

**THE UNIVERSITY OF ALABAMA
OFFICE FOR RESEARCH
FINANCIAL MANAGEMENT OF SERVICE CENTERS**

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I. PURPOSE

This Policy Statement establishes The University of Alabama's policies and procedures for the financial management of service centers.

This University must comply with the Office of Management and Budget (OMB) Circular A-21, Cost Principles for Educational Institutions, including section J.47, Specialized Service Facilities, and the principles related to consistency in accounting and costing practices. Instances of non-compliance with Federal regulations may result in pay backs to the government as well as adverse publicity, which could impact future sponsored funding. With the wide variation in size, complexity and services provided, common administrative practices, such as billing rate development, are critical to maintaining compliance with regulations applicable to service centers.

II. DEFINITIONS

A. Service Center: A department/unit of the University that performs specific technical or administrative services primarily for the internal operations of the University and charges users for its services. There are three types of service centers - recharge center, specialized service facility, and service facility.

1. **Recharge Center:** A service center with annual direct operating costs of less than \$50,000. Examples of recharge activities include department owned and operated vehicles, copiers or other equipment for which the department charges users in order to recover costs. For purposes of this policy, activities generating direct operating costs of less than \$20,000 annually AND with annual charges to sponsored projects of less than \$10,000 are not subject to this policy. See "Other Internally Charged Activities" below.
2. **Specialized Service Facility:** A large service center that (a) provides specialized services to a select group of users rather than for overall University operations, and (b) has combined annual direct operating costs and internal overhead costs of \$1,000,000 or more
3. **Service Facility:** All service centers that do not fall within the definition of a recharge center or a specialized service facility. Examples of service facilities include the Central Analytical Facility and the Animal Care Facility.

B. Other Internally Charged Activities: For purposes of this policy, activities generating direct operating costs of less than \$20,000 annually AND with annual charges to

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sponsored projects of less than \$10,000 are not subject to this policy. Internal charges for goods or services to sponsored projects must not, however, be greater than the actual costs of those goods or services and federally sponsored projects must not be charged more than other customers, internal or external.

C. *Auxiliary Enterprise:* A department/unit of the University that provides goods or services primarily to students, faculty, staff and others for their own personal use, rather than as a service to internal University operations. Examples of auxiliary enterprises include residence halls, dining halls and bookstores. Auxiliary enterprises are not subject to this policy statement.

D. *Direct Operating Costs:* All costs that can be specifically identified with a service provided by a service center. These costs include the salaries, wages and fringe benefits of University faculty and staff directly involved in providing the service; materials and supplies; purchased services; travel expenses; equipment rental or depreciation; interest associated with equipment acquisitions; etc.

E. *Internal Service Center Pooled Costs:* All costs that can not be specifically identified to a particular service provided by the service center but that are specifically identifiable to the service center as a whole, such as the salary and fringe benefits of the service center director.

F. *Institutional Facilities and Administrative (F&A) costs:* The costs of administrative and supporting functions of the University. Institutional F&A costs consist of general administration and general expenses, such as executive management, payroll, accounting and personnel administration; operations and maintenance expenses, such as utilities, building maintenance and custodial services; building depreciation and interest associated with the financing of buildings; administrative and supporting services provided by academic departments; libraries; and special administrative services provided to sponsored projects.

G. *Unallowable Costs:* Costs that can not be charged directly or indirectly to federally-sponsored programs. These costs are specified in Circular A-21 issued by the U.S. Office of Management and Budget. Common examples of unallowable costs include advertising, alcoholic beverages, bad debts, charitable contributions, entertainment, fines and penalties, goods and services for personal use, interest (except interest related to the purchase or construction of buildings and equipment), selling and marketing expenses.

H. *Applicable Credits:* Transactions that offset or reduce costs, such as purchase discounts, rebates, allowances, refunds, etc. For purposes of charging service center costs to federally-sponsored programs, applicable credits also include any direct federal financing of service center assets or operations (e.g., the direct funding of service center equipment by a federal program).

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I. *Equipment:* An item of tangible personal property having a useful life exceeding one year and an acquisition cost of \$5,000 or more. Purchases under this amount are considered consumable supplies.

J. *Cost Unit:* The unit of service provided by a service center. Examples of cost units include hours of service, animal care days, tests performed, machine time used, etc.

