Is Indirect an Element of Cost for Projects?

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Advanced Sources and Detectors (ASD) Project

Premise: Treating Indirect as an Element of Cost does not meet the intention of Indirect accounting within EIA-748C

- Indirect costs are defined in EIA-748: “The cost for common or joint objectives that cannot be identified specifically with a particular program or activity. Also referred to as overhead cost or burden.”’
- Section 2.1.d: “Identify the organization or function responsible for controlling overhead (indirect costs).”
  - The intent of this statement is that for a Project (Program) that will collect and use overhead for pooling purposes, a specific organization/function ***associated with the Project (Program)***, will manage the overhead and will be held accountable for its ***scope, budget, and cost accounting***.
  - In the case of M&Os, it is not ‘a’ or ‘the’ Project, but the site writ large (typically the President or Director, Deputy Directors, ALDs, etc.) that controls Indirect. In the case of Triad, Indirect rates are approved by NNSA OFFM, and the M&O Finance and Accounting organization manages the Indirect budget , scope, and cost accounts, not the Project Office.
  - The purpose of indirect is to provide pooling appropriate for managing the overall “Business Unit” in accordance with Cost Accounting Disclosure, not for use by Project(s).

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- 2.2.h Planning, Scheduling, and Budgeting: Establish overhead budgets for each significant organizational component for expenses which will become indirect costs. Reflect in the program budgets, at the appropriate level, the amounts in overhead pools that are planned to be allocated to the program as indirect costs.
  - This reflects the pooled values to provide budget for "joint objectives"
    - Allocations made to "Directorates" or other controlling entities
  - At LANL, the allocated costs to the programs/projects are the burdened ***rates*** for:
    - Labor
    - Material
    - Subcontracts
    - ODCs

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- 2.3.d Accounting Considerations: Record all indirect costs which will be allocated to the program consistent with the overhead budgets.
  - This is not the Project – this is referring to the Accounting Organization referring to the burden rate that the project/program experiences
- 2.4.c Analysis and Management Reports: Identify budgeted and applied (or actual) indirect costs at the level and frequency needed by management for effective control, along with the reasons for any significant variances.
  - This responsibility falls to those that receive Indirect Budget in conjunction with the Financial and Accounting Team (Director/Associate Directors; President/Vice Presidents)
  - The Financial and Accounting Team conducts Variance Analysis to support those that control the Indirect Budget

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- Note that Indirect Costs are not considered as a Time-Phased Element of Cost in the Budget Element Hierarchy in EIA-748 C:

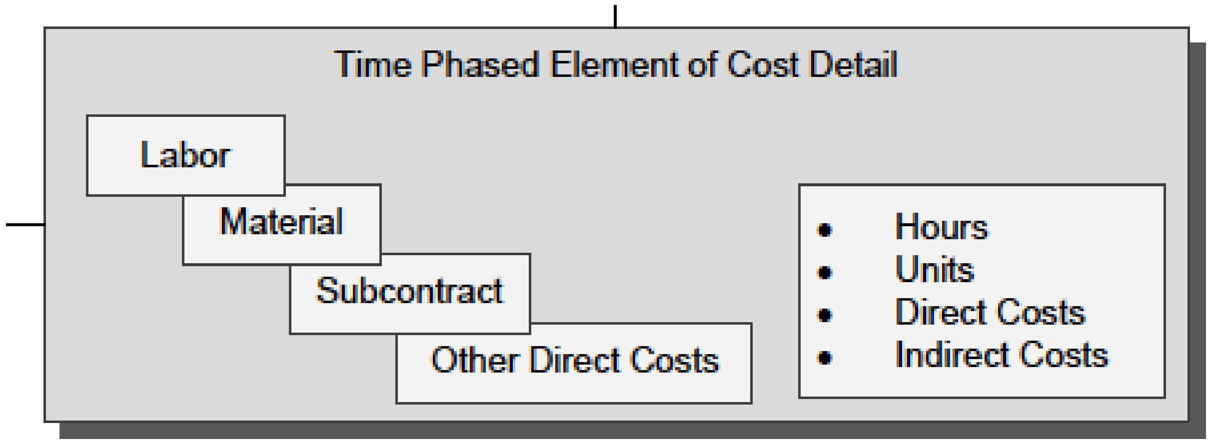

Figure 3.5-1 — Budget Element Hierarchy

- The Budgeted Element consists of hours, units, contract costs, and their associated burdens (indirect costs)
- The Intent Guide calls out the EOCs as: Labor, Material, Subcontract, and ODCs not Indirect

