SYSTEM REGULATION

21.01.05 Service Departments

August 25, 1997
Revised November 18, 2000
Supplements System Policy 21.01

1. PURPOSE

The purpose of this regulation is to prescribe general rules to govern the establishment, utilization, and operation of service departments within the System.

2. GENERAL

The Board of Regents (BOR) is authorized by the Appropriations Act to establish service departments for the purpose of supplying goods or services to one or more System components. With the exception of appropriations made exclusively for salaries, service departments may be reimbursed by user departments and units from State general revenue appropriations, local funds in the State Treasury, and other local funds provided that such reimbursement follows state purchasing guidelines.

3. DEFINITIONS

3.1 Service Departments: Service Departments are units within a System component that provide goods or services at approved rates to departments within that component and to other System users. The term service departments will be used to collectively refer to the three types of service departments defined below.

(1) Recharge Centers: Departmental service operations providing goods or services internally within their own departments.

(2) Service Centers: Service operations providing goods or services internally and to other System components.

(3) Specialized Service Facilities: Service operations that use highly complex or specialized facilities to provide specific, unique services to specific users.

3.2 Auxiliary Enterprise: An activity that provides goods or services primarily to students, faculty, staff and others for their own personal use, rather than as a service to internal System operations. Examples of auxiliary enterprises include residence halls, dining halls, and bookstores. Auxiliary enterprises are **not** subject to this System Regulation.

3.3 Direct Operating Costs: All costs that can be specifically identified with a service provided by a service department. These costs include the salaries or wages (not paid for by other sources) and fringe benefits of System faculty and staff directly involved in providing the service, materials and supplies, purchased services, travel expenses, equipment rental or depreciation, and interest associated with external debt used for equipment acquisitions.

3.4 Facilities and Administrative (F&A) Costs: The costs of F&A support functions of the System. F&A costs (formerly referred to as indirect 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 external interest associated with the financing of buildings; administrative and supporting services provided by academic departments; libraries; and special administrative services provided to sponsored agreements.

3.5 Internal Support Costs: All costs that can be specifically identified to a service department, but not with a particular service provided by the center, such as the salary and fringe benefits of the service department director and support staff.

3.6 Unallowable Costs: Costs that cannot be charge directly or indirectly to federally sponsored programs. These costs are specified in Office of Management and Budget Circular A-21: *Cost Principles for Educational Institutions.* Examples of specifically unallowable costs include bad debts; alumni activities; entertainment costs; fines and penalties resulting from violations or non-compliance of federal, state, or local laws and regulations; and interest associated with internal debt. Unallowable costs should not be included in service department rates.

3.7 Applicable Credits: Transactions that offset or reduce costs, such as purchase discounts, rebates, allowances, refunds, etc. For purposes of charging service department costs to federally sponsored programs, applicable credits also include any direct federal financing of service department assets or operations (e.g., the direct funding of service department equipment by a federal program). Additionally, where significant, service departments should be credited with interest earned on fund balances.

3.8 Equipment: An item of tangible personal property meeting the state capitalization levels. Purchases under this amount are considered consumable supplies.

3.9 Billing Unit: The unit of service provided by a service department. Examples of billing units include hours of service, animal care days, tests performed, machine time used, and number of units sold.

3.10 Billing 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 billing units expected to be provided to users of the service during the year.

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

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

4. RESPONSIBILITIES OF COMPONENTS FOR SERVICE DEPARTMENT OPERATIONS

4.1 Each System component is responsible for developing procedures for establishing user rates, maintaining proper documentation of rate calculations, verifying that rates are not discriminatory towards different groups of users, and periodically reviewing operations for compliance with procedures. Additionally, each component shall establish procedures for the operation of service departments, including requisition of equipment, goods and services, issuance of departmental credit cards, and billings and payments. All such procedures and management systems must conform with System Regulations.

4.2 The Chief Financial Officer (CFO), or designee, of each System component is responsible for approving and reviewing billing rates; determining when inventory records must be maintained by a service department; ensuring record retention; approving transfers of funds out of service departments; and recommending to the Chief Executive Officer (CEO) the closing of unnecessary service departments. Additionally, the CFO, or designee, of each component is responsible for establishing and implementing business and financial procedures and management systems that are necessary for the effective and economical operation of service departments of the component.

