An Accounting Model for Allocating Indirect costs in Higher Education Institutions

This accounting model for higher education institutions in Sweden is based on traditional cost accounting theory. The aim has been to create a fair and cost-effective model for the purpose of management decision making and financial reporting. The model supports true and fair accounting and cost calculation.

The basic principles in the model are

- The operations of the higher education institution are divided into core/basic activities and support/joint activities.
- Core activities are defined as either education/training or research and then divided into cost units (cost unit = activity for which a separate measurement of total revenue and total costs is desired).
- Support activities (administration) are classified as support for either education or research. Activities that support both education and research are divided between the two. The costs for support activities (indirect costs) are then accumulated and allocated to cost units.
- The preferred cost allocation basis is direct labour costs; an alternative basis is direct labour costs + direct operational costs.
- All revenues and costs are to be allocated to cost units, allowing for an appraisal of full-costing.
- The project budget is based on full-cost calculation and shows total costs (direct costs and a fair share of indirect costs) and total revenues (external funding and government grants).

Direct and indirect costs and stepwise allocation

Direct costs can be identified specifically and exclusively with a given cost unit while indirect costs must be allocated to cost units on basis of a relevant cost driver.

Direct costs can be both internal and external purchases and are sorted into four groups:
- Direct labour costs: salaries including payroll tax for those directly involved in the project
- Direct operational costs: materials, travel, conferences, reference material, consultancy services in the project
- Direct equipment/depreciation: depreciation of project equipment
- Direct premises: offices and laboratory space for the project and a fair share of common areas at the department

Indirect costs are shared by all or several cost units. The costs are not the result of the core activities of the project but from the indirect use of the joint resources in the support activities.
The indirect costs are found as joint costs on every level in the organisation (central, faculty and department).

In a higher education institution with three levels (central, faculty and department) the indirect costs are allocated stepwise. The costs for support activities at central level are allocated to faculty level, each faculty allocates its share of central level support costs and faculty support costs to the departments within the faculty. Finally each department allocates the accumulated support costs (departmental and sectional costs included) to its cost units.

The cost allocation basis for allocation to cost units should be direct labour costs or direct labour costs + direct operational costs. Allocation of central and faculty based costs for support activities can make use of the same, or other relevant cost drivers from subsequent level. This stepwise allocation from level to level can be calculated in the form of fixed amounts as well as in the form of rates aiming directly at individual cost units.