Rate Development Guidance
For Facilities and Services Charged to Federal Programs
Under University Policy AD15

Overview

A service center is established in order to recover costs through a charge-out rate. At a simple conceptual accounting level, a charge-out rate consists of accumulated total direct costs of providing the service (numerator) divided by an activity base (denominator) for a specified period of time (generally fiscal year). The material in this document is intended to provide guidance for developing charge-out rates in accordance with sound accounting practices, University policies and procedures, and government regulations.

Two essential concepts should be followed in developing service center rates:

- Rates are established on a break-even basis only. The activity should not generate a profit.
- Rates must be nondiscriminatory and all users must be billed for services received. Nondiscriminatory means that all users are charged the same rate for the same level of service purchased under similar circumstances.

Activity Base

The activity base is used to develop a rate that reasonably allocates costs to those receiving the benefits. An appropriate activity base is essential to ensure that users pay only their share of the costs for the services rendered. Two methods are most commonly used to determine the activity base:

- **Consumption** is used when expenses are directly proportional to how much a unit of measurement is consumed. For example, if usage costs are determined to be consumed on an hourly basis, the rate would be based on number of hours of services provided, machine hours, etc.

- **Output** is used when the amount produced of a service provides a better measurement of the activity. Examples would be number of samples tested or ounces of product generated.

The activity basis selected should be documented in the rate submission and consistently used.

Cost Components

**Direct Personnel**

An appropriate portion of the salaries of all personnel directly related to the service center activities should be included in the rate. For purposes of labor consumption, full-time allocation to a rate is 2,080 hours per year for staff. The allocation basis for faculty should be documented in relation to an appointment period. If a specific individual works on several activities associated with different rates or only part-time to an activity with a rate, appropriate allocations should be made. If more than one
person is providing the same service, rates may be calculated for specific individuals or a composite labor rate may be developed.

**Fringe Benefits**

Where labor is a component of cost, fringe benefits must be included in the rate calculation based on university fringe benefit rates negotiated with the federal government for the applicable fiscal year.

**Materials and Supplies**

The cost of all materials and supplies necessary to the provision of service should be included in the rate. The rate should be based on actual usage or estimated consumption, if no actual usage is available, during the period rather than estimated inventory purchases. If the activity has production loss, such as material spoilage during a preparation process or scrap with no salvage value, those costs should also be included with appropriate documentation of those costs or percentages.

**Equipment**

- **Non-capital equipment**

  Non-capital equipment is defined as one single item having either a useful life of less than two years or a value less than $5,000. The cost of non-capital equipment may be included in a rate with appropriate documentation.

- **Capital equipment**

  Capital equipment is defined as one single item having both useful life of two or more years and a value of $5,000 or more. Charge-out rates under AD15 may not include the costs of

  - Acquiring capital equipment
  - Equipment depreciation
  - Reserve for capital equipment replacement

**Maintenance**

Costs for routine repair and maintenance of equipment, both capital and non-capital, used to provide the service should be included in the rate.

- **New equipment**

  When new capital equipment is purchased by the University, separately-stated costs for warranties, maintenance/service agreements and the like are not capitalized. These costs may be included in charge-out rates under AD15 over the life of the agreement.

  In situations where equipment is purchased without such agreements, individuals should make an effort to estimate repair and maintenance costs through discussions with knowledgeable persons such as manufacturer’s representatives, other owners of the equipment with similar usage (as in, another university or research facility) or by searching the Internet. This may also
be used in the case of equipment received through donation. Documented estimates are allowable in charge out rates. If necessary, the unit should subsequently adjust rates to reflect actual experience after a period of usage.

Existing equipment

After some period of time and usage, a unit would be expected to have an experience record of the routine repair and maintenance needs and costs of equipment. The experience record would form the basis for estimating ongoing costs in the charge out rates. Departments may also use quotes from vendors to document anticipated repair and maintenance costs.

Reserve for repair and maintenance

Capturing equipment repair and maintenance costs in charge out rates without causing unacceptable fluctuations is critical to the rate development process. To that end, units may build reserves into their rates to smooth the potential spike which would be caused by a large repair or maintenance cost which is likely to occur in one period. For instance, suppose a laser will require a new tube after 500 hours of usage. The department would estimate either the time period or unit of usage (x samples) over which the costs for tube replacement would be included in the rates to build in the anticipated cost.

Major overhaul or refurbishment of capital equipment

From an accounting perspective, equipment costs that either fundamentally extend the life of the asset or prepare the asset for a different function are also considered capital expenditures. Provision for these expenditures should be made outside of the rate-setting structure.

Other Direct Costs

Other costs associated with the provision of the services should be included. Examples would include:

- Rental contracts
- Service contracts (other than equipment maintenance)
- Professional development (related to the provision of services)
- Non-capital software
- Professional services

Over/Under Recoveries

Under or over recoveries must be calculated based on actual revenues and expenses. If a rate produces a profit or loss, the loss should be added to or the profit subtracted from the following year’s proposal when developing the subsequent rate, so the operation will break even over time. Losses may also be covered through a subsidy. Units should also review the historical activity base in order to determine if an adjustment is needed in future pricing calculations. Documentation must be provided.

Subsidies to Operation
In certain situations departments or units may decide for valid business reasons to subsidize a portion of a recharge center’s costs. In theory, the subsidy could be applied only to certain users identified in a rate proposal, such as members of a department. In practice, application of a subsidy to a sub-group of users is difficult in that the costs and usage attributable to that group would have to be segregated from total costs in order to correctly calculate a subsidized rate. The correct methodology for developing a subsidized rate is to apply the subsidy against total cost to derive net recoverable cost, which is the numerator in the rate calculation.

**Internal vs. External Rates**

Internal rates are established for usage within the university, whether to general or restricted accounts.

External rates are established for usage with entities outside of the university and must include the appropriate F&A rate depending on whether or not the funding is Federal direct or pass through.

**Federal Regulations**

Charge out rates which will be charged to federal grants and contracts must comply with 2 CFR 220 (formerly OMB Circular A-21) *Cost Principles for Educational Institutions*. Two key issues concerning charge-out rates are covered in the referenced document:

**Pricing**

Recipients of federal funds are not to recover more than cost, which may be achieved on a long-term basis by agreement between the university and its cognizant agency. The university may not discriminate in the price charged to governmental users from non-governmental users.

**Unallowable Costs**

Unallowable costs are defined in 2 CFR 220, Section J, and are expressly prohibited for inclusion in billings to sponsored research. Further guidance on unallowable costs can be found in university Guideline FNG05.

Last updated: October 6, 2010