Subject: Managerial Cost Accounting

1-20-00 General

A. Managerial cost accounting is the process of accumulating, measuring, analyzing, interpreting, and reporting cost information useful to both internal and external groups concerned with the way in which the organization uses, accounts for, safeguards, and controls its resources to meet its objectives. In managing Federal Government programs, cost information is essential in the following five areas: (1) budgeting and cost control, (2) performance measurement, (3) determining reimbursements and setting fees and prices, (4) program evaluations, and (5) making economic choice decisions.

B. The Office of Management and Budget (OMB) in conjunction with the Department of Treasury and the General Accounting Office (GAO) established managerial cost accounting concepts and standards to provide reliable and timely information on the full cost of federal programs, their activities, and outputs. Determining the cost of an agency's specific programs and activities is essential for effective management of government operations. Congress and the President have deemed cost accounting important and have enacted several mandates to ensure effective cost accounting. These include:

- **The Chief Financial Officers Act of 1990**, which includes among the functions of the Chief Financial Officer (CFO) the development of an integrated financial management system which provides for the development and reporting of cost information, and the systematic measurement of performance;

- **The Government Performance and Results Act (GPRA***)*, which mandates performance measurement by the federal agencies;

- **The National Performance Review (NPR)**, which includes a recommendation to require OMB to issue a set of cost accounting standards for all federal activities; and

- **The Clinger-Cohen Act**, which requires defining all technology, related activities, their costs, and measurements. This Act requires cost benefit analysis before IT acquisition decisions are made concerning building systems internally or pursuing commercial off-the-shelf options.

1-20-10 Authority

A. Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting" - this standard, developed by the Federal Accounting Standards Advisory Board (FASAB) and issued by OMB, represents requirements for cost accounting for Federal agencies.

B. OMB Bulletin 97-01, "Form and Content of Agency Financial Statements" - prescribes the form and content of agency financial statements. This bulletin provides proforma formats for preparing principal financial statements and specifies the disclosure requirements for notes accompanying the principal statements, as well as required supplemental information.

C. Standard General Ledger (SGL)/Treasury Financial Manual (TFM) Bulletin, "U.S. Government Standard General Ledger" - The SGL, published annually as a supplement to the Treasury Financial Manual, provides a uniform chart of accounts to standardize Federal agency accounting and to support the preparation of standard external reports. Managerial cost accounting systems will need to use the SGL and may require additional SGL accounts as new cost related reports are designed.

D. The CFO Council's "Managerial Cost Accounting Implementation Guide" - this ***non-authoritative*** guide is a technical practice aid to assist Federal entities in implementing cost accounting.

<u>1-20-20</u> Definitions

A. *Reporting Entity*: an organization for which financial statements must be prepared. For HHS, all Operating Divisions (OPDIVs) are considered reporting entities, including the Office of the Secretary. In addition, HHS produces Departmentwide audited financial statements.

B. *Responsibility Segment*: Responsibility segments are the largest components of a reporting entity. A responsibility segment is equivalent to a suborganization, as discussed in OMB Bulletin 97-01. (Section 1-20-40, Responsibility Segments, provides a detailed explanation of how to define and establish responsibility segments.) Management has the flexibility to establish responsibility segments and to use any cost collection method within each segment. Within a segment, management may define sub-units, functions, projects, business processes, activities, or a combination of them as cost centers to accumulate costs. The costs accumulated at lower levels can then be aggregated first to the program level, and then to the responsibility segment level (i.e., the organization responsible for managing the particular program or activity).

C. *Full Cost:* Full cost accounting is the assignment of direct and indirect costs, as well as inter-entity costs, to a cost object (program, activity, output, etc.). Direct and indirect costs are defined in sections 1-20-51 & 1-20-52.

D. *Cost Object:* The term “cost object” refers to an activity or item whose cost is to be measured. A cost object may be a particular output (good or service produced), a program, an organization, a business activity performed, or other item whose cost is to be measured. Costs may be assigned to a cost object by direct tracing, cause-and-effect basis, or allocations. **For HHS and its OPDIVs, the term cost object will predominantly refer to a program or activity.** There may be intermediate cost objects that are used in the course of the cost assignment process. For example, a computer technology division provides technical support to other divisions within an organization. By assigning costs on a “cause-and-effect” basis, first costs are assigned to the activities of the computer division, such as hardware installation and maintenance, software design and installation or programming adjustments. Secondly, the costs of these computer division activities are further assigned to other divisions based on their consumption of the technical services.

