What Are Indirect Costs?

Idea In Short

Treat indirect costs as a decision input with a clear purpose, an accountable owner, and a record of the evidence behind it. The team should identify cost pools, allocation bases, consistency, and relationship to the work. It should examine the risk of accepting an allocation without checking whether it reasonably reflects benefit before turning preliminary information into a commitment. A proportionate process lets the organization move quickly when evidence is strong and pause when uncertainty could change the outcome. The main practical safeguard is to make assumptions visible and invite review from people who can challenge them. That approach protects the organization from avoidable rework, makes the decision easier to explain, and preserves flexibility when the facts change. The sections below show how to turn this principle into repeatable practice.

Indirect costs support multiple activities or contracts and cannot be assigned wholly and directly to one specific output without allocation. In practice, the question is how to understand shared cost components included in a supplier’s price or claim while respecting the organization's objectives, available evidence, and constraints. This article focuses on indirect costs: what it contributes, how to approach it, and how to make the result useful to later decisions. It treats supplier and stakeholder information as evidence to assess, not as instructions to accept without scrutiny. The process should be proportionate to the decision, transparent to responsible reviewers, and revisited when material conditions change.

Clarify the decision

Start by identifying the decision that indirect costs must support. Teams should state what they need to know, why it matters now, and what could change as a result. That framing prevents activity from becoming an end in itself. It also helps determine the level of effort: a routine, reversible choice may need a short review, while a high-impact or difficult-to-reverse decision may need broader evidence and independent challenge. The team should identify the decision owner and the people affected by the outcome. It should separate

essential constraints from preferences that can be reconsidered. A short written question gives contributors a shared reference point and helps reviewers assess whether the work answered the real need. 1

Choose reliable inputs

The quality of the result depends on the quality and fit of its inputs. The team can combine internal records, user experience, supplier information, independent publications, and expert advice, but each source has a different perspective. It should capture when information was produced, what population or product it covers, and whether the source has a commercial interest. Where evidence conflicts, the team should investigate the difference instead of averaging incompatible values. It should also note missing information and decide whether that gap is material enough to delay a decision or seek more evidence. A balanced evidence set is more robust than a large collection of unexamined documents. 2

Apply a consistent method

Before reviewing evidence, agree on the method and the criteria that matter. A consistent approach makes comparisons more useful and reduces the risk that teams shift standards to favor a familiar option. Define how information will be collected, who will review it, and how uncertainty will be treated. Where judgment is unavoidable, describe the dimensions of judgment and use more than one reviewer for material choices. The method should be simple enough that participants can follow it and detailed enough to reproduce the conclusion. If the evidence suggests that the original method is inadequate, revise it openly, document the reason, and apply the revision consistently. 3

Test assumptions and limits

No method removes uncertainty. Teams should identify assumptions that could materially alter the result and test them against plausible alternatives. They should ask whether the available sample is representative, whether conditions have changed, and whether an apparent pattern has another explanation. The team should distinguish facts, estimates, forecasts, and opinions in its analysis. A range or scenario may communicate uncertainty more honestly than a single precise number. Reviewers should also consider what the research cannot establish, because limits matter when translating evidence into commitments. This discipline protects decision-makers from false confidence and makes it

easier to update conclusions when new information appears. 4

Turn findings into action

The work is complete only when its findings shape a decision or explain why no change is needed. Summarize the evidence in terms of the original question, identify the practical implications, and name any unresolved issue that needs monitoring. A recommendation should connect the evidence to an action rather than repeat the analysis. The decision owner should record whether the recommendation was accepted, adapted, or rejected and why. If the result affects suppliers or users, communicate changes through an appropriate and consistent channel. The organization should revisit important conclusions when assumptions expire or conditions move. This follow-through creates organizational memory and makes the effort valuable beyond the immediate decision. 5

Keep the process proportionate

Proportionate work protects both speed and decision quality. Too little analysis can leave a team exposed to avoidable error; too much can consume time without changing the choice. The decision owner should match effort to value, risk, reversibility, and uncertainty. Teams can use a short checklist for routine work and a deeper review for consequential commitments, while keeping the underlying principles consistent. They should preserve enough evidence for oversight without collecting irrelevant personal or commercially sensitive data. A periodic check can reveal whether the method is adding value, creating delay, or missing important perspectives. Adjust the process on evidence, and assign someone to confirm that the change is used in practice.

