



More Uniform Methodology Is Needed for State Agencies' Unit Cost Information

at a glance

All agencies submitted unit cost information for activities in their Fiscal Year 2005-06 legislative budget requests as required by law. However, several factors limit the Legislature's ability to validly compare the efficiency of similar activities performed by different agencies and assess changes in agency performance over time.

To enhance the usefulness of activity and unit cost information, a more uniform methodology for allocating costs should be developed and used by reporting agencies. The Legislature may wish to consider directing agencies to use the federal government's cost allocation methodology to calculate activity and unit cost information. Such a cost allocation methodology would require agencies to develop an indirect cost allocation plan that could be used to appropriately allocate all agency expenditures to activities.

Scope

As requested by the Florida Legislature, we examined state agency practices in developing and using unit cost information as required by s. [216.023\(4\)\(b\)](#), *Florida Statutes*. We also examined Aspire, the state's new financial accounting system which is under development, to determine its capability to capture and process activity and unit cost information.

Background

To improve information regarding program activities, the 1999 Legislature required that agencies identify the costs for their activities and the associated cost for each unit of output in their legislative budget requests.¹ Legislative budget request instructions define an activity as a set of transactions that translates inputs into outputs using resources in response to a business requirement.² The unit cost of an activity represents the average total cost of producing a single unit of output. Examples of activities, output measures, and unit costs are shown in Exhibit 1.

¹ As specified in ss. 216.1826 and 216.023(4)(b), *F.S.*

² Input means the quantities of resources used to produce goods or services. Output means the actual service or product delivered by a state agency.

Exhibit 1
Examples of Activity and Unit Cost Information Reported by State Agencies

Agency	Activity	Output Measure	Unit Cost
Department of Environmental Protection	Controlling aquatic invasive plants	Number of acres of water bodies treated for aquatic invasive plants (48,832)	\$543.60 per acre
Department of Financial Services	Processing state employees payroll	Number of payroll payments issued (5,184,846)	0.45 per payment
Department of State	Campaign finance report audit and compliance	Number of campaign reports received and processed (5,823)	189.04 per report

Source: LAS/PBS and OPPAGA analysis.

An important consideration in calculating unit costs is how to allocate direct and indirect costs. Direct costs are labor and material costs that can be linked exclusively to the activity being performed, and vary with fluctuations in the number of outputs being produced. These costs would likely be eliminated if the activity were no longer provided. Indirect costs, often referred to as overhead costs, cannot readily be associated with the performance of an activity or the production of a specific output, but provide necessary support for those activities. They include the costs of providing executive direction, legal services, and administrative support services such as personnel, finance, and budgeting, as well as the costs of shared space, equipment, or services. Indirect costs also include the costs of program direction, program monitoring, rule making, and other activities that are essential to operate the program. In contrast to direct costs, agencies would continue to incur indirect costs (although at a somewhat lower level) if an individual activity were eliminated. In general, unit cost calculations should consider both direct and indirect costs.

Activity and unit costs can provide useful information for assessing whether the state is efficiently using its resources. Legislators can use unit cost information to help determine whether an agency is improving its efficiency over time, as well as to compare the efficiency of similar services among agencies. Legislators also can use unit costs to predict how changes in the demand for services will affect agency budgets and to compare the costs of providing services in-house with those of outside

providers. In addition, unit cost information can be used to make decisions regarding the most cost-effective use of available resources to accomplish desired outcomes.³

Findings

Agencies are submitting unit cost data as required, but differences in costing methods limit usefulness

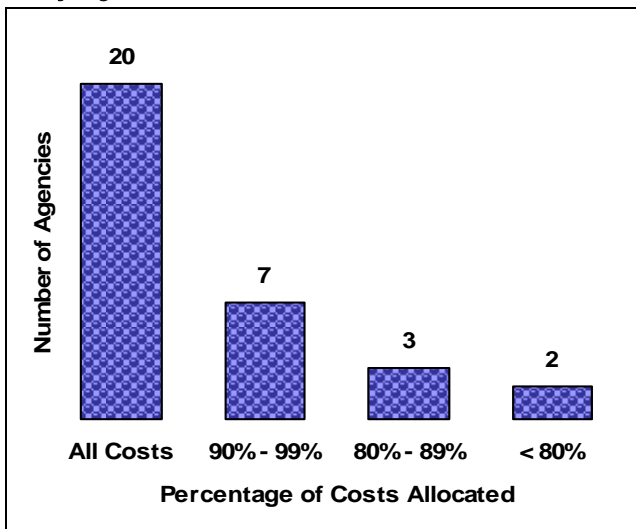
All agencies submitted unit cost information for activities in their Fiscal Year 2005-06 legislative budget requests as required by law. However, several factors limit the usefulness of this unit cost information as a budgeting, policymaking, and accountability tool. Specifically, many agencies are not allocating all of their costs when calculating their unit costs, and agencies are using different methodologies to calculate their direct and indirect activity costs. These differences limit the Legislature’s ability to validly compare the efficiency of similar activities performed by different agencies or to assess changes in agency performance over time.