E. *Inter-entity cost*: Costs incurred by one responsibility segment for the benefit of another responsibility segment or another reporting entity, regardless of funding or reimbursement. Inter-entity costs are always costs between two entities within the Federal Government. Costs incurred by one responsibility segment for the benefit of another responsibility segment *within the same OPDIV* are “Intra-entity costs.” Intra-entity cost must always be recognized by the responsibility segment which receives the benefit of the costs. However, inter-entity costs are only recognized for particular situations. See section 1-20-60 for the guidance on recognizing inter-entity costs.

F. *Program*: Program refers to activities that are identified as programs in the OPDIVs’ GPRA annual performance plans for the year being reported and for which goals and indicators have been submitted. GPRA programs may be consolidations, aggregations or disaggregations of line items in the OPDIVs’ budget program and financing schedules. For external reporting, the OPDIV Statement of Net Cost will show the net cost of GPRA programs.

G. *Activity:* Activity generally refers to lines of business or services offered by a responsibility segment. For example, the Program Support Center (PSC) provides accounting services (within the Financial Management program) and payroll services (within the Human Resources program); these would be considered separate activities within PSC. An activity may also be a revolving fund, an operation funded by user fees, a gift or other trust fund, etc., which has not been included as a part of the named GPRA programs.

H. *Output*: Outputs are goods or services produced by a program identified in the OPDIVs’ GPRA annual performance plans (per the GPRA law, performance plans shall establish performance indicators to be used in measuring or assessing the relevant outputs, service levels, and outcomes of each program activity). The ultimate purpose of cost accounting, as defined in SFFAS No.4, is to measure the full costs of program outputs. **However, OPDIVs are not required to report by outputs on the Statement of Net Cost.**

I. *Non-Production Cost:* These are costs incurred based on particular events which occur during a specific accounting period, but are not particularly related to the current operations, or production of goods and services for the period.

1-20-30 Requirement for Cost Accounting

A. FASAB’s Managerial Cost Accounting Standard (SFFAS No. 4) issued by OMB is the authoritative guidance on cost accounting for Federal entities (HHS and OPDIVs). The standard contains both concepts for cost accounting as well as specific standards to be followed. OPDIV CFOs may institute additional cost accounting policy to meet the unique needs of their OPDIV, provided these policies do not conflict with SFFAS No. 4.

B. Managerial cost accounting will enable OPDIVs to measure and report the full costs of their programs and activities. Full cost should incorporate the sum of (1) the costs of resources consumed that directly or indirectly contribute to the program or activity (direct or indirect costs), and (2) the costs of identifiable supporting services provided by other responsibility segments within HHS, and by other Federal agencies (inter-entity costs). Costs of resources consumed should be accumulated by type of resource (HHS sub-object class). Full costs should be assigned to programs and activities through appropriate costing methodologies or cost finding techniques on a consistent basis. Cost assignments should be performed using the following methods listed in the order of preference: (a) directly tracing costs wherever feasible and economically practicable, (b) assigning costs on a cause-and-effect basis, or (c) allocating costs on a reasonable and consistent basis.

C. Each OPDIV should accumulate and report the cost of its programs and activities on a regular basis for management information purposes. However, the resources required to obtain cost information should not outweigh the value of the information obtained. Managerial cost accounting should be a fundamental part of the financial management system and, to the extent possible, should be integrated with other parts of the system. Cost information developed for external and internal reporting purposes should be drawn from a common data source, and reports should be reconcilable to each other.

D. A sophisticated cost accounting system to accumulate and assign costs is not required. In most instances, cost data can be obtained from the OPDIV’s current accounting system using the HHS Common Accounting Number (CAN) structure and sub-object class codes. This will require OPDIVs to map or crosswalk their CAN structure to their programs designated under GPRA guidance and to other activities, such as lines of business being provided by service organizations. Exhibit 1-20-A provides an example of a crosswalk between Indian Health Service’s budget (CAN) structure with their reporting (GPRA) structure. Costs can also be determined and analyzed through special cost studies and analyses. However, OPDIVs are encouraged to modify their existing systems as necessary to include automated cost assignments to expedite the preparation of internal cost reports and annual financial statements. Use of a combination of a formal cost accounting system supplemented by cost finding techniques and studies is acceptable. Each OPDIV should determine the appropriate detail for its cost accounting processes and procedures based on several factors. Some of these factors include the:

- nature of the OPDIV's operations;
- precision desired and needed for cost information;
- practicality of data collection and processing;
- availability of electronic data handling facilities;
- cost of installing, operating, and maintaining the cost accounting processes; and
- specific information needs of the OPDIV.

