

FMSIC

**FINANCIAL MANAGEMENT SYSTEMS
IMPROVEMENT COUNCIL
(FMSIC)**

***INDIRECT COST CLASSIFICATION
AND DEFINITIONS
JULY 1, 1994***

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PREFACE AND BACKGROUND

The increased competitiveness and climate of budget constraints in which government contractors are conducting business necessitates the overall need for increased visibility and understanding of resource utilization and asset allocation. This is especially true with respect to indirect costs since they are a significant element of total expenditures. While the DOE and its contractors adhere to Generally Accepted Accounting Principles, Cost Accounting Standards, and the DOE 2200 Series of Financial and Accounting Orders, nowhere is there specific, documented guidance on the definition of indirect costs. As a result, significant variations exist across the DOE complex, and these variations have the potential to impact fundamental business decisions. Appropriate, consistent cost classification and allocation should be the very foundation for financial data collection, accumulation, and reporting, as they directly affect DOE's ability to accurately measure the efficiency and effectiveness of specific tasks, as well as overall missions and objectives.

In June 1993, the Department chartered a Financial Management Systems Improvement Council. The goals of the Council are to improve contractor financial management system processes by (1) sharing successful approaches (best business practices) and benchmarking among contractors; (2) developing business requirements and common terminology for financial management systems; (3) identifying systems that lend themselves to common processes, and (4) pursuing standardization where appropriate. Membership on the Council includes senior financial management representatives from twelve contractors and three field offices, as well as two representatives from DOE's Office of Chief Financial Officer.

In response to the increased emphasis that has been placed on the management and reduction of indirect costs, as one of its first projects the Council published a Glossary of Indirect Cost Terms in June, 1994. The FMSIC began a follow-on effort to address the concerns of costing practices, with the objective of developing appropriate indirect cost classification and allocation methodologies. To address this issue, the Council chartered the Classification of Indirect Cost Working Group (CICWG).

The CICWG was comprised of a cross-section of individuals from throughout the DOE complex, including seventeen representatives from Contractors and a DOE Field Office. In addition, several of the members also participated on the Budget Stakeholder's Group in order to integrate products of the two groups.

The CICWG began by reviewing current cost allocation practices from contractors in order to understand the variety of practices and determine where commonality already existed. The CICWG's goal was to design a desired cost allocation framework while recognizing the diverse business requirements across the DOE complex. In undertaking this objective, the CICWG developed the assumptions and principles listed below :

- The DOE Glossary of Indirect Cost Terms (GICT) provides fundamental structure and definitions.**
- The proposal developed will be in compliance with Cost Accounting Standards (CAS) and the GICT.**
- Per CAS, costs should be charged direct where appropriate and possible.**

