an effective, efficient, and economical approach to allocating depreciation, O&M, and interest expenses among the functional expense categories, this Advisory Report steps through a cost allocation approach. Because independent institutions have been allocating such costs for more than a decade, the Advisory Report

focuses on methods currently used by independent institutions. The essential cost accounting process can be summarized in the following steps:

1. Select consistent categories of cost.
2. Identify costs to be allocated.
3. Review recommended allocation methodologies.
4. Analyze the availability of data for your institution that could support recommended allocation methodologies.
5. Consider the mission, objectives, and operating practice of your institution.
6. Document considerations and approach.
7. Map the connection between available allocation data and the current functional expense categories of your institution, and assign depreciation, O&M, and interest expenses to the functional expense categories using a methodology or combination of methodologies that makes sense for your institution.

NACUBO's preferred industry guidance is solely for the purpose of completing the IPEDS Finance Survey. *At this time there is no recommendation or requirement for expanding the functional expense footnote disclosure to include the allocation of depreciation, O&M, and interest expenses to the functional expense categories.* Public institutions, however, should consider the many users of their external audited financial statements and evaluate the possible benefits of having Part C IPEDS survey allocation results, or methodologies, be consistent with, used, or disclosed in general purpose external financial statements or other external reports.

Background

The Secretary of Education's Commission on the Future of Higher Education completed its work in September 2006 with the release of its final report, *A Test of Leadership: Charting the Future of U.S. Higher Education*. The report addressed accessibility, accountability, and affordability in higher education and notes that a prominent issue on the minds of the American public is the rising cost of attending college. The report also contends that lack of transparency in college and university accounting and reporting is an additional challenge for policy makers expected to fund higher education.

Sparked by the commission's work, the National Center for Education Statistics (NCES) convened a technical review panel in January 2007 to study higher education finance data available in IPEDS. IPEDS is a system of interrelated surveys conducted annually, which gathers information from every college, university, and technical and vocational institution in the United States and other jurisdictions (such as Puerto Rico) that participates in the federal student financial aid programs. The Higher Education Act of 1965, as amended, requires that institutions that participate in federal student aid programs report data on enrollments, program completions, graduation rates, faculty and staff, finances, institutional prices, and student financial aid. Those data are made available to students and parents through the College Navigator college search Web site and to researchers and others through the IPEDS Data Center.

IPEDS provides basic data needed to describe—and analyze trends in—postsecondary education in the United States, in terms of the numbers of students enrolled, staff employed, dollars expended, and degrees earned. Congress, federal agencies, state governments, education providers, professional associations, private businesses, media, students and parents, and others rely on IPEDS data for this basic information. IPEDS data are used at the federal and state levels for policy analysis and development and at the institutional level for benchmarking and peer analysis.

Each year, NCES administers the IPEDS Finance Survey, in which higher education institutions must submit data that reconcile to audited financial statements. These statements comply with generally accepted accounting principles as defined by the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB), and auditing standards set by the American Institute of Certified Public Accountants (AICPA) or the U.S. Government Accountability Office.

The challenge for higher education, and NCES, is that financial reporting is regulated by two different sets of accounting standards. In addition, the independent versus public control of institutions can result in unique auditing and reporting guidance. For example, AICPA requires institutions that follow FASB to allocate depreciation, O&M, and interest expenses to all functional expense categories, whereas no similar requirement exists for public institutions that follow GASB. Examples of functional expenses in higher education include instruction, research, academic support, student services, institutional support, auxiliaries, and public service. Because independent institutions allocate depreciation, O&M, and interest expenses to the functional expense categories, conceptually the categories are more comprehensive and result in higher costs per category. This results in less comparability in frequently analyzed areas, especially the cost of instruction, between public and independent institutions.

Because NCES's IPEDS finance data are commonly used by various stakeholders to calculate and evaluate college costs (despite the differences in functional expense definitions between public and independent institutions), the NCES meeting in January 2007—"Expanding and Improving IPEDS Finance Data"—was specifically aimed at improving the comparability between public and independent institutions. Panel members included 46 people representing the federal government, state governments, institutions, national data users, accounting standards boards, and associations. To meet the objective, the primary question discussed was whether public and independent institutions should use similar definitions for functional expenses. Panel participants recommended that to increase cost comparability—especially the cost of instruction—public institutions need to allocate depreciation, O&M, and interest expenses to all functional expense categories. All proposed Finance Survey changes were posted to the NCES Web site for public comments in early 2008. All recommendations are intended to enhance presentation and analytical comparability between independent and public institutions. The most significant change, however, is the revision of the expenses section (Part C) for public institutions. Finance Survey changes can be found at https://edsurveys.rti.org/IPEDS_TRP/trp_Technical_Review_08222007_18.aspx.

Applicability

NACUBO's guidance provides allocation methodologies for public institutions to consider when completing Part C of the IPEDS Finance Survey. Public institutions vary by size, complexity, and mission. Consequently, institutions must evaluate the methodology that makes the most sense for their institution and weigh the pros and cons of the various allocation methodologies against factors such as accuracy, ease, burden, consistency of financial information, and cost of implementation.

NACUBO's preferred industry guidance is solely for the purpose of completing the IPEDS Finance Survey. Although public institutions may report functional expenses on the face of their financial statements (i.e., the statement of revenues, expenses, and changes in net assets, or SRECNA) or in the footnotes, *at this time there is no recommendation or requirement for expanding the functional expense footnote disclosure to include the allocation of depreciation, O&M, and interest expenses to the functional expense categories*. Public institutions, however, should consider the many users of their external audited financial statements and evaluate the possible benefits of having Part C IPEDS survey allocation results, or methodologies, be consistent with, used, or disclosed in general purpose external financial statements or other external reports.

