

VA Financial Policies and Procedures
Managerial Cost Accounting

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0301 OVERVIEW

This chapter establishes the Department of Veterans Affairs (VA) financial policies and procedures for managerial cost accounting. Managerial cost accounting should be a fundamental part of the overall financial management system and, to the extent practicable, be integrated with other parts of the system. Managerial costing should use a basis of accounting, recognition and measurement appropriate for the intended purpose. Cost information developed for different purposes should be drawn from a common data source and output reports should be reconcilable to each other.

The Chief Financial Officers (CFO) Act of 1990 requires the agency CFO to provide for the development and reporting of cost information and the periodic measurement of performance. In addition, the Government Performance and Results Act (GPRA) of 1993 requires each agency to establish performance indicators for each program and to measure or assess relevant program outputs, service levels and outcomes as a basis for comparing actual results with established goals. Together, these two acts require reporting entities to develop and report cost information on a consistent and regular basis.

030101 MANAGERIAL COST ACCOUNTING STANDARDS AND PRINCIPLES. VA will perform cost accounting and provide a basic amount of cost accounting information necessary to accomplish the many objectives associated with planning, decision making and reporting, in accordance with the Financial Accounting Standards Advisory Board's (FASAB) Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government Standards*.

030102 MANAGERIAL COST ACCOUNTING ACTIONS. VA will comply with the Managerial Cost Accounting standards, as required in SFFAS No. 4 and SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*, requiring Federal reporting entities to accumulate and report the costs of their activities on a regular basis.

030103 MANAGERIAL COST ACCOUNTING METHODOLOGY. VA will determine and consistently use an acceptable costing methodology appropriate to the service or product provided.

Refer to Volume XIII, Chapter 4, *Accounting for Full Cost Recovery*, and Chapter 5, *Cost Accounting Compliance*, for further information.

0302 POLICIES

030201 MANAGERIAL COST ACCOUNTING STANDARDS AND PRINCIPLES. VA will perform managerial cost accounting based on concepts and standards contained in SFFAS No. 4. This is aimed at providing reliable and timely information on the full cost of Federal programs, activities and outputs for use in making decisions about allocating Federal resources, authorizing and modifying programs and evaluating program

performance. VA will also comply with SFFAS No. 7, which requires Federal reporting entities to collect and report the costs of their activities on a regular basis. The accumulated cost information will be used by program managers in making decisions to improve operating economy and efficiency where applicable.

030202 **MANAGERIAL ACTIONS FOR COST ACCOUNTING.** VA will determine the appropriate level of cost accounting for the mission by collecting cost information by responsibility segments, measuring the full cost of outputs, providing information for performance measurement, and integrating cost accounting and general financial accounting.¹ VA will use standards based on sound cost accounting concepts which are broad enough to allow maximum flexibility for VA managers to develop costing methods best suited to their operational environment.

- A. VA will identify and cost products and services by responsibility segments.
- B. VA will capture the full cost of products and services.
- C. VA will capture inter and intra-entity costs. The value of these costs provides that no one VA entity is responsible for funding a product or service used by other VA or governmental entities.

030203 **MANAGERIAL COST ACCOUNTING METHODOLOGY.** VA will use a costing methodology that meets its needs and allows for cost information to be compared from year to year on a consistent basis. See Volume XIII, Chapter 5, *Cost Accounting Compliance*, for detailed information on VA's cost accounting system.

0303 AUTHORITY AND REFERENCES

030301 [Chief Financial Officers \(CFO\) Act of 1990](#)

030302 [Government Performance Results Act of 1993](#)

030303 [Federal Financial Management Improvement Act \(FFMIA\) of 1996](#)

030304 [Office of Management and Budget \(OMB\) Circular A-130, Management of Federal Information Resources](#)

030305 [OMB Circular A-136, Revised, Financial Reporting Requirements](#)

030306 [Federal Accounting Standards Advisory Board \(FASAB\), Statement of Federal Financial Accounting Standards \(SFFAS\) No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government](#)

¹ See Volume XIII, Chapter 5, *Cost Accounting Compliance*, for detailed information on the Decision Support System.

[030307 FASAB, SFFAS No. 7, Accounting for Revenue and Other Financing Sources](#)

[030308 FFMSR No. 8, Systems Requirements for Managerial Cost Accounting](#)

0304 ROLES AND RESPONSIBILITIES

030401 The Assistant Secretary for Management/Chief Financial Officer (CFO) oversees all financial management activities relating to the Department's programs and operations, as required by the Chief Financial Officers Act of 1990 and 38 U.S.C. 309. Specific responsibilities include the direction, management and provision of policy guidance and oversight of VA's financial management personnel, activities and operations. The CFO establishes financial policy, systems and operating procedures for all VA financial entities and provides guidance on all aspects of financial management.

030402 Under Secretaries, Assistant Secretaries, Chief Financial Officers, Fiscal Officers, Chief Accountants and other key officials are responsible for ensuring compliance with the policies and procedures set forth in this chapter.

