ENHANCED BUDGETING PRACTICES

Allocate Costs of Shared Support Services to Subunits to Better Understand the True Cost of Offering Services

Key Points

• Support services and facilities play an integral role in achieving a college’s goals. Therefore, it is important to develop an allocation model to fairly and transparently distribute the costs of support services to the college’s subunits.

• To determine which costs to allocate and by what basis to allocate, a college should develop an allocation model that takes into account the goals behind developing an allocation model and the cost and benefits of administering the allocation system.

• A college could develop a pricing system for internal services as part of its allocation model. This document references the general GFOA best practice on pricing internal services, which provides much greater detail on developing an internal pricing system.

Related Award Program Criteria

• **Criterion Enhanced B.1: Allocation Transparency.** The applicant can provide an internal document, as supplementary material, that is available to stakeholders and which describe the allocation formulas in a way that is also understandable to the judges.

• **Criterion Enhanced B.2: Allocation Rationale.** In the award application, the applicant can offer a compelling description of how its allocation strategy supports a strategic approach to budgeting.

• **Criterion Enhanced B.3: Understandability to Non-Finance Stakeholders.** The academic officer can describe the allocation methods to the judges in the award interview.
Introduction

Support services and facilities are an integral part of achieving a community college’s goals. Therefore, it is important that an allocation model is developed that is fair, understandable, accepted, and that does not incentivize counterproductive behavior.

Allocating fixed, support, and administrative costs (collectively referred to here as “shared services”) has three basic functions in the college budgeting process: 1) to reveal the true cost of offering programs and services to clientele by accounting for the costs of the shared services those programs consume; 2) to govern demand for shared services and, hence, manage the cost of those services; and 3) to help ensure that the cost of shared services remains reasonable by making the cost to the organization more evident. The first function is the most important for optimally aligning resources with student achievement goals because it enables a college to evaluate the cost-effectiveness of its programs.

This best practice document addresses:
1. Developing an allocation model.
2. Other resources to support developing an allocation model.

I. Developing an Allocation Model

A college should develop an allocation model that fits the organization (e.g., a model might differ based on the number of campuses a college has), ties to the hierarchy of the college’s programs and activities, and is pragmatic in which costs are allocated.

In determining which costs to allocate and by what basis to allocate, a college should consider the goals behind allocation and the management value that the allocation system will provide. Both the materiality of the cost and recipients’ degree of control over the expenses should be considered. The following table elaborates on this concept:

<table>
<thead>
<tr>
<th>Control</th>
<th>Financial Materiality</th>
<th>Low</th>
<th>High</th>
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</thead>
<tbody>
<tr>
<td>Low</td>
<td>Accounting Services</td>
<td>These costs are least relevant for allocation. Decisions to not allocate, or to allocate based on a very rudimentary and uniform basis, may be most appropriate.</td>
<td></td>
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<tr>
<td>High</td>
<td>Office Supplies</td>
<td>These costs are important to allocate, but overly precise usage measures will be difficult to manage with little incremental value. Internal pricing should be developed that is not overly granular, but adequately serves as a proxy for usage.</td>
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<td>Maintenance Cost</td>
<td>Allocation should be done, but with awareness that direct control is limited. Less specific usage measures will be possible; charges based on percent total of full-time equivalent (FTE) salaries or based on enrollment might be most practical.</td>
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<td></td>
<td>Laboratory Utilization</td>
<td>Cost allocation should be done based on usage metrics designed specifically for the cost element and charged most precisely of all allocated costs to the subunits.</td>
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Costs should be allocated to the same organizational level for which budgeting and strategic planning is done. For example, if a college budgets at the department level, then cost allocation should be structured to the department level, as well. If programs are used as the basis for budgeting, then programs should be used for cost allocation. This will vary by college, but consistency is important.
II. Other Resources to Support Development of an Allocation Model

For additional support in developing allocation models, colleges can reference the GFOA best practice on pricing internal services (which was not written specifically for community colleges). This provides additional guidance on how to develop a pricing system for internal services.

A college should follow these steps when considering an internal-service pricing system:

Identify goals of internal service pricing. As an initial step, colleges should identify the goals they hope to achieve through a pricing system for internal services. The goals will guide the design of the system. For example, if a college does not charge for a particular service based on customers’ usage, then there may be an incentive to overuse the service. In this case, an internal service pricing goal may be to govern demand for a service.

Define level of costing detail. A college needs to determine the level of detail associated with costing services. This decision can be guided by an organization’s willingness to develop a more complex internal services pricing system for a more accurate costing system. For example, a low level of detail may be sufficient for a costing system with limited goals, while a high level of detail might be needed for goals governing the demand for service.

Determine cost of service. After identifying internal services as having either a high or low level of detail, the organization will then determine the cost of the service. Common variables to consider include direct costs, interest costs from internal loans, and services used from other support services. Direct costs include personnel, materials, and supplies related to the service. Interest costs from internal loans apply if the internal service takes loans from other parts of the organization. Lastly, if the service requires other support services, then indirect costs may apply. An IT service that uses payroll is one such example.

Decide basis of allocation. With the cost of the service decided, the organization will decide the basis for allocating costs from internal services to customers. In determining the basis, general principles should be observed. The first principle is the cause-and-effect relationship, so that cost should be allocated based on usage or causal factors related to costs incurred by the service provider. The basis for allocation should also bear a relationship to the benefit the customer receives from the services. For example, “miles driven” might be a good measure of the benefit that security receives from its vehicles, whereas “hours used” might be better for facilities management. The third principle requires that users of the costing system perceive the method of cost allocation as fair and legitimate. Lastly, legal constraints need to be recognized when developing the basis for allocation.

Consider potential drawbacks. A college should recognize potential drawbacks of internal costing systems and should consider mitigating strategies. Common potential drawbacks include a diminished trust between providers and customers, subverting processes or not using shared services, acrimony and debate over the charge system, and costs exceeding the benefits of the system.

Program costing strategy. This document provides a guide to developing a full-costing system for programs. The method described could also be applied to departments.

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Endnotes