

## ¶701.1 Introduction

A functional expense classification is a method of grouping expenses according to the purpose for which the costs are incurred. The classifications tell *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.

The functional classifications listed in [¶701.2](#) as the “NACUBO Functional Category Definitions” have been widely used by both public and independent institutions for decades and date back from *College and University Business Administration* (CUBA) first published in 1985 by NACUBO and the original AICPA College and University Audit Guide first published in 1973. These functional categories were slightly modified in 1999 by NACUBO’s Accounting Principles Council, and the guidance in the following Advisory Reports incorporated into FARM:

- [Advisory Report 1999-6](#), Accounting and Reporting Safety and Security Expenses by Higher Education
- [Advisory Report 1999-3](#), Accounting and Reporting Information Technology Expenses by Higher Education
- [Advisory Report 1999-4](#), Accounting and Reporting for Special Session Instruction
- [Advisory Report 1999-2](#), Accounting and Reporting for Auxiliary, Auxiliary-Other, and Other Self-Supporting Activities

Both public and independent institutions are expected and required to use these definitions for functional expense classifications when reporting expense information in the Integrated Postsecondary Education Data System (IPEDS) Finance Survey. Additionally, because Office of Management and Budget cost accounting requirements (related to sponsored research activity) are dependent on the functional expense definitions and related chart of account structure that has been in place for decades, institutions are advised to keep these definitional standards and general ledger structure in place. Accounting information systems must be capable of producing expense information by that functional classification. Although not exhaustive or comprehensive, [Appendix D](#) illustrates a way to think about organizing activities, organizational units, position titles, and types of expenditures, conducted at both public and independent universities, and the item's conventional association with one or more functional expense category/subcategory combinations.

While there has been little change in those classifications, there has been a lot of conversations about how to make the functional classifications more meaningful to readers of the financial statements and more consistent allocation techniques so that the expenses are comparable across institutions. [¶703](#) contains some alternative classifications that institutions are using instead of the IPEDS required functions.

## ¶701.2 NACUBO Functional Category Definitions (for G/L Account Structure and Required for IPEDS Reporting)

The current functional expense categories are:

- Instruction
- Research
- Public Service
- Academic Support
- Student Services
- Institutional Support
- Scholarships and Fellowships
- Auxiliary Enterprise
- Hospitals
- Independent Operations
- Operations and Maintenance of Plant (Public Institutions only)

## ¶701.21 Instruction

The instruction classification 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 are included.

Expenses for departmental research and public service that are not separately budgeted also are included in this classification.

This classification excludes expenses for those academic personnel whose primary activity is administration—for example, academic deans.

The instruction classification includes the following five subclasses:

- General Academic Instruction
- Vocational/Technical Instruction
- Community Education
- Preparatory/Remedial Instruction
- Instructional Information Technology.

### ¶701.211 General Academic Instruction

This subclass includes expenses for formally organized and/or separately budgeted instructional activities that are associated with academic offerings described by the 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.

This subclass 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.

### **¶701.212 Vocational/Technical Instruction**

This subclass 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.

This subclass 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.

### **¶701.213 Community Education**

This subclass 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 subclass 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.

### **¶701.214 Preparatory/Remedial Instruction**

This subclass 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, which are 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.

### **¶701.215 Instructional Information Technology**

This subclass 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 classified as academic support and the remainder as institutional support.

## **¶701.22 Research**

The research classification 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 those conditions, the classification includes expenses for individual and/or project research as well as that of institutes and research centers.

This classification 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 classification.

Expenses for departmental research that are separately budgeted are included in this classification. However, the research classification does not include expenses for departmental research that are not separately budgeted. Departmental research that is not separately budgeted is included in the instructional category.

The research classification includes the following three subclasses:

- Institutes and Research Centers
- Individual and Project Research
- Research Information Technology.

#### **¶701.221 Institutes and Research Centers**

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

#### **¶701.222 Individual and Project Research**

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

#### **¶701.223 Research Information Technology**

This subclass 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 classified as academic support and the remainder as institutional support.

### **¶701.23 Public Service**

The public service classification includes expenses for activities established primarily to provide non-instructional services for the benefit of individuals and groups that are external to the institution. These activities include community service programs (excluding instructional activities) and cooperative extension services. Included in this classification are conferences,

institutes, general advisory services, reference bureaus, radio and television, consulting, and similar non-instructional services to particular sectors of the community.