0305 PROCEDURES

030501 MANAGERIAL COST ACCOUNTING STANDARDS AND RESPONSIBILITIES.

A. Perform Cost Accounting and Implement Principles.

1. Each reporting entity within VA will collect and report the costs of its activities on a regular basis for management information purposes. Costs may be collected either through the use of cost accounting systems or through the use of cost finding techniques.
2. Detailed expense, acquisition, maintenance costs, depreciation costs, inventory and building accounts will be maintained and reconciled with related general ledger accounts.
3. VA costs, without regard to funding mechanisms or organizational segregation, will be charged to a product or service or product/service line, either directly or indirectly.

B. Establish Responsibility Segments. VA's senior leadership will define and establish responsibility segments. Managerial cost accounting should be performed to measure and report the costs of each segment's outputs. Special cost studies, if necessary, should be performed to determine the costs of outputs.

030502 MANAGERIAL COST ACCOUNTING ACTIONS.

A. Each responsibility segment, for example, VBA, VHA NCA, OI&T, will identify the cost of products and services. Entities which receive products or services from other Government entities, within and outside of VA, will need to reflect the cost of the products and services they receive as a part of their cost of doing business. Each entity's full cost incorporates the full cost of goods and services it receives from other entities. The entity providing the goods or services has the responsibility to provide the receiving entity with timely information on the full cost of such goods or services. Regardless of whether a transaction for a product or service is reimbursed, its cost will be determined and communicated. Refer to Appendix A for additional information on non-production costs.

1. The determination of costs will follow a number of steps as appropriate, to the products and/or services provided by the organizational component. An example of necessary steps may include the following:

a. Determine if the responsibility segment produces a distinct product and/or service or line of products or services or if it should be classified as "overhead".

b. Identify the costs associated with the acquisition, management and delivery of those products and/or services. For example, in the case of VHA's responsibility centers providing medical care, this would include identifying the resources consumed in the provision of each intermediate product or procedure.

c. Categorize the costs as direct, indirect or overhead. Refer to Appendices B and C for detailed information on categorizing cost when determining the application of the cost.

d. An accounting system, whether automated or manual, will be in place to track those costs. It will capture costs associated with providing a product or service to a customer.

e. With concurrence from the VA CFO, define, standardize and monitor the cost. The full cost methodology chosen will create a sufficient degree of standardization throughout the Administrations (or staff office) and be based on the VA accounting system (general ledger).

2. Each responsibility segment will identify products and/or services for each responsibility center. A responsibility center is an organizational unit, headed by a manager or group of managers, responsible for the unit's activities.

a. Each Administration CFO (VHA, VBA, NCA), staff office CFO (e.g., Supply Fund, OI&T), or senior executive of an office which has no CFO will authorize responsibility centers under his or her direction and determine if the units produce a distinct product and/or service or line of products or services. In the case of a VBA claims office, the services may include processing claims or responding to customer inquiries. The

products/services will be consistent with the mission of the organization. In the case of a medical center, a product may include a laboratory test, a medical ward bed day, a counseling session and/or a magnetic resonance imaging procedure.

b. The goal is to identify the product or service at the level in which the product or service is rendered to a requester (e.g., an internal customer such as a clinic or a regional office, an external customer such as a Veteran applying for student educational benefits, an alternative health care provider or an external health insurance plan provider).

3. VA will determine how the costs will be applied.

a. Each Administration CFO, (VHA, VBA, NCA), staff office CFO (e.g., Supply Fund, OI&T) or senior executive of an office which has no CFO, with the concurrence of the Departmental CFO, will be responsible for categorizing each responsibility segment. Costs will be categorized as direct, indirect or overhead. This will include creating the order by which costs will be applied to direct units or segments. Refer to Appendices A, B and C for detailed information on categorizing costs when determining the application of the cost.

b. Each Administration or staff office will maintain a prioritized listing of the direct, indirect and overhead segments and units in order of their allocation and the direct segments or units to which the direct overhead and indirect overhead segments or units are being allocated. The allocation sequence will be standardized within an Administration or staff office.

c. Additionally, the method of allocation (e.g., square feet, FTE, dollars) for each indirect and overhead segment will be noted. This list will be kept up-to-date. Any additions or changes to the cost allocation method will be done with the concurrence of the Administration CFO or staff office CFO, or the senior executive of an office which has no CFO, and the Departmental CFO.

B. VA will capture the full costs of products and services. Reporting entities should report the full costs of outputs in general purpose financial reports. The full cost of an output produced by a responsibility center is the sum of the following:

- the costs of resources consumed by the segment which directly or indirectly contribute to the output; and
- the costs of identifiable supporting services provided by other responsibility segments within the reporting entity and by other reporting entities.

1. When calculating the cost(s) of a product and/or service, the cost elements which make up a product or service cost(s) will be identified. Some of these costs are easily identified, but others are more nebulous. For example, when costing delivery of educational benefits, along with the cost of the Veterans Claims Examiners, their desks,

supplies and other equipment requirements will need to be considered. In the case of an X-ray, the equipment, technician, film and film development would all be a part of the delivery costing.

