## Business Unit Balances & Reserve Policy

### Contents of Policy

- **Policy Overview**
- **Unrestricted Business Unit Balances**
  - Break-Even Concept
  - Types of Unrestricted Balances
  - Surpluses and Deficits
  - Tracking Balances
  - Estimating Appropriate Balances
  - Annual Rate Changes
- **Unrestricted Designated Reserves**
  - Reserve Definition
  - What is Allowable
  - Contributions/Uses
  - Tracking Balances
  - Estimating Appropriate Balances
- **Contingent Liabilities and Allowance Accounts**
  - Allowance for Uncollectible Receivables
  - Allowance for Inventory Write-offs
  - Estimating Appropriate Balances
- **Interest Income/Expense on Balances**
- **For More Information**

### Policy Overview

Harvard’s Service Center departments function as business units, where the majority of the operating funds for these departments are provided through some form of fee-for-service charge to customers. The schools are rarely required to use University services, and many of the services face direct competition from outside the University. Therefore, Service Center departments must be competitive, self-supporting, and operate only on a cost-recovery basis. They are not intended to be profit centers. However, surpluses and deficits may be generated from time to time.

Depending on the nature of the business, some service departments may also carry balances in accounts to fund additional needs as they arise in the business operations. These reserves, allowances, contingent liabilities and/or accrued expenses must be documented and substantiated, and are subject to A-21 Service Center compliance.

This policy provides an understanding of unrestricted business unit balances, unrestricted designated reserves, and contingent liabilities & allowance accounts and the corresponding accounting treatment of each.

### Unrestricted Business Unit Balances

Unrestricted business unit balances represent the accumulation of surpluses and/or deficits generated by a business unit from year to year. At the end of each fiscal year, each business
unit’s “bottom line” is added or subtracted from the prior year’s carry-forward balance to obtain the businesses’ current fund balance.

Break-Even Concept
Although, in most cases, it is ideal for a business unit to break-even each year, several factors may result in a business generating a surplus or deficit, either intentionally or unintentionally:

Intentional Surpluses or Deficits:
- To return or recover a prior year surplus or deficit to customers
- To provide working capital for ongoing operations

Unintentional Surpluses or Deficits:
- When rates are based on customer volumes that fluctuate from original estimates
- When changes to customer bases or services provided result in unplanned revenue shifts
- When unplanned increases or decreases in expenses occur

When a business unit creates a surplus or deficit, the balance will be transferred from the operating accounts into the balance sheet and will be carried in an interest bearing account until it is offset in future years. The business unit must develop and/or adjust rates so that revenues offset expenses over a reasonable period of time.

Types of Unrestricted Balances

Working capital. In addition to full recovery of actual costs, specialized and central service units may also establish and maintain a working capital fund balance for immediate spending needs. Working capital funds are intended to ensure that the Service Center has the ability to pay short-term obligations (e.g., payroll, operating expenses, cost of goods sold, debt maintenance, etc.), as they arise. The working capital allowance should not exceed 60 days of annual operating expenditures and should be tracked and adjusted to appropriate levels annually.

Business balances. Business unit balances represent the “roll-forwards” of the prior year surplus or deficit for each HUIT business or project unit, and as such, represent the true position of each business at the end of each fiscal year. They are comprised of balances maintained in accounts 3700 (unrestricted/undesignated balances), 3800 (funds invested in facilities) and 3810 (funds invested in equipment). Service Center policy requires that each business track these balances and refund or recover the surplus or deficit in subsequent fiscal years.

Surpluses and Deficits

Surpluses and deficits less than 10%: The 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 breakeven range of +/- 10%, that surplus or deficit may be carried forward and the rates adjusted in the following period.

Surpluses and deficits in excess of 10%: When it appears at mid-year that the operating results will exceed the 10% break-even range, the service center should adjust its rates mid-year.

If, at fiscal year end, the service center’s operating results exceed the 10% break even range: surpluses beyond the 10% range must be eliminated through retroactive adjustments to users, or deficits beyond the 10% must be funded by another non-federal source and transferred into the service center account.
Long-term break-even agreements: It may be necessary for a specialized service center or a central service center or a central service unit to liquidate excess balances over a period longer than one year. When operating conditions justify a longer break-even term, tub financial officers may approve the carrying over of excesses for up to three years with notification of the Service Unit Review Committee. Periods longer than three years require the approval of the Committee.

Transfers: Service centers may not transfer excess balances to another business unit account. Balances must be carried forward in the service unit’s operating account and used to fund future rate adjustments. Any transactions to reserve balances must be approved by the tub financial officer with notification to the Service Unit Review Committee.

Tracking Balances
At the end of each fiscal year, a Business Unit Balance Summary Table is published by HUIT Financial Services as part of the Summary of Annual Operating Results Report. This table details all fund balance activity related to each Business Unit, and is maintained in the general ledger in accounts 3700 (unrestricted/undesignated), 3800 (funds invested in facilities), and 3810 (funds invested in equipment). Business Managers are responsible for tracking their individual business unit balances to ensure compliance with Service Center policies outlined above. A sample of the year-end report is shown below.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Business A</td>
<td>$150,000</td>
<td>$10,000</td>
<td>$(2,000)</td>
<td></td>
<td>$158,000</td>
<td>$158,000</td>
<td>N/A</td>
</tr>
<tr>
<td>Business B</td>
<td>$200,000</td>
<td>$(10,000)</td>
<td></td>
<td></td>
<td>$190,000</td>
<td>$170,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>Business C</td>
<td>$50,000</td>
<td>$5,000</td>
<td>$(10,000)</td>
<td></td>
<td>$45,000</td>
<td>$45,000</td>
<td>N/A</td>
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<tr>
<td>Total U/U Funds</td>
<td>$400,000</td>
<td>$5,000</td>
<td>$(12,000)</td>
<td></td>
<td>$393,000</td>
<td></td>
<td></td>
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</table>

Estimating Appropriate Balances
If a business is capital intensive, experiencing a technology transition, or has reorganization plans, that business should have a strategic plan on its fund balance in order to minimize fluctuations in customer rates while remaining compliant with Service Center Policy.