The public service classification includes the following four subclasses:

- Community Service
- Cooperative Extension Service
- Public Broadcasting Services
- Public Service Information Technology.

#### **¶701.231 Community Service**

This subclass 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 (for example, soil testing, carbon dating, structural testing), and similar activities. The activities included in this subclass are generally sponsored and managed outside the context of both the agricultural and urban extension programs and the institution's public broadcasting station.

#### **¶701.232 Cooperative Extension Service**

This subclass includes expenses for non-instructional 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. 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.

This subclass is intended primarily for land-grant colleges and universities and includes both agricultural extension and urban extension services. Independent institutions rarely use this subclass.

#### **¶701.233 Public Broadcasting Services**

This subclass includes expenses for operation and maintenance of broadcasting services operated outside the context of the institution's instruction, research, and academic support programs.

The following broadcasting services are excluded from this subclass:

- Broadcasting services conducted primarily in support of instruction, which should be classified in the ancillary support subclass of academic support
- Broadcasting services operated primarily as a student service activity, which should be classified in the social and cultural development subclass of student services

- Broadcasting services that are independent operations, which should be classified in the independent operations/institutional subclass of independent operations.

### ¶701.234 Public Service Information Technology

This subclass 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 classified as academic support and the remainder as institutional support.

## ¶701.24 Academic Support

The academic support classification includes expenses incurred to provide support services for the institution's primary programs of 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 audio-visual services, and technology, such as computing support
- Academic administration (including academic deans but not department chairpersons) and personnel providing administrative support and management direction to the three 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 classification does not include those expenses.

The academic support classification includes the following eight subclasses:

- Libraries,
- Museums and Galleries,
- Educational Media Services,
- Ancillary Support,
- Academic Administration,
- Academic Personnel Development,
- Course and Curriculum Development, and
- Academic Support Information Technology.

### ¶701.241 Libraries

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

### **¶701.242 Museums and Galleries**

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

### **¶701.243 Educational Media Services**

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

### **¶701.244 Ancillary Support**

This subclass includes expenses for organized activities that provide support services to the three primary programs of instruction, research, and public service, but that are not appropriately classified in the previous subclasses. 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. Hospital expenses have their own functional classification.

### **¶703.245 Academic Administration**

This subclass includes expenses for activities specifically designed and carried out to provide administrative and management support to the academic programs. This subclass 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 subclass 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 subclass, but should be classified as institutional support due to the institution-wide nature of that individual's responsibilities.

### **¶701.246 Academic Personnel Development**

This subclass 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 subclass also includes formally organized and/or separately budgeted activities that evaluate and reward professional performance of the faculty. Included in this subclass are sabbaticals, faculty awards, and organized faculty development programs.

### **¶701.247 Course and Curriculum Development**

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

### **¶701.248 Academic Support Information Technology**

This subclass 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 institution's three primary programs— instruction, research, and public service—will be included to this subclass and the remainder will be included in institutional support.

## **¶701.25 Student Services**

The student services classification includes expenses incurred for offices of admissions and the registrar and activities that, as their primary purpose, contribute to students' emotional and physical well-being and intellectual, cultural, and social development outside the context of the formal instruction program. This classification 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 classification includes the following eight subclasses:

- Student Services Administration
- Social and Cultural Development
- Counseling and Career Guidance
- Financial Aid Administration
- Student Admissions
- Student Records
- Student Health Services
- Student Services Information Technology.

### **¶701.251 Student Services Administration**

This subclass includes expenses for organized administrative activities that provide assistance and support (excluding academic support) to the needs and interests of students. This subclass includes only administrative activities that support more than one subclass of student activities and/or that provide central administrative services related to the various student service activities.

Some institutions consolidate various activities in a unit titled enrollment management. Expenses of an enrollment management unit would be included in this subclass.



This subclass includes services provided for particular types of students (for example, minority students, veterans, and disabled students).

Excluded from this subclass are activities of the institution's chief administrative officer for student affairs, whose activities are institution wide and therefore should be classified as institutional support.

#### **¶701.252 Social and Cultural Development**

This subclass includes expenses for organized activities that provide for students' social and cultural development outside the formal academic program. It includes cultural events, student newspapers, intramural athletics, student organizations, etc.