Public institutions that wish to disclose functional expense totals that agree with Part C of the IPEDS Finance Survey can refer to Appendix A for a sample format.

Cost Accounting Discussion

The cost objectives or activities to which costs are attributed in higher education are the functional classification of expenses. In higher education, the functional classifications originated from the old *College and University Business Administration* publication, have been updated by the NACUBO Accounting Principles Council, are defined in FARM, and are required as the definitional standard in the IPEDS Finance Survey.

The cost accounting process is summarized as follows:

1. Select consistent categories of cost.
2. Identify costs to be allocated.
3. Review recommended allocation methodologies.
4. Analyze the availability of data for your institution that could support recommended allocation methodologies.
5. Consider the mission, objectives, and operating practice of your institution.
6. Document considerations and approach.
7. Map the connection between available allocation data and the current functional expense categories of your institution, and assign depreciation, O&M, and interest expenses to the functional expense categories using a methodology or combination of methodologies that makes sense for your institution.

1. Select consistent categories of cost.

All higher education institutions should code the function, organizational unit, or object code within the chart of accounts structure to allow for consistent groupings of expenses by function. Institutions typically identify organizational units (such as departments) and objects (such as salary, benefits, supplies, and utilities). The groupings should be internally consistent (for an individual institution) and consistent across the higher education industry because NACUBO provides definitions and the Department of Education requires institutions to use the NACUBO definitions.

All higher education institutions should code current fund expenses in a manner that identifies the following functions

- Instruction
- Research
- Public service
- Academic support
- Student services
- Institutional support
- **Operation and maintenance of plant**
- Scholarships and fellowships
- **Depreciation**
- Auxiliary enterprises
- Hospitals
- Independent operations

2. Identify costs to be allocated.

Part C of the Finance Survey was recently revised and adds columns that allow depreciation, O&M, and interest expenses to be allocated to all other functional expense categories. Depreciation and O&M are separate functions for public institutions (in bold in the preceding list). Interest expense is considered a financing cost and is separately identified as a nonoperating expense on the SRECNA.

3. Review recommended allocation methodologies.

The NACUBO Accounting Principles Council and the results of a January 2007 NACUBO survey support the use of the following common methodologies:

- Direct assignment based on functional category of space
- Assignable square footage
- Salaries (and wages), or salaries (and wages) plus benefits
- Total expenses by function
- Combination of the above

Such methodologies are used by independent institutions that have been allocating depreciation, O&M, and interest expenses for the past decade.

4. Analyze the availability of data for your institution that could support recommended allocation methodologies.

As previously noted, all public institutions likely capture functional expense data; consequently, a percentage of each functional expense category (not including interest, depreciation, and O&M) over total expenses (less interest plus depreciation plus O&M) would be available and should be reliable. This methodology, however, may fail to recognize the differential operating cost increases associated with research versus instruction and other functions.

Because all institutional employees are regularly paid through the payroll system, salaries (and wages) or salaries (and wages) plus benefits is another example of data that should be available. The value of compensation data is that as higher education is a service industry, such information is likely significant and should relate to the functional expense categories if object codes are properly assigned and maintained. Another benefit is that salary and wage allocations are acceptable surrogate allocation methodologies for facilities and administration (F&A) rate calculations. Weaknesses can result, however, when using compensation data as some functions may have low personnel costs but relatively high O&M costs. For example, student services personnel costs may be low when compared with instruction and research activities, but if student services operates in higher-cost facilities, using personnel as an allocation base will result in less costs allocated to the student services function.

Ideally O&M costs should be allocated based on the functional use of space. The weakness of this model may be the lack of an accurate space inventory, or space inventories that are infrequently updated. Further, systems may be limited in their ability to assign multiple functions to a multiple-use space. Institutions with regularly updated space data that can handle multiple-use space issues should carefully consider whether space is the optimum methodology. Research institutions that use assignable space as an allocation methodology for their F&A study required by Office of Management and Budget (OMB) Circular A-21 should consider using space as an allocation starting point. For such institutions, using space will facilitate reconciliation between allocated functional expenses and F&A results. However, IPEDS finance component reporting does not reference a need for reported values to reconcile to F&A results.

5. Consider the mission, objectives, and operating practice of your institution.

The following scenarios are not exhaustive and are listed to serve as a starting point:

- a. A community college that emphasizes instruction
- b. A community college that emphasizes instruction and public service
- c. A community college that emphasizes instruction and community education (consider whether community or adult education is budgeted in the instruction or

- public service categories; NACUBO definitions would recommend these expenses be considered instruction)
- d. A comprehensive and doctoral institution with some departmental research (expenses for these activities are likely captured as instruction per NACUBO definitions)
 - e. A comprehensive and doctoral institution with expanding departmental research or an expanding federal research objective (the institution may already be, or be moving in the direction of, a separate research functional expense category; the institution may be planning, beginning, or already have space studies that support current or future F&A reporting requirements)
 - f. A research institution with little or no athletics
 - g. A research institution with extensive athletics
 - h. A traditional tuition-dependent small institution

Each institution's starting point in determining an allocation methodology should generate written documentation of a rationale that makes sense for that institution. The documentation can be parenthetical, or outside of administrative or general ledger systems. Allocations can be for reporting purposes only—they can be worksheet based and not system generated. Some institutions may have administrative systems in place that are sophisticated enough to perform this function or that may already be performing this function; it is not, however, a requirement.

The following examples, taken from the list above, are intended to illustrate how to begin thinking about the mission, objective, and practice of your institution with an eye toward cost allocations.

