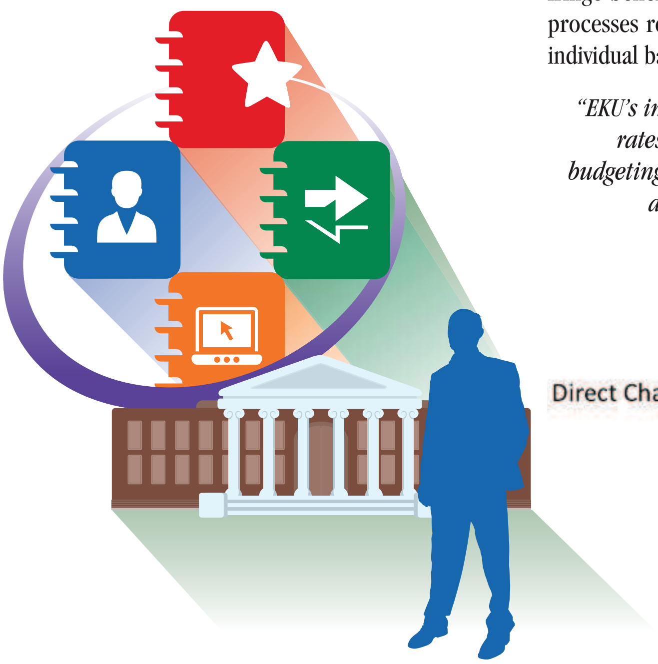
The Advantages of Using Fringe Benefit Rates

By Jim Carter & Kari Kelly

The more rates you use the smaller the impact across institution funding sources



Introduction

Institutions have a choice of directly charging benefits by specific identification by individual or using a fringe benefit rate to charge grants and contracts for these costs – who knew? Applying and tracking fringe benefit costs on an individual basis can be one of the more frustrating and maddening activities a research administrator must deal with in budgeting and charging benefits accurately to projects.

Because the tracking of benefits for each individual employee is complicated, more institutions are establishing a fringe benefit rate system to better manage the process. While such rates have great potential for simplifying fringe rate application, reducing errors, and potentially increasing cost recovery, they are actually not suitable for all institutions.

Eastern Kentucky University (EKU), as an example, recently implemented fringe benefit rates on its campus with assistance from the Huron Consulting Group. At EKU, the primary goal was to develop a more efficient methodology for the budgeting and charging of fringe benefits across campus. EKU had other requirements including the ability to create an annual budget using fringe benefit rates and eliminate the detailed processes required by charging benefits on an individual basis.

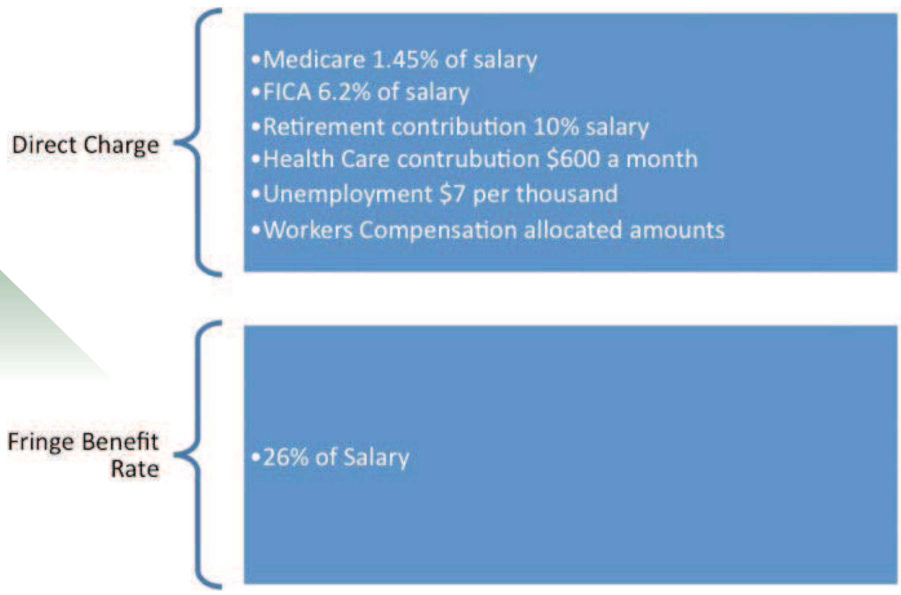
> *"EKU's implementation of fringe benefit rates has helped us solve significant budgeting issues and allowed us to manage our grants more efficiently."*
>
> **– Brad Compton, Executive Director, University Accounting & Financial Services, EKU**

The implementation of fringe benefit rates at EKU resulted in a decrease in administrative burden for the campus and the simplification of accounting for fringe benefits. However, no two institutions are the same. What questions does a university need to answer in deciding which type of method to use? First, let's answer some of the basics.