Indirect Rate Changes need to be understood by CAMs – rate changes impact Total Project Cost

- 3.8.2 Cost Performance
  - Cost performance is determined by comparison of the actual costs and the earned value for the same work scope. The resultant metric is the cost variance. The cost variance is a true measure of cost performance as it compares the actual costs incurred to the value of work accomplished and eliminates the effects of schedule status variations, which are inherently present in a simple comparison of actual costs to a budget. (Rate analysis and analysis of prime costs, e.g., labor hours, may be segregated to isolate rate changes and efficiency factors as calculated using the following:)
    - Labor Rate Variance Calculation = Actual Hours x (Budget Rate – Actual Rate)
    - Efficiency Variance Calculation = Budgeted Rate x (Earned Hours – Actual hours)
- This is merely pointing out that for purposes of variance analysis, the Element of Cost can be segregated
  - If Indirect Rates were to change substantially (typically not at large M&O's) then the Labor Rate Variance would be significant
  - Due to a large change in Indirect Rate a CAM would include this information in their Variance Analysis Report if the impact exceeded prescribed thresholds
  - ***There is a separate organization that manages the Indirect Budget Variance Analysis – typically the Finance and Accounting organization***

During LANS recertification, PM-30 provided guidance that Indirect should be an Element of Cost for the LANS (now Triad) SD

- Why? To create visibility that Indirect at M&O's contributes significantly to the overall costs
  - Arguably true, but this is a function of the rate: time-phasing as an Element of Cost yields no additional information or benefit to the project, and in fact violates the guideline over that which the CAM controls
- Let's assume for a moment that Indirect as an element of cost is a best practice, then why not break it down further and treat the underlying components as individual elements?
  - Certain elements do not change and if we are trying to understand the variance in burdened costs due to Indirect, this seems appropriate:
    - Site Support
    - Program Office Support
    - G&A
    - Gross Receipt Tax
    - LDRD

What is potentially wrong with this approach?

Treating Indirect as an EOC becomes inconsistent with EIA guidelines

- CAMs are responsible for controlling, budgeting, accruing, and conducting variance analysis – CAMs do not have Indirect Budget to apply to project
- Indirect as an EOC is simply derived from the burden associated with the EOCs:
  - Labor, Material, Subcontracts, ODCs
  - Indirect = (burden on labor) + (burden on materials) + (burden on subcontracts) + (burden on ODCs)
  - ***CAMs need the loaded costs to understand impact on the Project for what-if and risk analysis***
- The CAM does not:
  - Control – the rate is set by management assigned to manage Indirect (with NNSA approval)
  - Budget – it is simply the arithmetic derivation from the other EOCs
  - Accrue –
  - Conduct variance analysis - it is simply the arithmetic derivation from the other EOCs, ***except when rate changes occur***, for which we all agree they should be cognizant

Indirect does need management, and there are guidelines within EIA-748 and as referenced in the IP2M/METRR

- IP2M/METRR included "Sub-Process E: Indirect Budget and Cost Management"
  - Within this section the role of the CAM is specifically acknowledged:
  - "Generally, Control Account Managers (CAMs) have little or no direct responsibility and/or control associated with analysis of indirect budgets and actual indirect costs. Commonly, it is the role and responsibility of management assigned to oversee indirect budgets and actual costs, to engage in recurring analysis and communicating the results of indirect variance analysis to the appropriate project/program personnel. Project managers, CAMs, and others are responsible for knowing and integrating the results of indirect variance analysis into project/program planning, control, and decision-making."
- The the highlighted section refers to the fact that CAMs need to understand rate changes, since they can impact costs

Planning Indirect as an EOC does not Improve visibility and in fact replicates functions that the Financial and Accounting is responsible for

Premise: Treating Indirect as an Element of Cost (Control) does not meet the intention of Indirect accounting within EIA-748 C

- Do you agree or do you believe treating Indirect as an EOC is a best practice?
- Why or why not?

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