However, in both examples, an accounting will be made for other indirect costs such as electricity and heating, ventilation and air conditioning costs, and information technology support. It is not enough to consider "some" or "most" costs when calculating the cost of a product or service; nor can such consideration be limited to "local" costs. All identified costs incurred by VA will be considered when calculating product/service costs.

2. The Administration CFO or the senior executive of an office which has no CFO, with concurrence from the Departmental CFO, will have the responsibility of standardizing, defining, regulating and monitoring the identification of cost elements. However, any further breakdowns will be standardized throughout each individual Administration (office) and be based on the VA accounting system (general ledger).

3. Cost considerations for labor and property, plant and equipment are in Appendix D.

C. VA will capture the inter- and intra-entity costs and will only allocate those costs benefiting the entity. The total cost for each entity will incorporate the full cost of goods and services it receives from other entities. The entity providing the goods or services has the responsibility of providing the receiving entity with information on the full cost of such goods or services, either through billing or other advice.

1. Recognition of inter- and intra-entity costs that are not fully reimbursed are limited to material items as follows:

- significance to the receiving entity;
- an integral or necessary part of the receiving entity's output; and,
- identifiable or matched to the receiving entity with reasonable precision.

2. Per SFFAS No. 4, broad and general support services provided by an entity to all or most other entities generally should not be recognized, unless such services form a vital and integral part of the operations or output of the receiving entity. As an example, Treasury costs for services provided to all Federal entities are not included in the VA calculation of full cost.

3. The inter- and intra-entity costs captured and recognized by VA provides that no one VA entity remains responsible for funding a product or service that may be utilized by other VA or other Governmental entities. For example, a central dental laboratory located on the grounds of one VA medical center, yet shared by many VA medical centers and out-patient clinics, is funded through the host VA medical center. Under the

charges defined by the CFO Act, fiscal burdens must be removed from host sites and shared by all entities receiving the good or service.

The entities such as the central dental laboratory used in the example above should operate in a business-like manner which ensures the charges are associated with their products cover the costs of generating, managing, and delivering the products. It also helps in ensuring the costs of providing those products is shared fairly and equitably.

030503 MANAGERIAL COST ACCOUNTING METHODOLOGY. VA will ensure the cost accounting methodology is in compliance with applicable regulations and will encompass areas of acquisition, maintenance costs, depreciation costs, inventory, building accounts, overhead, etc.²

A. A full costing methodology will be used to accurately determine the costs of the products and services a responsibility segment supplies to others, including other Government agencies, private industries, companies and individuals. For example, VA should be able to accurately account for the public and private resources it consumes and accurately bill for the products and services it provides.

B. Costs of resources consumed by responsibility segments should be accumulated by type of resource. Outputs produced by responsibility segments should be accumulated and, if practicable, measured in units. The full costs of resources which directly or indirectly contribute to the production of outputs should be assigned to outputs through the use of acceptable costing methodologies or cost finding techniques appropriate to the segment's operating environment and should be followed consistently.

C. Cost assignments should be performed using the following methods listed in the order of preference:

1. Directly tracing costs wherever feasible and economically practicable;
2. Assigning costs on a cause-and-effect basis; or
3. Allocating costs on a reasonable and consistent basis.

D. VA's cost accounting methodology will be used to identify and assign costs for products and/or services.

1. The cost accounting methodology will allow for comparisons between the cost of products and/or services provided by VA and those provided by other Government agencies or on the open market.

² See Volume XIII, Chapter 5, *Cost Accounting Compliance*, for detailed information on the Decision Support System.

2. The cost accounting methodology will identify and assess a responsibility segment's total capacity, readiness capacity, operating capacity and its related costs.

E. The financial accounting system will be used as the basis for figures used in the cost accounting methodology, which is used to develop costs that accurately reflect VA's expenditures without regard to funding mechanisms.

F. Expenses detailed in the cost accounting methodology will be reconciled to the cost (i.e., expenses) recorded in the general ledger of the VA financial accounting system.

0306 DEFINITIONS

030601 Administration. One of the three VA Administrations: Veterans Health Administration (VHA), Veterans Benefits Administration (VBA) and National Cemetery Administration (NCA).

030602 Allocated. Distributed among users.

060603 Capacity. The output capability of an organization when it fully utilizes its resources to create the maximum value for customers while generating the minimum amount of waste.

030604 CFO. Chief Financial Officer of the U.S. Department of Veterans Affairs. Also referred to as the Departmental CFO.

030605 Cost. An amount or value expended for goods or services produced or received, as distinguished from amounts obligated for the purchase of goods or services.

030606 Decision Support System (DSS). VA's managerial cost accounting system, DSS is a derived database built from standard VA data sources. It provides a mechanism for integrating expenses, workload and utilization. The information contained in DSS supports process and performance improvement by measuring quality, outcomes and financial impact.