__1-20-40__ Responsibility Segments

A. SFFAS No. 4 defines a responsibility segment as a component of a reporting entity that is responsible for carrying out a mission, conducting a major line of activity, or producing one or a group of related products or services. A responsibility segment usually possesses the following characteristics:

1) The manager reports to the entity's top management directly, and;

2) The segment’s resources and results of operations can be clearly distinguished from those of other segments of the entity.

B. SFFAS No. 4 states that the designation of responsibility segments should be based on the following factors: (a) the entity's organization structure, (b) its lines of responsibilities and missions, (c) its outputs (goods or services it delivers), and (d) budget accounts and funding authorities. However, the predominant factor is the agency’s organization structure and its existing responsibility components, such as bureaus, centers, institutes, or other divisions.

C. For HHS, each OPDIV is a responsibility segment of the Department. Within an OPDIV, a responsibility segment is the sub-organization that is responsible for the management of each of its programs and activities. However, a particular program may also be divided among several responsibility segments. Likewise, when there is a need to develop costs for a particular project or service, a cost center manager would be designated. For service oriented organizations, such as the PSC, each line of business may be termed a responsibility segment with its own manager. A business-like fund, such as HCFA's Clinical Laboratory Improvement Amendments of 1988 program (CLIA), may be termed a responsibility segment with its own manager.

D. The manager of each OPDIV responsibility segment should receive internal management reports periodically to be fully informed of the costs and revenues accruing to the segment's programs and activities. The head of each OPDIV should also be informed periodically of the costs and revenues of all program and activity costs of the OPDIV's responsibility segments.

E. At the Departmental level, the Secretary and Assistant Secretaries should be informed of the costs and revenues of each OPDIV segment to be able to report to OMB and Congress the net cost of operating the Department. For the fiscal year, the Department's Statement of Net Cost will serve this purpose.

F. At the Government-wide level, each cabinet-level agency will be reported as a responsibility segment. The Governmentwide Statement of Net Cost will report costs by responsibility segment and major budget function.

1-20-50 Full Cost

A. The full cost of an output produced by a program or activity is the sum of (1) the costs of resources consumed by the program or activity that directly or indirectly contribute to the output (**regardless of the source of funding**), and (2) the costs of identifiable supporting services provided by other programs or activities within the responsibility segment and by other responsibility segments and reporting entities (**regardless of the source of funding**).

B. Although the ultimate purpose of cost accounting, as defined in SFFAS No.4, is to measure the full costs of program outputs, unit costs of outputs are not presently a part of HHS' current accounting systems; and in fact, unit cost data may not be a practical goal for all programs. Emphasis should first be placed on incrementally achieving full cost accounting for outputs by developing full cost information for programs and activities, which can be achieved using the current HHS Common Accounting Number (CAN) structure and sub-object classification codes. This incremental approach makes sense because: 1) programs and activities are the intermediate cost objects which may be used to accumulate and allocate costs to outputs, and 2) GPRA requirements for identifying and reporting performance measures (including output measures) are not effective in their entirety until FY 1999.[1]

[1] **Even though OPDIVs should currently focus on full cost of programs/ activities, according to the Project Leader for GPRA Implementation at OMB, as agencies' cost accounting systems become more mature, OMB will place greater emphasis on cost performance measures, such as the cost per unit of service.**

C. OPDIVs are not required to identify direct and indirect costs as components of program/activity costs in the Statement of Net Costs, or as supplemental information. These costs are identifiable by sub-object class code and should be so categorized in internal cost reports prepared for program managers.

1-20-51 Direct Costs

A. Direct costs are costs that can be specifically identified with a single cost object (i.e., a program, activity, or output[2]). Typical direct costs include:

1) salaries and other benefits for employees who work directly on the cost object;

2) materials and supplies used in the work;

3) various costs associated with office space, equipment, facilities, and utilities that are used exclusively for the cost object; and

4) costs of goods or services received from other segments or entities that can be directly traced to the cost object.

1-20-52 Indirect Costs

A. Indirect costs are costs of resources that are jointly or commonly consumed by two or more cost objects (program, activity or output), but are not specifically identifiable with a single cost object. There are two levels of indirect costs:

1) Indirect costs incurred within a responsibility segment. These indirect costs should be assigned to cost objects 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 (inter-entity costs). These support costs should be first directly traced or assigned to various segments that receive the support services. They should then be assigned to cost objects.

(*"Are Agencies on Target with the Implementation of the Results Act?"* JFMIP News, Spring 1998, Vol. 10, No. 1, pg. 7)

[2] **For HHS and its OPDIVs, the term cost object will predominantly refer to a program or activity.**

B. Indirect costs must be reasonably allocated to the cost objects that have benefitted from the cost based on a reasonable and consistent cost allocation methodology. The following are examples of some common indirect costs that must be directly identified or allocated. This is not an inclusive list; OPDIVs may identify other indirect costs.

