

Ch 8 - Analyzing Other Direct Costs

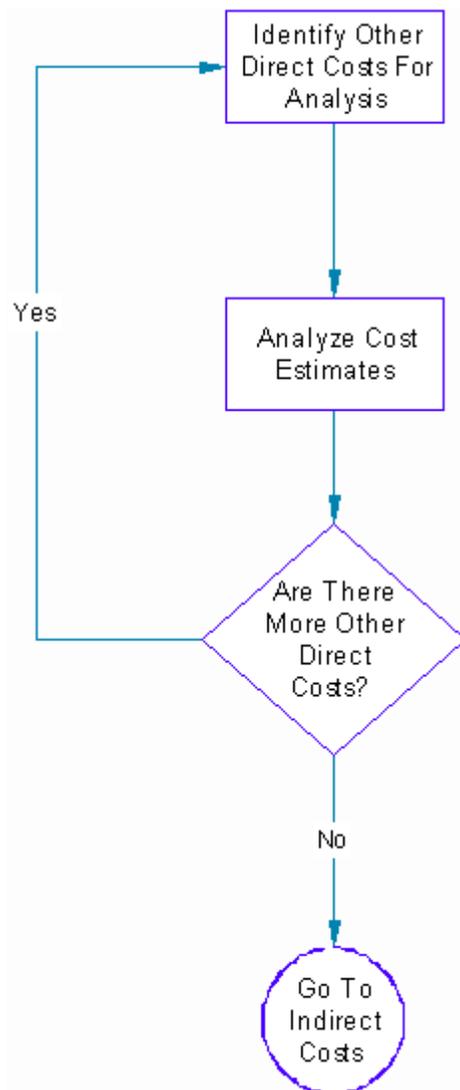
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8.0 Chapter Introduction

This chapter identifies points to consider as you develop your prenegotiation position on other direct costs.

Analysis Responsibility ([FAR 15.402\(a\)](#) and [15.404-2\(a\)](#)). The contracting officer has the ultimate responsibility for determining price reasonableness, but the contracting officer should request any necessary support from other members of the Government Acquisition Team. Any request for support should be tailored to the proposal under analysis. Requesting unnecessary assistance can waste important Government resources.

Flowchart of Other Direct Cost Analysis. The following flowchart depicts the key events completed as part of a typical other direct cost analysis:



8.1 Identifying Other Direct Costs For Analysis

Identifying Other Direct Costs ([FAR Table 15-2](#)). FAR describes other direct costs as costs not previously identified as a direct material cost, direct labor cost, or indirect cost. In other words, an other direct cost is a cost that can be identified specifically with a final cost objective that the offeror does not treat as a direct material cost or a direct labor cost. Examples of the types of cost that are commonly proposed as other direct costs include:

- Special tooling and test equipment;
- Computer services;

- Consultant services;
- Travel;
- Federal excise taxes;
- Royalties;
- Preservation, packaging, and packing costs; and
- Preproduction costs.

Reasons for Other Direct Cost Identification and Treatment. Costs are identified and treated as other direct costs to assure proper allocation and treatment.

- **Cost allocation.** An other direct cost is often the type of cost that the firm would normally charge as an indirect cost, but the proposed contract requires a large, unusual, or one-time expenditure (e.g., special tooling) that will benefit only the proposed contract. It would be unreasonable to expect the rest of the firm's products to share these unique costs.
- **Cost treatment.** Costs may be treated as other direct costs to assure that they will receive proper treatment. For example, special tooling bought to complete a specific Government contract will normally become Government property. That property may then be furnished to that firm or other firms for similar contracts.

Points to Consider. As you plan for other direct cost analysis, look for indicators of uneconomical or inefficient practices. Consider the results of any technical or audit analyses. If an element of proposed other direct cost appears suspicious, concentrate more analysis effort on that element than on a less suspicious cost element of similar dollar value. As you plan:

- Identify any proposed other direct cost that apparently should be classified as an indirect cost.
- Identify any proposed other direct cost that appears to duplicate another proposed direct cost.
- Identify any proposed other direct cost that does not appear reasonable.
- Identify any proposed other direct cost that merits special attention because of high value or other reasons.
- Assure that concerns about other direct cost estimates are well documented.

Identify Any Proposed Other Direct Cost That Apparently Should Be Classified As an Indirect Cost.

