



A Simple Example of the Government Indirect Rate Process

The purpose of this paper is to provide a simplified discussion of the Government indirect process. It assumes a total cost input (TCI) method of preparing indirect rates. It demonstrates the use of a fringe, overhead and G&A rate. Some companies might use a single rate or more complex rates for company segments. This discussion is intended for a general overview and we would encourage you to contact us if your situation requires a different analysis using alternative assumptions.

Let's begin by making certain cost assumptions. Note that in our example our only direct costs are direct labor. We note below that if your operation includes other direct costs they will be included in the development of the Overhead and G&A rates.

Direct Costs

Let's assume we have three categories of labor; Direct Labor representing individuals who charge directly to a job, Overhead Labor representing individuals who supervise the direct labor and G&A labor who generally are responsible for managing the business or are not otherwise categorized as direct or overhead labor. Let's assume costs for the year as follows:

Direct Labor	\$280,000
Overhead Labor	\$ 10,000
G&A labor	<u>\$ 50,000</u>
Total Labor	<u>\$340,000</u>

It's important to note that in this example we have excluded labor costs for paid-time-off (PTO). These costs need to be calculated and the labor dollars numbers need to be adjusted for this holiday and vacation time. We include these PTO costs in the fringe costs below.

Fringe

Fringe costs represent costs such as paid time off, employer taxes, health and other insurance benefits, and retirement plan costs. Since this is a simple example we will not be addressing Government accounting requirements provided under Cost Accounting Standards (CAS) which apply to larger contractors. If you have CAS covered contracts and wish to discuss their impact, please contact us.

Let's assume total fringe costs of \$97,000 for the year.

Overhead

Overhead costs relate to a service activity (e.g., indirect people who are supporting direct contracts such as direct people who are waiting for a direct contract to charge or program managers who manage multiple contracts), or a factory or production area. They can labor, facility, utility, depreciation, and similar costs related to the operation activity or area.



Let's assume these costs total \$56,300 for the year.

G&A

G&A costs include all other costs not otherwise direct costs to the job or properly included in Overhead. We will not be discussing the Government provisions for unallowable costs as provided in the Federal Acquisition Regulations (FAR). See FAR 31.205 for a more detailed explanation or contact us to discuss. Such unallowable costs must be excluded from the development of indirect rates.

So our actual or anticipated costs for the year total \$510,900 (Direct Labor \$280,000; Fringe \$97,000; Overhead \$56,300; and G&A \$77,600).

Fringe Rate

This is calculated by taking total fringe costs and dividing by total labor dollars.

Fringe Pool	\$ 97,000.00
Total Labor	\$ 340,000.00
Fringe Rate	28.53%

Overhead Rate

Note that Overhead labor did not include fringe, so we need to add that to the overhead costs or pool as it is referred to. Also, note that the denominator or base is determined by adding the direct labor + fringe on direct labor ($\$280,000 \times 1.285292 = \$359,882$). It's very important to note that in our example we only had direct labor of \$280,000. It is quite likely that in a Government contract setting you might have direct travel, direct materials, subcontractor costs and other direct costs related to the contract. These costs, in addition to direct labor and fringe, are included in the Overhead base and the G&A base. The overhead pool costs (\$59,153) are divided by the overhead base to obtain the overhead rate of 16.44%.

OH Pool	\$ 56,300.00
Fringe On OH Labor	\$ 2,852.94
Total OH	\$ 59,152.94
OH Base (DL Including Fringe)	\$ 359,882.35
OH Rate	16.44%

G&A Rate

In a similar fashion, the G&A rate is determined by first taking the pool of G&A costs and adding fringe to the G&A labor. The G&A base simply accumulates all prior costs such that we take the overhead base and add the costs that are in the overhead pool ($\$359,882 + \$59,153 = \$419,035$). Let me say again, that if our example had direct materials, direct travel, subcontractor



costs and other direct costs, they would be include in the G&A base. The G&A pool is then divided by the G&A base.

G&A Pool	\$ 77,600.00
Fringe On G&A Labor	\$ 14,264.71
Total G&A	<u>\$ 91,864.71</u>
G&A Base	<u>\$ 419,035.29</u>
G&A Rate	<u>21.92%</u>

So let's test our results. If we did it correctly we should get full absorption of costs.

		<u>Rates</u>	
Direct Labor			\$ 280,000
Fringe	@	28.53%	<u>\$ 79,882</u>
Total Direct Costs			\$ 359,882
Overhead	@	16.44%	<u>\$ 59,153</u>
G&A Base			\$ 419,035
G&A	@	21.92%	<u>\$ 91,865</u>
Total Costs			<u>\$ 510,900</u>

It looks like it works! When we apply all the rates we get full absorption. Of course if we were using these rates for a proposal we add in our profit factor after the G&A rate was applied.

Feel free to contact us to discuss at 877-254-9998.

Below is a link to DCAA Incurred Cost Submission Excel Model for preparation of indirect rates.

[https://www.dcaa.mil/Home/ICEmodel?title=ICE%20\(Incurred%20Cost%20Electronically\)%20Model](https://www.dcaa.mil/Home/ICEmodel?title=ICE%20(Incurred%20Cost%20Electronically)%20Model)