Rate Adjustments

Annual Rate Changes
Because the Harvard community is very sensitive to rate volatility, every effort should be made to ensure that rates remain stable and do not grow more than a reasonable increase for University departments. The rationale for higher increases (e.g., required capital investments, changes in technology, increased security requirements, etc.) should be well understood and approved by the Executive Director, the CIO, and the Rate Advisory group, prior to implementation. Rate decreases or rate rebates can occur from time to time; however, before giving a rate decrease, a director must do a multi-year rate model to demonstrate that rate stability over multiple years can be maintained, and that future rate spikes will not occur.

Mid-Year Rate Changes
Mid-year changes to customer rates are rare and should only be provided in the following circumstances:

- When mid-year surpluses are greater than 10% of total expenses and Service Center Policy requires a reduction or rebate.
Business Unit Balances & Reserve Policy

- When an increase/decrease in volume significantly changes the cost per unit
- When a change to the rate methodology or unit cost can save the University significant amounts of money by promoting leveraging or avoiding duplicate environments
- When other extraordinary changes occur in the business

For more information on mid-year rate changes, please see the HUIT Rate Model Development Process policy.

Unrestricted Designated Reserves

Reserve Definition
Unrestricted designated reserves are allowable accumulations of funds that have been set aside (i.e., designated) for a specific purpose in account 3710. The purpose, use and optimal balance of the reserve must be clearly defined at the time the reserve is established.

What is Allowable
Service Center Policies do not allow for the accumulation of reserves to pay for future events (e.g., equipment upgrades), therefore, only certain areas/activities can maintain these types of funds in a designated account. HUIT maintains allowable reserves for auxiliary services, and building renewal and infrastructure upgrades.

Contributions/Uses
Business units cannot spend directly out of their reserve accounts, nor can they contribute to them directly from operating funds. Contributions and uses are recorded in the general ledger annually (usually at year-end) through the use of transfer accounts (i.e., 9300 object codes range), and are reported below the businesses’ net operating position for the year.

Tracking Balances
At the end of each fiscal year, a Reserve Summary Table is published by HUIT Financial Services as part of the Summary of Annual Operating Results Report. This table details all the activity related to each account, including beginning balance, contributions/uses, and ending balance. Business Managers are responsible for tracking their reserve balances to ensure compliance with Service Center policies. A sample of the year-end report is shown below.

<table>
<thead>
<tr>
<th>Reserve Summary</th>
<th>Beg.Bal.</th>
<th>FY2009</th>
<th>End Bal.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allowable Reserves</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Building A</td>
<td>$500,000</td>
<td>$25,000</td>
<td>$525,000</td>
</tr>
<tr>
<td>Building B</td>
<td>$10,000</td>
<td>($2,000)</td>
<td>$8,000</td>
</tr>
<tr>
<td>Project A</td>
<td>$100,000</td>
<td>$5,000</td>
<td>$105,000</td>
</tr>
<tr>
<td><strong>Total Reserves</strong></td>
<td><strong>$610,000</strong></td>
<td><strong>$28,000</strong></td>
<td><strong>$638,000</strong></td>
</tr>
</tbody>
</table>
Estimating Appropriate Balances
The target balance for designated reserves should be at a level consistent with the needs of the specific project or initiative for which the money was set aside. The target for designated balances associated with specific buildings should be equivalent to potential mid-term planning needs for items such as maintenance or infrastructure improvements that are not covered in the lease agreement.

Contingent Liabilities and Allowance Accounts
Contingent liabilities result from the possible outflow of cash that may or may not be incurred by a business and which is dependent on the outcome of a forthcoming event. Examples of contingent liabilities include potential contract liabilities or outstanding legal cases. In order to be placed on the balance sheet, a contingent liability must be probable, material and quantifiable.

Allowance for Uncollectible Receivables
An Allowance for Uncollectible Receivables measures receivables that are recorded but not expected to be collected. Often, it is not known which specific accounts receivable invoices will be uncollectible. An allowance is therefore established to estimate the value of those receivables believed to be uncollectible.

Allowance for Inventory Write-offs
An Allowance for Inventory Write-offs measures inventories on the books, but not expected to be sold. These inventories may not be sold due to obsolescence, shrinkage, damage, etc. Often, it is not known which specific inventory items will not be sold. An allowance is therefore established to estimate the value of those inventories that are likely to be written off.

Estimating Appropriate Balances
For contingent liabilities, the estimated balance should be equal to the estimated future cash outlay. For allowance accounts, the estimated balance should be determined using historical write-off averages over several years. For example, if annual inventory write-offs average $10,000 and annual sales average $100,000, then the allowance account should maintain a balance of 10% of sales, or $10,000. If inventory write-offs in a given year are only $5,000, then that particular year’s contribution into the reserve would only need to be $5,000 in order to maintain the $10,000 level.

Interest Income/Expense on Balances
Some unrestricted balances sit in interest bearing accounts and are subject to University interest transaction rules, while others do not. Interest bearing accounts with surpluses (i.e., credit balances) at fiscal year end earn interest income, while those with deficits (i.e. debit balances) are charged interest expense. The University calculates interest income and expense once the general ledger has closed for the fiscal year, and posts it in the subsequent fiscal year. Business managers are responsible for understanding the balances in their accounts, including the potential impact of interest.

For More Information
Should you have any questions or concerns, please contact your Financial Partner.