

Managing



Central Support Services Through Service Level Agreements¹

The purpose of a service level agreement (SLA) is to define the responsibilities and relationships between a client or service department and a provider of support services. It aims to clarify expectations on the quality of support delivery and its costs. The agreement can serve as an informal contract between departments within an organization or between organizations when a formal contract is undesirable or even impossible.² The process is internal to the organization as it establishes quality standards at a price the users of central support services are willing to pay. Whether external parties compete against the internal provider to provide such services depends on the political will of the organization.

Funding for public services in the United Kingdom has declined in recent years. There is also a trend toward devolved or delegated budgets and the market testing of public sector functions. Central support departments are therefore subject to increasing scrutiny by front-line service departments. More than ever, budget managers are questioning the cost and quality of services from "overhead" departments and considering whether external providers could offer the same services at a better value. This trend is set to continue as the most recent U.K. government initiative to encourage "best value"³ in public services is aimed at delivering quality service at a price people are willing to pay.

The result is a continuing requirement to deliver efficient services. Therefore, public bodies are introducing SLAs or exploring the idea in some or all of their support areas. This article examines the progress in implementing SLAs within local government in a sample of local authorities in England and Wales.⁴ It covers such areas as the traditional method of allocating overheads in U.K. local government, the potential content of SLAs, the advantages and disadvantages of such agreements and alternative methods of charging for financial services. It concludes with the view that service level agreements have the potential to lead to better resource management.

The Traditional Approach⁵

Local authorities in England and Wales are required to divide their overheads into three distinct elements:⁶

- management that comprises direction, supervision and guidance by the council, its committees and senior officers;
- overheads from which no user benefits; and
- support services such as finance, information technology, management services, administrative buildings etc.

These three categories require distinct accounting treatments. The first category, corporate management costs, is not charged to front-line services but to an account essentially showing the costs of democracy. The goal is to isolate costs that would not be faced by private companies. This prevents local authority services that are subject to competitive tendering being placed at a disadvantage in the market testing process.⁷ The second category includes specialized expenses. They would include the back funding of pension increases and long-term unrealizable assets, such as computer mainframes that are unused because work was lost as a result of competitive tendering. This category of overheads is exempt from apportionment and is borne as a central cost. The third category of costs must be charged to services.

Traditionally, there has been no written agreement between support service providers and users on how to determine charges and service quality. Providers work within their own departmental instructions, and any influence users exert on the quality of service is informal or through supervisors. The main method of apportionment is a staff time analysis that requires support staff to complete timesheets regularly. Costs are then allocated to front-line departments on the basis of time spent on particular services. Costs for administrative buildings are pooled and then apportioned on the basis of floor space initially occupied by all departments and functions.⁸ Costs are then reapportioned to front-line services based on the staff time analysis. All apportionments of actual costs are performed at the end of the financial year and are charged to service departments when accounts are closed. The foundation for this system is the staff time analysis, although this analysis can be out of date in many local authorities. This raises further questions over already questionable figures.

This system has a number of disadvantages. It can lead to major fluctuations between the original estimate in the annual budget and the actual charge at year's end. For services subject to competitive tendering, central support costs must be predictable, controllable as well as easily, accurately and readily identifiable. The traditional system fails these tests. One way around this has been to treat central support charges as outside the control of front-line service managers. This could work for services not subject to competitive tendering, but even here it is obvious that no control is being exercised over the support provider.

Devolved budgeting requires that all costs and revenues match, while the above system inevitably results in some departments subsidizing others. The fact that some service departments can get apparently "free" services can distort priorities. It is also clear that as the service department has no say in the quality of central support, there is no control over the support service provider.⁹

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Service

Service Level Agreements— an alternative approach

SLAs specify the support services to be provided, their quality, timing and frequency, the charge for the services and the length of the agreement. The written agreement has the effect of:

- identifying the providers and users of support services;
- making providers more accountable for the quality and costs of services;
- making users more conscious of the services they receive and their quality;
- enabling users and providers to monitor the quality and quantity of services received and provided; and
- identifying service costs.

The main features of SLAs are shown in *Figure 1*. They are subject to negotiation between service and support departments, so the list is not exhaustive.

Figure 1—Main Features of Service Level Agreements¹⁰

- *Clear identification of objectives of the agreement and definition of terms*
- *Definition of quality standards and setting of performance targets*
- *Definition of roles and responsibilities of both support provider and service department*
- *Establishment of methods of, and the reporting cycle for, monitoring performance*
- *Establishment of grievance and arbitration procedures in the event of poor service*
- *Establishment of procedures in the event of "contract" variations*
- *Built in continuous improvement goals over the time period of the agreement*
- *Charging methods and rates (including the treatment of inflation) at the agreed performance level*
- *Frequency of billing/payment methods/ reporting mechanisms*
- *Time period for agreement to operate*

One of the advantages of this approach is a more businesslike attitude. Clear standards, responsibilities and monitoring lead to better control by users. Critical success factors (performance indicators) can be built into the agreements and should be linked to the business plan of both parties. The emphasis is on the customer because the process forces an examination of whether services are being delivered at a cost and standard of quality that satisfies the service department. A clear advantage for any overhead department is that it can identify possible tender requirements before it becomes subject to competitive tendering. The service department also has clarified one element of its costs should it become subject to future market testing.

