



# 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.

# 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 :  $\text{Total Fringe benefits (pool) / total wages (base)}$

# 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.**

# Questions?

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

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