Superfund Full Cost Indirect Cost Rate Methodology

Background

OMB, the Secretary of the Treasury and the Comptroller General established the Federal Accounting Standards Advisory Board (FASAB) in October 1990 to set Federal Government Accounting Standards. In September 1993, the Vice President in his report on the National Performance Review recommended an action which required the FASAB to issue a set of cost accounting standards for all federal agencies. FASAB issued the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* on July 31, 1995, which became effective for EPA on October 1, 1997. Title VIII of the Federal Financial Management Improvement Act of 1996 (Title VIII, Public Law 104-208) requires federal agencies to comply with the Federal Financial Accounting Standards and emphasizes that agencies' systems must report the total costs of programs and activities. EPA will comply with this requirement for all the Agency's programs, based on specific needs of each program and applicable accounting requirements. The methodology described in this Policy Announcement applies to EPA's Superfund site-specific activities as set forth below.

SFFAS No. 4 sets forth five fundamental elements of managerial cost accounting to provide information on the cost of federal programs. One of those elements is to determine the full cost of government goods and services. According to the Standard, full cost includes both direct and indirect costs. Direct costs are defined as "costs that can be specifically identified with

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an output." Indirect costs are costs that are common to multiple outputs but cannot be specifically identified with any particular output. In the context of the Superfund program, direct costs include those that are directly incurred by the United States for site-specific activities performed at or in connection with a particular site or a particular group of sites. Site-specific activities include the assessment, investigation and clean-up of a site, ancillary site-associated activities, and related enforcement actions. Indirect costs are those that support the Superfund program as a whole and cannot be identified to any one site or other "output" of the program. The government's full cost at a Superfund site consists of the direct costs incurred for site-specific activities and the proportionate share of all the costs that provide indirect support to the site.

In 1985, EPA, with the assistance of the accounting firm Ernst & Whinney, developed an indirect rate methodology for determining the government's cost of site-specific activities under CERCLA. The indirect rates developed were conservative. As a result of the conservative methodology, a substantial portion of the indirect cost pool was not allocated to individual Superfund sites, even though site-specific activities are the direct output that the indirect costs support. As a result, the General Accounting Office (GAO), the EPA Office of Inspector General (OIG), OMB and Congress have repeatedly criticized the methodology for failing to identify the full cost of Superfund site clean-ups and therefore failing to allow potential recovery of all indirect costs. The OIG considered this method of recovering less than full overhead costs as a Federal Manager Financial Integrity Act (FMFIA) "material weakness" and suggested the Agency identify it as such.

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EPA has revised the Superfund indirect cost methodology to enable the Agency to report the full cost of the program in compliance with SFFAS No. 4 and with other federal mandates requiring the reporting of cost information. During the preparation of the revised methodology, EPA sought separate independent reviews of the methodology by both GAO and the national accounting firm KPMG. KPMG found the revised methodology in compliance with SFFAS No. 4, as well as "easier to understand, more thorough and more complete than the previous methodology." GAO reviewed the revised methodology and found "that the design of EPA's proposed Superfund indirect cost methodology complies with cost accounting standards for federal government" as well as the requirements of SFFAS No. 4.

Approach

EPA's approach to developing a full cost indirect cost methodology for Superfund is based on the guidance provided by SFFAS No. 4. In addition, certain other factors are also taken into account. These include the nature and classification of Agency costs, private sector cost accounting practices and the cost/benefit of obtaining the data necessary to compute indirect cost rates. Indirect cost rates will be developed for each region and each Fiscal Year beginning with FY 1990. We are beginning with FY 1990 because active Superfund sites have costs incurred in prior years generally no earlier than FY 1990, with limited exceptions. Thus, computing full cost indirect rates back to FY 1990 will allow Superfund managers to determine the full cost of site-specific activities for nearly all active sites, while going back before FY 1990 would be of

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primarily historic interest. Therefore, we consider it most cost effective to compute rates no further back than 1990; if managers need indirect cost information for years prior to 1990, the rates computed using the current methodology may be used for those earlier years. Use of the revised indirect cost rates will provide Superfund managers, other EPA management and Congress with the full cost of Superfund site-specific activities.