- procurement and contracting services
- financial management and accounting services
- information technology services
- automated data processing
- employee health and recreation facilities
- services to acquire and operate PP&E
- publication, reproduction, graphics and video services
- research and analytical services
- general administrative support
- scientific facilities
- office and ground maintenance
- security
- communications
- mail/messenger services
- personnel services
- library services
- legal services
- rent
- utilities
- office supplies

1-20-53 Certain Cost Elements[3]

A. Costs of Employee Benefits

1) Employee benefits include:

a) Health and life insurance benefits for current employees;

b) Pension benefits for employees, their survivors and dependents, covered by defined pension plans such as Civil Service Retirement System (CSRS), Federal Employees Retirement Plan (FERS), and Military Retirement System (MRS);

c) Health and life insurance benefits for retired employees, their survivors and dependents, referred to as "other retirement benefits" (ORB), and;

d) Other post-employment benefits (OPEB) for terminated and inactive employees, which include severance payments, training and counseling, continued health care, and unemployment and workers compensation.

[3] **These costs can be identified using HHS sub-object class codes.**

2) Federal financial accounting standards require that the employing entity accrue the costs to the Federal Government of providing pension and ORB benefits to employees and recognize the costs as an expense when the benefits are earned. The employing entity should recognize those expenses regardless of whether the benefits are funded by the reporting entity or by direct appropriations to the trust funds. This principle should also be applied to health and life insurance benefits for current employees. The costs of employee benefits incurred by responsibility segments should be directly traced or assigned to established programs and activities.

3) Federal financial accounting standards require that OPEB costs be reported as an expense for the period during which a future outflow or other sacrifice of resources is probable and measurable. Since the recognition of OPEB costs is linked to the occurrence of an OPEB event rather than the production of outputs, assigning OPEB costs recognized in a period to outputs of that period would distort the cost of outputs. Therefore, OPEB costs should be reported as "Costs Not Assigned to Programs."

B. Costs of Public Assistance Programs

1) The full cost of public assistance programs includes: (a) the costs of Federal resources that have been or will be transferred to individuals and state/local governments, and (b) the costs of operating the programs. These two types of costs are separately identified by sub-object class. Entitlement and grant programs administered by each OPDIV fall under this category.

C. Costs Related to Property, Plant and Equipment

1) **General Property, Plant, and Equipment (Gen PP&E).** Since Gen PP&E are used to provide goods and services, the cost of acquiring Gen PP&E should be included in the full costs of the goods and services provided by programs and activities. Gen PP&E is capitalized and depreciated over the useful life of the asset, so the full cost of acquiring Gen PP&E will be recognized through depreciation charges over the useful lives of the individual assets.

2) **Stewardship Assets.** The costs of acquiring or constructing Heritage PP&E and Stewardship Land (referred to as Stewardship Assets) should be charged to expense as acquisition costs are incurred. The cost of acquiring Stewardship Assets should be reported as "Costs Not Assigned to Programs."

D. Non-Production Cost

1) Non-production costs are costs linked to events other than the production of goods and services. Examples include:

- other post-employment benefits (OPEB) costs recognized as expenses when an OPEB event occurs (e.g., a reduction in force);
- costs of acquiring or constructing Stewardship Assets;
- reorganization costs, and;
- nonrecurring cleanup costs resulting from facility abandonments that are not accrued.

2) Under certain circumstances, non-production costs may be assigned to goods and services over a number of periods. This practice should only be considered if: (a) experience shows that the costs recur in a regular pattern, and (b) a definite connection can be established between the non-production costs and the goods and services.

1-20-54 Costs Not Assigned to Programs

A. Costs not assigned to programs are high level general management and administrative support costs that cannot be directly traced, assigned on a cause-and-effect basis, or reasonably allocated to OPDIV programs and activities. Such costs must be identified and the rationale for why these costs should not be assigned to programs should be documented and retained for audit purposes. Additionally, the largest of these costs should be identified in a financial statement footnote.

