



Defense Acquisition University

Lunch n' Learn

DoD Contractor Costs & Rates

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Learn. Perform. Succeed.

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Top 10 Things You Always Wanted to Know about Indirect Costs & Rates



Learn. Perform. Succeed.

Top 10 Things You Always Wanted to Know about Indirect Costs & Rates

**CEASE &
DESIST**

Scenes from an Imaginary PMO

Boss, we've got a problem.

The rates for our prime made a big jump.

They were expecting to win a huge contract but it didn't come through.

Their base is now smaller.

A smaller base for them means higher rates for us.

Never mind. We'll make it work . . .

What is it?

But the contract was signed two years ago.

And this effects me how?

What does BRAC have to do with us?

???



Meanwhile back at ACME Contracting Inc.

"Wally's Idea of Indirect Cost"



From Costs to Pools to Rates to OH: Getting There from Here

- Before we get to indirect costs, their allocation, and rates . . .
 - Direct / Indirect Costs
 - Pricing of Contracts
 - Interim Contract Billing
 - Actual Contract Costs



ACQ 203



Contractor Planning, Scheduling and Resourcing

3.2

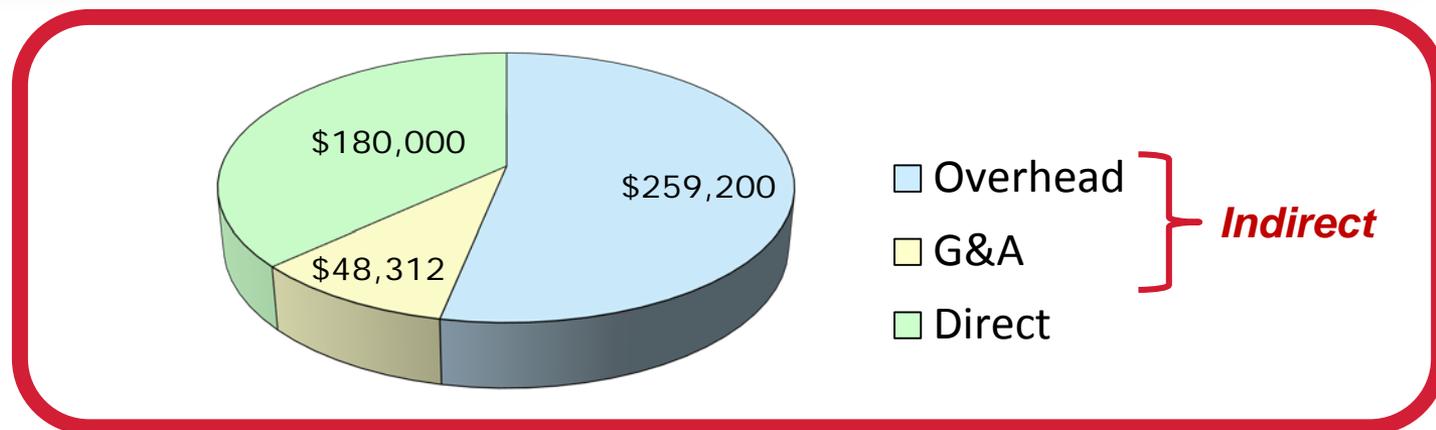
ACQ203: Contractor Costs

- **Direct Costs** – A cost that can be *tracked directly to one contract* or other unit of work (cost objective) for which an accounting system accumulates and measures costs.
 - Examples: touch labor, purchased parts, computer time

- **Indirect Costs** – A cost *identified with two or more contracts (cost objectives)*, but not identifiable directly to a single contract. Indirect costs must be *captured in appropriate discrete cost pools*. Overhead and General & Administrative (G&A) are commonly used indirect cost pools.
 - **Overhead**: Indirect costs that *support a specific part or function* of the company but not the entire company.
 - Examples: Factory maintenance, material handling
 - **General and Administrative**: Indirect costs incurred or allocated to a business unit for the *general management and administration of the business unit as a whole*.
 - Examples: Senior management salary, independent research and development

ACQ203: Contractor Costs Example (Fully Burdened Rate)

<i>Category</i>	<i>Rate</i>	<i>Cost</i>	<i>Note</i>
Salary and Benefits		\$180,000	Direct Cost
Engineering O/H	1.44	\$259,200	Direct Cost X Eng. O/H Rate. Indirect Cost.
G&A	0.11	\$48,312	(Direct Cost + Eng. O/H) X G&A Rate. Indirect Cost.
Total Indirect (O/H + G&A)		\$307,512	(\$259,200 + \$48,312)
Total Cost (Direct + Indirect)		\$487,512	(\$180,000 + \$307,512)