Because many other direct costs might be classified as indirect costs under different circumstances, it is particularly important to assure that the proposed treatment is proper. To identify any proposed other direct cost that apparently should be classified as an indirect cost, ask questions such as the following:

- ***Will the proposed cost benefit both the proposed contract and other work?***

If the cost will benefit the proposed contract and other contracts, it should not be treated as an other direct cost. Instead it should be treated as an indirect cost.

- ***Does the offeror customarily treat similar costs as indirect costs under similar circumstances?***

If the offeror customarily treats similar costs as indirect costs under similar circumstances, the proposed cost should also be treated as an indirect cost.

- ***Can the accounting system segregate proposed other direct costs from similar indirect costs?***

If the accounting system cannot differentiate between the proposed cost and similar indirect costs, the proposed cost should also be treated as an indirect cost

Identify Any Other Direct Cost That Appears To Duplicate Another Direct Cost. To identify any proposed other direct cost that appears to duplicate another proposed direct cost, ask questions such as the following:

- ***Does the proposed other direct cost effort duplicate tasks already proposed as part of direct material cost or direct labor cost?***

An estimator preparing an estimate of direct labor cost or direct material cost may not know that the same task is being estimated as part of other direct cost. It can be particularly easy for a firm to propose in-house labor and consultant labor to complete the same task.

- ***Does a cost estimating relationship used to estimate direct material cost or direct labor cost include costs to perform tasks also proposed as an other direct cost?***

Costs may normally be proposed using a cost estimating relationship. For example, computer support may be estimated based on the number of engineering hours. However, the unique nature of the proposed contract may require vastly more and different types of engineering computer support. Accordingly, the firm has proposed to purchase outside computer services as an other direct cost. Since the other direct cost will replace the in-house support, the in-house support should not be included in the cost estimate.

Identify any Cost That Does Not Appear Reasonable. To identify any proposed other direct cost that does not appear reasonable, ask questions such as the following:

- ***Is the proposed other direct cost consistent with the offeror's estimating assumptions?***

If any part of the estimate is not consistent with stated estimating assumptions, question the costs involved.

- ***Is the proposed other direct cost necessary to complete the contract?***

Require the offeror to support the need for any other direct cost that does not appear needed to complete contract tasks.

- ***Has the offeror identified all the other direct costs reasonably required to complete the contract?***

If the offeror appears to need additional other direct cost support to complete the contract, question why the cost for that support was not included in the cost proposal.

Identify Costs Which Merit Special Attention. To identify any proposed other direct cost that merits special attention because of high proposed cost or other reasons, ask questions such as the following:

- ***Is any single other direct cost a large portion of the total cost estimate?***

Occasionally, a single estimate will be a large part of the entire estimate. That estimate will normally merit special attention because of the dollars involved.

- ***Is any other direct cost critical to contract performance?***

The offeror's ability to obtain the resources treated as other direct costs may be critical to contract performance. Critical elements merit special consideration to assure that the offeror fully understands contract requirements.

Document Concerns About Other Direct Cost Estimates. To assure that concerns about other direct cost estimates are well documented, ask questions such as the following:

- ***Have you identified concerns about other direct cost estimates?***

If the answer is "yes" document the areas of concern for reference as you perform more in-depth analysis.

- ***Has the offeror had an opportunity to answer your concerns?***

Consider raising these concerns in fact-finding conversations with the offeror. If the problem is an error in the proposal, bring the error to the offeror's attention so that it can be corrected prior to formal discussions.

8.2 Analyzing Cost Estimates

This section identifies points to consider as you analyze other direct cost estimates.

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Special Points to Consider in Analysis. Your analysis of other direct costs should parallel your analysis of any direct cost. However, you should concentrate your analysis on the following points:

- Determine if other direct costs are properly proposed in accordance with the offeror's estimating and accounting practices, as well as accounting standards applicable to the contract.
- Determine if the proposed other direct cost is reasonable, considering any points identified for special emphasis.

Develop and Document Your Prenegotiation Position. As you develop and document your prenegotiation position on other direct costs:

- If you accept the offeror's proposed other direct cost, document that acceptance.
- If you do not accept the proposed other direct cost, document your concerns with the proposal and develop your own prenegotiation position for costs covered by the estimate.
- If you can identify information that would permit you to perform a more accurate analysis of direct labor-hours, use the available information. Your analysis is not bound by the estimating methods used by the offeror.