Scenario a: Community College That Emphasizes Instruction

The community college is a commuting school, and 60 percent of students are considered traditional day students. One building on campus is an all-purpose student-centered building, one building is used for both adult instruction and community activities, one building is used for administration and instruction, and all remaining buildings or locations are used for instruction. A large amount of campus space is devoted to parking. The 10-year goal is to introduce student housing.

The primary objective of the institution is education (two-year degrees, four-year degree preparation, adult literacy, college preparation, community education, and vocational training). Although costs of these educational activities are separately tracked, all such costs are accumulated into the functional expense category of instruction. The vast majority of depreciation, O&M, and interest expenses support the infrastructure needed to carry out the cost of instruction. Community college administration will consider using salary and wages or total expenses by function as an allocation base. The objective is to have the "instruction" functional expense category absorb the greatest amount of depreciation, O&M, and interest expenses.

Scenario d: Comprehensive and Doctoral Institution With Departmental Research

This public institution has residence halls, student life buildings, academic buildings, a bookstore, dining halls, a music and art center, and theaters. The institution plans to increase academic offerings to adults and expand distance learning capacity. Over time, many more buildings have become multiple-use community facilities. There are no plans to increase the research base. Both community service (public service) and research are budgeted and accounted for within the instruction functional expense category. Although there is no space study, the college has square footage information and can reasonably estimate how space is used. The college will compare allocation results using three methodologies: estimated square footage, salaries and wages, and total functional expenses. Based upon operating knowledge, administration believes that instruction, auxiliaries, and student services should absorb most of the depreciation, O&M, and interest expenses.

6. Document considerations and approach.

Documentation is strongly recommended. Public institutions fall along a continuum with little to no cost accounting on one end to highly sophisticated cost studies and cost accounting systems on the other. Because institutions, systems, and compliance requirements can evolve, documentation is recommended—especially for colleges and universities just beginning to develop an understanding of cost allocation. Documentation will be helpful and necessary should institutions choose to report allocated expenses in general purpose external financial statements or other external financial reports. Documentation serves an important institutional memory function and can evolve and change as institutional needs or mission progress.

7. Map (outline) the connection between available allocation data and the current functional expense categories of your institution, and assign depreciation, O&M, and interest expenses to the functional expense categories using a methodology or combination of methodologies that makes sense for your institution.

The outline comes directly from your documentation. Subsequently, an allocation decision is made. The following scenarios are presented to illustrate various considerations and decisions.

Scenario a: Tuition-Dependent Public Institution That Is a Commuting School

- Eighty-five percent of the square footage among all institutional buildings is used for instructional activities, 10 percent for student service activities, and 5 percent for administrative activities (institutional support).
- Ninety percent of salaries and benefits are directly identifiable to instruction activities.
- Depreciation is specifically identified for each building, and the function of each building directly comports to instruction, student services, or institutional support.
- Interest expense is for the two newest buildings used for instruction.

In this scenario, the public institution must decide whether it makes more sense to allocate O&M expense based on square footage or on salaries and benefits. The institution will be able to allocate more O&M expense to instruction if salaries and benefits are selected as the allocation base. The institution determines that this makes the most sense because the primary mission has always been, and remains for the foreseeable future, that of instruction.

Scenario b: State System That Produces General Purpose External Financial Statements at the System Level

- One community college, one small public institution, and two comprehensive and doctoral institutions are combined into one external general purpose financial statement at the system level but report to IPEDS as individual entities.
- O&M represents 10 percent, depreciation 5 percent, and interest 2 percent of total expenses; salary and wages are 60 percent of total expenses.
- One of the comprehensive and doctoral institutions has a detailed space and use study.
- Depreciation reports do not link depreciation expense to a function. Reports could be generated but would be time consuming and would not necessarily be reflective of building use.

In this scenario, the reporting entity (system) would like allocation consistency between institutions. The system also desires to minimize the accounting and administrative burden to meet the allocation requirement. Salaries and wages are by far the most material and precise expense that aligns with functional categories and, conceptually, with the use of buildings.

The system makes a decision to allocate based on salaries and wages, because that is both an efficient and an effective method given the materiality of the expenses and the space-occupied relationship of the salary to the function. Each institution uses this methodology for IPEDS reporting.

Scenario c: Complex Research Institution That Follows OMB Circular A-21 for F&A Rate Reimbursement for F&A Proposals

- O&M expense is allocated based on a combination of direct assignment to buildings and assignable square footage based on the functional use of space.
- Building construction/acquisition interest expense is allocated based on direct assignment to buildings and assignable square footage based on the functional use of space.
- Depreciation expense is allocated based on a combination of direct assignment/assignable square footage and student and employee full-time equivalents.

In this scenario, the institution will evaluate the pros and cons of using the same type of allocation base for IPEDS as for F&A reporting. Although this may require a bit more up-front work, the institution would like to have allocation consistency for all external financial reporting.

For O&M, the research institution decides to use an allocation to gross assignable square footage based on the functional use of space:

- Pros
 - This type of allocation allows O&M costs to correlate directly with how facilities are used.
 - Space functionalization data are available from F&A studies.
- Cons (for IPEDS)
 - This type of allocation requires the use of data outside the financial reporting process that are not stored in financial accounting systems.
 - Space functionalization data are not updated on an annual basis and require extensive scrubbing.

For interest expense, the research institution decides to use a combination of direct assignment/assignable square footage for building interest and allocation based on total expenses for nonbuilding interest:

- Pros
 - Interest expense is readily identifiable to buildings or projects.
 - Interest allocation to buildings and space functionalization data are available from F&A studies.
- Cons (for IPEDS)
 - For building interest, this type of allocation requires the use of data outside the financial reporting process that are not stored in financial accounting systems.
 - Space functionalization data are not updated on an annual basis and require extensive scrubbing.
 - This type of allocation requires a combination of methodologies for building versus nonbuilding interest expense.