Basics of Allocation for Indirect Costs

- **Cost allocation** is by definition an **estimate**
- We should strive for a **reasonable** and **equitable** means to **allocate** costs
- **Indirect costs** are incurred for a **common purpose** hence **cost pools**
- Allocation of indirect costs is an attempt to **fairly spread the cost** to the **contracts** that **benefited** from the purpose

Incurred Costs

**Contractor
Incurred
Costs**



**Federal
Contracts**



Incurred Costs

**Contractor
Incurred
Costs**



DIRECT COSTS



**Federal
Contracts**

Incurred Costs

**Contractor
Incurred
Costs**

Overhead



**Federal
Contracts**



Incurred Costs

**Contractor
Incurred
Costs**



INDIRECT COSTS



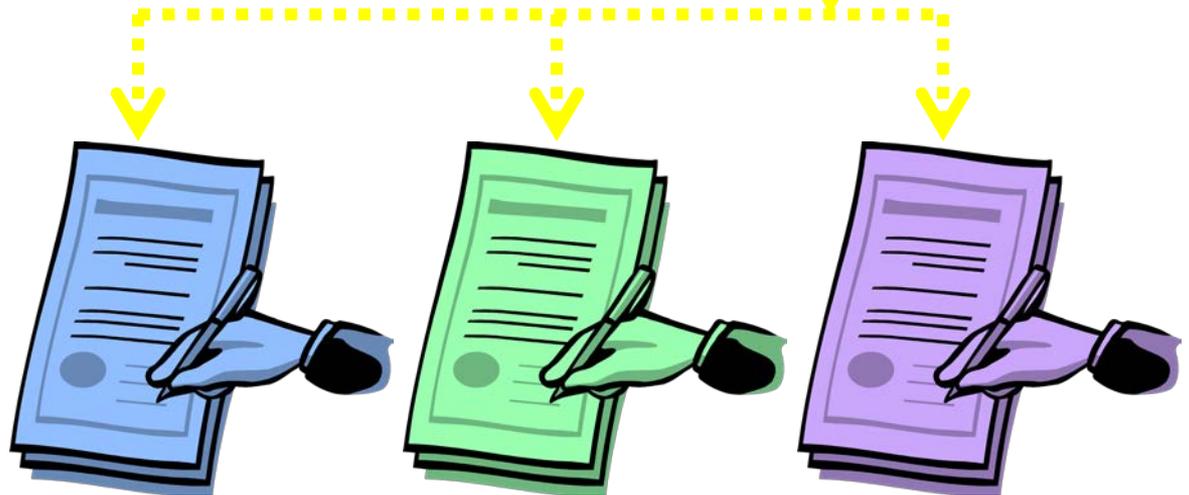
**Federal
Contracts**

Incurred Costs

**Contractor
Incurred
Costs**



INDIRECT COSTS



**Federal
Contracts**

Incurred Costs

**Contractor
Incurred
Costs**



**Federal
Contracts**





Defense Acquisition University

ACQ 315

Understanding Industry

Lesson 4:
Cost, Pricing, and Rates

Version 1.0

ACQ315: Indirect Cost Pools

- ***“Indirect cost pools”*** means a **grouping of incurred cost** identified with **two or more cost objectives** but not specifically identified with any final cost objective.
- The costs in each indirect cost pool should be **logical** and **homogenous** and **allocated** to a cost objective using appropriate bases that show the relationship of the expense to the segments concerned.
 - For example,
Manufacturing Overhead
allocated based
Manufacturing Direct
Labor Hours or Dollars