Distinguish the key test

Indirect costs support multiple activities or contracts and cannot be assigned wholly and directly to one specific output without allocation. The team should translate that description into a test it can apply to the actual transaction. It should state which facts must be present, which evidence can establish them, and who has authority to make the judgment. This step separates a real requirement from a habit, preference, or undocumented assumption. It also shows when the evidence is incomplete and what additional information could resolve the gap. Where different cases produce different answers, the organization should identify the relevant differences rather than force them into one rule. A defined test makes the decision

more predictable for staff and suppliers. It also gives reviewers a concrete basis for checking whether the process was followed.

Connect records to performance

Contract administration relies on a current view of obligations, delivery evidence, approvals, and payment status. The administrator should keep the executed agreement and amendments easy to locate, assign an owner to each deliverable, and record acceptance against the agreed criteria. Invoices should link to authorized work and supporting evidence rather than pass through on schedule alone. Issues should be logged with an owner, target date, and resolution status. Regular review can identify slippage or recurring defects before they become disputes. A clean record also supports continuity when the people managing the relationship change.

Check the consequences

A decision about indirect costs can affect timing, cost, access, performance, and the options available later. Before acting, the decision owner should identify who bears each consequence and whether that allocation matches the party's ability to manage it. Teams should consider effects on suppliers and users, not only internal convenience. A small change in wording, deadline, scope, or approval can have a larger effect when it shifts risk or removes an alternative. The owner should compare the likely benefit with the burden and document material trade-offs. If a consequence cannot be estimated confidently, state that uncertainty and decide how it will be monitored. This keeps the decision connected to operational reality.

Record the reasoning

A useful record explains how the team moved from evidence to a conclusion about indirect costs. It identifies the governing criteria, material facts, assumptions, alternatives considered, and the person who approved the action. The record should preserve original evidence while making the conclusion easy to locate. It should explain why contrary information did not change the result, where that information was material. If the team relies on expert judgment, name the judgment and its basis rather than presenting it as a measured fact. A concise record helps a later reviewer understand the decision without recreating the entire process. It also supports continuity when staff or suppliers change.

Revisit when conditions change

The original decision may need review when scope, market conditions, supplier performance, risk, or organizational needs change. Teams should identify practical triggers and assign an owner to monitor them. A review does not automatically mean the original choice was wrong; it determines whether the assumptions still hold. If a change affects other participants or contract commitments, the organization should follow the applicable notice and approval process. It should keep earlier versions so reviewers can see what changed and why. Lessons from implementation should feed into future decisions about indirect costs. This feedback loop helps preserve value and prevents temporary assumptions from becoming permanent by default.

- 1Project procurement for borrowers
- 2Government Functional Standard GovS 008: Commercial
- 3Strategic procurement planning
- 4UNCITRAL Model Law on Public Procurement
- 5WTO Agreement on Government Procurement

Summary

A sound approach to indirect costs gives decision-makers usable evidence and a defensible path from question to action. Teams should keep the work focused on its purpose, document the inputs and limits, and revisit conclusions when material facts change. The organization should assign responsibility for follow-through instead of leaving findings in a report. It should also examine whether the method treated participants consistently and protected information that should remain confidential. These habits create a record that supports oversight and future learning. They do not eliminate judgment; they make judgment more transparent and easier to improve. Applied consistently, they help the organization understand shared cost components included in a supplier’s price or claim with greater confidence and less avoidable uncertainty.