For depreciation expense, the research institution will compare the results of the F&A allocation method with allocation based on total expenses and use total expenses if not materially different:

- Pros (for IPEDS)
 - Allocation based on total expenses does not require the use of data outside the financial reporting system.
 - The pro rata method is simpler (and possibly more transparent), not requiring the use of assumptions that might not be readily apparent within IPEDS reporting.
- Cons (for IPEDS)

- This choice requires allocation to be calculated under two methodologies for comparison.

Appendix A

Sample Footnote Presentation: Functional Classification of Natural Expenses and Additional Allocations of Plant Operation and Maintenance, Depreciation, and Interest Expenses

(Note – alphabetical symbols are provided as illustrative placeholders)

	Salaries plus Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	ABB	ACC	ADD	AEE	AFF		AAA
Research	BCC	BDD	BEE		BFF		BBB
Public service	CDD	CEE	CFE				CCC
Academic support	DEE	DFE	DGG				DDD
Institutional support	EFF	EGG	EHH		EII		EEE
Student aid				FFF			FFF
Auxiliaries	GHH	GII	GJJ	GKK	GLL		GGG
Plant operation and maintenance	HII	HJJ	HKK	HLL			HHH
Depreciation						III	III
Total operating expenses	ABC	DEF	GHI	JKL	MNO	III	JJJJ

		Allocations	
Instruction	AAA	HIK	AAAA
Research	BBB	HIK	BBBB
Public service	CCC	HIK	CCCC
Academic support	DDD	HIK	DDDD
Institutional support	EEE	HIK	EEEE
Student aid	FFF	HIK	FFFF
Auxiliaries	GGG	HIK	GGGG
Plant operation and maintenance	HHH	(HHH)	
Depreciation	III	(III)	
Total operating expenses	JJJJ		
Nonoperating: Interest expense	KKK	(KKK)	
Total allocated functional expenses			ABCDEFGHIK

Appendix B

Expenses by Functional Classification

For external reporting purposes, public colleges and universities may report expenses by function or by natural classification. The functional classifications listed below have been brought forward from the previous editions of the *Financial Accounting and Reporting Manual* (FARM) and (originally) from the old *College and University Business Administration*, and have been updated by the NACUBO Accounting Principles Council.

Public institutions should report all tuition and fee revenue net of scholarship discounts and allowances, and amounts provided to students as financial aid should be recorded as scholarship allowances (netted against revenues) in amounts up to those owed by the students. Amounts paid to the students in excess of amounts owed (e.g., for living expenses) should be recorded as student financial aid expense. Tuition remission benefits for employees and their dependents should be accounted for as compensation expense since the tuition remission benefit was given in exchange for services rendered by the employee.

Classification of Expenses

When presenting expenses by functional expense categories in their general purpose financial statements, public institutions should use the following functional expense classifications:

- Instruction
- Research
- Public service
- Academic support
- Student services
- Institutional support
- Operation and maintenance of plant
- Scholarships and fellowships
- Depreciation
- Auxiliary enterprises
- Hospitals
- Independent operations

Instruction

The instruction category includes expenses for all activities that are part of an institution's instruction program. Expenses for credit and noncredit courses; academic,

vocational, and technical instruction; remedial and tutorial instruction; and regular, special, and extension sessions should be included.

Expenses for departmental research and public service that are not separately budgeted should be included in this classification. This category excludes expenses for those academic personnel whose primary activity is administration—for example, academic deans.

The instruction category includes the following subcategories.

General Academic Instruction

This subcategory includes expenses for formally organized and/or separately budgeted instructional activities that are associated with academic offerings described by the Integrated Postsecondary Education Data System (IPEDS) instructional program categories identified in the National Center for Education Statistics (NCES) publication *A Classification of Instructional Programs* and offered for credit as part of a formal postsecondary education degree or certificate program. Open university, short courses, and home study activities falling within this classification and offered for credit are included. However, this subcategory does not include instructional offerings that are part of programs leading toward degrees or certificates at levels below the higher education level, such as adult basic education.

Vocational/Technical Instruction

This subcategory includes expenses for formally organized and/or separately budgeted instructional activities that are associated with activities characterized as vocational/technical instruction in the IPEDS instructional program categories and offered for credit as part of a formal postsecondary education degree or certificate program. Open university, short courses, and home study falling within this classification and offered for credit are included. However, this subcategory does not include instructional offerings that are part of programs leading toward degrees or certificates at levels below the higher education level, such as adult basic education.

Community Education

This subcategory includes expenses for formally organized and/or separately budgeted instructional activities that do not generally result in credit toward any formal postsecondary degree or certificate. It includes noncredit instructional offerings carried out by the institution's extension division as well as noncredit offerings that are part of the adult education or continuing education program. This subcategory also includes

expenses for activities associated with programs leading toward a degree or certificate at a level below the higher education level, such as adult basic education.

Preparatory/Remedial Instruction

This subcategory includes expenses for formally organized and/or separately budgeted instructional activities that give students the basic knowledge and skills required by the institution before they can undertake formal academic course work leading to a postsecondary degree or certificate. Such activities, supplemental to the normal academic program, generally are termed preparatory, remedial, developmental, or special educational services. These instructional offerings may be taken prior to or along with the course work leading to the degree or certificate. They are generally noncredit offerings, although in some cases credit may be provided specifically for required preparatory or remedial skills or knowledge. If students may satisfy preparatory requirements by taking offerings provided primarily for other than remedial or preparatory purposes, those offerings should be classified elsewhere.