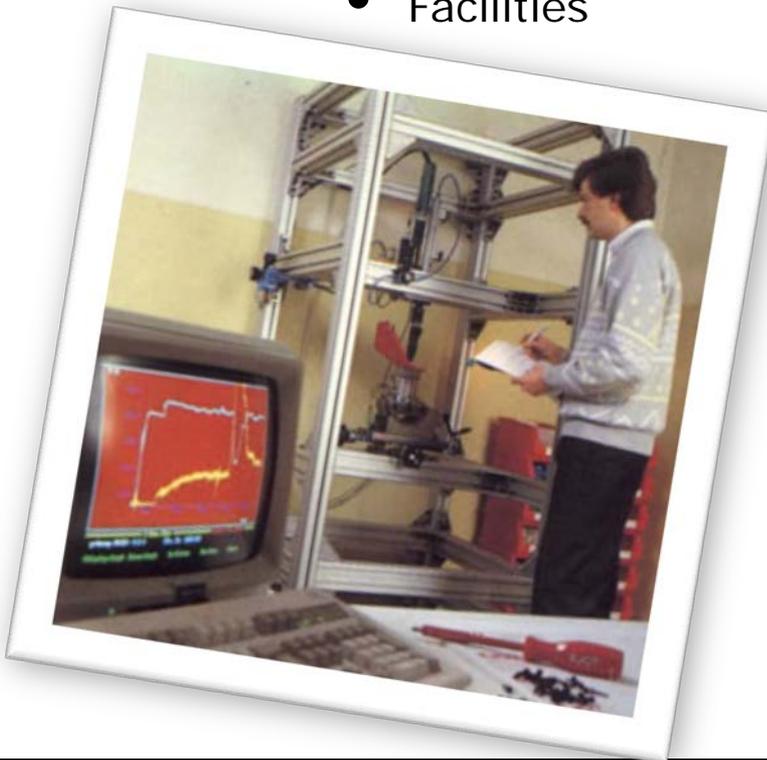
ACQ315: Indirect Cost Examples

Overhead

- Supervision
- Engineering
- Production Control
- Manufacturing
- Facilities

G&A

- Accounting
- Legal
- Executive
- Human Resources



ACQ315: Determination of Cost Allowability

Type of Cost	Description	Benefit or Detriment
Direct	Costs that are DIRECTLY identifiable as specific performance of or benefit to a contract (Labor, Material, and ODC).	Applied directly as <u>billable contract cost</u> . Ultimately <u>results in cash</u> .
Indirect	Costs incurred to provide GENERAL support to overall operations (Labor and Other Expenses).	Applied as a rate to the direct costs. <u>Becomes part of billable costs</u> which ultimately <u>results in cash</u> . If not kept under close control ,these WILL contribute to making cost <u>NON-COMPETITIVE</u> .
Allowable	The <u>majority</u> of the costs incurred as <u>direct or indirect</u> are allowable with the <u>exception</u> of those specifically <u>prohibited</u> by <u>Government regulations</u> .	<i>If costs are allowable, they are billable.</i> If they are billable, they will ultimately result in <u>cash</u> to the organization.
Unallowable	Costs that <i>CANNOT be passed on to the Government</i> as defined by Federal Acquisition Regulations (<i>FAR Part 31</i>).	UNALLOWABLE COSTS <i>COME OUT OF PROFIT!</i>

Determined by:

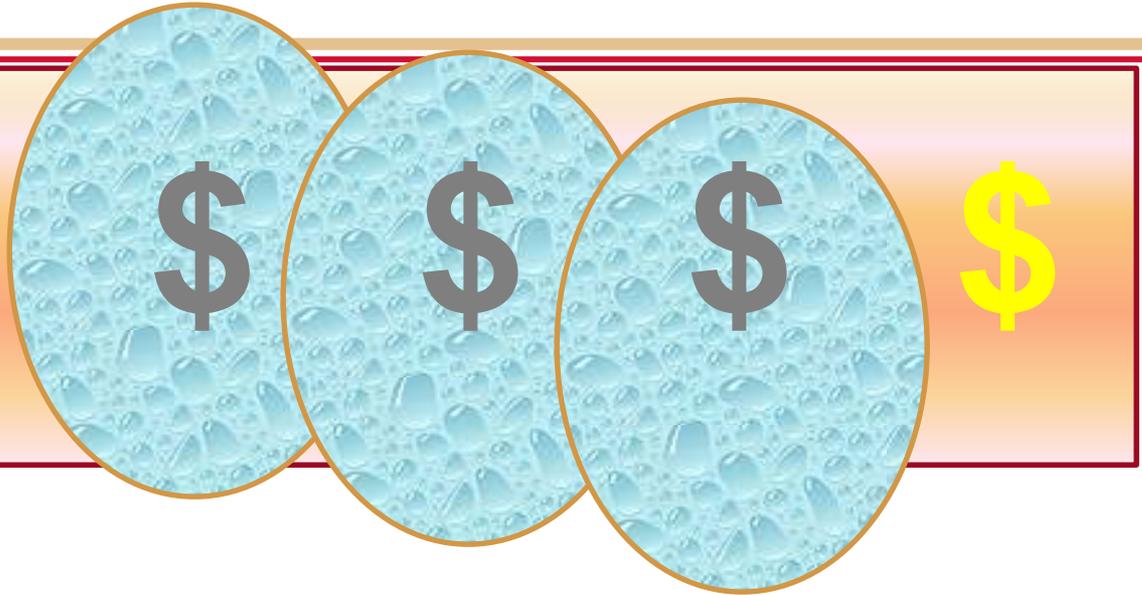
- **Cost Accounting Standards (CAS) and Federal Acquisition Regulation (FAR) requirements**
- **Generally accepted accounting practices (GAAP)**
- **Company disclosure statement, finance policies, and procedures**