The current Superfund indirect cost methodology uses indirect rates which are expressed as a rate per hour of labor effort. This rate is computed using a base consisting of all labor hours (including both site and non-site labor), but is applied to only site labor hours. This results in an under-allocation of indirect costs. This approach, although acceptable from an accounting standpoint, is conservative in its allocation of indirect costs to individual sites and led to the criticisms noted above. The principal conceptual change the Agency will make as it moves to full cost accounting in compliance with SFFAS No. 4 with respect to Superfund site-specific activities, is to ensure that indirect costs that support site clean-up are fully allocated to site charges. In order to do so, EPA will allocate the appropriate indirect cost pool using total direct site costs as an allocation base. This will result in indirect cost rates expressed as a percentage of total direct site costs rather than a dollar rate per hour as is the current method. The change in the allocation base is the most important difference between the full cost accounting methodology and the prior methodology, with only minor changes to the indirect cost pool (further described below). The indirect cost pool identified for calculation of the new indirect cost rate will reflect only those costs which are appropriately allocable to and support the Superfund site-specific

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activities.

In determining the indirect costs associated with the Superfund program, certain costs funded from non-Superfund appropriations are included as indirect costs because they provide services that benefit the Superfund program and are necessary to reflect full cost. SFFAS No. 4 states that one of the components of full cost is the "cost of support services provided by other responsibility segments...and by other reporting entities." We include other appropriations because our approach determines the allocability of indirect costs according to the organizational unit that provides the support services regardless of which appropriation has been charged with the costs. We begin with the total costs of organizational units and then allocate these costs to all units receiving support services.

Not all appropriations, however, are included as indirect costs. For example, charges under the Oil Spill appropriation are not included. Oil Spill disbursements support only the Oil Spill program and should not be allocated to other programs. State and Tribal Assistance Grants appropriations are also excluded. These are grants to states, local and tribal governments which fund a variety of environmental programs and infrastructure projects pertaining to water quality initiatives. Funding under the Science and Technology appropriation is excluded. These funds support research and development initiatives. The treatment of research and development costs is discussed under the section on direct costs. The programs funded by the appropriations listed above are considered to be separate from Superfund and have their own outputs. These

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appropriations do not include any indirect costs that are allocable to the Superfund program.

As explained below under *Exclusions from the Pool*, costs associated with certain organizational units are also removed from the indirect cost pool depending on their relationship to the Superfund program.

The concept of full cost, according to the Standard, also requires that inter-entity costs or the costs of services received from other entities be recognized. Costs of employee benefits funded by the Office of Personnel Management (OPM) are considered inter-entity costs and will be included as indirect costs. Because methodologies to estimate the costs of services received from federal agencies other than OPM are still under development, these costs are not included in the indirect cost pool at this time.

The methodology for determining indirect costs allocable to Superfund site-specific activities is patterned after private sector models that group costs according to levels of organization and benefit. Indirect costs are classified hierarchically. At the highest level are Agency-wide costs, i.e., national costs which benefit all organizations. Examples of these are facilities management, budget functions, human resource management, and OPM inter-entity costs. The next level incorporates regional costs which benefit each of the Agency's ten regions. These are general costs which are essentially counterparts of national costs but benefit regions only. Examples include the costs of regional administration, support, and policy and planning

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functions. Superfund program management costs comprise the next two levels. These are the support costs incurred at both headquarters and regions to implement Superfund site-specific activities. Costs from each of these four levels form the basis of the indirect cost pool. The final product - separate indirect cost rates for each of EPA's ten regions - will be expressed as a percentage of direct (site-specific) costs for each region.

Direct Costs

In determining the direct costs of the Superfund program, we use SFFAS No. 4's definition of direct costs. However, the direct costs of the Superfund program as a whole, are not necessarily synonymous with the direct costs of Superfund site-specific activities. Superfund site-specific activity is one component of the Superfund program.

Site-Specific Costs

The major component of Superfund direct costs is the costs of site-specific activities, i.e. the cost of all activities that go toward the assessment, investigation and actual clean up of a site, related enforcement actions, and other site-associated activities. Examples include, but are not limited to, the costs of salaries and benefits of employees who work directly at the site or provide other site-related effort, contractor costs of removal or remedial activities, and analytical work performed for the site.

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Certain other Superfund-related costs are also considered direct costs, although they may or may not be associated with site-specific activities. These costs are described in the next several paragraphs.

ZZ Costs

"ZZ" costs are expenses incurred for site work before a site is established as a Superfund site and assigned a site-specific identifier. If a site-specific identifier is established, the ZZ costs incurred in connection with the site are reclassified to that site-specific identifier. If reclassified, they become part of direct site-specific costs, but for purposes of the indirect rate calculation, ZZ costs are classified as direct costs even if not reclassified.

R&D Costs

Research and Development (R&D) costs are treated as direct costs. All costs incurred within the Office of Research and Development, a separate and distinct organizational unit within the Agency, are excluded from the indirect cost pool. Research and Development costs are considered to be directly incurred for production of R&D outputs. Superfund-related research and development costs are mainly related to the Superfund Innovative Technology (SITE) program. This program evaluates the application of emerging remediation technologies.