030607 Direct Cost. Costs directly associated with providing services.

030608 Entity. Any group separated from others by an official or organizational designation.

030609 Exempt Cost. Cost brought into DSS, but not allocated to products when there is no workload to capture (for example, some non-VA care, readjustment counseling, cemetery activation).

030610 Fixed Costs. Costs that do not vary in direct proportion to the volume of activity. The word "fixed" does not mean the costs may not be changed, but rather they do not change as a result of volume.

030611 Full Cost. The full cost of an output produced by a responsibility segment is the sum of (1) the costs of resources consumed by the segment which directly or indirectly contribute to the output and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity and by other reporting entities.

030612 Good(s). Same as Product(s). Any discrete, traceable or measurable goods or services provided to a customer.

030613 Indirect Cost. Costs not directly associated with providing services. These costs are allocated to direct departments through the indirect cost allocation process.

030614 Inter-entity. A term meaning between or among different reporting entities. It commonly refers to activities or costs between two or more agencies, departments or bureaus.

030615 Intra-entity. A term meaning between or among common entities. It commonly refers to activities or costs between two or more administrations or staff offices within VA.

030616 Normal Capacity. The average total of production/service units a responsibility segment produces over an extended period of time.

030617 Overhead. Cost that cannot be identified in a practical manner with specific units of production. Overhead is analogous to fixed costs. Overhead may be classified as direct or indirect.

030618 Product(s). Same as Good(s). Any discrete, traceable or measurable good or service provided to a customer.

030619 Production Unit. A function organizational subdivision, contract or other work unit for which cost data are desired and for which provision is made to accumulate and measure the costs of processes, products, jobs, capitalized projects, etc.

030620 Readiness Capacity. Capacity is not used in normal operations but is maintained for war or emergency readiness.

030621 Reporting Entity. Any VA entity that is responsible for controlling and deploying resources, producing outputs and outcomes, executing the budget (or a portion of) and being held accountable for their performance. Their scope would provide a meaningful representation of operations and financial condition that users of the financial statements are interested in and could use the information to make resource allocation and other decisions and hold the entity accountable for its use of resources.

030622 Responsibility Center. An organizational unit headed by a manager or group of managers who are responsible for its activities. Responsibility centers may be measured as revenue centers (accountable for revenue/sales), cost centers (accountable for costs/expenses), profit centers (accountable for revenues and costs) or investment centers (accountable for investments, revenues and costs).

030623 Responsibility Segment. A significant organizational, operational, functional or process component which has the following characteristics: (a) its manager reports to the entity's top management; (b) it is responsible for carrying out a mission, performing a line of activities or services or producing one or a group of products; and (c) for financial reporting and cost management purposes, its resources and results of operations may be clearly distinguished, physically and operationally, from those of other segments of the entity.

030624 Service(s). An intangible product/task which tends to be rendered directly to or at the request of a customer. (Also see: Product(s)).

030625 Staff Office. A VA organizational unit which does not report to or otherwise function under one of the three VA Administrations (VHA, VBA and NCA).

030626 Support Costs. The costs of activities not directly related or associated to the production of a product or service (e.g., automation support, communication, postage, engineering and purchasing).

030627 Variable Costs. Costs that vary directly and proportionately with volume. Many direct costs, such as supplies, are examples of pure variable costs since the increase is in direct proportion to the number of services performed.

030628 Volunteer. A private citizen not employed or paid by the VA who provides value added activity which contributes to customer value or satisfies an organizational need. This would include an individual who performs a service which would otherwise have to be provided by a paid employee and would continue to be required even if the volunteer's services were no longer available.

0307 RESCISSIONS

030701 VA Directive 4560, Cost Accounting

030702 VA Handbook 4560.1, Cost Accounting

030703 OF Bulletin 99GC2.05, Cost Accounting Policy Applicable to Staff Offices

030704 OF Bulletin 99GC2.06, Accounting for Non-Production Costs

0308 QUESTIONS

Questions concerning these financial policies and procedures should be directed as follows:

VHA	VHA Accounting Policy (Outlook)
VBA	VAVBAWAS/CO/FINREP (Outlook)
All Others	OFP Accounting Policy (Outlook)

APPENDIX A

NON-PRODUCTION AND EXEMPT COSTS

A. **Non-production costs** are costs linked to events other than the production of goods and services. These costs are not factored into the full cost of an output, but are considered part of the full cost of a program (business line as defined in VA's Strategic Plan). For financial statement reporting purposes, VA categorizes its costs by business lines (for example, medical care, medical research, medical education, compensation, pension, loan guaranty, vocational rehabilitation and counseling, education, insurance and burial). These business lines are subject to change.

VA's non-production costs relate to hazardous waste clean-up, heritage assets, actuarial liabilities for workers' compensation and Veterans' compensation and burial benefits as well as contingent liabilities for Judgment Fund claims.