K. *Cost Rate:* The amount charged to a user for a unit of service. Billing rates are usually computed by dividing the total annual costs of a service by the total number of cost units expected to be provided to users of the service for the year. Examples of and instructions for billing rate computations can be found in Exhibit A.

L. *Surplus:* The amount by which the revenue generated by a service exceeds the costs of providing the service during a fiscal year.

M. *Deficit:* The amount by which the costs of providing a service exceed the revenue generated by the service during a fiscal year.

N. *Internal Users:* Internal users are the primary service center customers. Sales to internal users are represented by charges to accounts over which UA has fiduciary responsibility. Internal users from academic, administrative and auxiliary areas purchase the services or products to support their work at UA.

O. *External Users:* External users are entities or persons over whom UA has no fiduciary responsibility, regardless of the user's relation to UA's academic mission. External users include commercial entities, non-affiliated not-for-profit organizations, students and members of faculty or staff acting in a personal capacity.

III. GENERAL POLICIES

A. Recharge Centers

1. Billing rates should be designed by the center to recover the direct operating costs of providing the services on an annual basis. No costs other than the costs incurred in providing the services should be included in the billing rates. The costs should exclude unallowable costs and be net of applicable credits.
2. Billing rates should be computed annually by the center at the start of each University fiscal year. The rates should be based on a reasonable estimate of the direct operating costs of providing the services and the projected number of cost units for the upcoming fiscal year.

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3. The cost unit(s) should represent, logically, the type of service provided.
4. The billing rate computation should be documented.
5. All users should be charged for the services they receive and should be charged at the same rates.
6. Records should be maintained by the center to document 1) the actual direct operating costs of providing the service, 2) units of service provided, 3) revenues, billings and collections and 5) the annual surplus or deficit.
7. The billing rates should be reviewed at least every six months by the center and adjusted as necessary.
8. Actual costs and revenues should be compared at the end of each University fiscal year. Deficits or surpluses should be carried forward as an adjustment to the billing rates of the following year. Where feasible, the adjustments may be made by increasing or decreasing the actual charges to users for the completed year, rather than through the "carry-forward" adjustment process.

B. Service Facilities and Specialized Service Facilities

1. Billing rates should be designed to recover the direct operating costs of providing the services and internal service center pooled costs, on an annual basis. No costs other than the costs incurred in providing the services should be included in the billing rates. The costs should exclude unallowable costs and be net of applicable credits. For specialized service facilities, the computation of the billing rates should also include the facility's allocable share of institutional F&A costs.
2. Billing rates should be computed annually at the start of each University fiscal year. The rates should be based on a reasonable estimate of the costs of providing the services for the year and the projected number of cost units for the year.
3. The cost unit(s) should logically represent the type of service provided.
4. The billing rate computation should be documented.
5. All users should be charged for the services they receive and be charged at the same rates.
6. Separate accounts should be established in the University's accounting system to record the actual direct operating costs of the service facility, internal service center

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pooled costs, revenues, billings, collections and surpluses or deficits. Documentation to support the costs of the service facility and records of units of service should also be maintained.

7. The billing rates should be reviewed at least every six months and adjusted where necessary. Adjustments must be approved by the Office for Sponsored Programs Cost Accounting Analyst (CAA).
8. Actual costs and revenues should be compared at the end of each University fiscal year. Deficits or surpluses should be carried forward as an adjustment to the billing rates of the following year or the next succeeding year. Where feasible, the adjustments may be made by increasing or decreasing the charges made to users for the completed year, rather than through the "carry-forward" adjustment process.

IV. SERVICE CENTERS THAT PROVIDE MULTIPLE SERVICES

Where a service center provides different types of services to users, separate billing rates should be established for each service that represents a significant activity of the service center. The costs, revenues, surpluses and deficits should also be separately identified for each service. The surplus or deficit related to each service should be carried forward as an adjustment to the billing rate for that service in the following year or the next succeeding year. The surplus from one service may be used to offset the deficit from another service only if the mix of users and level of services provided to each group of users is approximately the same.

V. COST ALLOCATION

Where separate billing rates are used for different services provided by a service center, the costs related to each service must be separately identified through a cost allocation process. Cost allocations will also be needed where a cost partially relates to the operations of a service center and partially to other activities of a department/unit.

