

CONTENTS

Background.....	1
Objectives, Scope, and Methodology.....	2
Results:	
1) Fiscal Year 2000 Direct Cost Verification.....	3
2) Fiscal Year 2000 Indirect Cost Allocation Assessment.....	6
3) Fiscal Years 1999 and 1998 Cost Calculations	10
Appendix A: Fiscal Years 2000, 1999, and 1998 Students Channel Cost by Expense Category	
Appendix B: Fiscal Year 2000 and 1999 Students Channel Cost by Core Business Process	
Appendix C: Fiscal Year 2000 Students Channel Collections on Defaulted Loans	

Background

The Higher Education Amendment of 1998 required the establishment of the first Performance-Based Organization (PBO) in the Federal government, the Office of Student Financial Assistance (SFA). As a PBO, SFA was granted increased operating flexibility and chartered to improve customer service, reduce cost and integrate its computer systems.

The Students Channel, a component of SFA, is responsible for providing services to potential and current borrowers and financial aid recipients, while ensuring that students and parents understand their options to finance student education. The Students Channel delivers these services through contracts entered into with various vendors. The total contract cost accounts for a significant portion of the Students Channel total cost.

Reducing costs is a priority for the Students Channel. However, the Students Channel does not currently have adequate financial management tools to effectively monitor its costs. Recently, SFA Office of the Chief Financial Officer, elected to adopt Activity Based Costing (ABC) and designed a cost model.

ABC is a method that assigns costs to activities based on the use of resources and assigns costs to outputs. **ABC is a management tool that links cost data to the organization's operations and performance and in some cases provides more accurate unit cost.**

Additionally, it is a management tool that:

- Provides insight into the relationship between Inputs (Resources) and Outputs (Products/Services) by quantifying the work performed (Activities) in an organization.
- Identifies the cause and effect relationship that better assigns costs of products and services by identifying the activities used in the production and delivery of the outputs.

ABC is a management tool that addresses the intent of the Statement of Federal Financial Accounting Standard (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards*, which is aimed at providing timely and reliable information on the full cost of federal programs, their activities, and outputs. According to SFFAS No. 4, "Managerial cost accounting should be a fundamental part of the financial management system and, to the extent practicable, should be integrated with other parts of the system. Each reporting entity should accumulate and report the cost of its activities on a regular basis for management information purposes. Cost may be accumulated through the use of cost accounting systems or through the use of cost finding techniques."

Objectives, Scope, and Methodology

The Students Channel engaged Accenture to verify cost information produced by the Activity Based Costing Model (ABC Model) and assess the basis for allocating indirect costs for fiscal year 2000. Additionally, Accenture was requested to calculate fiscal years 1999 and 1998 costs for the SFA Students Channel.

We performed the following procedures:

Fiscal Year 2000 Direct Cost:

- Obtained and documented our understanding of the basis used in the ABC Model to identify and accumulate fiscal year 2000 direct costs for the Students Channel; and
- Verified the direct cost for payroll, contracts [and postage](#).

Fiscal Year Indirect Cost Allocations:

- Obtained and documented our understanding of the underlying assumptions used in the indirect cost allocation methodology;
- Interviewed ABC Model Team members to gain an understanding of the basis used to identify and allocate fiscal year 2000 indirect costs for the Students Channel;
- Reviewed the ABC Model and documented our understanding of the basis used to identify and allocate fiscal year 2000 indirect costs for the Students Channel;
- Assessed the basis for allocating indirect costs for fiscal year 2000; and
- Analyzed the allocation method for reasonableness and consistency.

Fiscal Year 1999 and 1998 Cost Calculation:

- Analyzed the ABC Model for fiscal year 1999 and ABC Model contribution reports for the Students Channel for fiscal years 1998 & 1999;
- Restructured the ABC Model data to create cost reports for fiscal years 2000 and 1999; and
- Created fiscal year 1998 cost by analyzing an ABC Model contribution report for fiscal year 1998 and available historical information and assumptions deemed reasonable by the Students Channel and the OCFO.

Results

1. Fiscal Year 2000 Direct Cost Verification

For FY 2000, the SFA Office of the Chief Financial Officer's ABC Team (ABC Team) assigned direct costs to the Students Channel through the Activity Based Costing Model (ABC Model). In the ABC Model, the Student Channel's direct costs were categorized in accordance with its three core business processes:

- Aid Awareness;
- Aid Application; and
- Loan Repayment.