1. The following costs have been identified as VA non-production costs and should be **excluded from the cost of outputs (products)**. As indicated above, these costs will be allocated to the business line-level.

a. **Hazardous Waste Clean-up Costs**

Hazardous waste clean-up costs include clean-up costs and disposal costs generated by the permanent or temporary closure or shutdown of Departmental capitalized property, plant and equipment (PP&E). Refer to Volume VI Chapter 8, *Environmental and Disposal Liabilities*, for additional information.

b. **Heritage Asset Costs**

Heritage assets are PP&E that are generally expected to be preserved indefinitely and unique for one or more of the following reasons: historical or natural significance; cultural, educational or artistic importance; and/or significant architectural characteristics. Refer to Volume III Chapter 6, *Heritage Assets*, for additional information.

c. **Actuarial Costs for Federal Employees' Compensation Act (FECA)**

FECA is a self-insured program administered by the Department of Labor (DOL). It provides workers' compensation coverage to Federal and Postal employees including wage replacement and medical and vocational rehabilitation benefits for work-related injury and occupational disease. FECA actuarial expense represents the change in VA's annual unfunded actuarial liability reported by DOL based upon estimates (using a method that utilizes historical benefit payment patterns).

d. **Costs for Judgment Fund Contingency**

In accordance with Federal accounting standards, VA will maintain a liability account for legal claims determined to be probable (as determined by the Department of Justice). Refer to Volume VI Chapter 20, *Judgment Fund Liabilities* for additional information.

e. Actuarial Costs for Compensation and Burial Benefits

VA has a liability for benefits expected to be paid in future fiscal years to Veterans and, if applicable, their survivors who have met or are expected to meet defined eligibility criteria. Compensation and burial benefits actuarial expense represents the change in the actuarial present value of the future liability for disability and burial benefits.

Annually, the Office of Financial Policy's Management and Financial Reports Service (047GB) will determine the amounts of compensation and burial benefits actuarial expense and post the resulting transaction in the AMAF Fund, general ledger account number 7600 (Changes in Actuarial Liability), with no specific budget object code number. This amount will be allocated solely to the compensation and burial business lines and will not be allocated to these business lines' products.

B. Exempt costs are costs not allocated to products when there is no workload to capture. For example:

NCA Cemetery Activation (under construction): Prior to opening for interments, a director is selected and assigned to the NCA. This may also include an Assistant. They are on-site during construction and conduct outreach with the community, i.e., going out to various groups to advise them of the burial services available to the Veterans and eligible beneficiaries. Other employees are also hired prior to the actual opening. These initial costs for the activation are recorded and reported in DSS as Cemetery Activation and are exempt. Construction costs are not included in Cemetery Activation costs, but are accumulated and capitalized, subsequent to the opening of the cemetery. Once the cemetery is opened, the operating costs are assigned to the different products.

C. Point of Contact: The Office of Financial Policy, Cost Accounting and Medical Rates Division (047GC2) is responsible for this appendix and for providing guidance and assistance to VA's Administrations. Each administration is responsible for allocating these costs to their business lines and not including these costs in product costing for goods and services.

APPENDIX B

CATEGORIZING DIRECT, INDIRECT AND OVERHEAD COSTS

A. DIRECT COSTS

1. A Direct Cost is a service or entity which supplies an identifiable product or service. (e.g., Surgical Service, Home Loan or Interment).
2. Direct costs are those costs that are directly associated or specifically identified with a product or service. These costs may be discretely and confidently identified with one particular product or service. As many costs as possible should be charged as direct costs so resources expended toward the product or service are attached only to the product or service and not spread to products or services that are not benefiting from the resources.
3. Direct costs include labor costs directly associated with the delivery of the product or service.
4. Direct costs include equipment used solely and identifiably for one or a discrete number of products or product lines. The purchase price, either expensed or depreciated, maintenance, and repair of the equipment would be a direct cost against the product(s) or service(s) for which it exists.
5. Direct costs include supplies and contracted services. If an entity purchases supplies, items or services which it expends in the generation of identifiable products or services or which it then passes on as a product, those costs are considered direct costs.

B. INDIRECT COSTS

Indirect costs are costs of resources that are jointly or commonly used to produce two or more types of outputs but are not specifically identifiable with any of the outputs. Typical examples of indirect costs include general administrative services, general research and technical support, security, rent, employee health and recreation facilities, and operating and maintenance costs for buildings, equipment, and utilities. There are two levels of indirect costs:

1. Indirect costs incurred within a responsibility segment. These indirect costs should be assigned to outputs on a cause-and-effect basis, if such an assignment is economically feasible, or through reasonable allocations.
2. Costs of support services that a responsibility segment receives from other segments or entities. The support costs should be first directly traced or assigned to

various segments that receive the support services. They should then be assigned to outputs.

C. OVERHEAD COSTS

1. Direct Overhead. Direct overhead costs are those cost areas defined as overhead, but which should only be charged to direct or selected direct costs rather than being allocated to all areas, both direct and indirect. For example, VA Central Office Pharmacy Service provides support for all pharmacy services. Pharmacy services have identifiable products and services. Therefore, costs associated with the VA Central Office Pharmacy Service and its programs and operations would be allocated only to VA Pharmacy Services. Another example would be the costs for the Surgical Service in VA Central Office. The costs of the VACO Surgical Service should only be allocated to the surgical services at the various VA medical centers and not to any other service.

