Indirect Rates for Government Contractors

What Are They?
Why & When Does Your Organization Need Them?
Objectives

• Present a High Level Overview of Indirect Rates
  • This is a 10,000 foot view of Indirect Rates

• We will be discussing what they are, why it is necessary to understand them and when you should be employing them.
• This is not a tactical discussion so we won’t specifically define and calculate the rates.

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What Are Indirect Costs?

First - Distinguish Between Direct & Indirect Costs:

• **Direct Costs:** Labor, materials, travel, subks, ODCs directly attributable to a product or service = direct contract costs.
  • i.e. John provides engineering services for contract XY4567 – the cost of his time working on the contract is a direct cost.

• **Indirect Costs:** Indirect costs are expenses that are incurred by the company, but are not directly associated with a contract or the delivery of a product or service, such as:
  • Cost of employee benefits
    • It costs the company $100 / month in insurance expense to contribute to health insurance for employees
  • Costs of maintaining an office (rent, utilities, etc)
  • Costs of indirect labor:
    • Jane is the Accountant for the company – the cost of her time is an indirect cost
    • John the engineer, who went to a company paid seminar– this time is indirect labor.
What are Indirect Rates?

• Indirect rates - are the indirect costs expressed as a % of the base of costs which they benefit.

• Fringe, Overhead and G&A are most common

• Example – what is Fringe?
  • Fringe are costs such as health care, payroll taxes, 401(k) matching contributions and other employer – borne costs of employment. This is called the “pool”.
  • Assuming all employees are eligible for the same benefits package, the base over which fringe benefits are spread is Total Wages (Direct and Indirect). This is called the “base”
  • Fringe Rate : Total Fringe benefits (pool) / total wages (base)
Why Understanding Rates is So Important

Because:

“You can’t manage what you can’t measure!”

W Edwards Demming
Importance

• Managing costs effectively in your company (and making a profit):
  • Irrespective of Contract type your organization incurs indirect costs.
    • If you do NOT know how to measure or manage them, you may or may not be making a profit.
  • Certainly your income statement shows your “bottom line” for the year, but are you making a profit on your multi year contracts?
Importance

• Identifying cost components and developing competitive cost proposals:

• Let’s consider a Time and Materials Cost Proposal: If we assume John is paid a base wage of $100.00 / hour; at what rate must the company bill out John’s time in order to cover its costs?
  • The T&M rate at which we bill John’s time must cover:
    • (A) His base wage
    • (B) Associated fringe or overhead
    • (C) G&A expenses incurred by the organization
    • (D) Profit

• Do you know how to calculate this T&M rate?
  • By identifying the component costs and grossing up John’s rate to cover these costs.

• The rate which covers (B) and (C) is the “wrap rate”
What is a “Wrap Rate”?

• The term wrap rate refers to the effective multiplier that is necessary to cover the cost of direct labor.
  • In other words..... The rate at which $1 of direct labor must be billed out at in order to cover all of the associated indirect rates.

A brief illustration:
Labor = $100.00/hr (B) Fringe Rate is 10% (C) G&A Rate is 25%
Wrap Rate is (1.10) * (1.25) = 1.375
Therefore we must bill John out at ($100 * 1.375) = $137.50 before profit to cover our indirect costs.
When do you Need Rates?

- You must have them in order to bid on and invoice against a Cost Type contract!
  - Measurable Indirect Rates are Required to bid on government Cost type contracts
  - Approved rates are required to invoice on Cost Type Contracts.

Caution: Although indirect rates are not specifically approved before an FFP or T&M proposal review, many proposals require you to disclose the rates in your pricing data backup; therefore you should know them and not just guess at them.
When do you Need Rates?

- You absolutely should have them as soon you start doing business – WHY?
  - The organization should have a thoughtful budgeting process each year to identify and plan its direct and indirect costs.
  - Actual costs should be monitored against the budgeted costs, minimally on a quarterly basis.
- If you don’t know what your costs are how will you ensure you are making money on a contract or series of contracts?

*Indirect costs are a crucial component to managing costs – take the time to understand them and manage them.*

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Questions?

Or do you need help calculating your rates? Let us help.

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