It can be argued that once services are specified in writing, the system becomes inflexible. The system is inevitably more bureaucratic and leads to additional costs, especially with extra information technology (IT) requirements to monitor and report on activities. Costs are difficult to establish, and inevitably, estimated activity will differ from actual activity, resulting in surpluses or deficits. Questions remain as to how these should be dealt with.

The Practice of Service Level Agreements

In 1998, information was sought on the use of SLAs in a sample of local authorities in England and Wales. A questionnaire was sent to 40 councils to establish the extent to which SLAs had been implemented and the content of those agreements. Thirty-one councils responded, and of these, nine had fully implemented SLAs, seven were in advanced stages of discussion, seven were in formative stages, six were considering how best to proceed and two authorities had rejected the concept. Agreements were either in place or under discussion most often for financial services, closely followed by legal and personnel services. Less popular areas were valuation and estates management and, perhaps surprisingly, IT support services.

The most frequent method of implementing SLAs was for each service department or section to negotiate directly with the service provider. This was seen as the best way for departments to understand the other's needs and problems. The authorities had already established or planned to include in their agreements clear definitions on the nature of the service (19), the quality standards to be achieved (14), the basis and rates of charges (18), review procedures (13), penalty clauses (9) and the treatment of over and under recoveries (7). These variations show how flexible the agreements can be. They are part of a learning process, so they will inevitably change.

The length of the agreements was from one to three years. Termination periods were allowed, although in most cases they were tied to the actual

Calendar

or proposed length of the agreements. It was not clear, however, what viable alternatives existed in the event of termination.

Billing was primarily monthly or quarterly. Monthly bills corresponded with the monthly production of budgetary control reports. The quarterly billing information was incorporated in the financial ledgers at that time. Bills were produced by the finance department and paid by the service department by comparing the terms of the agreement with actual performance.

If a dispute arose over the cost and quality of service, an arbitration process had been set up or was planned. A panel of three usually decided the merits of the cases, with the chief executive's representative serving as the independent official most of the time. When the services of the chief executive's office were in dispute, an independent member of an outside department chaired the arbitration panel. One authority had established a committee of elected council members to decide disputes.

The basis of charges for financial services for a variety of support functions is set out in *Figure 2*.

Underpinning these charging methods is a need to establish detailed costs of operating each sub-unit within the finance department by apportioning costs to individual sections. While direct employee costs may be fairly easy to establish, some of the apportioned costs will be fairly arbitrary.

In addition, estimates must be made to establish realistic charges for support services. For example, the estimated audit time for a specific project needs to be as accurate as possible or significant surpluses or deficits could arise. Those surpluses or deficits, taken cumulatively, could reflect on the central support function as a whole. Authorities indicated that the treatment of such surpluses or deficits was, or will be, subject to negotiation between service users and providers. An arbitration process will be available if disputes cannot be resolved.

Respondents said advantages of SLAs were:

- greater awareness and control of costs;
- increased client control of support service department's quality. One authority described its internal processes as a "customer-focused" activity;¹¹
- a more commercial approach, which was appropriate considering the climate of resource constraint;
- improved financial and administrative systems;
- more effective use of resources; and
- better management information systems.

It was pointed out earlier that two authorities rejected SLAs because they feared the bureaucratic nature of the process would outweigh potential benefits. Time-based apportionment is no longer acceptable, however, and they said they needed an

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May 19 • End of early registration for PDC 2000. Register online at www.agaofm.org/pdc.

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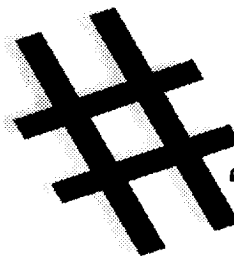
July 2 • National Board of Directors Meeting, San Francisco Marriott, San Francisco, CA.

July 3-7 • Professional Development Conference & Exposition, San Francisco Marriott, San Francisco, CA.

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alternative that was not an administrative burden. They were both considering charging on a basis appropriate to the service being delivered, such as an hourly rate for time-based services, without specifying other elements of an SLA, such as quality standards and arbitration procedures.

It should also be remembered that just as important as implementing an agreement is the way the agreement works. One authority stated that a significant deficit in legal services had occurred in the chief executive's department. The deficit was eliminated by apportioning it over all users of the legal service in that year without establishing whether a specific service was responsible. Even though one of the SLA objectives was to avoid such arbitrary processes, random apportionment had taken place. While an SLA implies the ability to look for equivalent services outside the local authority, the practicality of such an action is questionable because certain information may be sensitive.