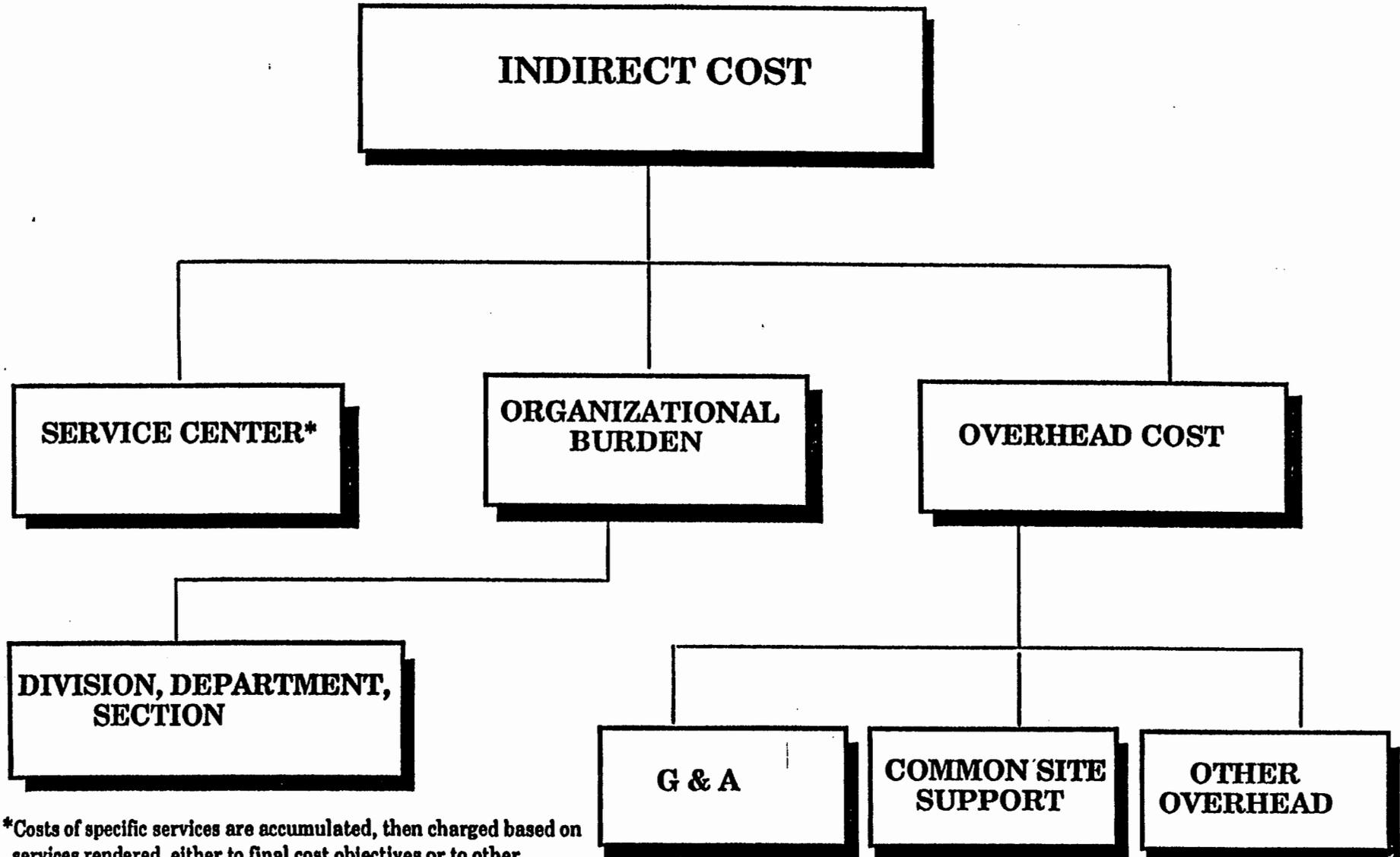
- **Cost materiality and cost/benefit analyses should be considered by individual contractors and Field Offices as commonalty is pursued/implemented.**
- **The proposal is intended to promote commonalty and comparability, and to allow for reasonable flexibility based on mission, function, diversity of operations, and programmatic needs.**
- **Indirect costs should be pooled and allocated at the point closest to a final cost objective (i.e. Human Resource organization assigned to a specific department should be allocated to the that department).**
- **Implementation of any changes may have to coincide with the DOE budget cycle.**

The CICWG reviewed current practices from contractors in order to understand both areas where commonalty already existed and also where there were significant differences. The group then prepared what it considered to be the most appropriate way to pool and allocate costs. The classification, allocation methods, and definitions following in this document should enhance the ability of contractors and DOE management to make informed, accurate, and timely decisions relative to business operations. Additionally, this should result in improved financial information to assist in the realization of unified, synergistic solutions to industry-wide challenges and opportunities. The most significant benefits which may be derived are as follows:

- **Better management visibility of indirect costs and their respective cost drivers.**
- **Improved understanding and awareness of the differences in industry operations and the effect differences have on cost.**