Depending on the specific circumstances involved, there may be three categories of cost that need to be allocated: (a) costs that are directly related to providing the services, such as the salaries of staff performing multiple services, (b) internal service center pooled costs, and (c), in the case of specialized service facilities only, institutional F&A costs.

When cost allocations are necessary, they should be made on an equitable basis that reflects the relative benefits each activity receives from the cost. For example, if an individual provides multiple services, an equitable distribution of his or her salary among

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the services should be accomplished by using the proportional amount of time the individual spends on each service. Other cost allocation techniques may be used for service center pooled costs and, for specialized service facilities, institutional F&A costs, such as the proportional amount of direct costs associated with each service, space utilized, etc. Questions concerning appropriate cost allocation procedures should be directed to the Office for Sponsored Programs, Cost Accounting Analyst. The CAA is also responsible for determining the amount of institutional F&A costs that is allocable to each specialized service facility.

VI. EQUIPMENT PURCHASES AND DEPRECIATION

A. Purchases: Expenditures for equipment purchases (including principle payments on debt) are not to be included in the costs used to establish service center billing rates. The costs should, however, include depreciation of the equipment. Including equipment depreciation in the billing rates will generate funds that will enable service centers to purchase equipment needed in the future. The revenues representing recovery of depreciation should be set aside in a Plant Fund Renewal and Replacement Account (Plant Fund Account). The funds in the Plant Fund Account will be used to purchase the equipment. If the amount in the Plant Fund Account is not sufficient to cover the cost of the new equipment, a transfer in from another unrestricted source is allowable, in accordance with normal University procedures.

B. Depreciation: The depreciation of all capital assets used in a service center will be incorporated in the service center rate using the straight line method over the useful life of the asset. Service center equipment must be depreciated using the useful lives assigned by the University's Office of Financial Accounting and Reporting in compliance with General Accepted Accounting Principles. In certain circumstances, service centers with "specialized" equipment or equipment which is unique in the nature or extent of its use, may need to estimate a more specific useful life. Specialized equipment is unique to the specific service center activity and not common to other University departments. Approval to deviate from standard useful lives must be obtained from the CAA.

Depreciation of equipment purchased by the Federal government, whether or not title has vested with the University, cannot be included in internal user rates. Where the University has specifically agreed to cost-share a piece of equipment in a Federal award, the depreciation of the University-funded portion is also unallowable in the rates.

C. Use of Federally Purchased Equipment: According to OMB Circular A-110, when equipment is acquired with Federal funds or purchased as cost share for a Federal award, it should be used in the following order:

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1. The original project or program it was purchased for.
2. Other projects sponsored by the Federal awarding agency which funded the original project.
3. Projects sponsored by other Federal awarding agencies.
4. Non-federal projects including external users.

D. *Equipment Inventory:* A list of equipment used in service centers, including asset identification numbers, should be provided at the end of each fiscal year to the CAA. This information is needed to ensure that the equipment is excluded from the depreciation portion of the University's F&A rate proposal to the federal government.

VII. VARIABLE BILLING RATES

All users within the University should be charged the same rate for a particular service. This requirement does not apply to alternative pricing structures related to the timeliness or quality of services. Pricing structures based on time-of-day, volume discounts, turn-around time, etc. are acceptable, provided that they have a sound management basis, do not result in recovering more than the costs of providing the services and are made equally available to all users. Also see the requirements for subsidization in section XI, below.

VIII. SERVICES PROVIDED TO OUTSIDE PARTIES

A. *External Users:* If a recharge activity or service facility provides services to individuals or organizations outside of the University, the billing rates may include institutional F&A costs even though these costs are not included in the rates for internal University users. (As indicated in section III.B.1., the billing rates for specialized service facilities include F&A costs for all users.) Where applicable, sales tax must also be charged to outside parties. Any amounts charged to outside parties in excess of the regular internal University billing rates should be excluded from the computation of a service center's surpluses and deficits for purposes of making carry-forward adjustments to future billing rates.

B. *UBIT:* Since revenue from outside parties may have Unrelated Business Income Tax (UBIT) implications, these arrangements must be approved by the University's Office of Financial Accounting and Reporting.

