



TEXAS TECH UNIVERSITY™

Operating Policy and Procedure

OP 62.23: Establishing and Operating Internal Services Activities

DATE: January 16, 2008

PURPOSE: The purpose of this Operating Policy/Procedure (OP) is to provide information and set Texas Tech University (TTU) policy on the establishment and operation of Internal Services Activities (ISA), including internal service accounts and their expenditures, charging rates, charging practices, and acceptable fund balance levels.

Compliance with internal service activity requirements from federal regulations (OMB Circular A-21, “Cost Principles for Educational Institutions,” OMB Circular A-133, “Audits of States, Local Governments, and Non-Profit Organizations,” and the OMB Circular A-133, “Compliance Supplement”) is necessary for TTU and other universities that accept federal sponsored project awards. Any questions or requests for further information related to this OP and/or its application should be directed to Financial Accounting and Reporting.

REVIEW: This OP will be reviewed in February of even-numbered years by the managing director of Financial Accounting and Reporting (FAR) and the managing director of Sponsored Programs Accounting and Reporting (SPAR) with recommended revisions forwarded to the associate vice president/comptroller (AVPC) and then to the senior vice president for administration and finance (SVPAF) by March 1.

POLICY/PROCEDURE

1. Applicability

- a. This policy applies to all ISA.
 - (1) ISA are activities established by a unit/department *primarily to provide goods and services to other internal units/departments* on a fee-for-service basis. ISA have the authority to charge users for their goods and services at break-even rates that will recover their full costs, including overhead, within the guidelines established by this OP. Examples of TTU ISA include MailTech, Central Warehouse, Communication Services, and CopyTech.
 - (a) Primarily to provide goods and services to other internal units/departments is having more than 50 percent of revenue from sales to internal units/departments on a fee-for-service basis.
 - (b) Internal units/departments include all instructional, research, and other operating units/departments of the components of the Texas Tech University System, including TTU, TTU Health Sciences Center (TTUHSC), and TTU System Administration (TTUSA). Examples include TTU Physics, TTUHSC Pharmacology, and TTUSA Office of Risk Management.

- b. This policy does not apply to the following:
- (1) Education related charges for instruction in regular, extension, evening, or continuing education programs;
 - (2) Grants, gifts, cooperative agreements, and contracts from both the public and private sectors that support research, instructional, and service projects;
 - (3) Auxiliary enterprises such as Housing & Residence Life, Hospitality Services, Intercollegiate Athletics, and the Jerry S. Rawls Red Raider Golf Course: (see OP 62.15, "Sales of Goods and Services by Auxiliary Enterprises and Education-related Business Activities"); or
 - (4) Education-related business activities established by a unit/department not primarily to provide goods and services to other internal units/departments on a fee-for-service basis. Examples of TTU education-related business activities established not primarily to provide goods and services to other internal units/departments on a fee-for-service basis include Livestock and Meat Operations, Thornton Beef Cattle/Feed, and Texas Tech Center at Amarillo – Pantex Operation. See OP 62.15, "Sales of Goods and Services by Auxiliary Enterprises and Education-related Business Activities."

2. **Initiation of ISA**

Initiation of ISA should not occur for which a charge will be levied against any institutional account until the internal service's charging rate(s), charging practices, and budget have been approved by FAR and SPAR.

3. **Requesting a New Internal Service Account**

- a. Establishment of an ISA will consist of submitting the following three forms to FAR:
- (1) *Service Department/Support Activity Account Request* (Attachment B);
 - (2) *Rate Development Worksheet* (Attachment D); and
 - (3) *Budget Revision Form* (Budget & Resource Planning & Management Web site)
- b. Creation of an Equipment Replacement Account (ERA) is required when an ISA meets the significant capital outlay threshold provided in section 7 of this OP.
- c. For a new ISA, the review and approval of the rate calculation methodology, the rate(s), and the establishment of the ISA(s) will take 15-60 days, depending on the completeness of the information provided and the complexity of the internal service and its charging rates.
- d. See section 8 of this OP for when requisition of services by non-campus organizations or private businesses may occur.