Instructional Information Technology

This subcategory includes expenses for formally organized and/or separately budgeted instructional information technology. If an institution does not separately account for information technology resources, the costs associated with the three primary programs—instruction, research, and public service—will be applied to academic support and the remainder to institutional support.

Research

The research category includes all expenses for activities specifically organized to produce research, whether commissioned by an agency external to the institution or separately budgeted by an organizational unit within the institution. Subject to these conditions, the category includes expenses for individual and/or project research as well as that of institutes and research centers. This category does not include all sponsored programs; nor is it necessarily limited to sponsored research, since internally supported research programs, if separately budgeted, might be included in this category under the circumstances described. Expenses for departmental research that are separately budgeted are included in this category. However, the research category does not include expenses for departmental research that are not separately budgeted. Such expenses are included in the instructional category.

The research category includes the following subcategories.

Institutes and Research Centers

This subcategory includes expenses for research activities that are part of a formal research organization created to manage a number of research efforts. Whereas this subcategory includes agricultural experiment stations, it does not include federally funded research and development centers, which, for public institutions, should be classified as independent operations.

Individual and Project Research

This subcategory includes expenses for research activities that are managed within academic departments. Such activities may have been undertaken as the result of a research contract or grant or through a specific allocation of the institution's general resources.

Research Information Technology

This subcategory includes expenses for formally organized and/or separately budgeted research information technology. If an institution does not separately account for information technology resources, the costs associated with the three primary programs—instruction, research, and public service—will be applied to academic support and the remainder to institutional support.

Public Service

The public service category includes expenses for activities established primarily to provide noninstructional services beneficial to individuals and groups external to the institution. Such activities include community service programs (excluding instructional activities) and cooperative extension services. Included in this category are conferences, institutes, general advisory services, reference bureaus, radio and television, consulting, and similar noninstructional services to particular sectors of the community.

The public service category includes the following subcategories.

Community Service

This subcategory includes expenses for activities organized and carried out to provide general community services, excluding instructional activities. Community service activities make available to the public various resources and special capabilities that exist within the institution. Examples include conferences and institutes, general advisory services and reference bureaus, consultation, testing services (e.g., soil testing, carbon dating, structural testing), and similar activities. The activities included in this subcategory are generally sponsored and managed outside the context of both the

agricultural and urban extension programs and the institution's public broadcasting station.

Cooperative Extension Service

This subcategory includes expenses for noninstructional public service activities established as the result of cooperative extension efforts between the institution and outside agencies such as the U.S. Department of Agriculture's extension service and the affiliated state extension services. This subcategory is intended primarily for land grant colleges and universities and includes both agricultural extension and urban extension services. The distinguishing feature of activities in this subcategory is that the institution shares programmatic and fiscal control with the Department of Agriculture's extension service, the related state extension services, and agencies of local government.

Public Broadcasting Services

This subcategory includes expenses for operation and maintenance of broadcasting services operated outside the context of the institution's instruction, research, and academic support programs. Excluded from this subcategory are broadcasting services conducted primarily in support of instruction (classified in the ancillary support subcategory in academic support), broadcasting services operated primarily as a student service activity (classified in the social and cultural development subcategory in student services), and broadcasting services that are independent operations (classified in the independent operations—institutional subcategory in independent operations).

Public Service Information Technology

This subcategory includes expenses for formally organized and/or separately budgeted public service information technology. If an institution does not separately account for information technology resources, the costs associated with the three primary programs—instruction, research, and public service—will be applied to academic support and the remainder to institutional support.

Academic Support

The academic support category includes expenses incurred to provide support services for the institution's primary missions: instruction, research, and public service. It includes the following activities:

- The retention, preservation, and display of educational materials, such as libraries, museums, and galleries
- The provision of services that directly assist the academic functions of the institution, such as demonstration schools associated with a department, school, or college of education

- Media such as audiovisual services and information technology
- Academic administration (including academic deans but not department chairpersons) and personnel providing administrative support and management direction to the primary missions
- Separately budgeted support for course and curriculum development

For institutions that currently charge some of the expenses—for example, computing support—directly to the various operating units of the institution, this category does not reflect such expenses.

This category includes the following subcategories.

Libraries

This subcategory includes expenses for organized activities that directly support the operation of a cataloged or otherwise classified collection.

Museums and Galleries

This subcategory includes expenses for organized activities that provide for the collection, preservation, and exhibition of historical materials, art objects, scientific displays, and so on. Libraries are excluded.

Educational Media Services

This subcategory includes expenses for organized activities providing audiovisual and other services that aid in the transmission of information in support of the institution's instruction, research, and public service programs.

Academic Support Information Technology

This subcategory includes expenses for formally organized and/or separately budgeted academic support information technology. If an institution does not separately account for information technology resources, the costs associated with the three primary programs—instruction, research, and public service—will be applied to this category and the remainder to institutional support.

Ancillary Support

This subcategory includes expenses for organized activities that provide support services to the three primary programs of instruction, research, and public service but are not appropriately classified in the previous subcategories. Ancillary support activities usually provide a mechanism through which students can gain practical experience. An example

of ancillary support is a demonstration school associated with a school of education. The expenses of teaching hospitals are excluded.

Academic Administration

This subcategory includes expenses for activities specifically designed and carried out to provide administrative and management support to the academic programs. This subcategory is intended to separately identify expenses for activities formally organized and/or separately budgeted for academic administration. It includes the expenses of academic deans (including deans of research, deans of graduate schools, and college deans), but it does not include the expenses of department chairpersons (which are included in the appropriate primary function categories). The subcategory also includes expenses for formally organized and/or separately budgeted academic advising. Expenses associated with the office of the chief academic officer of the institution are not included in this subcategory, but should be classified as institutional support due to the institutionwide nature of that person's responsibilities.