AND NOW BACK TO
OUR REGULARLY
SCHEDULED
PROGRAMMING

Indirect Cost Pools

**Contractor
Incurred
Costs**

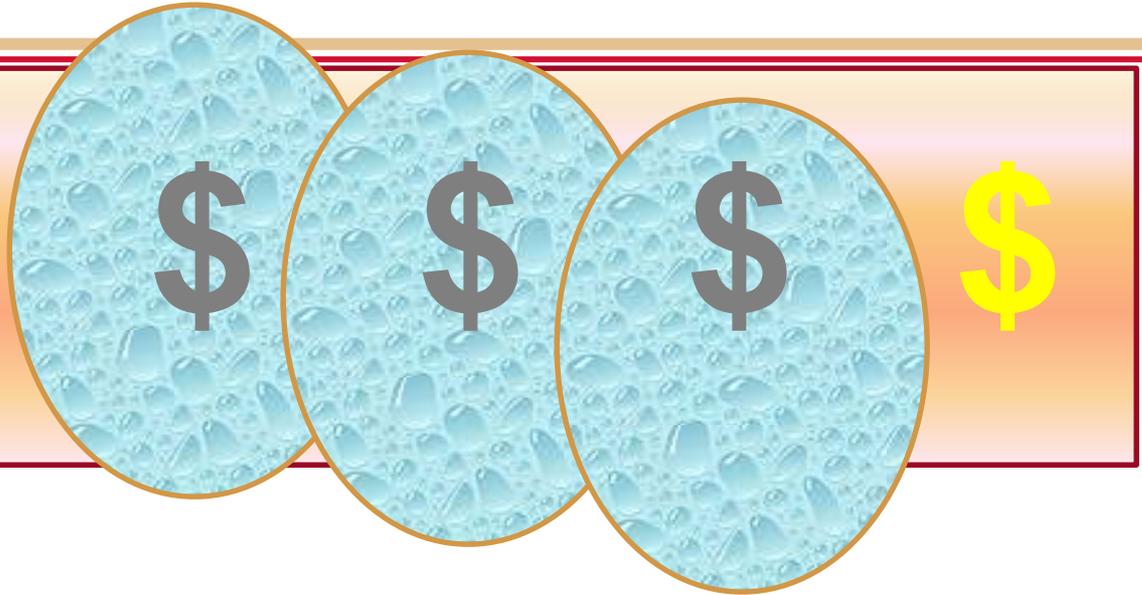


Indirect Costs are grouped into ***pools*** according to how they benefit each contract – ***“homogeneous costs”***

- Pools are not based on types of costs but how costs can be associated or allocated by contract

Overhead Cost Pools

**Contractor
Incurred
Costs**

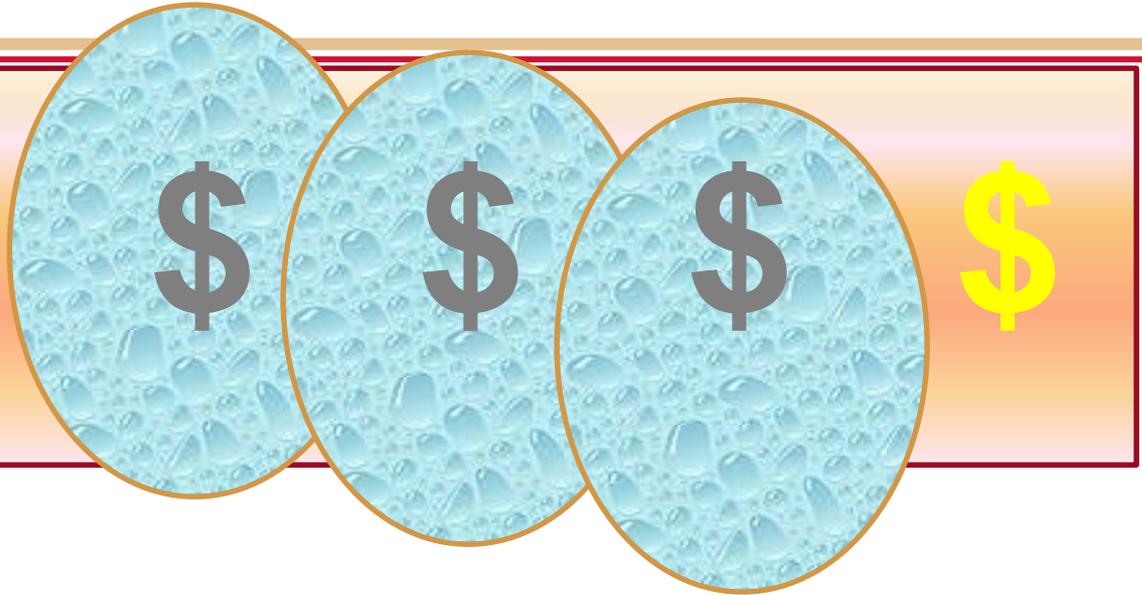


Basis of Allocation may be:

- Labor costs
- Labor hours
- Material costs
- Quantities of means of production

Overhead Cost Pools

**Contractor
Incurred
Costs**



*End result is a **RATE***

- derived from the **POOL** of Indirect Costs
- portioned by a **BASE** of Allocation

Overhead Cost Pools: Rate Example

Contractor Incurred Costs



Example:

- Engineering computer service costs are **\$5,000,000 (pool)** and supports **1,000,000 engineering hours (base)** annually
- The computer service rate is **\$5 per Engineering Labor Hour** (output).

To allocate computer service costs to each contract, use the \$5 rate applied to the base for each contract.

100,000 Hrs



\$500,000

200,000 Hrs



\$1,000,000

500,000 Hrs



\$2,500,000

ACQ315: Allocating Indirect Costs Rate Development

$$\text{Rate} = \frac{\textit{Pool}}{\textit{Base}}$$

A “POT” for *Homogenous (Similar) Costs*

Cost Pool Examples:

- Material Handling
- Design Support
- Heat and Air Conditioning
- Building Maintenance
- Manufacturing Support



1. Computation of *indirect cost rate*

$$\text{Rate} = \frac{\text{Total Allowable Plant-wide Pool}}{\text{Total Incurred Plant-wide Base}}$$

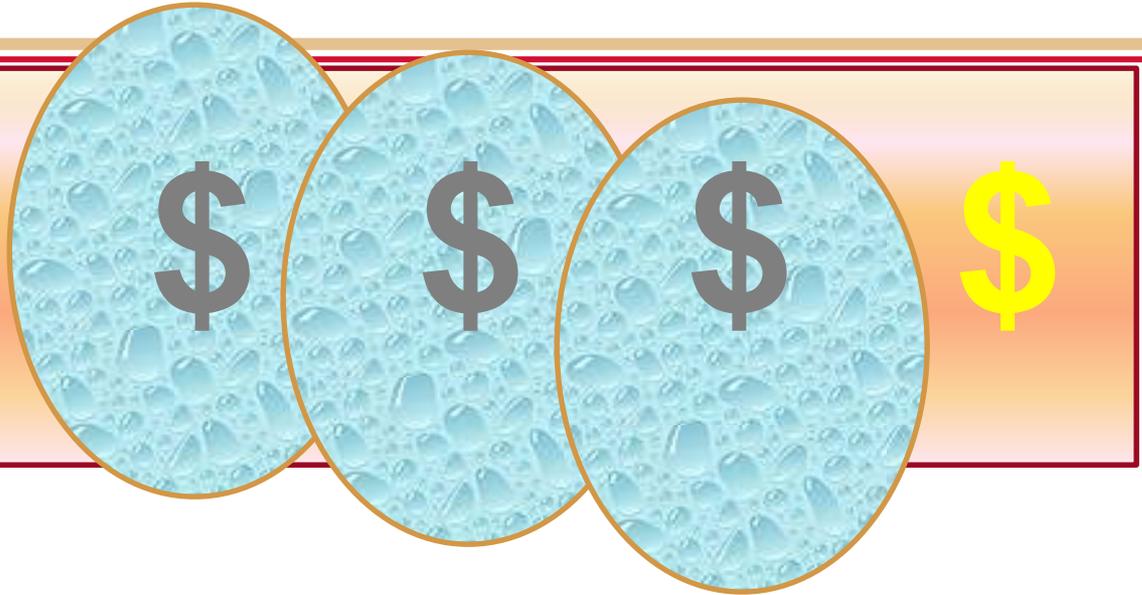
2. Allocation of *indirect costs*

$$\text{Allocation of Indirect \$ on the Contract} = \text{Rate} * \text{Allowable base on Contract}$$

AND NOW BACK TO
OUR REGULARLY
SCHEDULED
PROGRAMMING

Overhead Rate Pools

**Contractor
Incurred
Costs**



Contracting Officer should:

- Use the **same basis of allocation** in an individual contract as the plant-wide basis of allocation used to establish the rate
- **Validate** that **no direct individual contract costs** were **included** in the plant-wide overhead pool

General & Administrative Pool

**Contractor
Incurred
Costs**

\$

\$

\$

\$



G&A Costs are **allocated** to final cost objectives (contracts) based on **various methods**:

- Total Cost Input – Generally acceptable as a measure of total activity
- Value Add – (Total Cost less Material/Subcontracts) used if it produces less distortion
- Single Element – Used if it produces equitable results

Unallowable Costs Pool?

**Contractor
Incurred
Costs**

\$

\$

\$

\$



Unallowable Costs Pool?