4. **ISA Levels and Groupings**

- a. To ensure compliance with federal regulations, TTU recognizes three ISA levels, each with its own associated requirements. The levels are major, large, and small ISA with each based upon the ISA's total annual sales revenue and/or total annual sales made directly to federally funded awards reported in the most recently completed fiscal year. In calculating these levels,

grouping of closely related internal service operations determine the applicable ISA level. See Attachment A that lists ISA levels for TTU and TTUSA as of 09/01/07. The ISA levels are:

- (1) Major ISA – ISA with total annual sales revenue and/or total annual sales made directly to federally funded awards reported in the most recently completed fiscal year exceeding \$1,000,000 and/or \$100,000 respectively. (Note: TTU uses Federal Cost Accounting Standards Board Disclosure Statement, DS-2, Section 3.2.0(d), as the underlying federal source for its definition of major internal services.)
- (2) Large ISA – ISA with total annual sales revenue and/or total annual sales made directly to federally funded awards reported in the most recently completed fiscal year exceeding \$100,000 and/or \$0 respectively.
- (3) Small ISA – ISA with total annual sales revenue less than \$100,000 and no total annual sales made directly to federally funded awards reported in the most recently completed fiscal year.

5. Requirements for All ISA Levels

- a. A separate ISA is created after the *Service Department/Support Activity Account Request* (Attachment B), the *Rate Development Worksheet* (Attachment D) and a *Budget Revision Form* (Budget & Resource Planning & Management Web site) is submitted to FAR.
- b. The general federal standard for an ISA operating working capital reserves (fund balance) is that it should not be more than 60 days for cash expenses for normal operations incurred for the period, exclusive of depreciation, capital costs, and debt principal costs.
 - (1) If a working capital reserve (fund balance) of more than the general federal standard is justified by a business need, then documentation justifying the need is required for audit purposes.
 - (2) Fund balances in excess of the federal standard amount (or the justified need) are imperative to reduce the charging rates in the next review period.
- c. The following accounting limitations apply to internal services operating accounts:
 - (1) Expenses recorded in the ISA operating account(s) must be necessary and reasonable to the provision of the service. If there are questions about whether a charge is necessary and reasonable, please contact FAR. See *Federal Unallowables* (Attachment C).
 - (2) Interest, rebates, and other credits are to be dedicated to the specific ISA.
 - (3) Non-operating transfers from ISA require review by SPAR and AVPC and the approval of the SVPAF.

Refunds are required to the federal government for its share of any amounts transferred or borrowed from ISA for purposes other than to meet the operating liabilities, including interest on debt, of the internal services fund. Examples of operating liabilities for a specific internal service include its depreciation, capital costs, debt service, and administrative overhead charges specific to the internal service.

- (4) Beginning the second fiscal year following the first most recently completed fiscal year total annual sales revenue exceeding \$100,000, and continuing thereafter irrespective of future total annual sales revenue, ISA are subject to a charge for TTU general administration and general expense (administrative overhead). Effective 9/1/2007, the ISA administrative service charges (ASC) will:
 - (a) Be calculated and collected quarterly, based upon a percentage of the ISA non-capital expenditures (total expenditures minus capital outlay and debt service) for the fiscal year in which the ASC is applied;
 - (b) Not exceed the uncapped rate for the general administration and general expense from the most recent TTU Facilities and Administrative (F&A) Rate Agreement;
 - (c) Be set annually during the TTU budget process, reviewed by SPAR and AVPC and approved by the SVPAF;
 - (d) Be waived or reduced only with the approval of the SVPAF.
- d. The basis for ISA charging rates is the necessary and reasonable costs of providing the services, with the goal of breaking even (without large deficits or surpluses).
 - (1) Subsidies must be approved by FAR.
 - (2) Review of the ISA charging rate computations and rate structures by the ISA manager or designee will be at least annually to determine whether rate changes are necessary.
 - (3) Adjustments to the ISA charging rates for the next year(s) are required to eliminate excess surpluses or deficits.
- e. Charging rate(s) computation:
 - (1) The ISA will develop the rate(s) for charging users of internal service goods or services.
 - (2) The format of this information and the general computation method varies from ISA to ISA, depending on the number and nature of the services provided by the ISA. The format and computation method for deriving the rates will be under review by FAR and SPAR for compliance with federal requirements prior to account establishment.
 - (3) If the method of the computation of the charging rate(s) or the charging rate structure changes significantly, it is mandatory the ISA submit the new computation method for review and approval by FAR and SPAR.
 - (4) The ISA account manager must maintain documentation for the methodology of the charging rate. This documentation must be available for review/audit for a period including the fiscal year in which the charges based on the charging rate occur and four fiscal years following.
- f. ISA Charging Practices
 - (1) ISA do not have the authority to subsidize any other internal or external entity by providing goods or services without charge or without charging the normal charging rate(s).