Excluded from this subclass are expenses for an intercollegiate athletics program that is operated as an auxiliary enterprise.

#### **¶701.253 Counseling and Career Guidance**

This subclass includes expenses for formally organized placement, career guidance, and personal counseling services for students. It includes vocational testing and counseling services and activities of the placement office.

Excluded from this subclass are formal academic counseling activities (which are included in academic support) and informal academic counseling services provided by the faculty in relation to course assignments (which are included in instruction).

#### **¶701.254 Financial Aid Administration**

This subclass includes expenses for activities that provide financial aid services and assistance to students.

This subclass does not include outright scholarship or fellowship grants to students, which should be classified as revenue reductions, agency transactions, or expenses. More about classification of grants to students in public institutions is presented in [¶360.41](#). More information about the classification of grants to students in independent institutions can be found in [¶460.43](#).

#### **¶701.255 Student Admissions**

This subclass 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.

#### **¶701.256 Student Records**

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

### **¶701.257 Student Health Services**

This subclass includes expenses for organized student health services that are not self-supporting. (Health services that are self-supporting are reported as auxiliary enterprises.)

### **¶701.258 Student Services Information Technology**

This subclass 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 classified as academic support and the remainder as institutional support.

## **¶701.26 Institutional Support**

The institutional support classification 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, printing, and 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 fundraising.

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, and public service—or their related support classifications.

The institutional support classification includes the following five subclasses:

- Executive Management
- Fiscal Operations
- General Administration
- Public Relations/Development
- Administrative Information Technology

### **¶701.261 Executive Management**

This subclass 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). This subclass includes such operations as executive direction (for example, governing board), planning and programming operations, legal, risk, compliance, and internal audit operations.

All officers with institution-wide 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.

### **¶701.262 Fiscal Operations**

This subclass includes expenses for operations related to fiscal control and investments. It includes the accounting office, bursar's office, and external audits.

Independent institutions also include interest expense on working capital borrowings and any unallocable interest expense in this subclass. Public institutions report all interest in a separate classification as a nonoperating expense.

Both independent and public institutions include bad debt expense arising from student loans in this subclass. Independent institutions also include bad debts arising from student and other accounts receivables. Public institutions, however, record bad debts from receivables (other than student loans) as a reduction of the specific revenue source that generated the receivable (e.g., tuition, auxiliary fees) rather than as an expense.

### **¶701.263 General Administration**

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

### **¶701.264 Public Relations/Development**

This subclass includes expenses for activities to maintain relations with the community, alumni, or other constituents and to conduct activities related to institution-wide development and fundraising.

### **¶701.265 Administrative Information Technology**

This subclass 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 classified as academic support and the remainder as institutional support.

## **¶701.27 Scholarships and Fellowships**

Generally, institutions report most scholarships and fellowships as tuition discounts and allowances (reductions of tuition and fees revenues). Other student awards are funded by third parties and made to students specified by those parties (that is, recipients are not determined by

the institution); they are agency transactions, as discussed in ¶403.51, and do not result in either revenues or expenses.

However, as discussed in as discussed in ¶460.43 (independent institutions) and ¶360.41 (public institutions), if the applied aid exceeds charges to the student (tuition and fees, dormitory, and food service), and the excess is disbursed to the student, the excess disbursed is reported as an expense in the financial statements.

The scholarships and fellowships classification includes expenses for scholarships and fellowships—from restricted or unrestricted funds—in the form of grants that neither require the student to perform service to the institution as consideration for the grant, nor require the student to repay the amount of the grant to the funding source. In public institutions, they may result from selection by the institution or from an entitlement program. The classification also includes trainee stipends, prizes, and awards. (However, trainee stipends awarded to individuals who are not enrolled in formal course work should be charged to instruction, research, or public service.)

The scholarships and fellowships classification excludes student awards that are made in exchange for services provided to the institution, such as graduate and teaching assistantships and student work-study programs. When services are required in exchange for financial assistance, charges should be classified as expenses of the department or organizational unit to which the service is rendered and reported as expenses of the function classification benefited by the work provided by the student. For example, a tuition remission to a graduate teaching assistant in the biology department would be charged to instruction. Remission of tuition or fees granted as a result of faculty or staff status or family relationship of students to faculty or staff, should be recorded as staff benefits expenses in the benefits pool or of the department or organizational unit to which the service was rendered. (Benefit expenses will need to be allocated to the appropriate functional expense category if recorded in a broad benefit expense pool; benefit expenses directly charged to a functional category would not be allocated).