Academic Personnel Development

This subcategory includes expenses for activities that provide the faculty with opportunities for personal and professional growth and development to the extent that such activities are formally organized and/or separately budgeted. This subcategory also includes formally organized and/or separately budgeted activities that evaluate and reward professional performance of the faculty. Included in this subcategory are sabbaticals, faculty awards, and organized faculty development programs.

Course and Curriculum Development

This subcategory includes expenses for activities established either to significantly improve or to add to the institution's instructional offerings, but only to the extent that such activities are formally organized and/or separately budgeted.

Student Services

The student services category includes expenses incurred for offices of admissions and the registrar and activities with the primary purpose of contributing to students' emotional and physical well-being and intellectual, cultural, and social development outside the context of the formal instruction program. It includes expenses for student activities, cultural events, student newspapers, intramural athletics, student organizations, intercollegiate athletics (if the program is not operated as an auxiliary enterprise), counseling and career guidance (excluding informal academic counseling by the faculty), student aid administration, and student health service (if not operated as an auxiliary enterprise).

The student services category includes the following subcategories.

Student Services Administration

This subcategory includes expenses for organized administrative activities that provide assistance and support (excluding academic support) to the needs and interests of students. This subcategory includes only administrative activities that support more than one subcategory of student activities and/or that provide central administrative services related to the various student service activities. In particular, this subcategory includes services provided for particular types of students (e.g., minority students, veterans, and disabled students). Some institutions consolidate various activities in a unit titled enrollment management. Expenses for that unit would be included in this subcategory. Excluded from this subcategory are activities of the institution's chief administrative officer for student affairs, whose activities are institutionwide and therefore should be classified as institutional support.

Social and Cultural Development

This subcategory includes expenses for organized activities that provide for students' social and cultural development outside the formal academic program. This subcategory includes cultural events, student newspapers, intramural athletics, student organizations, and so forth. Expenses for an intercollegiate athletics program are included in this subcategory if the program is not operated as an auxiliary enterprise (in which case all the related expenses would be reported as auxiliary enterprises).

Counseling and Career Guidance

This subcategory includes expenses for formally organized placement, career guidance, and personal counseling services for students. This subcategory includes vocational testing and counseling services and activities of the placement office. Excluded from this subcategory are formal academic counseling activities (academic support) and informal academic counseling services provided by the faculty in relation to course assignments (instruction).

Financial Aid Administration

This subcategory includes expenses for activities that provide financial aid services and assistance to students. This subcategory does not include outright grants to students, which should be classified as revenue reductions, agency transactions, or expenses.

Student Admissions

This subcategory includes expenses for activities related to the identification of prospective students, the promotion of attendance at the institution, and the processing of applications for admission.

Student Records

This subcategory includes expenses for activities to maintain, handle, and update records for currently and previously enrolled students.

Student Health Services

This subcategory includes expenses for organized student health services that are not self-supporting; health services that are self-supporting are reported as auxiliary enterprises.

Student Services Information Technology

This subcategory includes expenses for formally organized and/or separately budgeted student services information technology. If an institution does not separately account for information technology resources, the costs associated with the three primary programs—instruction, research, and public service—will be applied to academic support and the remainder to institutional support.

Institutional Support

The institutional support category includes expenses for central, executive-level activities concerned with management and long-range planning for the entire institution, such as the governing board, planning and programming operations, and legal services; fiscal operations, including the investment office; administrative information technology (when not accounted for in other categories); space management; employee personnel and records; logistical activities that provide procurement, storerooms, and printing; transportation services to the institution; support services to faculty and staff that are not operated as auxiliary enterprises; and activities concerned with community and alumni relations, including development and fund raising.

Appropriate allocations of institutional support should be made to auxiliary enterprises, hospitals, and any other activities not directly related to the primary programs—instruction, research, or public service—or their related support categories.

This category includes the following subcategories.

Executive Management

This subcategory includes expenses for all central, executive-level activities concerned with management and long-range planning for the entire institution (as distinct from planning and management for any one program within the institution). All officers with institutionwide responsibilities are included, such as the president, chief academic officer, chief business officer, chief student affairs officer, chief research officer, chief enrollment management officer, and chief advancement officer. This subcategory includes such operations as executive direction (e.g., governing board), planning and programming operations, and legal, risk, compliance, and internal audit operations.

Fiscal Operations

This subcategory includes expenses for operations related to fiscal control and investments. It includes the accounting office, bursar's office, and external audits. Interest expense on working capital loans is recorded with other interest expense and is not recorded as institutional support. In addition, bad debt expense arising from student loans is recorded in this subcategory. However, bad debts arising from student and other account receivables are recorded as a reduction of the specific revenue source (e.g., tuition, auxiliary fees) rather than as an expense.

General Administration

This subcategory includes expenses for activities related to general administrative operations and services (with the exception of fiscal operations and administrative information technology). Included in this subcategory are personnel administration, space management, purchasing and maintenance of supplies and materials, campuswide communications and transportation services, general stores, and printing shops.

Administrative Information Technology

This subcategory includes expenses for formally organized and/or separately budgeted administrative information technology. If an institution does not separately account for information technology resources, the costs associated with the three primary programs—instruction, research, and public service—will be applied to academic support and the remainder to this category.

Public Relations/Development

This subcategory includes expenses for activities to maintain relations with the community, alumni, or other constituents and to conduct activities related to institutionwide development and fund raising. If institutions conduct fund-raising

activities in conjunction with instructional or other program or supporting activities, Statement of Position 98-2, *Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund Raising*, is used to determine whether the expenses can be allocated. This SOP requires that if certain criteria—purpose, audience, and content—are met, the costs of the activity should be allocated between fund raising and the appropriate program or institutional support. If all of the criteria are not met, the entire amount is classified as fund-raising costs.