2. Indirect Overhead Costs

a. An overhead cost area is a Service or entity which supports a direct cost area but is not directly involved with or related to supplying the identified product(s) or service(s). Overhead includes, but is not limited to: Acquisition and Materiel Management Services, Plant Operations and Security Services.

b. Overhead costs are those costs which are expended as a general, fractional and/or administrative support of a product or service, but cannot, either fully or partially, be charged directly to any one product or service.

c. Overhead costs include labor costs associated with the support or infrastructure needed to maintain the entity in its delivery of products or services.

d. Overhead costs may include equipment. If a piece of equipment is used to enhance the overall performance of a facility or operation and is primarily used by a group which is classified as overhead, the equipment, depending upon its value, would be fully charged or depreciated as overhead.

e. Overhead costs may include supplies and contractual services. Any supplies or contractual services used by a responsibility segment defined as overhead or expended in the performance of the mission of a responsibility segment defined as overhead, should be charged as overhead. Additionally, supply costs which cannot be directly applied to a product or service are to be considered overhead.

APPENDIX C

OVERHEAD COSTS

A. BASIC PRINCIPLES. In cost accounting methodology, as many costs as possible are linked either directly or indirectly to specific products or services. Some functions, however, are not amenable to direct product or service costing. Costs for these functions are labeled as "Overhead." The review of overhead designations for VA entities and responsibility centers and the verifying of overhead cost allocations, including methodology, amount and timelines, will be made by the Department CFO.

B. TYPES OF OVERHEAD.

1. **VA-WIDE OVERHEAD.** Those centrally organized functions which serve all VA organizations. The criteria for a service, division, office or other organization being classified as VA-wide overhead are as follows:

a. The entity produces no distinct, billable product or service for any person, service or organization to which its expenditures could be directly attached; and

b. The entity in the normal course of business serves all VA. VA-wide overhead costs are calculated, at a minimum, annually on the basis of prior year (or time period) gross costs to all entities which produce a product or a service. This allocation is based on an appropriate statistical basis to be determined by the Department CFO and accomplished at the highest possible level. For example, a VA-wide entity would allocate its gross expenditures to the Administrations and staff offices which it serves. Those offices would, in turn, fairly and reasonably allocate those costs to themselves and to those for whom they have responsibility (VHA to the VISNs, VAMCs and clinics; NCA to its area offices and sites).

2. **ADMINISTRATION OVERHEAD.** Those centrally organized functions that serve only one VA Administration or staff office. The criteria for a service, division, office or other organization being classified as Administration overhead are as follows:

a. The entity produces no distinct, billable product or service for any person, service or organization to which its expenditures could be directly attached and

b. The entity in the normal course of business serves one administration or staff office (such as VHA, VBA, NCA and OI&T).

c. Administration overhead costs are to be calculated annually and allocated monthly on the basis of prior year (or time period) gross costs to all entities which produce a product or a service. The allocation is spread over the current year's (or time period's) costs for the entity. This allocation is based on an appropriate statistical basis (such as FTE or dollars) determined by the Administration CFOs or the senior executives of the

offices which have no CFO, with the concurrence of the Department CFO and accomplished at the highest possible level. For example, the Office of the Under Secretary for Health will allocate its costs to all the VHA organizations or responsibility centers it serves, including VAMCs and VHA regional offices.

3. **GEOGRAPHICAL OVERHEAD.** Those regional or multi-facility administrative offices that serve to support the facilities in their areas. The criteria for a service, division, office or other organization being classified as regional overhead are as follows:

- a. The entity produces no distinct, billable product or service for any person, service or organization to which its expenditures could be directly attached; and
- b. The entity in the normal course of business supports several or many other entities, usually geographically located within a defined region. (Note: "Region" is smaller than a VA-wide organization and may be used to indicate any current VA organizational structure larger than an individual facility or facility cluster, such as a VAMC and its satellite clinics and operations.)
- c. The calculation method will be based on an appropriate statistical method determined by the regional director and the Administration CFO or the senior executive of the staff office which has no CFO, with concurrence by the VA CFO.