1-20-60 Inter-Entity Costs

A. Each OPDIV's full cost should incorporate the full cost of goods and services that it receives from other OPDIVs or Federal agencies (**regardless of the source of funding**). When inter-entity costs are reimbursed in full, they are accounted for in the same manner as direct and indirect costs. However, when inter-entity costs are only partially reimbursed, or not reimbursed at all, then the receiving entity must recognize an imputed cost and an imputed revenue (financing source) for the difference between the full cost of goods received and the total reimbursement. FASAB’s intent in identifying “inter-entity” costs is to focus on the costs of goods and services received by an entity which have traditionally been considered “free” goods and not included as a cost to the program or activity. In fact, no goods or services received from another Federal entity are free but are paid for by taxpayers, and should be included when determining the full cost of operations.

B. **If an OPDIV *provides* goods or services to another Federal entity**, regardless of whether full reimbursement is received, the OPDIV should continue to recognize in its accounting records the full cost of those goods or services. The full costs of the goods or services provided by the OPDIV should also be reported to the receiving entity by the OPDIV.

C. **If an OPDIV *receives* goods or services from another Federal entity**, an OPDIV should recognize in its accounting records the full cost of any goods or services it receives as an expense or, if appropriate, as an asset. OPDIVs should obtain documentation on costs from the providing entity to verify, as best they can, actual costs. However, if such cost information is not provided, or is partially provided, a reasonable estimate may be used. If the costs are not fully reimbursed, the OPDIV must recognize the difference as "Financing Sources Provided by Others." Imputed (inter-entity) costs and financing sources are eliminated in consolidated financial statements at either the OPDIV, Departmentwide, or Federal Governmentwide level.

D. For financial statements covering fiscal years 1998 and 1999, OMB is limiting the inter-entity costs to be recognized by Federal agencies to the following: (1) employee's pension benefits, (2) the health, life insurance, and other benefits for retired employees, (3) other post-employment benefits for retired, terminated, and inactive employees, which include severance payments, training and counseling, continued health care, and unemployment and workers compensation under the Federal Employees' Compensation Act, and (4) losses in litigation proceedings (see FASAB Interpretation No. 2, Accounting for Treasury Judgement Fund Transactions).[4]

1-20-70 Costing Methodology

A. Costs of resources consumed by HHS programs and activities are accumulated by type of resource (HHS sub-object class). The full costs of resources that directly and indirectly contribute to a cost object (program, activity, or output) should be assigned to the cost object through costing methodologies or cost finding techniques that are most appropriate to the OPDIV's operating environment, and should be followed consistently. Whenever possible, financial accounting and budgetary accounting

[4] **Memorandum from the OMB Controller, dated April 6, 1998, entitled *"Technical Guidance for the Implementation of Managerial Cost Accounting Standards for the Federal Government."***

activities should apply similar costing methodologies. If practicable, outputs produced by programs and activities should be accumulated and measured in units; this is particularly important for activities measured under the Government Performance and Results Act.

1-20-71 Selecting a Costing Method

A. Costs should be assigned to cost objects[5] in one of the following methods (listed in the order of OMB preference). No single methodology is required for all cost accounting applications.

1) Directly tracing costs to cost objects

Direct tracing applies to resources that are directly used by a cost object. The method of direct cost tracing usually relies on the observation, counting, and/or recording of the use of resources, such as staff hours or gallons of fuel consumed in a transport mission. Direct cost tracing often minimizes distortion and ensures accuracy in cost assignments. However, it can be a relatively costly process. It should be applied only to items that account for a substantial portion of the cost of a program or activity and only when it is economically feasible.

2) Assigning costs on a cause-and-effect basis

For costs that are not directly traced to a single cost object, intermediate cost objects can be established . The links reflect a cause-and-effect relationship between resource costs and programs and activities.

3) Allocating costs

Sometimes, it might not be economically feasible to directly trace or assign costs on a cause-and-effect basis. These costs can be allocated to programs and activities on a prorated basis. The cost allocations may involve two steps. The first step allocates the costs of support services to segments, and the second step allocates those costs to the programs and activities of each segment. The cost allocations are usually based on a relevant common denominator such as the number of employees, square footage of office space, or the amount of direct costs incurred in segments.

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[5] **For HHS and its OPDIVs, the term cost object will predominantly refer to a program or activity.**

B. To assist cost analyses and cost findings, cost accounting may segregate costs that are *traced or assigned* to cost objects from costs that are *allocated* to cost objects; but this is not required.

C. HHS does not mandate the usage of any particular indirect cost allocation methodology. OPDIVs may use any indirect cost allocation method that results in the fair presentation of the full cost of the cost object. Auditors will review the OPDIV allocation methodologies as part of their audit work.

1-20-72 Cost Allocation Methodologies

A. There are some generally recognized cost allocation methodologies that have common usage. The following table lists some common bases for the distribution of indirect costs.