Operations and Maintenance of Plant

The operation and maintenance of plant category includes all expenses for the administration, supervision, operation, maintenance, preservation, and protection of the institution's physical plant. They include expenses normally incurred for such items as janitorial and utility services; repairs and ordinary or normal alterations of buildings, furniture, and equipment; care of grounds; maintenance and operation of buildings and other plant facilities; security; earthquake and disaster preparedness; safety; hazardous waste disposal; property, liability, and all other insurance relating to property; space and capital leasing; facility planning and management; and central receiving. This category does not include interest expense on capital-related debt.

This category may be allocated to the other functional categories based on an acceptable allocation methodology such as square footage of buildings.

This category includes the following subcategories.

Physical Plant Administration

This subcategory includes expenses for administrative activities that directly support physical plant operations. Activities related to the development of plans for plant expansion or modification, as well as plans for new construction, should be included in this subcategory. Also included are property, liability, and all other insurance relating to property.

Building Maintenance

This subcategory includes expenses for activities related to routine repair and maintenance of buildings and other structures, including normally recurring repairs and preventive maintenance.

Custodial Services

This subcategory includes expenses related to custodial services in buildings.

Utilities

This subcategory includes expenses related to heating, cooling, light and power, gas, water, and any other utilities necessary for operation of the physical plant.

Landscape and Grounds Maintenance

This subcategory includes expenses related to the operation and maintenance of landscape and grounds.

Major Repairs and Renovations

This subcategory includes expenses related to major noncapital repairs, maintenance, and renovations. Minor repairs should be classified as building maintenance. The institution should establish criteria to distinguish between major repairs and minor repairs. Costs that will be capitalized in accordance with the institution's capitalization policy are excluded.

Security and Safety

This subcategory includes expenses related to security; earthquake and disaster preparedness; safety, including environmental safety; and hazardous waste disposal.

Logistical Services

This subcategory includes expenses related to logistical services such as central receiving as well as space and capital leasing.

Operations and Maintenance Information Technology

This subcategory includes expenses for formally organized and/or separately budgeted operation and maintenance information technology. If an institution does not separately account for information technology resources, the costs associated with the three primary programs—instruction, research, and public service—will be applied to academic support and the remainder to institutional support.

Scholarships and Fellowships

Generally, public institutions report tuition discounts and allowances and scholarships as reductions of tuition and fees revenues, as discussed in the "Tuition and Fee Revenue" section of FARM. Institutional resources provided in excess of amounts owed by the students, and refunded to students, should be recorded as expenses. NACUBO Advisory

Report 2000-5 sets forth and illustrates the appropriate accounting and reporting of various types of tuition discounts and scholarships.

The scholarships and fellowships category includes expenses for scholarships and fellowships—from restricted or unrestricted funds—in the form of grants to students, resulting from selection by the institution or from an entitlement program. The category also includes trainee stipends, prizes, and awards. Trainee stipends awarded to persons who are not enrolled in formal course work should be charged to instruction, research, or public service. Recipients of grants are not required to perform service to the institution as consideration for the grant; nor are they expected to repay the amount of the grant to the funding source. When services are required in exchange for financial assistance, as in the Federal Work-Study Program, charges should be classified as expenses of the department or organizational unit to which the service is rendered. Aid to students in the form of tuition or fee remissions also should be included in this category. However, remission of tuition or fees granted because of faculty or staff status, or family relationship of students to faculty or staff, should be recorded as staff benefits expenses in the appropriate functional expense category.

This category includes the following subcategories.

Scholarships

This subcategory includes grants-in-aid, trainee stipends, tuition and fees waivers, and prizes to undergraduate students.

Fellowships

This subcategory includes grants-in-aid and trainee stipends to graduate students. It does not include funds for which services to the institution must be rendered, such as payments for teaching.

Depreciation

Depreciation expense should be calculated in accordance with the institution's capitalization and depreciation policies. Depreciation expense is considered both a functional and natural expense category. In addition, when functional expenses are reported in the SRECNA, depreciation expense can be allocated to other functions, such as instruction, research, and student services, or allocated only to plant operation and maintenance expenses, or reported separately. When depreciation expense is reported as a functional expense, depreciation for all activities (educational and general, auxiliary enterprises, and hospitals) may be combined and reported as one amount in the SRECNA. Alternatively, it may be segregated between activities if the SRECNA has separate columns or other means to delineate expenses between such activities.

The allocation methodology may be either a simple or complex one such as a multiple allocation approach. Generally, depreciation expense for buildings may be allocated based on the usage of the buildings. This is accomplished by a periodic inventory of the usage of the space in each building. Depreciation expense on equipment may be allocated to other functions based upon the location of the equipment and the use of that space. This is also accomplished through a periodic inventory of the equipment.

Auxiliary Enterprises, Auxiliary Enterprises—Other, and Other Self-Supporting Enterprises

An auxiliary enterprise exists to furnish goods or services to students, faculty, staff, other institutional departments, or incidentally to the general public, and charges a fee directly related to, although not necessarily equal to, the cost of the goods or services. The distinguishing characteristic of an auxiliary enterprise is that it is managed to operate as a self-supporting activity. Over time, the revenues will equal or exceed the expenses, although in any individual year there may be a deficit or a surplus. Examples are residence halls, food services, intercollegiate athletics (only if essentially self-supporting), college stores, faculty clubs, parking, and faculty housing. Student health services, when operated as an auxiliary enterprise, also are included. Hospitals, although they may serve students, faculty, or staff, are classified separately because of their financial significance.

