

GOVERNMENT FINANCE OFFICERS ASSOCIATION
BEST PRACTICES ON PRICING INTERNAL SERVICES
WITH COMMENTS IN RED REGARDING THE CITY OF JACKSONVILLE

Pricing Internal Services

Internal services are those responsibilities a government provides to support its own internal operations. Common examples of internal services include information technology, payroll, motor pool, budgeting, legal, accounting, and human resources.

The City of Jacksonville charges users for the following internal services.

- Fleet Management – purchase, operation and maintenance of mobile equipment
- Copy Center & Central Mailroom
- Information Technologies – computers, communications, radios, phones, etc.
- General Counsel
- Self Insurance – health insurance, auto, liability, worker’s compensation, etc.
- Public Buildings – operation and maintenance of buildings housing City operations

Certain management objectives are served by creating a system to assign prices for the use of these internal services, which are then assessed to the departments that use the services. However, there is a cost to develop and maintain internal pricing systems. Governments must weigh the benefits of an internal services costing system against the cost and complexity of system design choices. Please note that this best practice is intended to apply to internal service charges regardless of whether it is accounted for in an internal service fund or as a general fund overhead allocation.

The City does not directly charge for other support services for which the users have little control over the level of usage. For example, the following services are included in the City’s annual indirect cost allocation and are charged to the various sub-funds which receive these services.

- Finance – accounting, payroll, treasury and budget management
- Employee Services and Procurement were charged as internal services in the past, but were moved into the General Fund.

Recommendation:

GFOA recommends that governments follow these steps when considering an internal service pricing system:

- 1. Identify goals of internal service pricing;**
- 2. Develop allocation strategy;**
- 3. Define level of costing detail;**
- 4. Determine cost of service;**
- 5. Decide basis of allocation; and**
- 6. Consider potential drawbacks.**

Identify goals of internal service pricing. As a first step, GFOA recommends that governments identify the goals they hope to achieve through a pricing system for internal services. The goals will guide the design of the system. Potential goals for a pricing system include:

- *Govern demand for a service.* If the customers of an internal service are not charged based on their level of use they may have an incentive to over-use the service. Alternatively, charges may cause customers to limit their use of the service.
- *Develop enterprise rate models.* Government enterprises (e.g., a water utility) may use services provided by the general government. A pricing system could provide an input into the rate model used to calculate fees for the customers of the enterprise.
- *Calculate indirect cost reimbursement for grants.* Some grants may allow indirect costs to be reimbursed. An internal pricing system provides support for the reimbursement request.
- *Provide input for full-costing model.* A full costing model provides the total cost of a given service, which enables better informed budgeting and planning. The full cost of a program is equal to the direct cost of program plus the indirect costs. Internal service pricing is essential to calculating indirect costs.
- *Promote discussion about the value of the service provided.* Charging customer departments for use of a service will raise questions about the value received from the service and what the best service delivery model is (e.g., centralized, decentralized, outsourced, etc.). A pricing system can facilitate comparisons with alternative methods of service delivery, including outside providers.
- *Examine value of a shared service model.* Shared services are thought to deliver greater efficiency through economies of scale. A solid pricing model is important for determining if a shared service model is delivering on this promise.
- *Promote competition in service delivery.* Internal services could be run much like a private business, including service level agreements with customers and competition from outside providers (e.g., private firms). Accurate internal charges are essential for a level competitive field.¹
- *Ability to customize service levels for different customers.* A detailed rate model makes it easier to provide a higher level of service to a customer that demands it because they can be charged a higher fee.

Costs must be weighed against the quality of service and the ability to control access to service or the priority of service delivery. For example, the need for some police, fire and rescue vehicles to be a priority and the need for thorough evaluations of vehicle condition at each service call must be considered.

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Develop allocation strategy. After the goals have been identified, the organization must decide which internal services will be priced and allocated to user departments. To make this decision, it may be useful to differentiate between market services and those that have more of a policy or regulatory character.

- *Market services* are those where the user departments play the role of consumer. Examples of market services include IT, fleet, and perhaps facilities.
 - The charges for market services have application to goals like promoting competition in service delivery, governing demand, and/or examining the value of a shared service model. Charging user departments for regulatory/policy services could be necessary for goals like developing a full costing system or calculating indirect cost reimbursement for grants.
- *Policy or regulatory services* are used to establish organization-wide policies or ensure compliance with standards. Users of these services cannot be as easily described as customers, but more accurately as regulated. Examples of policy/regulatory services include budgeting, internal auditors, or a chief executive.