Costs to be Allocated	Basis for Allocation
Facilities (Rent, Depreciation, Utilities, Security, Etc.)	Square footage
Personnel Services & Payroll	# of FTEs serviced; personnel actions completed; W-2s issued
Financial Management Services; General Administrative Support	# of FTEs serviced; # of transactions processed
Automated Data Processing	Machine hours; # of transactions processed
Procurement and Contracting Services	# of contracts written; labor hrs
Publication, Reproduction, Graphics & Video Services	# of documents produced; # of jobs completed
Mail & Messenger Services	Volume of mail or # of packages delivered
Information Technology (IT) Services	IT equipment serviced; # of IT contracts managed
Employee Health and Recreation Facilities	# of FTEs eligible or enrolled
Legal Services	# of legal inquiries or cases handled
Office and Ground Maintenance	Square footage; # of service maintenance calls
Services to Acquire and Operate PP&E	# of PP&E purchases; # of service calls
Research and Analytical Services	# of research projects or inquiries handled
Scientific Facilities	# of research/testing projects
Library Services	# of FTEs; usage measure
Office Supplies	# of FTEs; usage measure

Cost allocation estimates should be reviewed and updated annually by management. This review should consist of inquiries and, if possible, observations of program personnel and activity. OPDIVs must document the rationale behind the adoption of each cost allocation methodology. Special attention should be made to consider the validity of a current allocation methodology due to any changes that have occurred in the operating environment. This documentation should be part of the material provided to the financial statement auditors. Exhibit 1-20-B provides a worksheet illustration for allocating costs and revenues, recorded by CAN, SGL, and sub-object class, to the various programs and activities.

<u>1-20-73</u> **Selecting a Costing System**

A. SFFAS #4 requires that a costing system, once adopted, be used consistently. Consistent use provides cost information that can be compared from year to year. Several costing systems have been successful in the private sector and in some government entities. Four are briefly described here. It is important to note that those costing systems are not mutually exclusive, and in fact OPDIVs are currently using various combinations of these systems.

1) Activity-based costing (ABC)

   The ABC cost assignment is a two-stage procedure. The first stage assigns the costs of resources to activities and the second stage assigns activity costs to outputs. A major advantage of using ABC is that it avoids or minimizes distortions in product costing that result from arbitrary allocations of indirect costs. By tracing costs through activities, ABC provides more accurate service or product costs.

2) Job order costing

   Job order costing is a costing methodology that accumulates and assigns costs to discrete jobs. The word "jobs" refers to products, projects, assignments, or a group of similar outputs.

3) Process costing

   Process costing is a method that accumulates costs by individual processing divisions. The output of a processing division either becomes the input of the next processing division or becomes a part of the end product. Process costing is appropriate for production of goods or services with the following characteristics: (a) the production involves a regular pattern of process, (b) its output consists of homogeneous units, and (c) all units are produced through the same process procedures.

4) Standard costing

Standard costs are carefully predetermined or expected costs that can be applied to activities, services, or products on a per unit basis. As work is being done, actual costs incurred are compared with standard costs for various tasks or activities to reveal variances. This feedback helps discover better ways of adhering to standards, of altering standards, and of accomplishing objectives. Standard costing helps managers to formulate budgets, control costs, and measure performance.

B. OPDIV CFOs and program managers are in the best position to select a type of costing system that meets the OPDIV’s needs. In making the selection, management should evaluate alternative costing methods and select those that provide the best results under its operating environment.

<u>1-20-80</u> Cost Reports

A. Each OPDIV should accumulate and report the cost of its programs and activities on a regular basis for management information purposes. Managerial cost accounting should provide information for use by both financial accounting and budgetary accounting. Cost information is used in producing both internal and external reports.

<u>1-20-81</u> External Reporting

A. **Statement of Net Cost**: OMB Bulletin 97-01 requires all reporting entities (HHS and OPDIVs) to prepare principal financial statements, including the Statement of Net Cost. This statement was designed to display the net cost of individual programs and activities as well as to report the net overall cost of operations for the entity. By reporting on both the gross cost of programs and activities, less related exchange revenues earned, the statement provides information on the net cost of Federal operations that are paid for by citizens via their tax dollars.

B. OPDIV programs/activities must separately identify the gross costs of goods and services provided to the public and government agencies. In addition, the statement specifically identifies the following types of costs to be separately reported: costs related to grants and transfer payments (with identification of related administrative costs), revenue and expense related to lines of business for business-like activities, and the costs related to acquiring Stewardship Assets. Finally, the statement provides for separately reporting costs and revenues not attributable to specific programs and activities.