What is the Difference between Direct Charging and Fringe Benefit Rates?

Fringe benefits are employee related costs typically including: pension plans, contributions to health and life insurance, employment taxes, and workman's compensation. Institutions have two choices that can be used to apply fringe benefits to funding sources, including sponsored projects. The direct charging method allocates each individual's specific benefits to each salary source while fringe benefit rates use an average rate (normally a percentage of salary) for groups of employees. The example below shows how benefits are charged under each method. Under the direct charge there would be 6 entries, one for each benefit, whereas the fringe benefit rate requires a single line.

The direct charge methodology for fringe benefits is often used by institutions. This method charges each employee's specific benefit costs



to the appropriate funding source. All benefit costs are tied to an individual and are budgeted using each individual's benefit package. This results in continual fluctuation of fringe benefit costs by employee. One employee may have individual health insurance verses another employee with family coverage, for example.

When using the direct charge methodology, many institutions do not always charge restricted funds their share of benefit costs. This is because the tracking, budgeting and charging of these costs can be intrusive and complicated. Instead, many institutions choose to manage and pay these costs centrally.

When using the second methodology, a fringe benefit rate, the pooled benefit costs are divided by the total salaries in an assigned employee group. This results in a single rate for each employee group. These rates are then applied to the applicable employee salary to represent the associated benefits for that type of employee. The key components of a fringe benefit rate calculation are the fringe benefit costs, the salaries, and the defined rate structure (employee groups).

How do you Calculate a Fringe Benefit Rate?

The fringe benefit rate is an average cost of benefits for all employees within the defined employee group. The same benefits included under the direct charge methodology are included in the fringe benefit rate methodology. Also, one advantage to using a fringe benefit rate is the ability to include additional fringe benefits costs in the rate structure. Terminal leave, paid leave, graduate student insurance, sabbaticals, tuition remission, and other institutional specific benefit costs are often included in the rate structure. This allows the institution to allocate a fair share of these costs to all funding sources. It is important to analyze all employee benefit costs to determine whether they can be included in the rates.

Institutions that don't use a fringe rate that includes terminal leave in the rate may no longer be able to recover those costs if they use a cash basis to charge accrued leave on termination as a result of the new Uniform Guidance

An institution also needs to consider the types of salaries that should be included in the rate structure. In addition to employees' regular salaries, the following costs should be considered when developing rates: perquisites, bonuses, student salaries, and salary caps.

The defined rate structure, often referred to as "employee groups," can vary drastically across institutions. What works at one Institution may not work at others. Institutions may choose to calculate a single fringe rate or develop more than 10 rates. An institution should develop a rate structure that will group fringe benefit costs and align employees with the benefit costs they receive. If an institution chooses to develop multiple rates, then it defines an employee group for each rate. Each employee group will have an individual rate calculated and applied. Common criteria used to develop employee groups are employee type, staff categories, salary bands, and benefits received.

Before switching from direct charging to fringe benefit rates, the institution should fully understand the financial and budgeting impacts on the use of fringe rates across the campus. To determine the funding impacts, a comparative analysis should be completed to compare the differences by funding sources, departments, and other criteria. Completing this analysis will highlight the impact of benefits that were not being equitably charged and the funding sources that are paying for the benefits. The impacts to key stakeholders and the communication and transition plan should also be discussed by all decision makers.

Category	Direct Charging	Fringe Benefit	Reduction in Transactions
Employees	1,000	1,000	0
Funding Sources	2	2	0
Salary Transactions per Month	2,000	2,000	0
Fringe Transactions per Month	12,000	2,000	10,000
Annual Fringe Transactions	144,000	24,000	120,000

Advantages of Fringe Benefit Rates

There are numerous reasons why large and small institutions are switching to fringe benefit rates. Some of the key reasons are described below.