The City has wisely chosen to charge only for *market services* where the consuming agency has some discretion over the level of service used. Our indirect cost recovery process addresses *policy or regulatory services* over which departments have little discretion or ability to control.

Choosing the appropriate allocation strategy is important in facilitating the periodic review of whether services should be considered for privatization. For example, costs which remain regardless of privatization decisions, such as pension amortization costs, need to be removed from analysis.

Define level of costing detail. Governments need to determine the level of detail associated with costing services.

- A *low level* of detail might define internal services at the department level (e.g., finance department, IT department). A low level of detail might be sufficient for a costing system with limited goals, such as developing enterprise rate models or obtaining reimbursement for indirect costs under a grant.
- A *high level* of detail would define services at the level of programs or other subunits (e.g., the various subdivisions of finance and IT cited earlier). A high level of detail might be needed for goals like governing the demand for service or promoting discussions about the value of a service.

In summary, a higher level of detail will lead to a more accurate costing system since the activities represented by the internal service categories will be more specified. However, more detail also leads to a more complex internal services pricing system. The government must decide if greater complexity (and its associated costs) will be worth the benefits.

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The City has adopted a higher level of detail to provide transparency regarding the total cost of providing various departmental services. This is important in making decisions regarding the allocation of scarce resources – both operating and capital. As stated above, this higher level is useful for periodic reviews of the cost effectiveness of the level of service the City provides.

Determine cost of service. With the internal services identified at either a high or low level of detail, the next step is to determine the cost of the service. The elements of the cost that should be considered include:

- *Direct costs.* Direct costs are the most essential cost element. This includes the services personnel, materials, supplies, and contractors.
- *Interest costs from internal loans.* If the internal service takes loans from other parts of the government then a market interest rate may be applied.²
- *Services used from other support services.* A cost model can be designed such that the cost of the internal service reflects not only its direct costs, but also the indirect cost from other support services that it uses (e.g., an IT service uses payroll). This aspect of costing can be performed at varying levels of complexity – methods that fully reflect how each internal service uses the services of other internal providers can become much more complex than those that provide less precise estimates.³

Decide basis of allocation. With cost of the service decided, the bases for allocating costs from the internal service to customers must be decided. Table 1 provides examples of internal services and cost allocation bases. Below are general principles that should be observed when determining bases.

- *Cause-and-effect relationship.* Costs should be allocated based on usage or causal factors relating to costs incurred by service provider. See Table 1 for examples of how cost bases for internal services can be related to the usage of various internal services.
- *Benefit received.* The basis for allocation should bear a relationship to the benefit the customer receives from the service. For example, while miles driven might be a good barometer of the benefit that police patrol receives from its vehicles, hours used might be a better measure for public works.
- *Fairness.* The method of cost allocation that will be used must be seen as fair and legitimate by the users of the costing system. The fee should be charged equitably based on use and other considerations.⁴ Users must understand how the costs are calculated and should have a role in determining how the price system will be structured.⁵
- *Legal constraints.* State laws may place constraints on how charges are developed. For example, if the charge for providing a service exceeds the true cost of the service, it could be construed as a tax under the law. Also, federal regulations on grants may place limits on internal charges against grant programs.⁶

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Table 1 Examples of Internal Services Cost Allocation Bases

Internal Service	Allocation Basis
Payroll processing	Number of employees, number of checks
Budgeting	Labor hours, size of budget
Insurance	Number of employees, experience
Legal services	Direct labor hours
Office space / rent	Square feet of space occupied
Procurement services	Number of P.O.s, dollar volumes, direct labor
Vehicle costs	Miles driven, hours used
Information technology	Number of devices, server time, number of calls to help desk, direct labor hours

A government might also consider the accounting mechanism for the internal charge. An internal service fund provides the most detailed accounting, but also entails the most administrative effort. If the goals of the internal charge are modest (e.g., not charging back to federal grants, full cost recovery is not a goal), then it may be easier to simply recognize the charge as a general revenue in the general fund (or some other fund as may be appropriate to the circumstances).

The City operates on the basis shown in the table for some services. As recommended, we maintain a detailed accounting via internal service billings when other entities are involved and the users have some ability to modify their level of participation.

We account for employee services, procurement and finance functions within the General Fund / GSD and allocate costs to other sub-funds via the indirect cost recovery methodology.

Governments should also regularly review their internal charge rates against actual experience for appropriate adjustments. Governments should also develop guidelines to determine what will happen to excess funds should an internal charge generate cost recovery proceeds in excess of actual costs.

Periodic reviews should be performed regarding the appropriate quantity and quality of resources to be provided. Decisions must be carefully weighed, for example removing simpler tasks from a provider while retaining more difficult services may result in making incomplete privatization decisions that leave a lesser number of services burdened with overhead.