The scholarships and fellowships classification includes the following two subclasses:

#### **¶701.271 Scholarships**

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

#### **¶701.272 Fellowships**

This subclass 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.

### **¶701.28 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 (if operated as 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. Because of a desire to assess whether the enterprise is self-supporting, expenses for operation and maintenance of plant, depreciation, interest, and administration may be charged directly or allocated, even though that allocation is not required of public institutions for financial statement purposes. (Independent institutions, however, are required to make the allocation.) 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 includes a portion of indirect costs related to that enterprise, as well as the costs directly attributable to its operation.

The auxiliary enterprise classification includes the following seven subclasses:

- Auxiliary Enterprises—Student
- Auxiliary Enterprises—Faculty/Staff
- Intercollegiate Athletics
- Auxiliary Enterprises—Other
- Other Self-Supporting Enterprises
- Auxiliary Enterprises—Depreciation
- Auxiliary Enterprises—Information Technology

#### **¶701.281 Auxiliary Enterprises—Student**

This subclass 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.

#### **¶701.282 Auxiliary Enterprises—Faculty/Staff**

This subclass 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.

#### **¶701.283 Intercollegiate Athletics**

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

#### **¶701.284 Auxiliary Enterprises—Other**

This subclass 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.

#### **¶701.285 Other Self-Supporting Enterprises**

This subclass 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 these 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 only serve units within the same department.

For example, a telecommunications department that services the entire institution would be considered a self-supporting enterprise while the chemistry stores department that only services other chemistry units would be reported net within the academic support classification.

Expenses incurred under this subclass should be netted against revenues since 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).

#### **¶701.286 Auxiliary Enterprises –Depreciation**

This subclass includes depreciation expense for facilities, equipment, and infrastructure assets of the institution's auxiliary enterprises. Independent institutions are required to allocate depreciation among their functional classes. Public institutions may report depreciation expense separately, include it with operation and maintenance of plant expenses, or allocate it among all the functional expense classifications. If a public institution chooses to report depreciation as a separate line item or to include all depreciation in the operation and maintenance of plant classification, this subclass would not be used.

#### **¶701.287 Auxiliary Enterprises Information Technology**

This subclass includes expenses for formally organized and/or separately budgeted auxiliary enterprise 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 classified as academic support and the remainder as institutional support.

## **¶701.3 Hospitals, Independent Operations, Operations and Maintenance of Plant, Depreciation and Interest**

### **¶701.31 Hospitals**

The hospital classification includes all expenses associated with the patient care operations of a hospital, including nursing and other professional services, general services, administrative services, and fiscal services. Because of a desire to assess whether the hospital is self-supporting, an allocation of expenses for operation and maintenance of plant, depreciation, and interest may be included, even though that allocation is not required of public institutions for financial statement purposes. (Independent institutions, however, are required to make the allocation.) 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 classification and accounted for in their appropriate classifications.

The hospitals classification includes the following six subclasses:

- Direct Patient Care
- Health Care Supportive Services
- Administration of Hospitals
- Physical Plant Operations for Hospitals
- Depreciation of Hospital Facilities and Equipment
- Hospital Information Technology

#### **¶701.312 Direct Patient Care**

This subclass 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.

#### **¶701.313 Health Care Supportive Services**

This subclass 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.

### **¶701.314 Administration of Hospitals**

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

### **¶701.315 Physical Plant Operations for Hospitals**

This subclass includes expenses for activities related directly to maintaining the grounds and facilities of a hospital as well as providing utility services. Like operation and maintenance of plant, this is not a functional classification for an independent institution. However, it might be used internally to accumulate costs, which would be combined with other hospital costs in the statement of activities.

### **¶701.316 Depreciation of Hospital Facilities and Equipment**

This subclass includes depreciation expense for facilities, equipment, and infrastructure assets of the hospital. Independent institutions are required to allocate depreciation among their functional classes. Public institutions may report depreciation expense separately, include it with operation and maintenance of plant expenses, or allocate it among all the functional expense classifications. If a public institution chooses to report depreciation as a separate line item or to include all depreciation in the operation and maintenance of plant classification, this subclass would not be used.