Conclusions

The traditional system of apportionment of overheads to service departments without attention to the costs and quality of those services is increasingly at odds with the financial pressures faced by local government. Service Level Agreements have the potential to improve service delivery by support departments to service departments. The agreements put the emphasis on the customer because the central component is quality at a cost the service department is willing to pay. The survey demonstrated that of the 31 authorities who responded, 29 had either introduced, were developing or were considering SLAs. While two authorities had rejected them due to the potential bureaucratic burden, they recognized that their current systems needed review.

In addition to the existence of actual agreements, how they work is equally important. Only time will tell if SLAs can meet the needs of local government service managers. If implemented and managed correctly, however, they appear to have considerable potential to improve services delivered by central support departments. These services will then be delivered at a price and standard of quality that users are prepared to pay. This can only benefit the community as extra resources are released or protected for front-line service delivery. ■

Figure 2—Potential Bases of Charges for Selected Financial Support Services

Payroll

Per employee, per transaction, cost per payslip processed

Internal Audit services

Rate per hour, rate per person day, fixed charge plus time-based element

Revenue accounting services

Rate per hour, rate per person day,

Capital accounting services

Rate per hour, rate per person day, pro rata to size of service department capital programs, average daily rate

Credit income collection

Per invoice, per posting, rate per person day, per account

Insurance

On-cost to premiums, rate per hour

Capital investment debt management

Pro rata to outstanding debt, rate per person day, rate per hour

Financial consultancy

Rate per person day, rate per hour

Pension administration

Per pensioner, rate per hour, rate per person day

Cash management

Per transaction, rate per person day, rate per hour, per posting

Creditor payments

Per payment, per invoice, per posting

END NOTES

1. The authors are grateful to the educational development unit at the University of Glamorgan for funding this research.

2. The United Kingdom central government is in the process of developing Service Level Agreements within and between ministries as it is not possible under English law for the Crown to sue the Crown for a failure to perform. They have been given a major impetus by the change to resource (accruals) accounting within U.K. central government (Cmnd 2929).

3. Best value (the exact format has yet to be finalized) will broadly be achieved when services are responsive to local people's needs, meet performance targets and are provided at demonstrably competitive prices.

4. Local authorities are the second tier of government in the United Kingdom. They are funded both from central government grants and local property taxes. Local authorities provide such services as education, housing, social services and leisure and amenities.

5. The Institute of Municipal Treasurers and Accountants issued the first statement on the allocation of overheads in local government in 1903. A detailed history of the development of local authority accounting in England and Wales can be found in Coombs and Edwards (1996).

6. Chartered Institute of Public Finance and Accountancy, "Accounting for Overheads in Great Britain," CIPFA, 1995. Local authority accounting requirements are contained within the "Code of Practice on Local Authority Accounting for Great Britain" published annually by CIPFA. This is the main accounting body for the public sector in the U.K. and the code represents agreed best accounting practice under section 41 and 42 of the Local Government and Housing Act 1989.

7. In the United Kingdom many public sector bodies are required to put "in-house" services out for competition against the private sector for the contract to provide those services. The generic term for this process is "competitive tendering."

8. Where a building is particularly expensive its costs can be isolated and charged to a specific service as inevitably the system outlined involves cross-subsidization. This may also be appropriate where a grant claim needs to be made in respect of a specific service.

9. Coombs and Jenkins, 1994, p. 146.

10. For less complex arrangements between service departments and support departments a less detailed memorandum of understanding may be established rather than a full Service Level Agreement.

11. The importance of customer-centered development has also been demonstrated by the Audit Commission as a major criterion for the successful introduction of SLAs (1995).

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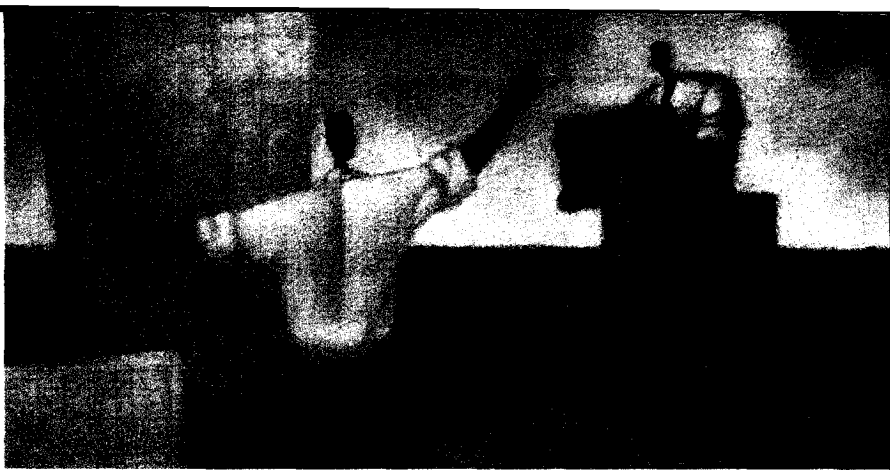
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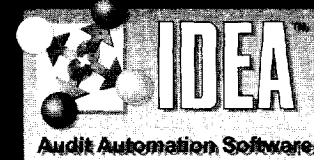


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