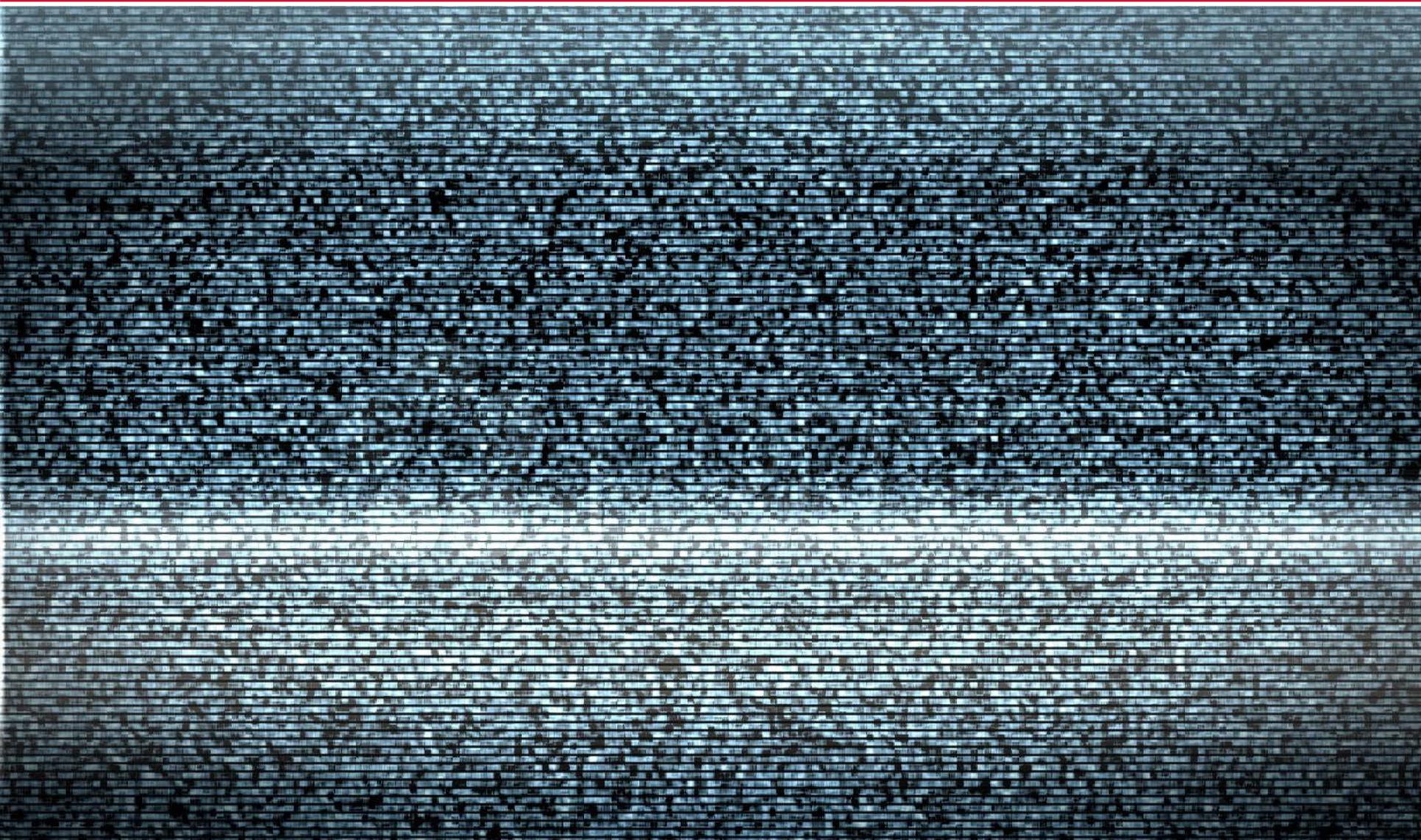
**Contractor
Incurred
Costs**



**UNALLOWABLE
COSTS NOT
PERMITTED IN
POOL AREA**



A Bit on Rates Before We Go . . .



ACQ315: Allocating Indirect Costs Rate Development

ACQ315: Government Contracting Rates

There are *three sets of rates* typically used in defense contracting:

1. Forward Pricing Rates
 2. Billing Rates
 3. End-of-Year Actual Rates
- } Based on *estimates*
- } Based on *historical accounting data*

- *Forward Pricing Rates (1)* cover both direct labor rates and indirect cost rates.
- *Billing Rates (2)* and *End-of-year Actual Rates (3)* cover only indirect cost rates.

The contractor must substantiate direct labor rates actually incurred when submitting a request for periodic payments on cost type contracts or progress payments on fixed price type contracts.