### **¶701.317 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 classified as academic support and the remainder as institutional support.

## **¶701.32 Independent Operations**

The independent operations classification includes the expenses of separately organized operations owned or controlled by an institution that are unrelated to, or independent of, the institution's mission but that may enhance its mission. This classification generally is limited to expenses associated with commercial enterprises and specific federally funded research and development centers (FFRDCs) operated by the institution but not established to provide services primarily to students, faculty, or staff.

Activities operated as auxiliary enterprises (that is, 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 classification, as are operations with commercial aspects that primarily support instruction, research, and/or public service. (For example, hospitals and ancillary support activities are excluded.) Also excluded are expenses associated with property owned and managed as investments of the institution's endowment funds.



The relationship between the institution and the independent operation needs to be carefully examined to determine the proper accounting. Independent institutions need to determine if the relationship requires consolidation of the independent operation or use of the equity method of accounting (if the independent operation is a corporation). The standards for making those determinations are discussed in [¶507](#). Public institutions need to determine whether the independent operation is a component unit. The standards for making that determination are discussed in [¶205](#).

If the entity is not a separate legal entity, the nature of the independent operation needs to be evaluated. Depending upon the nature of the contractual relationship between the institution, the FFRDC and the federal sponsoring agency, the accounting may vary between recognizing all of the revenues and expenses of the FFRDC in the institution's financial statements and just recognizing the institution's management fee for operating the FFRDC. In many cases, the employees of the FFRDC are in fact employees of the institution and the nature of the relationship is like other large research contracts or grant agreements. In those circumstances, the revenues and expenses of the FFRDC should be consolidated with the institution.

The independent operations classification includes the following two subclasses:

- Independent Operations/Institutional and
- Independent Operations/Federally Funded Research and Development Centers (FFRDCs).

### **¶701.321 Independent Operations/Institutional**

This subclass 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 (FFRDCs).

### **¶701.322 Independent Operations/Federally-Funded Research and Development Centers (FFRDCs)**

The National Science Foundation periodically publishes a list of all FFRDC's and that list can be found here: [NSF list of FFRDCs](#).

## **¶701.33 Operation and Maintenance of Plant Expenses**

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. These expenses include items such 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.

For external financial reporting purposes, independent institutions are required to allocate the costs assigned to this classification to the other functional categories. However, most independent institutions still use this functional expense category internally to capture costs prior to allocation. Consequently, although this category is necessary and important to an independent institution's general ledger structure—and a necessary cost pool for cost reporting under the Uniform Guidance—the expenses are not considered a functional expense category (for GAAP reporting) for independent institutions.

For public institutions, operation and maintenance of plant expenses may be reported as a separate functional classification or the expenses may be allocated to the other functional categories based on an acceptable allocation methodology (such as square footage of buildings). Operation and maintenance of plant is one of the classifications of expense that public institutions will be required allocate among the other functional classifications in the expenses section (Part C) of the IPEDS Finance Survey beginning in FY 2010 (that is, the survey submitted in 2011). For public institutions, this classification does not include interest expense on plant-related debt. [NACUBO Advisory Report 2010-1](#) explains IPEDS Finance Survey Allocation Requirements.

The operations and maintenance of plant classification includes the following subclasses:

- Physical Plant Administration
- Building Maintenance
- Custodial Services
- Utilities
- Landscape and Grounds Maintenance
- Major Repairs and Renovations
- Security and Safety
- Logistical services
- Operations and Maintenance Information Technology

#### **¶701.331 Physical Plant Administration**

This subclass 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 subclass. Also included are property, liability, and all other insurance relating to property.

#### **¶701.332 Building Maintenance**

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

#### **¶701.333 Custodial Services**

This subclass includes expenses related to custodial services in buildings.

### **¶701.334 Utilities**

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

### **¶701.335 Landscape and Grounds Maintenance**

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

### **¶701.336 Major Repairs and Renovations**

This subclass 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.

This subclass excludes costs that will be capitalized in accordance with the institution's capitalization policy.

