

## Calculating Indirect Costs

Here are step by step instructions for how to calculate your firm's indirect costs:

### Step 1: Identify Indirect Cost Categories

- Start by identifying the various indirect cost categories applicable to your business. Common categories include fringe benefits, overhead, and general and administrative (G&A) expenses. See Appendix 1 for more examples.
- For example, fringe benefits may include employee health insurance, retirement contributions, paid time off, and other employee benefits. Overhead costs may encompass rent, utilities, equipment maintenance, and depreciation. G&A expenses might include salaries of administrative staff, office supplies, professional services, and general business operations.

### Step 2: Gather Financial Information

- Collect all relevant financial records and documents that pertain to your business expenses. This includes payroll records, employee benefit information, invoices for rent and utilities, insurance costs, office supply receipts, and any other expenses that fall under the indirect cost categories.
- If you use accounting software, this information should be available there.
- Ensure you have accurate and up-to-date information for the specific period you are using for the proposal.

### Step 3: Determine Allocation Bases

Determining allocation bases is an important step in the process of calculating indirect cost rates. Allocation bases are factors or measures used to allocate indirect costs to specific cost objects (such as contracts, projects, or activities) based on the relationship between the costs and the activities or resources that drive them.

To determine suitable allocation bases for each indirect cost category, follow these steps:

- a) **Identify Indirect Cost Categories:**  
Start by identifying the different indirect cost categories applicable to your business. These may include fringe benefits, overhead, general and administrative (G&A) costs, or any other relevant indirect costs.
- b) **Understand Cost-Activity Relationships:**  
Review the activities or resources that drive each indirect cost category. Consider the factors that contribute to or consume these costs. For example, fringe benefits costs may be driven by the number of direct labor hours worked, while overhead costs may be influenced by direct labor costs or machine hours.
- c) **Evaluate Available Data:**  
Assess the data you have available or can reasonably obtain for each potential allocation base. Look for reliable and relevant information that accurately reflects

## Writing the Basis of Estimate for Indirect Cost Rates

Here are detailed instructions explaining how to use the date created using the steps above to write the required basis of estimate for indirect cost rates.

### Step 1: Introduction

- Start by introducing your small business and briefly state the purpose of the basis of estimate. Explain that it is a document that describes the methodology used to calculate indirect cost rates for your OASIS+ proposal. Refer to the sample document below.

### Step 2: Indirect Cost Categories

- List the indirect cost categories applicable to your business, such as fringe benefits, overhead, and general and administrative (G&A) expenses. Provide a brief explanation of each category and its significance in the pricing of your proposal.

### Step 3: Methodology for Indirect Cost Rates

- State the methodology used to compute the organization's indirect cost rates for each category. Briefly explain the steps taken, including the identification of indirect costs, determination of allocation bases, and allocation of costs to cost objects or projects.

### Step 4: Description of Indirect Cost Pool and Allocation Base

- For each indirect cost category, provide a detailed description of the indirect cost pool and the allocation base used. Explain how the costs are grouped and allocated based on the identified allocation base.
- Example: Fringe Benefits - The indirect cost pool for fringe benefits includes expenses related to employee health insurance, retirement contributions, paid time off, and other employee benefits. The allocation base used is the total direct labor hours worked by employees.

### Step 5: Calculation Period and Rates

- Specify the period of time the proposed indirect rates are based on. This could be the most recently completed contractor fiscal year, the current fiscal year-to-date, or a budgeted period.
- Provide the calculated indirect cost rates for each category based on the allocation of costs and the allocation bases used.
- Example: Fringe Benefits - The calculated fringe benefits rate is \$50 per direct labor hour, derived from the total allocated fringe benefits costs divided by the total direct labor hours worked.

### Step 6: Explanation of Indirect Costs Derivation

- Explain how the indirect costs were derived based on the calculated rates and the application to the proposed direct costs. Describe the process of multiplying the direct costs by the respective indirect cost rates to determine the indirect cost amount included in the pricing.

To ensure an equitable distribution of costs, we carefully selected allocation bases for each indirect cost category. The allocation bases were chosen based on industry best practices and the nature of our business operations.

Step 3: Allocation of Costs to Cost Objects:

Using the predetermined allocation bases, we allocated the indirect costs to the respective cost objects or projects. This ensures that the indirect costs are appropriately assigned to the activities that generate them.

4. Description of Indirect Cost Pool and Allocation Base:

a) Fringe Benefits:

- Indirect Cost Pool: Fringe benefits include employee health insurance, retirement contributions, paid time off, and other employee benefits.
- Allocation Base: Total direct labor hours worked by employees.

b) Overhead:

- Indirect Cost Pool: Overhead includes facility rent, utilities, equipment maintenance, and indirect labor costs.
- Allocation Base: Total direct labor dollars.

c) General and Administrative (G&A) Expenses:

- Indirect Cost Pool: G&A expenses encompass administrative staff salaries, office supplies, legal and accounting services, and other general business costs.
- Allocation Base: Total direct labor dollars.

5. Calculation Period and Rates:

The proposed indirect rates are based on the most recently completed Contractor Fiscal Year. The following are the calculated indirect rates:

a) Fringe Benefits:

- Rate: \$15 per direct labor hour
- Calculation: Total fringe benefits costs (\$300,000) divided by total direct labor hours (20,000).

b) Overhead:

- Rate: 50% of direct labor dollars
- Calculation: Total overhead costs (\$500,000) divided by total direct labor dollars (\$1,000,000) multiplied by 100.

c) G&A Expenses:

- Rate: 25% of direct labor dollars
- Calculation: Total G&A expenses (\$200,000) divided by total direct labor dollars (\$800,000) multiplied by 100.

6. Explanation of Indirect Costs Derivation:

## **Appendix 1: Common Indirect Cost Categories**

Common indirect cost categories for a professional services firm may include:

1. **Fringe Benefits:** This category includes costs associated with employee benefits such as health insurance, retirement plans, paid time off, and other benefits provided to employees.
2. **Overhead:** Overhead costs encompass various indirect expenses incurred to support the overall operations of the business. This can include rent, utilities, office supplies, equipment maintenance, software licenses, insurance, and other general administrative expenses.
3. **General and Administrative (G&A) Expenses:** G&A expenses are the costs associated with the overall management, administration, and support functions of the organization. This includes salaries of administrative staff, accounting and legal fees, marketing expenses, professional memberships, training and development, and other general business expenses.
4. **Subcontractor Costs:** If your firm engages subcontractors or consultants to provide specialized services or support, the costs associated with subcontracted work can be considered an indirect cost.
5. **Travel and Entertainment:** This category includes costs related to employee travel for business purposes, including airfare, accommodations, meals, ground transportation, and other travel-related expenses. It may also include entertainment expenses incurred during business trips.
6. **IT and Technology:** Indirect costs related to information technology (IT) infrastructure, software licenses, computer equipment, network maintenance, and other technology-related expenses can fall under this category.
7. **Facilities and Office Operations:** Costs associated with facility maintenance, office lease or rent, property taxes, cleaning services, security, and other operational expenses related to the physical workspace are considered indirect costs.

It's important to note that the specific categories and their allocation methods may vary depending on the nature of the professional services firm and its operations. It is recommended to consult with an accountant or financial professional to ensure accurate identification and allocation of indirect costs specific to your firm's circumstances.