The costs for the Students Channel totaled \$528 million, while the direct costs totaled \$441 million as shown in the table below by core business processes:

Students Channel
FY 2000 Direct Cost

Core Business Process	Amount (in millions)
Aid Awareness	\$ 9
Aid Application	\$ 89
Loan Repayment	\$343
Total	\$441

In addition to capturing costs by business processes, the Students Channel management needed to capture its costs at a more detailed level, by expense type for instance (e.g. – contracts, labor, postage, etc.), to be able to monitor and reduce cost. The ABC Model did not provide this level of detail. Alternatively, we obtained the fiscal year 2000 ABC Model contribution report which provided cost detail by object class code and contract tracking code and sorted this data by expense type for each core business process and for the Students Channel as a whole. (See Appendix A, Fiscal Year 2000, 1999 and 1998 Students Channel Cost by Expense Category and Appendix B, Fiscal Year 2000 and 1999 Students Channel Cost by Core Business Process)

The direct costs for the Students Channel, by expense category, is shown in the table below:

Students Channel
FY 2000 Direct Cost

Cost Category	Amount (in millions)
Contracts	\$379
Labor	\$ 20
Postage	\$ 33
Other	\$ 9
Total	\$441

See Appendix B, Fiscal Year 2000 and 1999 Students Channel Cost by Core Business Process.

We discussed the capability of the ABC Model to produce reports similar to the format of Appendix A. The ABC Team indicated that although such a format is not currently part of regular production, the ABC Model has the capability to produce the report by expense type similar to Appendix A and B.

Matters for Further Consideration

The ABC Cost Team is currently refining the ABC Model and is discussing user requirements with the Students Channel. The Students Channel Manager should direct her management to discuss its additional financial management needs relating to the generation of detailed ABC reports with the ABC Team.

Direct Cost Verification

Our review indicated that primary contracts, labor and [postage](#) expenses represented [82%](#) of the Students Channel costs for FY 2000. We performed the following procedures:

- Verified labor costs by reconciling ABC labor costs with the Students Channels labor expenses from the general ledger for FY 2000.
- Verified the primary contract costs managed by the Students Channel, which included Multiple Data Entry, Central Processing System, Public Inquiry Contract, Debt Collection Services, and Direct Loan Servicing and Central Database by agreeing the ABC Model costs to the relevant invoices. The invoices of these five contracts totaled \$329 million or 87% of total contract cost.

- Verified postage costs by reviewing and recalculating the ABC Cost Team’s cost assignment. The ABC Cost Team obtained the Department of Education’s statement of meter and permit usage and assigned the postage cost by associating postage charges with the activities of the Students Channel.

ABC Model

While verifying direct costs, we noted that the expense sub categories, referred to in the ABC Model as “activities” relating to specific core processes, did not represent the cost categories that Students Channel management needed to monitor costs. For instance, in the Aid Application core process, critical costs such as those relating to development, processing and call center needed to be added as specific activities. By doing so, Student Channel managers will be provided with the level of detail needed to monitor and formulate means for reducing costs.

Matters for Further Consideration

As previously mentioned, the ABC Team is currently refining the ABC Model and discussing user needs with the Students Channel. The Students Channel General Manager should ensure that its needs relating to activity categories in the ABC Model are communicated to the ABC Team. Additionally, once the ABC Model is refined, the Students Channel should analyze the new ABC Model to ensure that its user needs have been adequately addressed.

Performance Measures

The Students Channel has developed specific performance measures under the PBO structure that are reported on a quarterly basis. However, these performance measures were not linked to the relevant cost information. According to Statement of Federal Financial Accounting Standard (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards*, “measuring costs is an integral part of measuring performance in terms of efficiency and cost-effectiveness. Efficiency is measured by relating outputs to inputs and is often expressed by the cost per unit.” By not linking performance measures and cost data, there is no mechanism to track the cost of achieving performance measures to determine the efficiency and cost-effectiveness of specific performance measures. For example, one performance measure for the Students Channel is to process loan consolidations in 60 days or less. However, since this performance measure is not linked to cost, the Students Channel can not assess how much it cost to process loans within 48 days and whether it would be more cost effective to process loans in 55 days instead.

Matters for Further Consideration

The Students Channel Manager should consider obtaining cost information that can be linked to performance [measures to assess efficiency and cost effectiveness](#).