5. UTILIZATION OF SERVICE DEPARTMENTS

5.1 Service departments are established in order to obtain efficiency and economy of operations through purchasing frequently used items in large quantities, eliminating duplication of effort in the acquisition of good and services from suppliers, making it more convenient for user departments to obtain goods and services, and specialization of skills.

5.2 Each System component will encourage departments and users to fully utilize their component's service departments, except where distance or other reasons make such utilization impractical or uneconomical.

6. PRICING OF GOOD AND SERVICES

6.1 Billing rates should be computed at least annually. Historical trends and projected costs should be used in projecting future activity of the service department. Prior and current financial statements for the service department should be an integral part of the rate calculation and documentation.

6.2 Actual costs and revenues should be compared at least annually. (Revenues should not include subsidies.) 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 and cost effective, 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.

6.3 Rates and charges for the sale of services shall be set by the applicable System component to recover the full costs of providing such services without exceeding actual costs each year. Rates should be set on a break-even of allowable costs basis for the year. In some instances (e.g., when a new service is being provided), it may not be possible to establish billing rates to break even on an annual basis. In those cases, the break-even objective may be established for a longer term, such as 2 or 3 years. Additionally, an appropriate reserve (no more than 90 days) for working capital will not be considered a surplus.

6.4 Recharge Centers

6.4.1 Billing rates should be designed to recover the actual 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 rates should exclude unallowable costs and be net of applicable credits.

6.4.2 The rates should be based on a reasonable estimate of the direct operating costs of providing the services for the year and the projected number of billing units for the year.

6.5 Service Centers

6.5.1 Billing rates should be designed to recover the direct operating costs of providing the services and internal support costs, on an annual basis. The rates should exclude unallowable costs and be net of applicable credits.

6.5.2 The rates should be based on a reasonable estimate of the costs of providing the services for the year and the projected number of billing units for the year.

6.6 Specialized Service Facilities

6.6.1 Billing rates should be designed to recover the direct operating costs of providing the services and internal support costs, on an annual basis. The rates should exclude unallowable costs and be net of applicable credits. Additionally, specialized service facilities may include in their billing rates a certain amount of specifically identified F&A costs. Each component having specialized service facilities will receive an allocation F&A costs, as calculated by the System Office of Budgets and Accounting (SOBA), to be included in their rate determination.

6.6.2 The rates should be based on a reasonable estimate of the costs of providing the services for the year and the projected number of billing units for the year.

7. COST ALLOCATION

7.1 Where separate billing rates are used for different services provided by a service department, 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 department and partially to other activities of a department.

7.2 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 support costs; and (c) in the case of specialized service facilities, F&A costs.

7.3 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 the services can usually be accomplished by using the proportional amount of time the individual spends on each service. Other cost allocation techniques may be used for internal support costs and F&A costs, such as the proportional amount of direct costs associated with each service, space utilized, etc.

8. SERVICE DEPARTMENTS THAT PROVIDE MULTIPLE SERVICES

Where a service department provides different types of services to users, separate billing rates should be established for each service that represents a significant activity or function of the service department. 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 next succeeding year.

9. VARIABLE BILLING RATES

All System users should normally be charged the same rates for a service department's services. If some users are not charged for the services or are charged at reduced rates, the full amount of revenue related to their use of the services must be imputed in computing the service department's annual surplus or deficit. This is necessary to avoid having some users pay higher rates to make up for the reduced rates charged to other users. 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 and do not result in recovering more than the costs of providing the services.

10. EQUIPMENT PURCHASES

Expenditures for equipment purchases should not be included in the costs used to establish service department billing rates. However, the rate can include depreciation of non-federally purchased equipment. By including equipment depreciation in the billing rates, the service department will build a reserve to purchase equipment in the future, when the equipment needs to be replaced. The funds represented by depreciation should be set aside in an equipment replacement reserve account for future equipment purchases. If the amount in the equipment replacement reserve account is not sufficient to cover the cost of the new equipment, a request for non-service department funds to purchase the equipment should be submitted in accordance with normal component procedures.