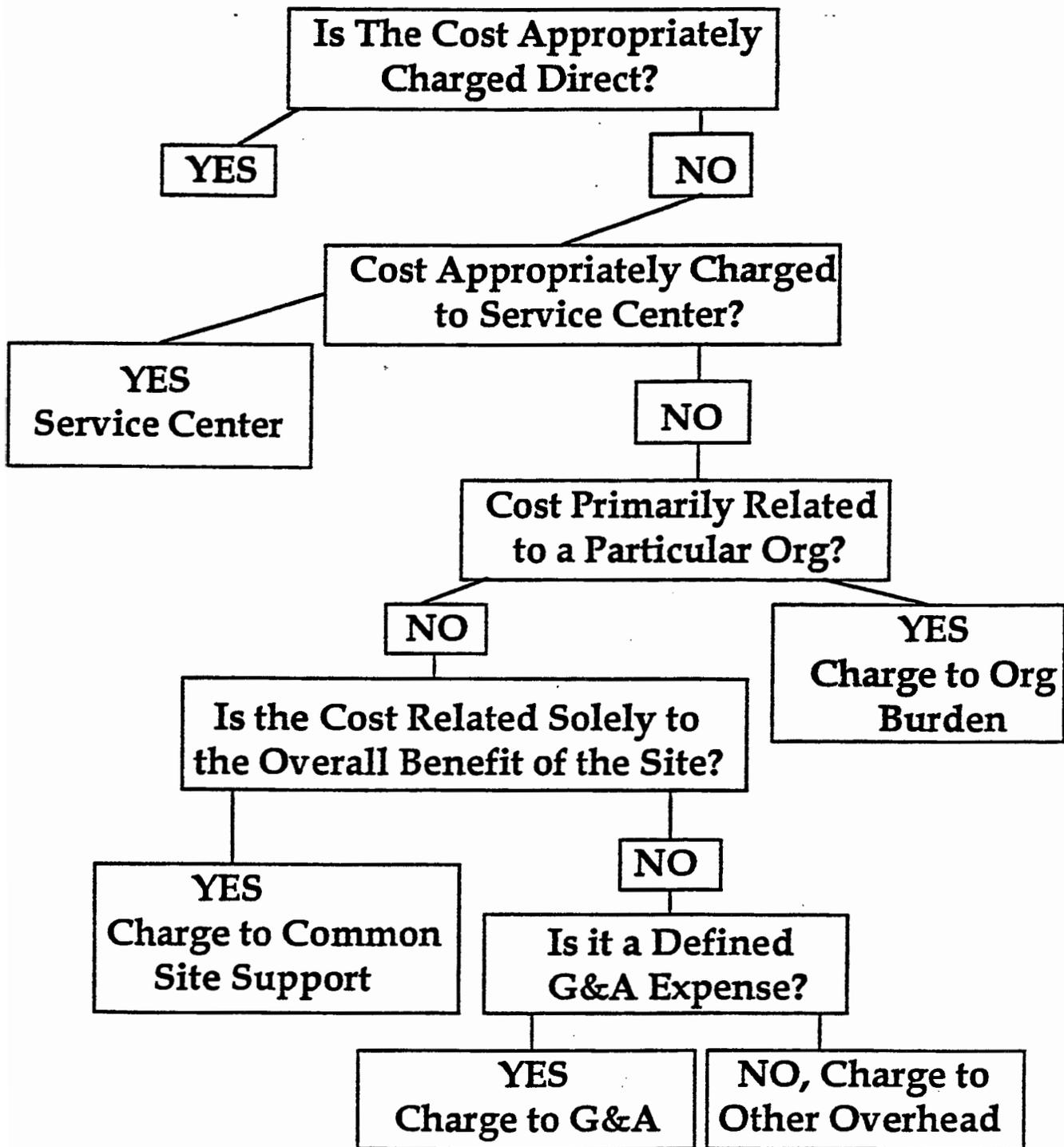
- **Opportunity, on an industry-wide basis, to provide the financial impact and, therefore, cost/benefit of existing and/or new requirements.**
- **Allow comparability within and outside the DOE industry to enhance the awareness and impacts of competition and market forces.**
- **Eliminate the confusion and subsequent audits and reviews by various stakeholders which results from the current inconsistent practices.**
- **Improve the quality, responsiveness, and cost effectiveness of responding to existing and future "cross-cut" exercises.**

INDIRECT COST HIERARCHY



*Costs of specific services are accumulated, then charged based on services rendered, either to final cost objectives or to other indirect cost pools.

Cost Classification Decision Tree



(6)

INDIRECT COST POOL COMPONENTS

OVERHEAD

<u>Service Center</u>	<u>Organizational Burden</u>	<u>Common Site Support</u>	<u>G&A</u>
Purchasing	Management/Supervision & Related Costs	Fire Protection/Suppression	Executive Management
Subcontract Administration	Organizational Administration Costs	Road Maintenance	Public Relations
Warehousing	General Training	Emergency Preparedness	Prime Contract Administration
Shipping/Receiving	Time Between Assignments	Cafeteria Services	Property Management
Publications	Common Equipment Maintenance	Bus Transportation	Management Fees
Video Services	Office Supplies	Mall Services	Business Taxes
Telecommunications	Decentralized Support Services	Library Services	Economic Development
Computing Services	- Human Resources	Medical Services	Records Management
Utilities	- Finance	Safeguards/Security	Document Control
Vehicle Operations	- Quality Assurance	Safety Infrastructure	Strategic Planning
Shop Services	- Records/Document Control	Operations Oversight Compliance	Training Infrastructure
Design Engineering	- Property Management	Site Environmental Compliance	Internal Audit
Environmental Testing	- Purchasing Specialist/Support	Site Quality Assurance	Site Total Quality/Productivity
Training Courses			Central Finance and Budgets
Waste Disposal			General Counsel/Legal
Facility/Occupancy Costs			Human Resources
			Laboratory Directed R&D

Other Overhead

Costs that are not appropriately included
in G&A or Common Site Support.

In conjunction with the Cost Classification Decision Tree on page 6, the components listed above provide the appropriate indirect cost pool for the most significant and common indirect cost functions. Based on the size, complexity and mission of the site, and the materiality of the cost, it may not be operationally practical and/or economically feasible to classify some costs as shown above. For example, Purchasing would be classified as G&A, and Utilities as Common Site Support, if it was not feasible or cost effective to treat these as Service Center costs.

ALLOCATION METHODOLOGIES

The following allocation methodologies and bases are consistent with Cost Accounting Standards requirements and will significantly enhance commonalty and promote consistency across the DOE complex.