### **¶701.337 Security and Safety**

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

### **¶701.338 Logistical Services**

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

### **¶701.339 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 classified as academic support and the remainder as institutional support.

## **¶701.34 Depreciation**

Depreciation expense is calculated in accordance with the institution's capitalization and depreciation policies. For independent institutions, see [¶415](#), especially [¶415.4](#). For public institutions, see [¶315](#).

Independent institutions are not permitted to report depreciation expense as a separate functional classification. FASB ASC 958-720-45-25 makes it clear that occupying and maintaining a

building is not a separate supporting service. As a result, independent institutions allocate depreciation to the functional classifications.

For public institutions, depreciation expense may be considered either as a functional or a natural expense classification. When expenses are reported by functional classification in the SRECNP, depreciation expense can be allocated to the other functional classifications (such as instruction, research and student services) or allocated only to operation and maintenance of plant expenses, or reported separately. When depreciation expense is reported as its own functional classification, depreciation for all activities (educational and general, auxiliary enterprises, and hospitals) may be combined and reported as one amount in the SRECNP. The majority of public institutions report depreciation as a separate functional classification, in some fashion.

The allocation methodology for both independent and public institutions may be either a simple one or complex one. 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 on the location of the equipment and the use of that space. This is also accomplished through a periodic inventory of the equipment.

## **¶701.35 Interest**

Different rules exist for the reporting of interest expense by independent and public institutions. In accordance with FASB ASC 958-720-45-24, independent institutions allocate interest expense to functional classifications to the extent possible. Interest expenses that cannot be allocated should be reported in Institutional Support-Fiscal Operations by independent institutions.

Public institutions report interest as a nonoperating expense in the SRECNP. This classification includes interest expense on capital debt, payments on capital leases classified as interest expense, and interest expense on other borrowings such as for working capital or student loans. See ¶315.4 for discussion on calculation of interest on debt and capital leases. Institutions may segregate the interest expense into capital related and noncapital related debt in the SRECNP to correspond to disclosures made in the statement of cash flows.

## **¶701.4 Areas of Potential Inconsistency**

Certain activities may vary from one institution to another. Those variances may result in inconsistencies in the reporting of expenses by function. For example, an NCAA Division I institution may classify its intercollegiate athletics programs as auxiliaries while a Division III school may classify its intercollegiate athletics as student services. When determining the appropriate functional categorization, management should look to the structure of the activities at their particular institution. If an activity is categorized in a way that may be different from the way it is classified by other institutions, management should include a disclosure in the financial statements that discusses the reasoning for such classification.

The following are known areas of inconsistency:

- Accreditation – Some institutions classify as Academic Support, other as Institutional Support. Since it pertains to the academic program, Academic Support is preferred.
- Campus security – Some institutions classify as Student Services, others as Operations and Maintenance of Plant. Since the scope of responsibility has generally been expanded to safety and security of the entire campus, Operations and Maintenance of Plant seems to be a more appropriate category.
- Development and fundraising – Fund raising activities conducted by an institution’s president or deans may not be segregated as fund raising expense and may instead be reported as institutional support or academic support, respectively. If the expenses are material, some allocation to institutional support/fundraising expenses should be made.
- Intercollegiate athletics - Some institutions classify as Student Services, others as Auxiliaries. A hybrid approach may be preferred, in which expenses to recruit, coach, supply and field teams of student athletes could be classified as student services. Expenses of maintaining stadiums, parking, food service, etc. and the ticket revenue could be considered auxiliaries.
- Intramural athletics - Some institutions classify as Instruction, others as Student Services. If the intramural activity does not lead to academic credit, classification as Student Services is preferred.
- Research post-award accounting - Some institutions classify as Academic Support, others as Institutional Support, and others as Organized Research. Since the activity is not associated with specific organized research projects (and generally cannot be “direct charged”), inclusion as Organized Research is not correct and violates OMB Uniform Guidance Cost principles. Further, since the activity is primarily associated with the academic enterprise, classification as Academic Support is preferred.
- Research pre-award services - Some institutions classify as Academic Support, others as Institutional Support, and others as Organized Research. Since the activity is not associated with specific organized research projects (and generally cannot be “direct charged”), inclusion as Organized Research is not correct and violates OMB Uniform Guidance Cost principles. Further, since the activity is primarily associated with the academic enterprise, classification as Academic Support is preferred.