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NIEHS Costs

Costs associated with the National Institute of Environmental Health Sciences (NIEHS) interagency agreement (IAG) are treated as direct costs. This indirect cost methodology is designed to determine the indirect costs that support Superfund site-specific activities. Therefore NIEHS costs are excluded in their entirety from the indirect cost pool.

OSWER Immediate Office Program Area Costs

Costs associated with certain offices within the Office of Solid Waste and Emergency Response (OSWER) Immediate Office are treated as direct costs. Although these costs are related to the Superfund program and are direct costs of the functions they perform, they are not allocable to Superfund site-specific activities and so are not included in the indirect cost pool for site-specific response costs. For example, the Chemical Emergency Preparedness and Prevention Office (CEPPO), which reports directly to the OSWER Assistant Administrator, implements Agency-wide chemical emergency preparedness and prevention programs. The costs connected with Federal Facilities activities, whether within OSWER or OECA, as well as the costs of activities associated with Brownfields and the Emergency Planning and Community Right-to-know Act, are also considered direct and thus excluded from the indirect cost pool.

Indirect Cost Pool

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The indirect cost pool consists of all costs classified as indirect for all appropriations that fund administrative, management and support functions. The pool includes Superfund non-site-specific costs that provide support to Superfund site-specific activities and the other direct Superfund activities. The indirect cost pool includes the non-site portion of: personnel compensation and benefits, travel, rent, communications, utilities, contracted services, materials and supplies costs. Depreciation and inter-entity costs are also included. The major organizational units contributing costs to the indirect cost pool are described below.

EPA headquarters organizations providing services on an Agency-wide or national basis include the Office of the Administrator, the Office of Administration and Resources Management (human resources, procurement, facilities), the Office of the Chief Financial Officer (Comptroller, budget, finance), the Office of Information Resources Management, the Office of Policy, Planning and Evaluation, the Office of the Inspector General and the Office of General Counsel. The ten EPA regional offices have corporate structures similar in function to those of headquarters. Each region has a regional administrator's office and offices providing general regional support services such as personnel, finance, policy and information management. Costs for these organizations comprise regional indirect costs.

Management and support costs associated with carrying out the Superfund program are another component of the indirect cost pool. These costs are incurred at both headquarters and the regions. At the headquarters level, these are the program management and support costs

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incurred by the Office of Solid Waste and Emergency Response (OSWER) and by the Office of Enforcement and Compliance Assurance (OECA). At the regional level, Superfund program management costs incurred by regional program divisions in support of Superfund site-specific activities are included in the indirect cost pool. Any of the offices noted above may also have Superfund site-specific charges. Those site-specific charges are subtracted from the total cost of the organization during the indirect cost computation.

The Superfund indirect cost pool, that is, the pool of indirect costs which is ultimately allocable to Superfund sites, will consist of proportionate amounts of Agency-wide, regional and program-related costs. In other words, the Superfund indirect cost pool will be comprised of only the portion of Agency-wide, regional and program-related costs which supports Superfund sites, with the remaining costs supporting all other Agency programs.

Exclusions from the Pool

Superfund non-site specific contractor costs, such as program management, that are distributed through the annual allocation process are excluded from the indirect cost pool. Annual allocation is the process by which response action contractor non-site support costs are allocated to sites on which the contractor worked. The site-allocable portion of these contracts is removed from the pool because it is allocated to individual sites under a separate process and is treated as a portion of direct site-specific costs incurred by EPA.

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Costs of organizational units that provide no direct or indirect support to Superfund are excluded. Examples include the Office of International Activities and certain organizations within the Office of the Administrator, such as the Science Advisory Board and the Office of Administrative Law Judges.

Indirect Cost Base

To properly distribute costs, the indirect cost base must reflect the services provided to each organizational recipient and finally, to the Superfund sites themselves. There are several intermediate allocations of costs, as described below, which use appropriate allocation bases. The choice of allocation base depends on the type of cost to be allocated.

Agency-wide or national indirect costs, also referred to as general and administrative (G&A) costs, are allocated using one of two allocation bases. Facilities, human resources and OPM inter-entity costs are allocated to all EPA organizations based on personnel compensation and benefits (PC&B) costs. The rationale for using PC&B costs as the allocation statistic is that these indirect costs are purely workforce-related and would not otherwise be incurred. Costs associated with other organizations providing Agency-wide benefits, such as procurement, budget, finance, information management, policy, planning, general counsel and inspector general, are distributed across the entire Agency based on total Agency costs. Depreciation will be allocated to all EPA organizations using appropriate cost accounting principles. We are in the

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process of gathering these costs and determining the appropriate allocation base. Depreciation costs will be incorporated into the rates as soon as possible.

