

Memo

To: John Elashkar, Director and General Manager
From: Dana W. Tousley, Chief Financial Officer
William Cook, Jr., Assistant General Manager
Date: July 2, 2003
Re: Revision of Indirect Cost Methodology and Application

This memo is a summary of the recommendations of the task force assigned to review the Board of Water and Light's indirect cost methodology. Indirect cost rates are used to add overhead costs to direct labor, direct material and other direct charges. The two primary applications are capitalizing capital projects and billing customers for construction work done by board forces.

The task force recommended the following changes:

- Direct Labor – Decrease from 103% to 72%
- Material – Decrease from 13% to 3.5%
- T & D Engineering and General – Decrease from 14% to 10%
- Equipment – Continue to use the existing hourly rate structure

The changes are based on the task force review of the detail components included in corporate, T & D, and material overhead. The above percentages should be used in all cases except where other guidelines exist such as MDOT contract work and reimbursable work generally required by the State or Federal Government within city limits. The task force concluded that the level of work force capital expenditure activity does not directly affect the following overhead cost components:

- Charges to overhead accounts by Managers, Directors, and General Manager
- Expenses associated with general facilities
- Charges to overhead accounts by Human Resources, Environmental Services and the Information Technology Resource Center
- Property and Casualty Insurance
- Injuries and Damages caused by others

Accordingly the charges associated with these activities were excluded from the calculation of the indirect cost rates and resulted in the recommended decreases in rates.

This change in indirect cost rates has consequences for budgeted net income. The FY 2004 budget used the old indirect cost rates to calculate the transfer from administrative and general expenses to capital of all overheads during the fiscal year. The estimated transfer was \$9 million. The recommended change in indirect cost rates reduces this transfer to an estimated \$6 million. See the revised budget for FY 2004 attached to this memo. The \$3 million shift affects net income and capital expenditures.