The auxiliary enterprise category includes all expenses relating to the operation of auxiliary enterprises, including expenses for operation and maintenance of plant, depreciation (if allocated to functional expense categories), and administration. Also included are other direct and indirect costs, whether charged directly as expenses or allocated as a proportionate share of costs of other departments or units. To ensure that data regarding individual auxiliary enterprises are complete and adequate for management decisions, cost data should be prepared using full costing methods. Full costing means that the costs attributed to each enterprise include a portion of indirect costs related to that enterprise, as well as the costs directly attributable to its operation.

This category includes the following subcategories.

Auxiliary Enterprises—Student

This subcategory includes expenses for auxiliary enterprise activities primarily intended to furnish services to students. A student health service, when operated as an auxiliary enterprise, is included. However, intercollegiate athletics are excluded from this category.

Auxiliary Enterprises—Faculty/Staff

This subcategory includes expenses for auxiliary enterprise activities primarily intended to provide a service to the faculty, staff, or both. Such activities include the faculty club, faculty/staff parking, and faculty housing.

Intercollegiate Athletics

This subcategory includes expenses for an intercollegiate sports program when the program is operated in accordance with the definition of an auxiliary enterprise (i.e., it is essentially self-supporting).

Auxiliary Enterprises—Other

This subcategory includes expenses for auxiliary enterprise activities primarily intended to furnish goods and services that are related to the higher education mission. Customers for these goods and services generally are not students, faculty, or staff. Entities of this type are formed to meet the geographic and public service needs of a region and generally relate to an institution's mission of teaching, research, or public service. Examples of such an entity would be a drug-testing center or a university press department.

Other Self-Supporting Enterprises

This subcategory includes activities that were established primarily to provide goods and services to other campus units on a fee-for-service basis. The following characteristics assist in identifying such units:

- They are self-supporting units that, over time, operate on a break-even basis for those goods and services offered to other units.
- They may provide, to a lesser extent, the same goods and services to faculty, staff, students, and related entities.
- The goods and services are provided at an institutional level. This characteristic excludes enterprises that serve only units within the same department. For example, a telecommunications department that services the entire institution would be considered another self-supporting enterprise, whereas the chemistry stores department that services only other chemistry units would be reported net within academic support under functional expense reporting.

Expenses incurred under this subcategory should be netted against revenues because the predominance of transactions is internal. Use of this classification does not preclude entities from reporting these and similar activities in other functional categories (e.g., research, academic support).

Auxiliary Enterprises—Depreciation

This subcategory includes depreciation expense for facilities, equipment, and infrastructure assets of the institution's auxiliary enterprises if the institution chooses to allocate depreciation among its functional expense categories.

Auxiliary Enterprises Information Technology

This subcategory includes expenses for formally organized and/or separately budgeted auxiliary enterprises information technology. If an institution does not separately account for information technology resources, the costs associated with the three primary programs—instruction, research, and public service—will be applied to academic support and the remainder to institutional support.

Hospitals

The hospital category includes all expenses associated with the patient-care operations of a hospital, including nursing and other professional services, general services, administrative services, fiscal services, depreciation (if allocated to functional expense categories), and charges for physical plant operations. Also included are other direct and indirect costs, whether charged directly as expenses or allocated as a proportionate share of costs of other departments and units. Expenses for activities that take place within the hospital but that are categorized more appropriately as instruction or research are excluded from this category and accounted for in the appropriate categories.

This category includes the following subcategories.

Direct Patient Care

This subcategory includes expenses for direct patient care such as prevention, diagnosis, treatment, and rehabilitation. Patient-care activities solely for the benefit of the institution's students should be classified within student services.

Health-Care Supportive Services

This subcategory includes expenses for organized activities that are unique to a teaching hospital, health services center, or clinic, and that directly support the provision of health care but cannot be considered part of the provision of direct patient care. Included in this subcategory are such activities as the pharmacy, blood bank, and X-ray services.

Administration of Hospitals

This subcategory includes expenses for both the day-to-day functioning and the long-range viability of the hospital, excluding physical plant operations.

Physical Plant Operations for Hospitals

This subcategory includes expenses for activities related directly to maintaining the grounds and facilities of a hospital as well as providing utility services.

Depreciation of Hospital Facilities and Equipment

This subcategory includes depreciation expense for facilities, equipment, and infrastructure assets of the hospital if the institution chooses to allocate depreciation among its functional expense categories.

Hospital Information Technology

This subcategory includes expenses for formally organized and/or separately budgeted hospital information technology. If an institution does not separately account for information technology resources, the costs associated with the three primary programs—instruction, research, and public service—will be applied to academic support and the remainder to institutional support.

Independent Operations

The independent operations category includes expenses that are independent of or unrelated to, but that may enhance the primary missions of, an institution. This category generally is limited to expenses associated with commercial enterprises and specific federally funded research and development centers. Activities operated as auxiliary enterprises (i.e., those established to provide a service to students, faculty, or staff and charging a fee related to the cost of the service) are excluded from this category. Operations with commercial aspects that primarily support instruction, research, and/or public service (e.g., hospitals and ancillary support activities) also are excluded. Also excluded are expenses associated with property owned and managed as investments of the institution's endowment funds.

This subcategory includes the following subcategories.

Independent Operations—Institutional

This subcategory includes separately organized operations owned or controlled by an institution but unrelated to, or independent of, the institution's missions and that are not federally funded research and development centers.

Independent Operations—Federally Funded Research and Development Centers

Included in this subcategory are the Ames Laboratory at Iowa State University and the Lawrence Berkeley Laboratory at the University of California. All other institutionally operated research centers should be classified as institutes and research centers in the research category.