- Overhead Cost:** A modified total cost base (MTCB) with the exclusion of costs for purchases and services above a predetermined threshold. The threshold established will be a range of \$50K to \$500K, depending on current contractor practice. By October 1, 1998, contractors will utilize a common threshold target of \$100K subject to further evaluation and analysis.
- Organizational Burden:** Direct labor dollars plus fringe benefits.
- Service Centers:** Charged to users on a standard rate representative of the services used or on a basis representative of the resources consumed.

GLOSSARY OF INDIRECT COST TERMS

Benefit Plans	A component of employee fringe benefits that may include, but is not limited to, <i>medical and life insurance, and investment and pension plans.</i>
Common Site Support	A subset of overhead costs, that are non-administrative in nature and maintain the entire site infrastructure, which are distributed to final cost objectives. Common site support costs may include, but are not limited to, <i>fire protection and suppression, road maintenance, bus, cafeteria, mail, library and medical services, and site-level oversight functions.</i> A separate common site support pool is recommended where multiple contractors operate at/share a common site or where a contractor has significant offsite work.
Cost Elements	Classifications of resources within a particular activity. Cost element examples are as follows: <i>labor, travel, supplies, and materials.</i>
Direct Labor Cost	Gross wage/salary costs, taxes and benefit costs for employees directly charging a final cost objective.

GLOSSARY OF INDIRECT COST TERMS

Direct Program Cost

Any costs which are (can be) identified with a particular program final cost objective the first time the costs are charged. These costs are charged to a program since they are directly related to and are being incurred principally for the benefit of the program receiving the charges. These costs generally consist of direct labor, materials, supplies and may include charges from service centers (*e.g. computer services*).

Employee Fringe Benefits

Benefits paid by the employer that are either offered by the employer or legally mandated, that include *payroll taxes, benefit plans, and paid absences*.

Final Cost Objective

A programmatic task which is charged with both direct and indirect costs. Examples of final cost objective are *DOE B&R's or Work-For-Others contracts*.

GLOSSARY OF INDIRECT COST TERMS

General and Administrative Costs

A subset of *overhead cost*, which are administrative in nature, that benefit, and are allocated to, all final cost objectives. The general and administrative costs may include, but are not limited to, *executive management, human resources, general counsel, central finance and budgets, management fees, and business taxes.*

Indirect Cost

Costs of any activity that can be identified with two or more final cost objectives or at least one intermediate cost objective. These costs, collected in cost pools, are distributed or allocated to a final cost objective based on a predetermined methodology. *Overhead costs and organizational burden are examples of indirect costs.*

Indirect Cost Pool

A collection of indirect costs, which are homogeneous, that are accumulated and subsequently distributed on a causal/beneficial basis to other intermediate indirect costs pools or directly to benefiting final cost objectives.

GLOSSARY OF INDIRECT COST TERMS

Indirect Cost Pool Distribution

The methodology utilized to distribute costs from cost pools to other indirect cost pools or to final programmatic cost objectives. This distribution is based on the most appropriate causal/beneficial relationship between the reason for the cost being incurred and the benefit to the distribution objective. For example:

A cost pool that may be distributed to other indirect cost pools and final cost objectives is a service center such as computer services. Technical computing services for a specific program would be charged to that program (i.e. final cost objective) whereas computer services for the Accounting Department would be charged to the General and Administrative cost pool.

The General and Administrative and Common Site Support cost pools are examples of cost pools distributed only to final cost objectives.

GLOSSARY OF INDIRECT COST TERMS

Indirect Cost Pool Variance Liquidation	The difference between the actual cost accumulated and the offsetting distribution within a particular indirect cost pool. Variances are periodically liquidated to final cost objectives.
Organizational Burden	Those costs associated with managing organizations whose labor is charged to and whose primary purpose is to support final cost objectives. Examples include <i>the cost of managers, administrative support, supplies, and contractual services</i> . These costs are generally distributed based on actual direct labor charged by that organization to specific final cost objectives, or to other organizations within the contractor's operation.
Other Overhead	A subset of overhead costs that are not appropriately included in General and Administrative or Common Site Support costs.
Overhead Costs	A component of indirect costs which are distributed to benefiting final cost objectives based upon a predetermined allocation methodology.

GLOSSARY OF INDIRECT COST TERMS

Paid Absences

A component of employee fringe benefits that includes, but is not limited to, the following: *holidays, sick time, vacation, jury duty, and other excused absences.*

Payroll Taxes

A component of employee fringe benefits that includes the following: *federal, state, and local payroll taxes.*

Service Center Pools

Costs associated with providing a specific service or group of services where the costs are accumulated and then charged to the user on a standard rate representative of the services used or on a basis representative of the resources consumed. Service center costs may be charged to other indirect cost pools (as indirect cost) or to final cost objectives (as direct cost.)