4. **LOCAL OVERHEAD.** Defined as one facility's support of another, usually smaller, office. Normally, these offices are in close geographic proximity to the supporting facility; however, that may not be the case. Local overhead should not be confused with internal, indirect costs. To be considered local overhead, the supporting and receiving entities will be discrete entities, each identified separately in VA's accounting system (general ledger), each identifying and costing its own products and services. The factors for determining if a service, division, office or other organization will be classified as local overhead are as follows:

- a. The entity produces no distinct, billable product or service for any person, service or organization to which its expenditures could be directly attached;
- b. The entity in the normal course of business supports one or several sites, facilities, offices, clinics, services, programs or other discrete entities, usually smaller and usually geographically clustered around the supporting entity;
- c. The costs and products of the entity being supported are accounted for separately and distinctly from the supporting entity and are not a part of the direct or indirect costs of the supporting entity;
- d. The entity being supported is not a department, service, function, office, division or other adjunct of the supporting entity; and

e. The entity being supported maintains a revenue stream separate and distinct from the supporting entity.

f. Local overhead entities will cost resources expended in support of local entities against the specific entities it serves. Local overhead costs are allocated monthly and calculated annually on the basis of gross costs to all entities or responsibility segments which produce a product or service.

g. The calculation will be based on an appropriate statistical method determined by the Administration CFO or the senior executive of an office which has no CFO, who will rely on the input of the facility or the regional senior executive of regions which have no CFO, with the concurrence of the VA CFO.

5. **INTERNAL OVERHEADS.** Those support or administrative offices or services within a facility. Internal overhead entities function in support of responsibility centers which in turn produce a product or service or which in turn support other internal overhead entities and offices. The criteria for a service, division, office or other organization being classified as internal overhead are as follows:

a. The entity produces no distinct, billable product or service for any person, service or organization to which its expenditures could be directly attached;

b. The entity in the normal course of business supports responsibility segments which in turn support the production of or produce products or services; and

c. The entity is organizationally a part of the same unit which produces the products and/or services (such as a VAMC or a regional office).

d. Internal overhead entities will cost resources expended in support of the entity of which it is a part. Internal overhead is calculated annually on the basis of gross costs to all entities or responsibility segments which produce a product or service.

e. The calculation will be based on an appropriate statistical method(s) (such as FTE, dollars or square feet) determined by the Administration CFO or the senior executive of an office which has no CFO, who will rely on the input of the facility senior executives, with the concurrence of the VA CFO.

C. OVERHEAD COST ALLOCATION IN SPECIAL CIRCUMSTANCES.

1. When an organization classed as an overhead entity performs and/or produces a distinct, billable service and/or product at the request of one, several or a group of VA organizations, offices, services or divisions; and if the requester(s) is not the sole entity to which the overhead organization assigns its costs (as in the case of VACO Pharmacy Service and field pharmacy services), then all costs associated with producing the

product and/or performing the service will be charged directly to the requesting entity. The costs charged directly to the requesting entity will be reduced from the total gross expenditures of the entity which performed the service and/or produced the product prior to the expenditures of the performing entity being allocated. For example, information technology services may be requested by a VA entity, such as VACO Pharmacy Service, to create or enhance a computer program that will be used only by pharmacy services. In such a case, the cost of fulfilling this request should be allocated to the requester (VACO Pharmacy Service) and not allocated to all VA entities.

2. When an overhead office or entity falls into more than one of the above categories, the office or entity will allocate its costs as fairly and accurately as is feasible and possible. For example, the Office of the Inspector General (IG) falls into both the VA-wide Overhead and Administrative Overhead categories. Some of its functions and personnel are dedicated to one particular administration, while others benefit all of VA. Those costs attributable to a specific administration or staff office should be allocated to the administration or staff office.

3. When an overhead entity, as a part of its managerial or functional capacity, has within it a responsibility center which produces a product or service, the cost of providing the product and/or service will be attached to the product and/or service or otherwise passed on to the entities benefiting from or using the product and/or service.

APPENDIX D

COST CONSIDERATIONS

A. LABOR. Labor costs are defined as funds expended for the people employed by an entity to conduct its business (providing a product or service). Labor costs include:

1. Gross salaries and/or wages earned in performance of the function(s) for which the person was hired (including all of the various premium pay items and benefits costs, such as health insurance and retirement);
2. Benefits accrued by the person, such as insurance and retirement benefits (above and beyond the gross salary or wages), which may be expressed in terms of a percentage of gross salary or wages. Each fiscal year OMB publishes the average percentage of gross salary or wage paid by the Federal Government in earned benefits. This percentage may be used to calculate the cost of labor for those individuals receiving benefits.
3. Wages paid through contractual agreements for persons employed by the entity to perform functions, which are essential to or contribute to the delivery of a product or service, which will be charged as labor costs. (For example, VAMC personnel engaged in direct patient contact, such as residents or other medical personnel who provide patient services through contracts, sharing agreements or any other arrangement.) [NOTE: Wages paid through contracts for support services, such as construction, heating and air conditioning equipment, maintenance, or waste management will not be classified as labor. These costs will be included in appropriate service or entity costs, such as "building," "engineering service," or "environmental service" costs.]
4. Within the VA system, there are numerous volunteers providing services, a value-added activity, which contribute to customer value and/or satisfy overall organizational needs. Costing of volunteer labor is vital when the work accomplished by the volunteer is equivalent to a paid employee. In order to show true value of a product or service delivered by VA, volunteers who contribute to delivered products or services will be charged to those products or services.