## ¶701.8 Tutorials

The Tutorials that follow are short vignettes describing situations and responses for applying the accounting and reporting guidance contained in the FARM. They are offered as an additional resource to describe how theoretical concepts may translate to real-life situations.

## ¶701.81 Functional Expenses – Hospital or Instruction?

### SITUATION

The new AVP Finance/Controller at a large research university with both a medical college and hospital, is preparing the financial statements for the first time. He is reviewing the functional classifications of expenses, specifically those related to the hospital services. He notices that in

the prior year's statements, expenses classified as hospital services are three times the expenses reported as instruction, and wonders if this is correct.

In researching it further, he finds that the function categories for expenses have been assigned in the financial system based on the organization. Therefore, the expenses incurred in all departments within the medical college and hospital organizations have been included in the "hospital" category for financial reporting. Assigning the function code by organization has resulted in the following incorrect classifications:

- Clinical trials on sponsored by pharmaceutical companies are not shown as organized research.
- All of the medical college dean's compensation is included as a hospital expense even though she teaches two courses each semester.

## **RESPONSE**

While some departments within universities may incur expenses associated with only one function (e.g. Finance office = institutional support), the one-for-one relationship between organization and function is almost never accurate for university academic departments that deliver instruction, research, public service, and the associated academic support services. Consequently, it is an oversimplification to rely solely on the organization field in a chart of accounts to assign the function code. The function classification is an indicator of the service being delivered, and not the department delivering the service.

Hospitals associated with universities have a dual function of both patient care and instruction. Therefore, a portion of the expenses incurred to deliver instruction to students in health care programs should be allocated to instruction. And expenses incurred in conjunction with sponsored research projects should be classified as organized research.

The various functional categories are described in very broad terms. Consequently, categorizing expenses into functional classifications is more art than science and requires sufficient judgment. Classifications should follow the general definitions and guidelines, be rational and consistent.

Based on the definitions below, it appears the critical factor is whether the cost is directly related to patient care or supports the instruction/research/public service initiatives.

Activities that are directly related to delivering the academic program should be classified as instruction. And clinical research projects should be classified as organized research.

Changes to the functional classification of expenses in the current year's financial statements will have to be applied to the prior year classifications as well. This will require a note explaining that the prior year amounts were changed to conform to the current year's presentation.

## **AUTHORITATIVE GUIDANCE**

The NACUBO FARM is the authoritative reference for the functional classifications used in the Integrated Post Secondary Data Survey, or IPEDS. The FARM definitions relevant to this issue are noted here.

The category of **Instruction** 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 are included. Expenses for departmental research and public service that are not separately budgeted also are included in this classification. This classification excludes expenses for those academic personnel whose primary activity is administration—for example, academic deans – which would be included as academic support.

The instruction classification includes five subclasses. The one relevant to the issue noted above is General Academic Instruction. The category includes expenses for formally organized and/or separately budgeted instructional activities that are associated with academic offerings described by the 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.

The **Hospital** classification includes all expenses associated with the patient care operations of a hospital, including nursing and other professional services, general services, administrative services, and fiscal services. Because of a desire to assess whether the hospital is self-supporting, an allocation of expenses for operation and maintenance of plant, depreciation, and interest may be included, even though that allocation is not required of public institutions for financial statement purposes. (Independent institutions, however, are required to make the allocation.) 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 classification and accounted for in their appropriate classifications. [emphasis added]

The hospitals classification includes the following six subclasses:

Direct Patient Care	Expenses for direct patient care such as prevention, diagnosis, treatment, and rehabilitation. <u>Patient care activities solely for the benefit of the institution’s students should be classified within student services. [emphasis added]</u>
Health Care Supportive Services	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	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	Expenses for activities related directly to maintaining the grounds and facilities of a hospital as well as providing utility services. Like operation and maintenance of plant, this is not a functional classification for an independent institution. However, it might be used internally to accumulate costs, which would be combined with other hospital costs in the statement of activities.
Depreciation of Hospital Facilities and Equipment	Depreciation expense for facilities, equipment, and infrastructure assets of the hospital. Independent institutions are required to allocate depreciation among their functional classes.
Hospital Information Technology	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 classified as academic support and the remainder as institutional support.