- (2) Internal users are considered “best customers” who receive the same rates and cannot exceed charging rates to auxiliary and external users. Best customers include:
 - (a) Internal units/departments
 - (b) Federal agencies
 - (c) Government or quasi-government entities, when it is evident that the sale is to be paid with funds from federal sources.
- (3) Actual purchases/usage of the internal service’s goods/services is the basis for the charging rate.
- (4) Internal services are to comply with OP 62.26, “Charging Departments for Goods and/or Services,” which addresses issues such as charge tickets, charge ticket retention, and the mechanics of charge processing.

6. **Additional Requirements for *Small ISA***

- a. If the format of current year charging rate computations and determination of the rates for an account are consistent with computations and determinations previously reviewed and approved by FAR and SPAR, then the annual rate worksheets do not require approval and are submitted to FAR or SPAR for review only upon request.
- b. Small internal services do not require an Equipment Replacement Account.

7. **Additional Requirements for *Major and Large ISA***

- a. Major and large ISA must maintain a separate property inventory (PRMO code) that includes property inventory used by the ISA, whether or not the property inventory purchased was from the ISA(s). Based upon the TTU property inventory with information provided by the State Property Accounting (SPA) system, SPAR will provide depreciation information for use in rate calculations to internal services that have significant capital outlay.
 - (1) ISA with significant capital outlays require ERA appointed for capital purchases where expected capital outlays will be budgeted. Significant capital outlays are:
 - (a) The current fiscal year’s expenditure plan from all sources that includes total capital outlay amounts (including capital outlay debt service) that exceeds:
 - \$50,000 or
 - 7.5 % of the current year’s total revenue budget, or
 - (b) The calculated depreciation for the prior fiscal year exceeding the larger of:
 - \$50,000 or
 - 7.5% of the current year’s total revenue budget

- (2) For ISA with significant capital outlays, depreciation (rather than planned capital outlay purchases) will be included in the rate computation.
 - (a) SPAR will furnish depreciation information based upon TTU property inventory and information received from ISA staff.
 - (b) Billing rate computations for internal units must exclude any portion of capital asset costs borne or donated by the federal government.
 - (c) Depreciation expense will be budgeted in the ISA operating account and expected capital outlay costs in the ERA.
 - (3) Debt service expense is a legitimate expense for an internal services account. However, debt service for internal services account capital outlay is normally included in internal service charging rates as depreciation recovered on the capital items. Before the debt arrangement is finalized, review by FAR and SPAR will give the ISA information as to the rate at which the depreciation can be recovered in the internal service charging rate and ensure that debt payment arrangements do not conflict with federal regulations.
 - (4) Federal regulation require depreciation as the federal regulations require depreciation as the basis for charging rates on capital items rather than the actual acquisition of the capital items:
 - (a) Major and large ISA must maintain accurate property inventories (see OP 63.08, "Property Management").
 - (b) The ISA property inventories must list inventory items used by the ISA, regardless of the source of funds used to purchase the items.
 - (c) SPAR completes quarterly transfers from the ISA operating account to the ERA, with amounts based upon depreciation rather than on planned capital outlays.
 - (d) ERA fund balances are excluded from the federal working capital reserves (ISA operating account's fund balance) limitations discussed earlier.
 - (e) See *Listing of Internal Services by Level, with annotation for those Internal Services requiring Equipment Replacement Accounts* (Attachment A) for the list of ISA requiring an ERA.
- b. Major and large ISA space must be separately identifiable in TTU facilities inventories.
 - c. Major ISA charging rate computations are subject to review and approval on annual basis prior to the budget process for the next fiscal year by SPAR.
 - d. Large ISA are subject to review and approval each biennial year by FAR and SPAR. On a non-review year, the annual rate worksheets will require review and approval by FAR and SPAR only upon request; therefore, the large ISA may continue using the same format of current year charging rate computations and determination of the rates for an account consistent with the computations and determinations previously reviewed and approved by FAR and SPAR.
 - e. If the rate structure of any series of charging rates changes significantly, submission of the new rate structure to FAR for review and approval is mandatory.