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Consider potential drawbacks of internal costing systems. Finally, governments should be aware of the drawbacks of internal costing systems below and should consider mitigating strategies.

- *Diminished trust between providers and customers.* A charge system could create a suspicion among customers about how charges are developed and/or administered, especially if the basis of the charges is not adequately communicated to customers.
- *Subverting processes or not using shared services.* If customers perceive charges to be too high or unfair, they may respond by developing their own service capabilities. This can lead to duplication of resources and wasted effort.
- *Acrimony and debate over the charge system.* Even if users do not subvert the system, a costing system that is viewed negatively by users could generate a great deal of debate and discussion energy that could be better spent on other pursuits.
- *Costs exceed the benefits of the system.* A precise internal costing system can be relatively complex. Complexity entails cost, such as training managers to use cost information. Whether this complexity and cost is worth it should be seriously considered in light of the goals for the system and system design choices.
- *Unmet expectations.* Managers can become frustrated with the system if they do not understand what it can and cannot accomplish. For example, if internal charges cause users to lower their consumption of a service they may see their per unit cost rise as the fixed cost of service is now allocated over a lower volume.

Throughout the years, the City has dealt with the negatives mentioned above. The solution is to make the amounts charged fair and relevant to decision making while maintaining communication with users regarding their concerns.

We will discuss this further as we progress through the presentation.

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Footnotes:

1 However, it should be noted that comparing internal charges to a potential external service providers proposed fee cannot be the basis for a sound outsourcing decision because the external providers proposed cost must be compared to the internal costs the government will avoid (i.e., no longer have to incur) by using the external provider (known as avoidable costs). For example, there may be overhead costs included in an internal charge that will not be eliminated (avoided) by using an external provider.

2 If used, the interest rate should be consistent with any governing laws/regulations.

3 For example, single step allocations are the least complex, but is less precise, while reciprocal allocations are more precise, but much more complex. For a complete explanation of these methods, please consult. R. Gregory Michel. Cost Analysis and Activity-Based Costing for Government. (Chicago, Illinois: GFOA) 2004

4 For example, the customer may provide value back to the internal service in some way that justifies a lower charge.

5 IT governance systems are on example of a means for giving customer departments input into rate modeling decisions. See GFOA's publication IT Budgeting and Decision Making (2009)

6 For example, the Federal Office of Management and Budget circular A-87 outlines standards for determining costs which can be charged to Federal grants and reimbursement contracts.

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Central Services Usage by the Independent Agencies and Constitutional Officers

The City's Internal Service Funds (formerly known as Central Services), along with Human Resources (now called Employee Services) and Procurement, were historically consolidated. Employee Services and Procurement are no longer treated as internal service funds, but they are areas that should also be considered when looking for financial savings through consolidation.

Internal Service Funds account for the financing of goods and services provided by one City department or agency to other City departments or agencies on a cost-reimbursement basis. The City's internal service funds are as follows:

The Fleet Management Fund accounts for the operation of the City's fleet of police cars, fire and rescue vehicles, public works and utility trucks, and many other automotive on and off road equipment. Fleet Management provides services to JEA for fuel and maintenance work that JEA contractors are unable to perform. JAA, JPA and JTA receive no services from Fleet Management.

The Copy Center Fund accounts for the operation of the centralized mailroom, centralized copy center/print shop and copier consolidation program for City agencies. JAA, JEA, JPA and JTA do not utilize the Copy Center.

The Information Technologies Fund accounts for centralized information management and computer services that include data processing, central telephone and network communications, and other voice/data electronic media services. The Sheriff's Office, Tax Collector, Supervisor of Elections, Property Appraiser's Office and City Council all have their own IT employees in addition to the employees in the City's Information Technology Division. The Clerk of Courts Office has its own IT employees, however they are State funded employees. JAA, JEA, JPA and JTA all have their own IT employees. In addition to the Information Technologies Fund, the Radio Communications fund allocates the cost for radio communications including installs, upgrades and repairs for the general government as well as JAA, JEA and JTA. JPA does not utilize the City's radio communications.

The Office of General Counsel accounts for centralized legal services to all City departments and agencies through the Office of General Counsel. JAA, JEA, JPA and the DCSB utilize the services of the Office of General Counsel; JTA only utilizes the Office of General Counsel on a limited basis.

The Self-Insurance Fund accounts for centralized risk management and safety and loss prevention services to all City departments including self-insured workers' compensation and general/auto liability. JAA, JEA and JPA participate in the City's Self-Insurance fund, but JTA does not.