Many agencies did not allocate all costs. As shown in Exhibit 2, over one-third (12 of 32, or 37.5%) of the state agencies did not allocate all of their costs among their activities. Most of the unallocated costs were incurred for agency activities that did not have an identified output. For example, the Department of Business and Professional Regulation reported that its

³ An outcome is an indicator of the actual impact or public benefit of a service

expenditures for services associated with preventing unlicensed activity in regulated professions were not included in its reported activity costs for this program area because these services did not have an identifiable unit of output. The percentage of each agency's expenditures that were allocated to specific activities ranged from 100% (all costs included) to 64% (36% of costs excluded) in Fiscal Year 2003-04. (See Appendix A.)

**Exhibit 2
Many Agencies Do Not Allocate All Costs to Activities**



Source: Agency-Level Unit Cost Summaries, Fiscal Year 2003-04, and OPPAGA analysis.

Agencies use inconsistent methods to calculate activity costs. Agencies also use differing methods to calculate the activity and unit costs of different activities. For example, both the Department of Environmental Protection and the Department of Health reported that they calculated activity and unit costs for some of their activities based on federal guidelines for programs with costs eligible for federal reimbursement. However, the departments used a different methodology for calculating costs for their other reported activities.

Use of different methods to calculate activity and unit costs limits the Legislature's ability to use this information to help determine whether an agency is improving its efficiency over time or compare the efficiency of similar services among agencies. It also makes it difficult for the Legislature to determine whether differences in agencies' unit costs are due to performance improvements or to differences in the methods used to calculate cost.

Agencies are not appropriately allocating indirect costs to activities. A related problem is that agencies are not appropriately allocating all of their indirect costs to activities. Agencies did not use allocation systems that considered the activities' demand on indirect services such as those associated with executive direction, administrative support, and information technology. These costs were allocated by the Statewide Appropriations and Budgeting System (LAS/PBS) based on the number of employees assigned to the reported activities.⁴

Allocating indirect costs based on the number of employees assigned to an activity may be problematic for two reasons.

- It may not accurately reflect the contribution of these administrative services to the cost of reported activities. This problem can be illustrated by the Department of Children and Families' unit cost reporting for its Forensic Treatment activity. For this activity, the department reported that the direct cost for each adult served was \$52,525; however, the department did not allocate all applicable indirect costs to this activity. Subsequently, LAS/PBS allocated \$11,552 in indirect costs for each adult served based on the number of employees assigned to this activity. This method for allocating costs for indirect services, such as executive management, legal services and contract management, does not consider the nature of the activity and its demand for indirect services.

⁴ The LAS/PBS statewide appropriations and budgeting system is maintained by the Executive Office of the Governor.

- It is not useful for allocating indirect costs for activities that have been privatized. This problem can be illustrated by the Department of Children and Families' unit cost reporting for its Residential Care activity. For this activity, the department reported that the direct cost for each child served was \$11,168. Because the activity had been privatized and had no agency employees assigned, LAS/PBS did not allocate any indirect costs to it. Thus, departmental indirect costs associated with monitoring private providers are not reflected in the reported unit costs for this activity.

Many agencies are not using activity and unit cost information to manage their operations

While all agencies are reporting activity and unit cost data, many are not using this information to help manage their activities. Agencies can use activity and unit cost data in many ways, including assessing program efficiency, determining how changes in operations would affect costs, and identifying activities that need reengineering. For example, an agency could use unit cost information to compare the efficiency of its field offices or assess the effect of changes in operating procedures.

However, our survey of agencies found that use of activity and unit cost information varies widely. Some agencies, such as the Department of Health and the Department of Transportation, reported extensive use of activity and unit cost information in managing their operations. For example, the Department of Health reported using county health department unit cost data to help determine whether these entities have met contractual requirements and to assess their productivity. However, other agencies reported that they do not use activity and unit cost information to manage their activities. For example, the Department of Lottery reported that it did not use the unit cost information

reported in its Legislative Budget Request to analyze its operations because its "focus is on outcomes rather than outputs." The Department of Business and Professional Regulation similarly reported that it did not use its reported unit cost information because the methodology used by LAS/PBS to allocate indirect costs did not accurately reflect each professional board's demands for indirect services.

Florida's new financial accounting system will provide more support of unit costs, but will not provide all information needed for determining these costs

The Department of Financial Services is currently developing a new accounting system (Aspire) to replace the state's current system, FLAIR.⁵ The first agency is currently not scheduled to begin using Aspire until at least October 1, 2005, with full implementation by all agencies occurring after June 2006. When fully operational, Aspire will provide agency managers and the Legislature with the direct costs of activities, which can be used in making operational and policy decisions. Aspire also will allow for increased use of this activity cost information through a new accounting structure that will allow activity costs to be grouped by agency, budget entity, and the outcome affected by the activity.