8. Sales to Non-campus Organizations or Businesses

Requisition of services by non-campus organizations and/or private businesses may occur. The direct sale of goods or services to internal units/departments for the convenience of and in support of the broad educational mission is distinctly different from sales to non-campus organizations and/or private businesses external to the institution. Therefore, ISA with sales to non-campus organizations and/or private businesses must comply with additional requirements.

a. Additional definitions pertinent to off-campus sales:

- (1) Sponsored projects include grants, contracts, and cooperative agreements from both the public and private sectors that support research, instructional, and service projects. The use of the funds received is restricted to the purposes intended by the sponsor; there are often other specific sponsor requirements concerning the use of the funds.
- (2) Unrestricted sales by ISA to non-campus organizations and/or private businesses are different from gifts and sponsored projects. The following are some typical characteristics of unrestricted sales:
 - (a) The goods or services are delivered without detailed reporting;
 - (b) The ISA structures any work plan for activity and determines all necessary expenditures;
 - (c) The ISA bears the risk of profit or loss on services rendered or goods sold;
 - (d) The amount due from the paying entity is based upon goods or services provided rather than upon cost reimbursement; and
 - (e) The expenditure of the funds received is not restricted in any way by the paying entity.

b. For all ISA proposed sales to other universities or governmental agencies that exceed \$5,000, ISA shall provide information about the proposed sale to FAR which shall determine whether the sale is appropriately classified as an unrestricted sale of goods and services, because:

- (1) TTU is committed to compliance with the sponsored project restrictions and reporting requirements usually associated with governmental support of university activities;
- (2) Most university interactions with governmental and quasi-governmental agencies involve restrictions and reporting requirements; and
- (3) Proper identification of sponsored project interactions enables TTU to follow established compliance procedures.

c. The request for approval of an ISA initial sale or the initial sale of a significantly different type of good or service to non-campus organizations and/or private businesses, along with the Cost Rate Development Worksheet (Attachment D) and Budget Revision Form (Budget & Resource Planning & Management website) shall be forwarded to FAR and SPAR for review and approval.

- d. The sale of a service to non-federal or state of Texas non-campus organizations and/or private businesses shall be on a “strictly cash” basis (i.e., payment in advance or upon delivery), unless the president’s approval to extend credit has been obtained (see OP 62.01). Federal, state of Texas, local, city, county, or other agencies are exempt from this provision, provided written agreements or other documents (e.g., state of Texas Interagency Cooperation Contracts (IAC)) are on file in the department of Contracting and Purchasing to pay for the service.

- e. Any surplus/profits that results from the sale of a service to non-campus organizations and/or private businesses shall be used only to cover any deficits arising from the sale of services to on-campus departments and organizations (note: under no circumstances will any surplus be used for discretionary purposes).

Attachment A: Listing of Internal Services by Level, with annotation for those Internal Services requiring Equipment Replacement Accounts

Attachment B: Service Department/Support Activity Account Request

Attachment C: Federal Unallowables

Attachment D: Rate Development Worksheet