Volunteer costs will be computed and allocated annually, at a minimum, on the basis of the prior year gross costs to all entities (responsibility segments, products or services) that benefited from the volunteer's service. The labor will be charged and reported separately and should include the responsibility segment level on all managerial reports. For managerial purposes, these costs should also be shown as a separate cost item at the product or service level.

B. SUPPLIES, SERVICES, TRAINING AND TRAVEL. To the extent possible and wherever feasible, supplies, services, training and travel expenditures will be assigned

directly to the product or service area which expends those supplies or utilizes those services. All other supply and service costs are to be allocated based on a recognized full cost accounting allocation methodology.

C. PROPERTY, PLANT AND EQUIPMENT

1. Equipment

a. All equipment will be fully charged in accordance with existing VA policy (see Volume V, Chapter 9, *Property, Plant and Equipment* for further information on accounting for depreciation).

b. Once a piece of equipment has been fully depreciated, it can no longer be shown as an expense to the organization. However, any ongoing or recurring costs associated with the equipment, such as maintenance and supplies needed to operate the equipment, will continue to be expensed and shown as a cost for as long as the equipment is in use.

c. Equipment will not be depreciated until it is placed in service. If a newly acquired piece of equipment remains idle or warehoused or for any other reason is not put directly into use, the equipment will not be depreciated until such time as it is utilized.

d. If a piece of equipment is transferred to another responsibility center within the entity which purchased the equipment and the equipment has not been fully depreciated, the remaining balance will be assigned to the responsibility segment or area to which the equipment has been transferred.

e. VA Administrations and staff offices will maintain monthly records of the equipment containing:

(1) The originating entity (or entity that purchased the equipment);

(2) The disposition of the equipment (name and date of the entity to which the equipment was transferred, date and method of disposal, etc.); and

(3) The balance (in both dollars and term remaining to be expensed/depreciated) remaining for the piece of equipment.

f. VA Administrations and staff offices will expense/depreciate a given piece of equipment and incur the expense until the equipment is fully depreciated.

g. All distinct and identifiable maintenance costs will be charged against the equipment which benefits from the maintenance. Labor specifically acquired on a limited time or basis for maintenance of specific pieces of equipment, as in "service calls" made by non-VA employees, will also be charged directly to the equipment which benefits from

the maintenance. Maintenance costs will be calculated by fiscal year (prorated, if necessary) and added to the cost of the equipment for the fiscal year.

- h. Supplies purchased for equipment without which the equipment cannot fulfill the function(s) for which it was purchased will be added to the cost of the equipment on a fiscal year basis.
- i. All costs associated with a piece of equipment will be allocated/assigned to the product or service which utilizes the equipment in the delivery of the product or service. The product or service may change over the life of the equipment.
- j. If a piece of equipment is used in the delivery of more than one product or service, the costs will be fairly and accurately allocated/assigned to each product or service which utilizes the equipment.
- k. The methodology for allocating/assigning all costs associated with a piece of equipment will be determined by current financial management policies, directives and/or handbooks.

2. Building Valuation, Capitalization and Depreciation. Refer to Volume V, Chapter 9, *Property, Plant and Equipment* for further information on capitalization and depreciation expense.

a. All buildings (structures which are permanently affixed to the land) owned by VA will be priced at acquisition or construction value and depreciated in accordance with current financial management policies and guidelines.

b. Allocating Depreciated Value. Building capitalization and depreciation costs will be shown as its own category of cost and allocated to all departments, services, responsibility segments or centers or production units.

(1) In the event one entity includes more than one building (e.g., a campus-style VA medical center), each building's depreciation expense will be calculated and reported separately.

(2) A building's depreciated expense will be allocated based on square feet to the responsibility segments or centers occupying the building.

c. Utilities. All utility costs will be fully allocated. In cases of extraordinary utility costs incurred in the production of a discrete number of products or services, those costs will be allocated to those products or services. However, in the majority of cases, utilities will be allocated based on an appropriate allocation methodology (e.g., square footage or FTE).

d. Capacity. Capacity refers to the resources (e.g., buildings, facilities, beds, wards, personnel, supplies, equipment and stockpiles) which are available to VA to fulfill its mission. All Federal entities are required to track, cost and report total and readiness capacity.

(1) Total capacity is the entire operating capacity of an entity. Total capacity will equal the sum of readiness capacity and operating capacity (see below).

(2) Readiness capacity is capacity reserved for declared emergencies (e.g., national disaster). All costs associated with readiness capacity will be reported separately, using restricted codes (e.g., budget object codes for declared emergencies). None of these costs, including maintenance and materiel management, will be allocated against any other product or service. When readiness and operating capacity are commingled (as in the case of materiel, equipment usage or space utilization), every reasonable effort will be made to fairly assign costs. If a cost object contributes to a product or service, which is provided as a normal part of doing business and expended other than in emergency or mobilization situations, it is then considered a part of used capacity and the cost of the contribution will be allocated against the product or service being rendered.

(3) Operating capacity is all other capacity (other than readiness capacity) that an organization has at its disposal.