Student Credit Management - Collections

The Students Channel utilizes various methods to collect on defaulted loans. The cost for various collection efforts was allocated to activities in the ABC Model. We also obtained the relevant revenue streams associated with the collection efforts. As an illustration, we created a schedule that related the cost of collection to the amount collected. (See Appendix C, Fiscal Year 2000 Collections on Defaulted Loans.)

2. Fiscal Year 2000 Indirect Cost Allocation Assessment

For FY 2000, the ABC Team allocated indirect costs to the Students Channel through the Activity Based Costing Model (ABC Model). In the ABC Model, the Student Channel's indirect costs are categorized in accordance with the following:

Student Channel's
FY 2000 Indirect Cost

Indirect Cost Category	Amount (in millions)
Channel Management and Administration	\$ 5.6
ED Support	\$ 40.9
SFA Support	\$ 40.0
Total	\$ 86.5

Channel Management and Administration

The Channel Management and Administration cost was mainly comprised of rent for \$3.3 million and labor for \$.8 million. The labor allocation included direct cost for personnel within the Students Channel front office. We assessed the reasonableness of the allocation by multiplying the FY 2000 average SFA salary by the number of employees in the front office. Our recalculation yielded an amount that was comparable to the cost derived from ABC Model.

The rent expense for SFA as a whole was provided by the Department of Education, Office of Management (OM). The ABC Team subsequently allocated the rent throughout SFA, including the Students Channel, based on full-time equivalent (FTE) units. The use of FTE units could result in a less precise cost allocation. Allocating rent expense by an alternative unit of measure such as

actual space occupied, measured by square footage, may produce a more accurate cost allocation.

We also noted that rent cost was fully allocated to Channel Management and Administration for the entire Students Channel. This method resulted in overallocating the cost allocation for the Channel Management and Administration and under allocating the costs of the core business processes and related activities. It would be more appropriate to further allocate rent cost to core business process and related activities to effectively recognize the full cost of conducting Student Channel activities.

Matters for Further Consideration

We recommend that the Students Channel General Manager discuss the following cost allocation issues with the ABC Team as part of the ABC Model refinement:

- a) Consider the use of alternative units of measure for rent as a means to a more accurate cost allocation.
- b) Consider allocating rent and other costs, as appropriate, to the core business processes and related activities.

Department of Education (ED) Support

ED Support costs were categorized in the ABC Model into two separate areas, General ED Support and Financial ED Support. Financial ED Support cost allocation consisted of costs relating to the Office of Inspector General (OIG) and the Office of the Chief Financial Officer (OCFO).

The ABC Team obtained costs incurred by the OIG related to SFA activities. The ABC Team subsequently allocated the OIG costs based on the percentage of operating budget for the channels in fiscal year 2000: Students 68%, Schools 26%, and Financial Partners 6%. We noted, however, that the OIG often specifies a particular subject to audit and remains solely within that area. For example, if the OIG only performed reviews on Guaranty Agencies within the fiscal year the majority of their costs should be allocated to the Schools Channel. However, by allocating by percentage of budgeted dollars the Students Channel is receiving 68% of the OIG's cost when no audits may have been conducted within the Students Channel. Alternative allocation methods need to be considered.

The ABC Team obtained the Department of Education OCFO cost and identified the SFA portion by taking the percentage of SFA net cost of operation relative to the overall Department of Education total net cost of operation, as reported in the FY 1999 Statement of Net Cost. SFA's assigned costs was subsequently allocated by the percentage of operating budget for the channels for fiscal year 2000: Students 68%, Schools 26%, and Financial Partners 6%. [We noted,](#)

however, that other offices within SFA benefit from the services of the Department of Education OCFO and should be considered when allocating its cost.

General ED support costs originated in the other Department of Education offices, such as Secretary of Education and Office of Management (OM). General ED support costs are categorized as either General Management (GM) or Office of Management (OM) costs. GM and OM costs were allocated to the various channels based on actual FTE percentages. The ABC Team initially determined the percentage of dollars that should be allocated to SFA based on FTE units. Upon determination of SFA's portion, the GM and OM costs were allocated to the specific SFA offices by percentage of FTE units. The allocation method is assessed as appropriate.

