



Preferred Industry Practice for Reporting VUCS as a Research Functional Expense

Purpose:

This Advisory Report (AR) provides preferred industry practice for colleges and universities reporting research as a functional class of expenses. A functional expense classification is a method of grouping expenses according to the purpose for which the costs are incurred. The classifications explain *why* an expense was incurred rather than *what* was purchased. Reporting expenses by functional classification helps donors, granting agencies, creditors, and other readers of the financial statements to understand the various mission-related activities of the institution and their relative importance. This AR clarifies when it is appropriate to classify costs associated with voluntary uncommitted cost sharing (VUCS) in the “research” functional expense category in an institution’s audited external financial statements.

Background:

There are mixed views among higher education business officers about which expenses to include in the functional expense category of research. Industry guidance on the subject is not consistent. In particular, it is not always clear how to classify costs associated with VUCS. VUCS is faculty effort that is over and above the amount committed and budgeted for in a sponsored agreement. In essence, the faculty is donating their time to the research project as the funding for such time is not paid by the sponsor or by the institution through committed cost sharing. Some common examples of uncommitted cost sharing include:

- Coverage of cost overruns on a project necessary to achieve the defined deliverables of the research.
- Academic year effort on a sponsored project for which only summer salary was proposed, if the effort was not listed either on the budget page or described in the body of the proposal.

In 2001, the Office of Management and Budget issued a clarification of the treatment of VUCS effort in the computation of facilities and administrative (F&A) rates. This clarification stated that “voluntary uncommitted cost sharing should be treated differently from committed effort and should not be included in the organized research base for computing the F&A rate or reflected in any allocation of F&A costs.” It should be noted that this definition relates only to the treatment of VUCS in the computation of F&A

rates and does not necessarily dictate the way those costs should be classified for functional expense purposes in the audited financial statements.

NACUBO's Financial Accounting and Reporting Manual (FARM) defines the functional category of research as including "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."

The phrase "separately budgeted and accounted for" has been a source of confusion when it comes to determining the amounts to be included in the organized research totals reported by institutions. This wording comes from the definition of research in the Cost Accounting Standards (CAS). Under those standards, institutions are required to establish separate budgets and account for the cost of research in the accounting records, preferably on a project by project basis.

Applicability:

Some institutions have relied on the term "separately budgeted" and included all amounts budgeted as research whether or not the budgeted amount represents the actual effort expended. Functional expense reporting should not be driven solely by budget allocations, but rather by the actual amounts spent on a particular function. For example, a faculty member may have 35% of their salary budgeted for three specific research projects. The budget for the institution, however, may use a more general approach to allocating salary such as 40% research, 40% instruction and 20% professional service. If the faculty member spent only the time budgeted to the specific research projects (35%) then that is the amount that should be included as research, not the 40% allocated for university budgeting purposes. Only those amounts actually spent on research should be included in the research category.

To the extent that VUCS can be associated with a specific research project, it should be included in the functional expense category of research. If, however, VUCS is not specifically tracked via a time and effort reporting vehicle that relates the effort to a specific research project, it should not be included in research. The mere fact that it is budgeted does not compel its inclusion in the research functional category. Discreet budgeting, underlying institutional objectives, and the ability to track and record actual incurred costs are all factors that enter into identifying and recognizing expenses by function.

Significance:

Research expenses, expenditures¹, and revenues are frequently funded from both external and institutional resources. These amounts are reported in a variety of venues to internal

¹ Expenditures are cash outlays of the institution and may include the purchase of capital equipment. Expenses are amounts presented in the institutions statement of activities and include accruals.

and external constituents and, depending on the criteria of a particular report, the amounts may not tie to one another.

For example, research expenditures reported to the National Science Foundation (NSF) exclude any non-science research (such as in the fields of education, humanities, etc.) while, to the extent that such non-science research is federally funded, it would be included in an institution's A-133 financial statements. Each report should accurately reflect the effort that has been expended to produce research from all sources (institutional and external). The reporting of research expenses should be based on actual effort – the budgeted allocation of effort should not be the basis for reporting.

Amounts appropriately considered VUCS tend to be relatively minor. The inclusion of amounts budgeted as research, however, that are not identified with a specific project could materially inflate reported research totals.

Conclusion:

Institutions should ensure that expenses and expenditures related to research activities are properly identified in their financial systems in order to facilitate the required reporting of such information in various venues such as F&A rate proposals, NSF reporting, audited financial statements, etc. The accurate tracking and reporting of an institution's research efforts is essential in providing comparability across institutions.