C. There is flexibility in whether these specifically identified costs are shown on the principal statement or in supplemental schedules or notes, depending upon the number of designated OPDIV programs and activities reported on the face of the statement. The principal statement should be limited to one page. A high degree of standardization within OPDIVs is desired for

D. Departmental comparisons and possible consolidation. OPDIVs and the Department will agree upon the format of the report before the statement is prepared for audit.

E. As described in section 1-20-40, each OPDIV is designated a responsibility segment within the Department. In turn, each OPDIV will have designated responsibility segments within its organization according to the need to report costs and revenues for its programs and activities. For the OPDIV Statement of Net Cost, the OPDIV is the responsibility segment. There is no requirement to report program/activity costs and revenues by the designated sub-organizational responsibility segments. These detailed data are intended for internal reporting to program managers to assist in the management of their operations.

F. Besides reporting program/activity costs on the OPDIV Statement of Net Cost, with the OPDIV as the responsibility segment, net costs will be displayed within the appropriate budget function in accordance with past practice and, as well, to the portrayal of the Government-wide Statement of Net Cost.

G. Although SFFAS No. 4 specifically requires accounting for the full cost of outputs, OMB Bulletin 97-01 only requires Federal agencies to report costs by programs and activities. OPDIVS are not required to report in the Statement of Net Cost the full cost of outputs in terms of units of output. However, if OPDIVs report output measures in the *Overview* section of the financial report, any cost measures included in the *Overview* must incorporate full cost as defined in the standard.

H. The Departmentwide Statement of Net Cost, to be included in the HHS Accountability Report, will be reported at the OPDIV level, and this statement will not report program and activity details, but instead will refer the reader to the OPDIV’s statement. The Statement of Net Cost will display the net operating cost of each OPDIV and the total cost within each budget function.

1-20-82 Internal Reporting

A. Internal reporting needs are fundamentally different from external reporting requirements. Internal cost reporting should be specifically tailored to meet management's needs for cost information. Internal cost reports prepared for each responsibility segment within an OPDIV should provide relevant information to managers responsible for programs and/or activities, and this information should be used by managers for making operating decisions. In addition, internal cost reports should allow OPDIVs to:

- report the full cost of outputs by type of resource (HHS sub-object class);
- identify the different components of program costs (direct, indirect, inter-entity), and;
- accumulate cost information for program services (lines of business), and match these program revenues and costs.

B. Internal cost reports should also serve managers in tracking and reporting (as necessary) on the full cost of achieving GPRA program goals and objectives. These reports must be tied to the different programs and activities defined thru the GPRA process. GPRA program staff should be consulted when identifying GPRA programs to be tracked.

1-20-90 Roles and Responsibilities

Specific roles and responsibilities are set forth for the Chief Financial Officers (CFOs), Financial Management Officers (FMOs), and Accounting Officers (AOs) as follows:

A. **The OPDIV CFOs** are responsible for the following:

- oversight of the implementation of the OPDIV cost accounting policy;
- the development of a cost accounting reporting system, with the FMOs;
- review of all cost accounting procedures developed or revised by each FMO for consistency with SFFAS #4 and Departmental guidance, and;
- final determination of the scope (nature and frequency) of reporting cost accounting information applicable to cost objects.

B. **FMOs** have overall responsibility for:

- the design and implementation of a system of cost accounting for their OPDIV;

- review of programs identified by the OPDIV's Annual Performance Plan, for which costs should be accumulated and assigned, and for program/activity outputs (where applicable), and the proper assignment methodology;

- final approval of the identification of the resources applicable to cost objects, and a proper cost assignment methodology;

- determining whether the appropriate cost accounting procedures can be accomplished through their current accounting system, cost finding techniques, or other cost studies and analyses;
- identification of significant inter-entity costs to ensure that full costs are recorded in the OPDIV’s accounting system, and;

- ensuring that the general ledger is the basis for cost data.