IX. TRANSFERS OF FUNDS OUT OF SERVICE CENTERS

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Except for transfers to the Renewal and Replacement Plant Fund Account, discussed in Section VI, it is normally not appropriate to transfer funds out of a service center account. If a transfer involves funds that have accumulated in a service center account because of prior or current year surpluses, an adjustment to user charges to compensate for the surpluses will be necessary. Any transfers (other than those to the Plant Fund Account discussed in section VI.) must be approved in advance by the CAA.

X. INVENTORY ACCOUNTS FOR PRODUCTS HELD FOR SALE

If a service center sells products and has a significant amount of stock on hand, inventory records must be maintained. If the value of the inventory is expected to exceed \$50,000 at any point in the year, a formal inventory account should be established. If the inventory is not expected to exceed \$50,000, internal inventory records may be used in lieu of a formal account. A physical inventory should be taken at least annually at the end of the fiscal year and be reconciled to the inventory records. Inventory valuations may be based on any generally recognized inventory valuation method (e.g., first-in-first-out, last-in-first-out, average cost, etc.).

XI. SUBSIDIZED SERVICE CENTERS

In some instances, the University or a school or department may elect to subsidize the entire operation of a service center, either by charging billing rates that are intended to be lower than costs or by not making adjustments to future rates for a service center's deficits. Service center deficits caused by intentional subsidies cannot be carried forward as adjustments to future billing rates. In addition, the University may choose to subsidize a particular group or activity. In this case, no expenditures or usage may be excluded from the rate calculation. Subsidization must be accomplished through the provision of funding to the user rather than through a reduction or elimination of billing. Usage must be charged to an account with a function appropriate to the activity. This is necessary to avoid having some users pay higher rates to make up for the reduced rates charged to other users. Since subsidies can result in a loss of funds to the University, they should be provided only when there is a sound programmatic reason. Subsidies should be brought to the attention of the CAA in order to ensure proper treatment and adequate documentation.

XII. RECORDS RETENTION

Financial, statistical and other records related to the operations of a service center must be retained for three years from the end of the fiscal year to which the records relate. Records supporting billing rate computations must be retained for three years from the end of the fiscal year covered by the computations. For example, if a billing rate computation covers

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the University fiscal year ending September 30, 2005, the records supporting the computation must be retained until September 30, 2008.

XIII. ESTABLISHMENT OF NEW SERVICE CENTERS

A. *Recharge Centers:* The establishment of new recharge centers must be approved by the dean or director of the college/school/unit where the center will be located and by the CAA.

B. *Specialized Service Facilities and Service Facilities:* In addition to the approvals required for a recharge center, the establishment of new service facilities or specialized service facilities must be approved by the Associate Vice President for Research. The requests for approval must contain the following information:

1. A description of the services to be provided and the users of the services.
2. The reasons why the services can best be provided by an internal service center, rather than by an external service provider.
3. A projection of the costs and utilization of the services.
4. A billing rate calculation and, where possible, a comparison of the internal rates with the rates charged by external service providers.

XIV. REVIEW OF SERVICE CENTERS

The CAA will make periodic reviews of the financial operations of service centers. These reviews will focus on the development of billing rates, the handling of surpluses and deficits, the adequacy of the service center's recordkeeping procedures, treatment of subsidies and Plant Fund balances. Any major problems or disagreements that arise in these reviews will be referred to the Director of the Office for Sponsored Programs for resolution.

XV. TECHNICAL ASSISTANCE

The CAA is available to provide technical assistance and advice on the financial management of service centers. This assistance may be requested in connection with the development of billing rates, cost allocation procedures, equipment depreciation, recordkeeping, etc.

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XVI. FUNCTIONAL RESPONSIBILITIES

A. *Cost Accounting Analyst:* The CAA has primary management responsibility for monitoring compliance with the University and government service center policies. The CAA is located in the Office for Sponsored Programs.

Responsibilities of this position include:

- oversees and assists in the formation of new academic and administrative service centers;
- reviews and approves academic and administrative service center budgets and rates annually;
- monitors service center performance during the last six months of the fiscal year to ensure adherence to A-21, GAAP, and University policies;
- ensures service center compliance with breakeven, non-discriminatory rate setting and other service center policies;
- updates the service center policies as needed;
- assists service center managers with policy or procedural matters;
- visits service centers periodically to assess service center needs; and
- provides service center training as needed.