11. INVENTORY RECORDS FOR PRODUCTS HELD FOR SALE

Inventory records must be maintained if a service department purchases an unusually large amount of inventory during one rate cycle or the service department has significant stock on hand that is not expected to be used during the next rate cycle. The accumulation of inventory results in higher than appropriate future billing rates. The component CFO, or designee, should determine the amount of inventory that can be held for sale without maintaining inventory records. Excessive purchases of inventory should be excluded when calculating billing rates.

12. SERVICES PROVIDED TO OUTSIDE PARTIES

12.1 Service department's primary users should be internal System departments. Use by private organizations should be secondary or incidental to the operation of the service department. Service departments should not compete with established community businesses for private customers or users. When services are provided to private organizations, the billing rates may include F&A costs even though these costs are not included in the rates for internal users. However, as indicated in paragraph 6.6.1, billing rates for specialized service facilities already include F&A costs for all users. Under no circumstances shall the rates charged to federal users be used to subsidize rates billed to private users.

12.2 Sales of goods and services to individuals or non-System organizations and entities should be reviewed for federal income tax considerations (i.e., unrelated business income tax) in conjunction with guidelines provided by the SOBA.

13. SUBSIDIZED SERVICE DEPARTMENTS

In some instances, a school or department within a System component may elect to subsidize the operations of a service department. This may be accomplished either by charging billing rates that are intended to be lower than costs or by not making adjustments to future rates for a service department's deficits. Service department deficits caused by intentional subsidies cannot be carried forward as adjustments to future billing rates. Subsidies should be provided only when there is a sound programmatic purpose.

14. ACCOUNTING AND RECORD RETENTION

Each service department is required to keep proper documentation (e.g., workpapers) regarding the calculation of the billing rate and records that identify the services provided to each class of users. Accounting records should be maintained to account for the actual direct operating costs of the service department, internal support costs, revenues, billings, collections, and surpluses or deficits. The component CFO, or designee, is responsible for ensuring records are maintained to comply with System Regulation 61.99.01, *Retention and Disposition of Public Records.*

15. TRANSFERS OF FUNDS OUT OF SERVICE DEPARTMENTS

Transfers of funds out of a service department account should not be made for non-service department related purposes. Exceptions should be approved by the component CFO, or designee. If a transfer involves funds that have accumulated in the service department account because of prior or current year surpluses, an adjustment to user charges to compensate for the surplus may be necessary.

16. CREATION, CONSOLIDATION, OR SEPARATION OF SERVICE DEPARTMENTS

16.1 Each component shall have a designated committee that has the responsibility to review all requests for the creation, consolidation, or separation of service departments within its component. The committee reviews proposals for their impact on the System, its components and the citizens of Texas. The committee shall report to the CFO who will make recommendations on the service department to the CEO.

16.2 Requests for approval of the creation, consolidation or separation of a service department must contain the following:

(1) a description of the services to be provided and the users of the services;

(2) an analysis showing that the request is feasible and appropriate;

(3) the reasons why the services can best be provided by an internal service department, rather than by an external service provider;

(4) expected benefits/potential problems for the component;

(5) a projection of the costs and utilization of the services;

(6) a billing rate calculation and, where possible, a comparison of the internal rates with the rates charged by external service providers; and

(7) the component CEO's endorsement of the proposal.

16.3 After reviewing a request, the CEO will submit recommendations to the Chancellor for approval, disapproval, or approval with modifications. The Chancellor will annually report to the BOR a comprehensive listing of all such approved service departments along with the estimated operating budget.

17. CONTINUED AUTHORIZATION OF SERVICE DEPARTMENTS

Service departments which may be operated by each System component during ensuing fiscal years are authorized by the BOR as part of the annual budget approval process.

18. CLOSING OF SERVICE DEPARTMENTS

If, at any time, it appears that the goods and services of a specific service department are no longer needed (i.e., a service department is inefficient or too costly) the component CEO, or designee, may eliminate the service department. If an eliminated service department has any remaining fund balances, the component CFO, or designee, will determine where to allocate the funds. If surplus funds are related to over charging, the service department should return funds to users.

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CONTACT OFFICE: System Office of Budgets and Accounting

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Section 21 Rules