However, Aspire is not designed to provide all information needed to determine the unit cost for an activity. For example, the system will not automatically allocate all indirect costs to activities. Consequently, agencies will need to continue to allocate these indirect costs in order to report this data in their legislative budget requests. In addition, Aspire is not designed to define or calculate the units of output for an activity. Agencies will thus need to rely on other state information systems to provide data on the number of units of output produced by each activity for use in calculating unit costs.

⁵ The Florida Accounting Information Resource subsystem, FLAIR, is owned and maintained by the Department of Financial Services.

Conclusions and Recommendations

To enhance the usefulness of activity and unit cost information, the state should develop a uniform methodology for allocating direct and indirect costs to program activities. This would help ensure that agencies define activities, allocate costs in a consistent manner, and enable agency managers and the Legislature to better use this data in assessing agency efficiency and program options. We therefore recommend that the Legislature consider revising the legislative budget request instructions to establish a uniform methodology for allocating costs to activities.⁶

One option the Legislature may wish to consider in establishing this methodology is to direct agencies to use the federal government's cost allocation methodology for calculating activity and unit cost information.⁷ As a condition of eligibility for federal awards, state agencies are required to certify that federally reimbursable expenditures have been identified in accordance with these federal guidelines.

⁶ According to s. 216.023(3), *F.S.*, the Executive Office of the Governor and the legislative appropriations committees are responsible for jointly developing legislative budget instructions.

⁷ Office of Management and Budget Circular A-87.

Nearly all of Florida's state government agencies have activities that are eligible for federal reimbursement of costs and are therefore familiar with these federal reporting requirements.⁸ In addition, many state agencies report using these federal guidelines to calculate activity costs that include expenditures that are eligible for federal reimbursement.

One advantage of using the federal cost allocation methodology is that it would require all agencies to develop an indirect cost allocation plan to apportion their indirect costs to programs and activities. These plans would then serve as the basis for computing indirect and direct costs for all of the state's activities, and would help ensure that all agencies' expenditures are appropriately allocated to activities with defined units of output in a consistent manner.

Once a uniform methodology is established, the Office of Policy and Budget should work with the Department of Financial Services, the Auditor General, and legislative appropriations committees to train agency staff in applying the methodology and monitoring implementation of this effort.

⁸ The Florida Auditor General noted in a 2005 report ([*State of Florida Compliance and Internal Controls Over Financial Reporting and Federal Awards*](#), Report No. 2005-158, March 2005) that the Department of Lottery, the Public Service Commission, the Division of Administrative Hearings, and the Florida Parole Commission did not have any expenditures from federal funding sources in Fiscal Year 2003-04.

Appendix A

The Percentage of Fiscal Year 2003-04 Agency Expenditures Not Allocated to an Activity Varied

The percentage of unallocated costs represents the amount of agency expenditures agencies did not directly allocate to an activity in their Fiscal Year 2003-04 unit cost reports. Reported percentages incorporate expenditures reported by agencies as Executive Direction, Administrative Support, and Information Technology activities. These expenditures were subsequently allocated to activities based on the number of full-time equivalent (FTE) positions reported for each activity and as described in the Legislative Budget Request Instructions. Funds classified as fixed capital outlay and funds transferred to local governments or other budget entities were not included in the calculation of the percentage of unallocated cost.

As seen in the table below, 12 of the 32 agencies did not fully allocate their expenditures to activities.

Agency	% Not Allocated
Management Services	36.07
Lottery	21.04
Children and Families	14.78
Financial Services	13.75
State Court System	12.88
Business and Professional Regulation	5.90
Revenue	5.81
Education	3.98
Executive Office of Governor	3.44
Health	0.40
Workforce Innovation	0.39
State	0.26
Administrative Hearings	0.00
Agriculture and Consumer Services	0.00
Attorney General/Legal Affairs	0.00
Citrus	0.00

Agency	% Not Allocated
Community Affairs	0.00
Corrections	0.00
Elder Affairs	0.00
Environmental Protection	0.00
Fish and Wildlife	0.00
Health Care Administration	0.00
Highway Safety and Motor Vehicles	0.00
Justice Administration	0.00
Juvenile Justice	0.00
Law Enforcement	0.00
Legislative	0.00
Military Affairs	0.00
Parole Commission	0.00
Public Service Commission	0.00
Transportation	0.00
Veterans' Affairs	0.00

Source: Governor's Office of Policy and Budget Report: Agency-Level Unit Cost Summaries, Fiscal Year 2003-04.

The Florida Legislature

Office of Program Policy Analysis and Government Accountability



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