C. **AOs** are responsible for:

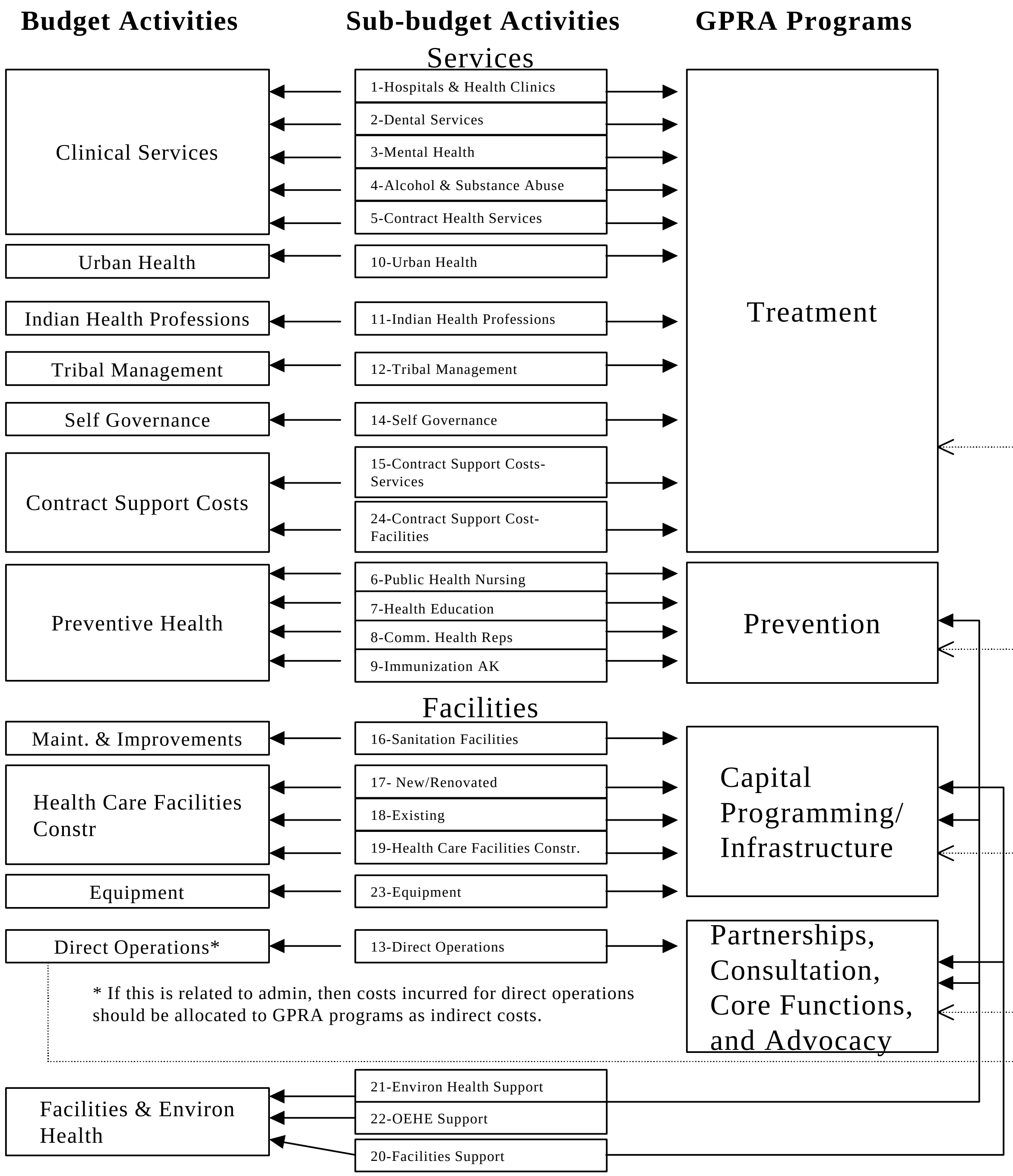
- serving as a technical source to the CFO and FMO in implementing cost accounting within their respective organizations;

- providing oversight on implementation of cost accounting within their OPDIV, or the OPDIV for which they provide accounting services;

- identifying information needed to effectively implement cost accounting within their OPDIV, and taking the actions necessary to obtain this information, and;

- identifying, with program managers, the organization's programs and activities for which this standard is applicable, and (to the extent possible) quantifying program outputs on a timely basis.

Indian Health Service
Crosswalk between Budget Reporting, Cost Reporting, GPRA Programs and the Statement of Net Cost



WORKSHEET ILLUSTRATION
ALLOCATING COSTS TO PROGRAMS AND ACTIVITIES
FOR REPORTING ON THE STATEMENT OF NET COST

Common Accounting Number	SGL Series	G/N	Sub-object Classification Codes	$	Allocation Method
	6000-7200 5000-7100		Group those related to a single program/ activity		N/A (Directly traced)
			Group those using common allocation criteria		
			Costs/ Revenue having unique allocation criteria		
			Group those not related to a program/ activity		N/A (Not allocated)

Reported as →

GPRA Programs (1)	(2)	(3)	Other Activities (1)	(2)	(3)	Not Allocated	TOTAL
						N/A	$$$
						N/A	$$$
						N/A	$$$
N/A	N/A	N/A	N/A	N/A	N/A	N/A	$$$