

**SACUBO BEST PRACTICES ENTRY:
A MORE PRECISE METHOD OF OVERHEAD COST RECOVERY**

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Abstract

Auxiliary Enterprises are, by definition, self-supporting entities. Therefore, these units should absorb all direct costs, as well as an allocable portion of overhead (indirect costs), that are associated with the facilities, goods and services they utilize in delivering various goods and services to UGA's students, faculty and staff. Under current practice, the University of Georgia's (UGA) Auxiliary Enterprises (including the UGA Athletic Association) receive significant overhead support from various administrative units whose operating costs are funded solely by UGA's Resident Instruction budget.

A number of higher education institutions assess their self-supporting entities some form of overhead fee, similar to a flat tax among units. However, the University of Georgia chose to pursue a more individualized plan, which is ultimately more equitable to the units being assessed. Working collaboratively with representatives from Auxiliary Enterprises and the Athletic Association, the University's Budget Office and Controller's Office developed a mechanism that recognizes and properly apportions overhead costs to the self-supporting units. The result achieves the University's goal of minimizing the level of state-appropriated and tuition-generated funding that subsidizes these self-supporting operations.

Introduction of the Organization

The University of Georgia (UGA), established in 1785, is the flagship institution among the 35 colleges and universities in the University System of Georgia. As a federal land-grant/sea-grant institution, it holds public service and outreach, along with teaching and research, as key components of its tripartite mission. UGA operates on a \$1.3 billion annual budget and employs more than 9,500 people. Total enrollment stands at approximately 33,000 – about 24,500 undergraduates and 8,500 graduate and professional students.

The institution's academic reputation is rising steadily, resulting in increasingly selective undergraduate admissions and higher faculty quality. For the past six years, the University of Georgia has been ranked as a top 20 public university by *U.S. News & World Report's* "Best Colleges" guide. Since 2001, more than 25 students have won major national scholarships, such as the Marshall, Rhodes, Truman, Goldwater, Gates-Cambridge and Mellon. In addition, private giving to the University soared close to \$100 million in 2004-05, and UGA ranked 22nd among public universities and 34th among all universities in research. The University of Georgia has also recently been heralded by the *Princeton Review* as one of the nation's top 10 "most connected campuses," with the best technological capabilities for teaching, learning and communicating.

A significant number of auxiliary functions at the University of Georgia augment the basic programs provided by state funding and provide essential support to the faculty and staff. These services include housing, food services, transit, parking, bookstore operations, the student health center and continuing education, among others.

Statement/(Restatement) of the Problem/Initiative

Auxiliary Enterprises are, by definition, self-supporting entities. Therefore, these units should absorb all direct costs, as well as an allocable portion of overhead (indirect costs), that are associated with the facilities, goods and services they utilize in delivering various goods and services to UGA's students, faculty and staff. Under current practice, the University of Georgia's Auxiliary Enterprises (including the UGA Athletic Association) receive significant overhead support from various administrative units whose operating costs are funded solely by UGA's Resident Instruction budget.

A number of colleges and universities assess their self-supporting entities some form of overhead fee, similar to a flat tax among units. However, the University of Georgia desired a more individualized plan, which ultimately would be more equitable to the units being assessed. By recognizing and properly apportioning overhead costs to Auxiliary Enterprises, UGA has minimized the level of state-appropriated and tuition-generated funding that subsidizes these self-supporting operations.

Before proceeding further, it may be helpful to explain the definition of overhead.

Commonly referred to as "indirect costs," overhead consists of:

- a. costs that cannot be readily assigned nor billed to a specific unit without effort that is disproportionate to the benefits received; and
- b. costs incurred for purposes common to all programs and activities of the campus, but which cannot be identified and charged directly to such programs with a reasonable degree of accuracy and without an inordinate amount of accounting.

Design

The Budget Office and Controller's Office realized from the outset that the optimal solution to the overhead dilemma would result from a collaborative effort with the affected units. Bringing them to the discussion table would ensure that all viewpoints were considered and would secure buy-in to the new system. Therefore, the Budget Office and Controller's Office worked closely with the University's Auxiliary Enterprises and Athletic Association during all stages of the process.

The first step in developing the methodology was to identify the Institutional Support functions whose annual costs should be allocated to the self-supporting entities through an overhead assessment. The following criteria were established: functions whose expenditures were classified as Institutional Support, as well as Physical Plant expenditures that were not directly billed to the benefiting units, would be allocated to the units as part of the overhead assessments.