The next level of indirect costs is regional costs which provide general and administrative support similar to that provided at the Agency-wide level. Regional G&A cost pools, including each region's share of national G&A, personnel and facilities costs, depreciation and inter-entity costs are distributed across the entire region based on total regional costs. This is similar to the distribution of Agency-wide support costs across total Agency costs.

Headquarters program management and support costs incurred by OSWER and OECA must be allocated to program areas within each office of an EPA Assistant Administrator and to the regions. Program areas are designated by sub-organization or by funding vehicle such as interagency agreements which fund a particular type of activity. The allocation of headquarters program management and support costs is based on the total costs associated with each program area and region. The headquarters allocation base includes administrative and program costs from appropriations other than Superfund and Superfund site-specific and non-site-specific costs. The regional allocation base consists of regional site charges made within each office of an EPA Assistant Administrator.

The final Superfund indirect cost pool is allocated using Superfund site charges. These site charges include both headquarters and regional site charges, ZZ charges, site charges made

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under the Department of Justice (DOJ), Corps of Engineers, Bureau of Reclamation, etc., interagency agreements and the Superfund response contract program management costs that are allocated to sites in a separate process. EPA charges arising from mixed funding settlements are direct site costs and are also included in the indirect cost base. The charges for the Agency for Toxic Substances and Disease Registry (ATSDR) are not included in the indirect cost base because their funding mechanism - a "transfer allocation" - does not result in a charge to EPA's accounting system. Again, instead of a rate per hour as in the current methodology, the indirect cost rate will be expressed as a percentage of direct (site) costs.

Computation of Indirect Cost Rates

Data used for the indirect cost computations are obtained from the Agency's Integrated Financial Management System.

The indirect cost pool supporting Superfund site-specific activities in each region for a given fiscal year consists of proportionate shares of the following: program management and support costs incurred by relevant units of EPA headquarters (including their share of nationwide G&A); the region's G&A; and the region's non-site Superfund costs.

The computation of the indirect cost rates consists of nine steps. A detailed document more fully describing the accounting methodology employed will be released with the calculated

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rates by region by fiscal year. That document will contain a detailed description of each of the nine steps. Briefly, steps 1 and 2 compute the nationwide G&A rate and step 3 computes the regional G&A rates. Steps 4 through 9 perform various allocations and refinements of costs ensuring that the regional Superfund cost pools, which are summarized in step 9, reflect only costs by region associated with Superfund site-specific activities.

Estimated Indirect Rates by Region

As noted above, the revised indirect cost rate methodology will for the first time provide information on the full costs of the outputs of Superfund site-specific activities. The process of computing rates using the full cost methodology is ongoing. As noted above, the revised rates by region by fiscal year will not be issued for several months. In the meantime, we are providing an approximation of the rates that can be used as a means to estimate the full cost of Superfund site-specific activities. These rates are based on the average of preliminary computed rates for fiscal years 1994, 1997 and 1998. It should be noted that rates for any given region may vary considerably from year to year; therefore, the final calculated rates may differ from the estimated average rates listed below.

Estimated Rates*

(Subject to Change)

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Region 1	30.0%
Region 2	30.8%
Region 3	43.6%
Region 4	48.1%
Region 5	41.6%
Region 6	29.0%
Region 7	54.4%
Region 8	35.1%
Region 9	40.9%
Region 10	38.6%

*based on the average of preliminary rates for Fiscal Years 1994, 1997 and 1998

The overall effect of implementing the full cost accounting methodology for Superfund indirect costs will be to increase the aggregate amount of indirect costs allocated to site-specific activities. As compared to indirect costs allocated using the current methodology, the indirect costs allocated to individual sites may increase or decrease, depending on a number of factors, and will not be known with certainty until all the rates are computed. The estimated rates provided above, however, may be used to predict generally the amount of indirect costs to be allocated to a particular site using the full cost accounting methodology.

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To apply these rates to an individual site, identify the total direct site-specific costs of that site (including any DOJ costs but excluding any ATSDR costs) and multiply that total by the appropriate region's indirect cost rate. If you have total site costs *including* indirect costs using the current labor hours-based rates, total direct site-specific costs consists of the total site costs minus the previously-assessed indirect costs. Adding the direct site-specific costs and the indirect costs calculated under the new methodology will result in the full cost of that site.

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