Matters for Further Consideration

We recommend that the Students Channel General Manager discuss the following with the ABC Cost Team:

- a) The use of an alternative method for allocating OIG. It would be more appropriate if costs were allocated based on the level of effort expended by the OIG within various SFA channels and offices.
- b) [Allocating the Department of Education OCFO costs to other SFA offices.](#)

using an alternative method for allocating OIG costs with the ABC Team. It would be more appropriate if costs were allocated based on the level of effort expended by the OIG within various SFA channels and offices.

SFA Support

All SFA Support costs were allocated to the channels based on percentage of FTEs, percentage of budgeted dollars, or based on management's estimates. SFA Support totaled \$40.8 million and was comprised of the following:

FY 2000 SFA Support

SFA Support Components	Amount (in millions)
Information Technology Management (CIO)	\$13.3
Chief Financial Office (CFO)	\$ 4.9
Chief Operating Office (COO)	\$16.4
Other	\$ 6.2
Total	\$40.8

The CIO allocation primarily represented information technology (IT) related costs that could not be directly charged to a subprocess and related activity in the ABC Model as the related services/products benefit the entire SFA organization. These costs that could not be allocated included expenses for modernization, contracts, and labor. These costs were allocated by percentage of FTE units **to the channels only. The allocation should include other SFA offices that benefit from the services of the CIO.**

CFO costs were primarily allocated by percentage breakdown of effort. Since there was no support for these percentages, we were not able to assess the basis for allocating the costs. **However, we noted that the CFO costs were allocated only to the channels. Since other SFA offices benefit from CFO services, it would be appropriate to assign cost to these SFA offices.**

The COO costs included costs that could not be directly charged to a subprocess and related activity and miscellaneous expenses that could not be charged to any other area of the organization. These expenses could not be assigned due to lack of information to enable the ABC Team to allocate costs. These costs that could not be allocated included expenses relating to the SFA program administration and expenses, labor, general management and office management. These costs were allocated based on percentage of budgeted dollars **to the channels only.** Such allocation was implemented by the ABC Team due to a significant adjustment to certain miscellaneous contract expenses. Consequently, the COO allocation was overallocated due to the inclusion of the miscellaneous expenses. Furthermore, an alternative allocation method needs to be considered.

Matters for Further Consideration

We suggest that the Students Channel General Manager discuss the following issues with the ABC Team:

- a) Remove miscellaneous expenses from the COO cost. Additionally, consider alternative means for allocating the COO cost such as by FTE as the COO's function benefits all of SFA personnel.
- b) Assess the reasonableness of the CFO's allocation **basis** and ensure adequate documentation exist for cost allocation.
- c) **Allocate CIO, CFO, and COO expenses to other SFA offices as appropriate.**

3. Fiscal Years 1999 and 1998 Cost Calculations

The Students Channel did not exist until fiscal year 2000. For purposes of this analysis, we recreated the cost for fiscal years 1999 and 1998 as if the Students Channel existed based on available cost and historical information and assumptions deemed reasonable by the Students Channel and the SFA OCFO.

The ABC Team obtained the fiscal year 1999 cost data from the general ledger. We obtained the fiscal year 1999 ABC contribution reports which provided cost detail by object class code and contract tracking code. We sorted this data by expense type (e.g. – contracts, labor, postage, etc.) for each core business process and for the Students Channel as a whole. We identified the expense type by using the object class code. This resulted in a cost report for fiscal year 1999 for the Students Channel highlighting specific cost categories. See Appendix B, Fiscal Year 2000 and 1999 Students Channel Cost by Core Business Process.

We obtained the fiscal year 1998 ABC contribution reports which provided cost detail by object class code and contract tracking code. However, the fiscal year 1998 contribution report was not categorized by channel. We subsequently used the contribution report to calculate Students Channel primary contract costs for fiscal year 1998 which accounted for 73% of total cost. For the remaining expense categories, we calculated cost using historical or FTE percentages. For the expense categories driven by FTE (labor, benefits for former employees, travel, transportation, supplies, equipment and other administrative expenses) we applied the percentage change in personnel cost from 1998 to 1999. For the expense categories not driven by FTE (printing, other contractual services, program refunds, administrative charges, miscellaneous receipts, rent, postage expense, communication service, and FTS 2001 communications) we applied 95% of the previous year figures. This percentage was determined by discussion with OCFO personnel that indicated that expenses (budget object classes) were determined based on previous year's history and inflation. Based on these discussions with the OCFO, we determined that a 5% increase from one year to the next was reasonable. See Appendix A, Fiscal Years 2000, 1999, and 1998 Students Channel Cost.