1. Increased Efficiency

A fringe benefit rate will pool fringe benefit costs and distribute costs to the benefiting departments and sponsored projects. This will result in one charge for fringe benefits instead of multiple charges for individual benefits (FICA, retirement, health, etc.). The use of a fringe benefit will allow for easier recordkeeping and less maintenance of benefits and costs of programs for employees. A fringe benefit rate will simplify the following processes: the monitoring of fringe benefit charges to departments, grants, and contracts; billing for grants and contracts; and salary transfers. A fringe benefit rate will provide consistency in how benefits are negotiated and paid and significantly minimize the labor distribution programming. The number of transactions required for an individual employee will significantly decrease.

The table below demonstrates how many accounting transaction would be eliminated for an institution with 1,000 employees that each have 6 benefit categories.

2. Increased Recovery

A fringe benefit rate will allow an institution to recover additional costs. Often times, restricted funding sources are not currently charged the full proportion of benefit costs. Some fringe benefits are paid centrally within the institution from unrestricted funds. Fringe benefits that are funded by central administration are only partially recovered through the Facilities and Administrative (F&A) indirect cost rates. Fringe benefit rates will allow an institution to further increase recovery by directly charging full fringe benefit rates to sponsored awards and auxiliary operations. Sponsored awards will be charged their "full" fair share of actual fringe benefit costs, increasing the recovery of fringe benefit costs.

3. Reduced Risk of Non-Compliance

Fringe benefit rates are negotiated annually with the institution's cognizant federal agency (Department of Health and Human Services Cost Allocation Services or the Department of Defense Office of Naval Research). An institution will need to inform their cognizant agency of the change in methodology. The fringe benefit rate structure is required to be recalculated and negotiated on an annual basis. This decreases the opportunities for charging unallowable/unallocable fringe benefits. In addition, the fringe rates are adjusted annually for any overage/shortage that an institution may incur from prior base year benefit costs.

4. Easier Budgeting

A fringe benefit rate can be used to budget sponsored projects and departmental expenditures. A fringe benefit rate will result in consistency between budgeting and expense practices. The same fringe benefit rate will be used for both budgeting and charging purposes, which will improve the budgeting process for all the institution's funds and standardize benefit costs across employee groups. A fringe benefit rate will also simplify budget negotiations with sponsors.

Reasons to Continue Using a Direct Charge Methodology

There are several practical reasons why a direct charge methodology is still a viable option. Switching to fringe benefit rates requires an affirmative action by an institution, and this may not be feasible because of budgeting rules. This is also a change that requires support campus-wide to be successful. Fringe benefit rates require predictability to avoid large rate swings on a year-to-year basis, and that information may not be available prior to rates being submitted. Many state-funded institutions receive direct funding for fringe benefits and spreading those benefits using fringe benefit rates may not be allowed under the state funding rules.

Conclusion

There are many advantages to implementing a fringe benefit rate structure. A fringe benefit rate will provide consistent accumulation and allocation for fringe benefit expenses to all functional activities. In addition, the rate structure will simplify the accounting for fringe benefit expenses and reduce the risk of noncompliance. Importantly, the rate structure will decrease the administrative burden to budget and manage sponsored awards and decrease the risk of under-recovering funds. N

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What's on my DESK

Katie Plum's Desk

Because of the closure of a neighboring department, my office recently doubled in staffing—now there are two of us!—and I have received the mixed blessing that accompanies changes in office size and composition. Currently, I am addressing several related issues, such as the update of my office's strategic plan, reallocation of workload, and training my new staff member. Because my time is limited, I've adopted a "train as you go" approach in addition to more formal professional development. For example, this month features the annual submission of significant financial interest disclosure forms. As we prepare the disclosure forms, send reminders, and evaluate the returned forms, we are reviewing federal and institutional regulations (including the new Uniform Guidance) and discussing the whys and wherefores of FCOI training and disclosure processes. Thus far, I'm finding this method of training saves time and provides valuable context for my new staff member. Next up: end of fiscal year reporting!

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