B. *The Office of Financial Accounting and Reporting:* This Office prepares the University's Annual Financial Report which includes the service center's operations. This Office is located in The Office of the Vice President for Financial Affairs.

Responsibilities of this office include:

- process service center accounting transactions in compliance with University requirements;
- provide assistance with external user transactions i.e. unrelated business income tax issues;
- provide guidance on the GAAP regulations; and
- open and close service center accounts including plant accounts.

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C. College and Department Administrative Offices: The offices are responsible for the operations of their service centers, as are the equivalent Directors' Offices for service centers located in non-academic units. Service center operations must comply with appropriate University payroll, reimbursement, accounting and personnel policies and practices.

Responsibility for service center operations is normally delegated to a department or unit administrator. This person monitors operations and breakeven position by reviewing the center's income, expenses, and rates throughout the fiscal year and ensures that expenses or rates are adjusted as necessary.

The departmental or unit administrator must also ensure that:

- the service center's budget is reviewed and balanced on a monthly basis;
- service center personnel charges and expenses are correctly allocated;
- annual rate submissions are prepared and submitted at the scheduled time (and as needed if changes in circumstances require a change in the rate(s)) and are approved by the CAA;
- monthly service center billings are accurate, timely and adequately documented;
- the approved rate schedule is used for all service center billings;
- the service center operates at breakeven and in accordance with its budget;
- service center records are appropriately maintained;
- effort of personnel with duties outside the service center is allocated appropriately (i.e. based on actual time spent in service center work compared to total time spent on UA work); and
- service center operational procedures are current.

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EXHIBIT A

BILLING RATE COMPUTATION

A service center rate is the cost per unit of output. Output being the basis used to recover the expenses of the service center. To compute this rate, departments should use the following equation:

$$\frac{\text{Budgeted Expenses +/- Prior Year Under/Over Recoveries (within +/- 10\%)}}{\text{Budgeted Usage Base}}$$

The budgeted usage base is the volume of work expected to be performed, expressed in units.

The two most commonly used methods used to measure activity are:

- Consumption Base – This type base is used when expenses are directly proportional to how much of a unit of measurement is consumed. For example, if labor and equipment usage costs can be accurately identified as being consumed on an hourly basis, the service center would base its charges on the number of hours of service provided.
- Output Base – This type of base is used when the costs of the center are most accurately identified by the number of units produced per year. For example, a machine used to test samples where each test requires approximately the same amount of labor might base its charges on number of samples tested.

For example: a computer costs approximately \$100,000 per year to operate (total allowable costs) and has an estimated activity level of 1,500 hours per year. This would result in a rate of \$100,000/1,500 hours = \$66.67 per hour. If a researcher uses the computer for four hours for a sponsored project, his or her award should be charged 4 x \$66.67 or \$266.68.

A service center must develop rates so that revenues offset expenses over a reasonable period of time. A service center's surplus or deficit for a given fiscal year should not exceed 10% of annual operating expenses.

To the extent that a surplus or deficit is within the break-even range of +/- 10%, that surplus or deficit must be carried forward and the rates adjusted in the following period.

For example, the rates submitted for approval by June 1, 2004, for fiscal year ending September 30, 2005, would be based on the 2005 projected volume and expenses

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plus/minus under/over recoveries carried forward from the fiscal year ending September 30, 2004.

Example 1: Service Center XYZ

	FY 2004 Actual		FY 2005 Budgeted
Total Revenue	\$230,000	Budgeted Expense	\$250,000
Total Expenses	<u>(220,000)</u>	Less P/Y Surplus	<u>(10,000)</u>
Surplus	\$10,000	Total Budgeted Expense	\$240,000

Since the surplus for FY 2004 is within +/- 10% [$(230-220)/220=4.5\%$], it will be subtracted from budgeted expenses in FY 2005, thereby reducing the rate.

Example 2: Service Center XYZ

	FY 2004 Actual		FY 2005 Budgeted
Total Revenue	\$230,000	Budgeted Expense	\$250,000
Total Expenses	<u>(250,000)</u>	Plus P/Y Deficit	<u>\$20,000</u>
Deficit	\$20,000	Total Budgeted Expense	\$270,000

Since the deficit for FY 2004 is within +/- 10% [$(230-250)/250=8\%$], it will be added to the budgeted expenses in FY 2005, thereby increasing the rate.