Once the eligible functions for overhead recovery were identified, the next step was to determine the share of the annual variable costs of each function that would be assessed across all campus programs and activities. Two options existed: an assessment of 100 percent of the costs; or an estimation of what portion of the annual expenditures for these functions was for fixed costs (do not vary based on volume of support provided) and how much was for variable costs (increase proportionally to volume of service provided). The team decided on the second option and then established three categories of variable costs for assessment. For example, 75 percent of the Payroll Department's expenditures were estimated to vary by volume, while 50 percent of the Police Department's and only 25 percent of the Legal Affairs Office's expenditures were considered variable; thus, 75 percent of Payroll's annual costs, 50 percent of

the Police Department's annual costs and 25 percent of the Legal Affairs Office's annual costs would be assessed to all campus programs and activities.

The collaborative team then determined the appropriate measure for each of the eligible functions (percent of expenditures, percent of campus headcount, percent of campus acreage, etc.) to use in assessing overhead costs to all campus programs and activities. In a few cases, some functions were excluded or adjusted from the overhead assessment for an individual unit. For example, since Food Services has its own Central Receiving function, UGA's Central Receiving function was excluded from the overhead assessment bill to Food Services.

Finally, the starting point for the assessment was determined. The previous fiscal year's actual expenditures were to be used as the basis to develop the overhead assessment for which each auxiliary unit would be billed in the current fiscal year.

A major objective in developing this methodology was for the new assessment to have minimal impact on the budget and staff, a goal which was achieved. The overhead assessment program requires no additional funding or special equipment, and because the recovered amount is based on the actual expenditures of the previous year, requires very little staff time to determine. Collection occurs via established administrative systems.

Implementation

The University of Georgia's new overhead assessment plan was developed by the senior staff of the Budget Office and Controller's Office, in collaboration with their colleagues in Auxiliary Enterprises and the Athletic Association, over a period of several months in the late summer and fall of 2004. Ultimately, the plan was shared with the senior administrative leadership of the University and received approval from the highest levels.

The plan was implemented for Fiscal Year 2006. The administrative process to charge the overhead assessment to each auxiliary unit takes place once per year. The previous year's actual expenditures are accumulated at the end of the first quarter of the current fiscal year. The annual overhead assessment is then calculated and reviewed for reasonableness. Each unit is notified of its annual assessment, and the collection is facilitated via an internal accounting process. Because representatives of the auxiliary units have been directly involved in the development of the program, the directors understand the need for overhead cost recovery and appreciate that the mechanism is tailored to recognize their unique levels of use of common campus services, rather than being an across-the-board assessment. The participation of the units in the development process has resulted in a better solution and has been essential to the program's successful implementation.

Benefits

The primary benefit of the overhead cost recovery plan is that it returns state-funded and tuition-generated dollars to the Resident Instruction budget. Auxiliary Enterprises are, by definition, designed to be self-supporting units, barrels that sit on their own bottoms. Therefore, recovery of overhead costs minimizes the current practice of subsidization of these programs with state or tuition-generated funds.

The University of Georgia projects an annual overhead cost recovery of approximately \$1.8 million. Since this amount is based on the actual expenditures of the previous fiscal year, it can be projected with accuracy and budgeted as a stable source of revenue in the Resident Instruction budget. These recovered funds may then be used to hire new faculty, expand course offerings or for other initiatives that directly benefit students. In an era of reduced state

allocations and constant belt-tightening, such creative methods are vital to preserving and enhancing the quality of education at a public institution of higher learning.

In addition, the plan provides an incentive to the assessed units that they would not receive through a flat tax. Since the basis for the assessment is the previous year's actual expenses, the University is able to reduce indirect costs to the units when it employs a better method to recover them. The unit gains in the long run as the University streamlines its collection. Thus, the auxiliaries have a vested interest in the program's success.

The collaborative team was deliberate in its development of the overhead cost recovery plan. Significant time and thought were invested on the front end in order to minimize implementation problems. Involvement of the affected units was particularly helpful in anticipating concerns and achieving buy-in. In addition, the assessment is being phased in over a two-year period in order to allow the auxiliary units sufficient time to prepare for its impact.

Retrospect

What would the University have done differently in retrospect? Because the overhead cost recovery plan is new, the planners do not have enough experience with the program to pinpoint areas for improvement. However, many potential flaws have been mitigated through the patient, collaborative, front-end deliberations of all units involved in the process. The University realized that some method of recovering indirect costs was needed, but it did not settle for a simple assessment of a flat tax. The resulting overhead cost recovery plan benefits all involved. It enables the University to reduce the flow of state funds to auxiliary units and rewards auxiliaries with a more equitable and, ultimately, lower assessment for overhead costs as the University's efficiency in this area improves.