



# Recovering & Allocating Indirect Costs

## What are indirect costs?

Indirect costs are real costs. They are generally defined as overhead costs associated with providing an **indirect service** that are not easily attributable to a **direct service**. In other words, direct costs to operate the police department might include the cost of the officers' salaries and uniforms. However, Human Resources is used to hire the officers; thus the HR staff salaries are indirectly attributable to the cost of providing police services. Likewise the staffing costs incurred by Purchasing to order the uniforms might also be an indirect cost of operating a police department.

### Indirect Services Examples

- City Council
- City Manager
- Finance
- Human resources
- Facilities maintenance
- Information services
- Department administration
- Purchasing

### Direct Services Examples

- Police
- Fire
- Public Works
- Development services (building, planning, permits, land use)
- Parks & recreation
- Library
- Utilities

## Why is it important to recover indirect costs?

Government agencies can realize a number of benefits from calculating indirect costs and devising a plan to recover them. The most obvious is that the federal government will reimburse agencies for certain allowable indirect costs if the agencies track these costs in accordance with the guidelines outlined in OMB Circular A-87, which identifies reimbursable expenditures and describes the approval process. Calculating how much you spend on indirect costs can also help you to:

- Recover the full costs of services when developing user fees. Ex: How much should you charge to rent the gazebo at the community park for weddings?
- Include indirect costs in billings to enterprise funds and pass them on to end users. Ex:

Setting utility rates at a level that recovers a share of indirect services.

- Understand the full costs of “doing business” and as a result control costs more effectively.
- Obtain reimbursement from outside agencies such as fire districts or the county museum for any general support they receive. Ex. How much should you charge to contract police services to a neighboring jurisdiction?

By implementing a successful indirect cost allocation plan(s), you will most likely be able to free up General Fund resources for other critical community needs.

“...General Fund resources are no longer subsidizing services that should be paying for themselves through direct user fees and charges.”

## How to Successfully Implement an Indirect Cost Allocation Plan

FCS Group's tailored approach to indirect cost recovery will help you identify services within your governmental entity that should be paying for themselves through direct user fees and charges and free up general fund resources for other critical community needs. Our Six Steps to Successful Indirect Cost Recovery Planning are designed so that our clients "own the end product", and are able to apply the results of the plan. The initial work in carefully identifying all the services being provided throughout the organization and agreeing upon the allocation basis for each service is an investment in future sustainability of the plan.

- 1. Evaluate the organization:** Categorize the departments as direct or indirect services; within indirect service departments, identify distinct program areas of service; identify any indirect services provided by direct-service departments and vice-versa.
- 2. Utilize available budget information:** Compile the total costs related to indirect services, as described in the budget.
- 3. Determine allocation factors:** Form the basis for allocating indirect service costs by gathering available data sets or easily-estimated workload measures. (Key point: Only use data sets that can be easily gathered in subsequent updates to ensure that the allocation plan can be kept current.)
- 4. Make adjustments:** Adjust for non-allocable costs, costs that can be assigned directly, and any other agreed upon revisions that don't diminish the "cost-basis" of the plan.
- 5. Allocate costs:** Using a one-, two-, or three-step methodology, depending on the complexity of the organization and the levels of indirect service included in the plan, allocate indirect costs based on the proportions derived from workload measures.
- 6. Calculate full overhead:** Identify each direct service's full share of indirect costs.

### Great Reasons to Get Started Today!

...For fairness: Apportions costs at those who receive the services; seeks to reduce subsidies.

...For cost recovery: Completes the portrayal of the full cost of providing direct services to the public and becomes a cost-based component that should be included when setting user fee and rate levels.

...For awareness: Results provide a reasonable picture of how services are used which can assist managerial decisions and make others aware of the actual costs of doing business.

...For communication: Fosters discussion about the true cost of services provided and the performance standard of those services.

Ask about our full complement of general government resource enhancement consulting services including:

User Fee Studies, Performance Audit, Organizational Reviews and Benchmarking.