The Group Health Fund accounts for employee health, life insurance and other types of employee insurances. The City switched to a self-insurance plan in 2015. Although the Constitutional Officers are part of the City's group health program, the JAA, JEA, JPA, and JTA each have their own plans.

The Insured Programs Fund accounts for providing all forms of property and casualty, commercial liability and other types of coverage to City departments. JPA is the only independent agency that participates with the City.

Public Building Allocations accounts for the cost of the daily operation, maintenance, utilities and security for all public buildings. None of the independent agencies are located in the City's public buildings.

As discussed above, Employee Services and Procurement are no longer internal service funds, but they should also be taken into consideration.

Employee Services - performs the functions of recruiting, interviewing, examining, selecting and hiring employees. JAA, JEA, JPA and JTA do not utilize the City's Employee Services Division.

Procurement – performs the function of centralized purchasing. Listed below are some areas where the independent agencies could utilize the City's Procurement Division.

Centralized Procurement

Regarding procurement, there are many opportunities of different magnitudes. Does each independent agency really need its own procurement code, procurement director and staff? For example, up until 1997, JEA utilized the City's procurement department. Now, JEA has its own procurement code and department, as does JAA, JPA, and JTA. It is possible that the independent agencies could utilize City procurement for some or all their procurement needs.

Joint Procurement

The joint procurement of various items or services should be investigated. A review should be made of all the items and services regularly procured by the City and independent agencies. A chart with the items and services listed down the left side and the City and independent agencies listed across the top could be used to identify those areas where commonalities exist. Office supplies including copier and printer paper would probably be the easiest joint procurement to tackle. Use of the City JSEB Program by the independent agencies should be achievable and would eliminate duplications of service. Currently, JEA is utilizing the City's JSEB Program, but continues to employ its own JSEB staff.

Piggybacking

Where items are procured on a unit price basis, contracts should be written to allow piggybacking by the City and independent agencies. The City contracts include provisions for piggybacking and if the independent agencies don't have a piggyback provision, the City could get permission to piggyback. Even if every contract includes the possibility of piggybacking by other government agencies, if no one uses it, then it accomplishes nothing. It may be as easy as making it standard practice to check with all other agencies prior to initiating a purchase or it may be necessary to create a searchable database where the City and independent agencies record all of their open procurement contracts.

Discussion Item

A survey could be conducted of the independent agencies, the constitutional officers, and the school board to determine why they are not using the City's internal services.

Internal Services and Current Participants

Fleet Management

- Vehicle maintenance including parts
 - City agencies
 - FDOT
 - JEA
 - Health Department
 - Public Defender
- Fueling
 - City agencies
 - JEA
 - JTA
 - Health Department
 - Neptune Beach
 - State Attorney
 - Public Defender
 - FDOT
 - Solid Waste contract haulers
- Vehicle Replacement

Copy Center / Central Mailroom

- Duplication

JSO and the Courthouse have their own copy center

 - City agencies included in the Mayor's budget (excluding: Clerk, Courts, Public Defender, State Attorney and JSO)
 - Police and Fire Pension
- Central Mailroom includes postage

There are many areas in the City that still have their own postage budget.

 - City agencies included in the Mayor's budget (excluding: Clerk, Courts, Property Appraiser, Public Defender, State Attorney and JSO)
 - Police and Fire Pension
- Copier Contract

There are discussions ongoing with JPL about including more of their citizen facing copiers in the contract and a meeting was held last week with Courts to discuss adding them as participants.

 - City agencies included in the Mayor's budget (excluding: Courts, Clerk and State Attorney)
 - Police and Fire Pension

Information Technologies

- Computer system / equipment maintenance, security, network etc.
- Computer / Laptop Equipment Refresh
- IT System Development / 5 Year-Plan

- Radio communications
 - City agencies
 - Atlantic Beach
 - Baldwin
 - JAA
 - JEA
 - JTA
 - Neptune Beach
 - School Board
 - UNF
- Radio Refresh
 - City agencies

Risk Management

- General liability / Workers Comp
 - City Agencies
 - JAA
 - JEA
 - JHA
 - JPA
 - Police and Fire Pension
 - Clerk of Court state side
- Miscellaneous insurance
 - City agencies
 - Police and Fire Pension
 - JPA

Group Health

- Health, Life, Dental, Vision and COBRA
 - Any agency with employees in Oracle including Courts, Clerk's state side and Police and Fire Pension

Public Buildings

- Facility costs including maintenance, utilities and security
 - Agencies that occupy space in City facilities that Public Buildings maintains and/or pays the utility / security costs for.