ACQ315:

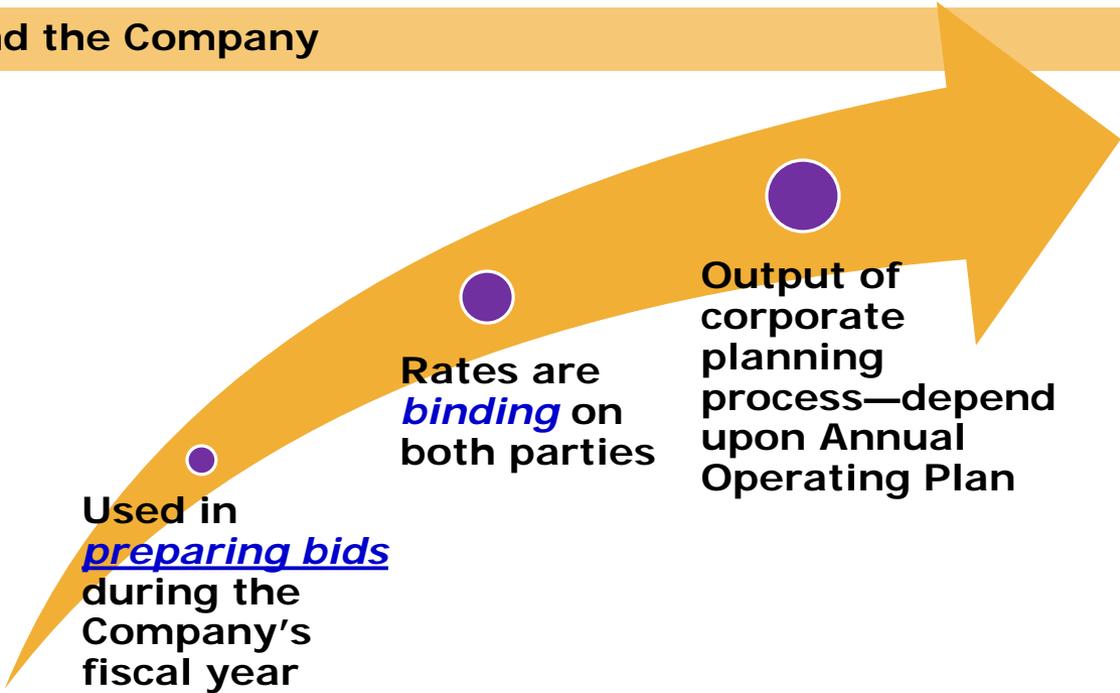
1. Forward Pricing Rates (Bidding on Contracts)

Rates mutually agreed upon

Prior to the start of the company's fiscal year

By the Administrative Contracting Officer (ACO)

And the Company



Used in preparing bids
during the
Company's
fiscal year

Rates are binding on
both parties

Output of
corporate
planning
process—depend
upon Annual
Operating Plan

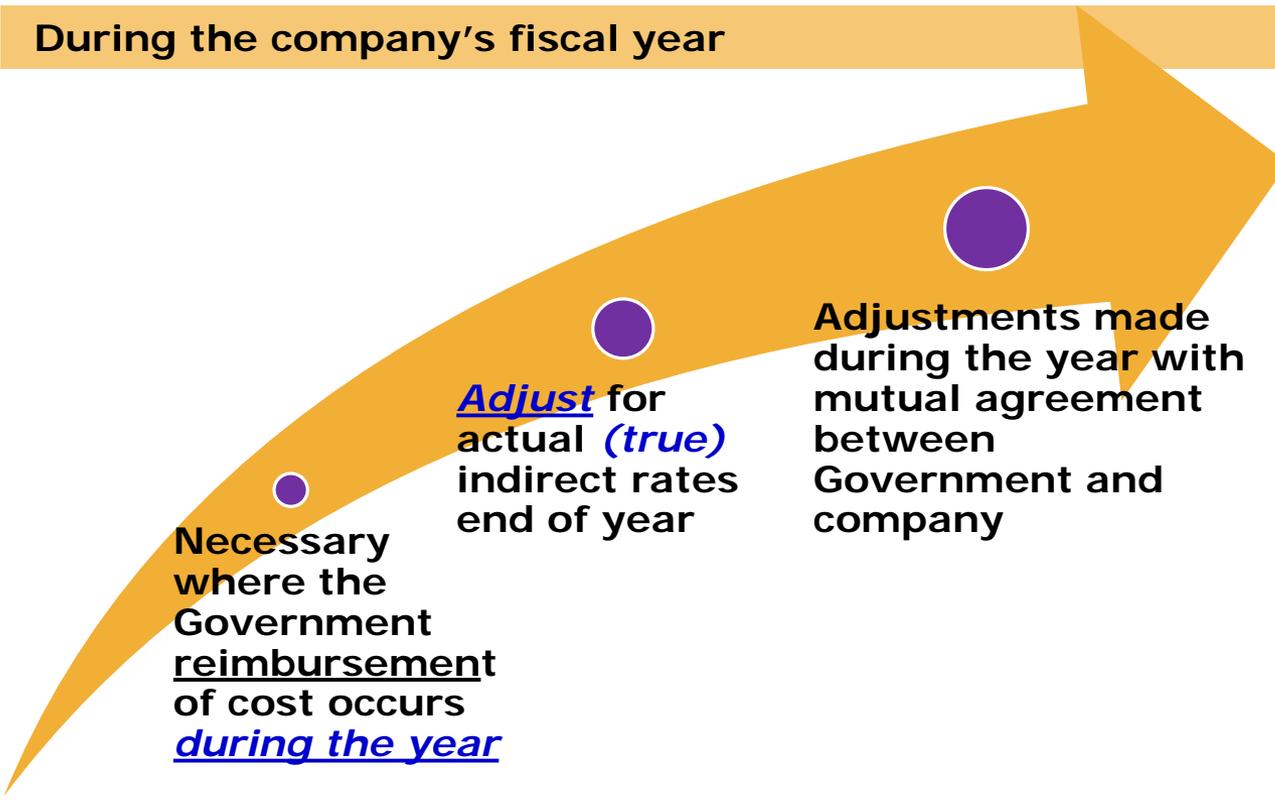
ACQ315:

2. Billing Rates (Paying Contracts)

Rates used to *recover indirect costs*

Overhead and *G&A*

During the company's fiscal year



Necessary where the Government reimbursement of cost occurs during the year

Adjust for actual (*true*) indirect rates end of year

Adjustments made during the year with mutual agreement between Government and company

ACQ315:

3. End-of-Year Actual Rates (Adjusting Payments/Close Out)

Rates express the relationship between:

- Indirect costs actually incurred
- And actual number of dollars/hours in the allocation base
- For each indirect cost “pool”

Rates were used for bidding and billing purposes throughout the company's fiscal year

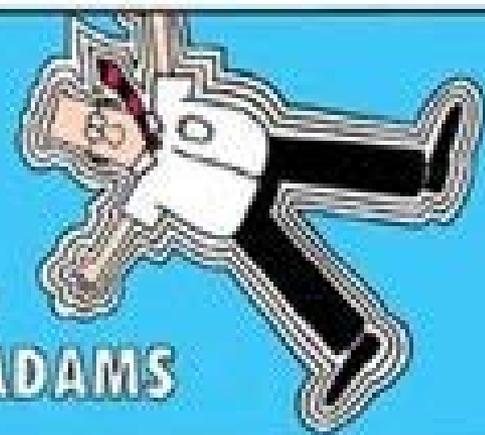
If contract costs had been known in advance with certainty

Company submits final indirect-rate proposal

- DCAA reviews for cost allowability
- ACO negotiates final rates



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BY
SCOTT ADAMS

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THAT WAY YOU CAN'T COMPARE OUR PRICES TO OUR COMPETITORS' PRICES.



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OUR COMPETITORS DO THE SAME THING. IT'S CALLED A CONFUSOPOLY.



WE ALL GET OUR FAIR SHARE OF CONFUSED CUSTOMERS AND WE DON'T NEED TO LOWER OUR PRICES TO COMPETE.



WE USE THE PROFITS FROM OUR ANTI-COMPETITIVE BEHAVIOR TO FUND INNOVATION.



SO DON'T RUIN A GOOD SYSTEM BY TRYING TO UNDERSTAND WHAT YOU'RE BUYING.



THAT ALMOST SOUNDS REASONABLE.



NOW SPANK YOURSELF AND THANK ME!



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For more info, please check out . . .

- CLC 008 Indirect Costs
- CON 232 Overhead Management of Defense Contracts
- ACQ 315 Understanding Industry
- DAU Defense Acquisition Portal
 - Indirect Costs Blog (Prof. Fred Schlich, DAU South, Friedrich.Schlich@dau.mil)
 - Part of the Defense Acquisition Portal “Communities of Practice”
 - <https://dap.dau.mil/cop/indcostsblog/default.aspx>
- DoD Contract Pricing Reference Guides
 - Part of the DAU Acquisition Community Connection
 - <https://acc.dau.mil/CommunityBrowser.aspx?id=406579&lang=en-US>
- Indirect Cost Management Guide
 - Defense Systems Management College (DSMC) Press
 - Prof. Jack D. Cash (Retired)
 - http://www.dau.mil/publications/publicationsDocs/icm_guide.pdf