8.2.1 Analyzing Special Tooling And Test Equipment Costs

Special Tooling ([FAR 45.101](#)). Special tooling includes jigs, dies, fixtures, molds, patterns, taps, gauges, other equipment and manufacturing aids, all components of these items, and replacements for these items which are of such a specialized nature that without substantial modification or alteration their use is limited to the development or production of particular supplies or the performance of particular services. It does not include material, special test equipment, facilities (except foundations and similar improvements necessary for special tooling installation), general or special machine tools, or similar capital items.

Special Test Equipment ([FAR 45.101](#)). Special test equipment includes single or multipurpose integrated test units engineered, designed, fabricated, or modified to accomplish special purpose testing in performing a contract. It consists of items or assemblies of equipment including standard or general purpose items of components the are interconnected and interdependent so as to become a new functional entity for special testing purposes. It does not include material, special tooling, facilities (except foundations and similar improvements necessary for special test equipment), and plant equipment items used for general plant testing purposes.

Determine If the Cost Is Properly Proposed. To determine if the cost of special tooling and test equipment is properly proposed in accordance with the offeror's estimating and accounting practices, as well as accounting standards applicable to the contract, ask questions such as the following:

- ***Is the proposed tooling or test equipment only usable on the proposed contract or is it general purpose (usable for other products/contracts)?***
 - If the tooling or test equipment is usable only for the proposed contract, consider the proposed other direct cost.
 - If the equipment is general purpose and can be used elsewhere, it should be capitalized and depreciated through the appropriate indirect cost account. Through the application of indirect cost rates, each contract will receive its fair share of the depreciation expense. You should not accept any estimate as other direct cost.
- ***Can the necessary task be performed at a lower total cost (equipment plus labor) with general purpose tooling or test equipment?***

Do not accept special tooling or test equipment as an other direct cost, when general purpose equipment can do the same job at lower total cost. If general purpose equipment will not do the job at a lower total cost, further consider the cost of the special tooling and test equipment.

Determine If the Proposed Cost Is Reasonable. As you determine if the proposed special tooling or test equipment cost is reasonable, ask questions such as the following:

- ***Is the proposed special tooling or test equipment appropriate for the required period of use?***

This question really deals with the total period that the special tooling or test equipment will be required. If there are projected follow-on requirements, you may need to look beyond the immediate proposal to determine the total Government need. You will probably need technical assistance in making your analysis.

- ***Does the proposal include appropriate quantities of special tooling and test equipment?***

This question deals with capacity. If the contract calls for a production rate of 100 units per month, and a single tool can only produce 50 per month, then additional capacity is needed. If the contract calls for production of 50 units a month and a single tool will produce 100, the expenditure may be excessive. Support from Government technical personnel can be invaluable in reviewing the capacity of proposed tooling, suggesting different tooling or approaches that can meet the contract requirements, or identifying existing tooling that could augment the proposed tooling and meet contractual requirements at reduced costs.

- ***Is there Government owned tooling or test equipment available that can be used on a rent-free noninterference basis?***
 - If appropriate Government owned tooling or test equipment already exists, consider providing the tooling for contractor use on the proposed contract rather than paying the contractor to acquire new tooling or test equipment. If the Government owned tooling or test equipment is being used by the offeror on other Government contracts, it can be used on the proposed contract provided that use does not interfere with use of the tooling or test equipment by the "owning" contract. Rent-free use on a noninterference basis between Government contracts is a normal and customary practice.
 - If the required tooling or test equipment is not already available within Government resources, further consider the cost of proposed special tooling or test equipment.

- ***Is the proposed cost reasonable for the special tooling or test equipment required?***

Proposed special tooling and test equipment costs may include a variety of direct and indirect costs. Analyze the proposed cost just as you would analyze the proposed cost for any separately price line item of the contract.

8.2.2 Analyzing Computer Service Costs

Computer Service Center ([FAR 31.205-26](#)). Firms often collect in-house computer costs under a service center and charge users for using the computer services. In-house users of the computer services may be completing tasks in direct support of a specific contract requirement or in indirect cost support of company operations. Accordingly, the service center costs may be charged as direct or indirect costs, depending how the services are used.

Determine If the Cost Is Properly Proposed. To determine if computer service cost is properly proposed in accordance with the offeror's estimating and accounting practices, as well as accounting standards applicable to the contract, you must understand how the offeror collects and allocates computer-related costs. The cognizant Government auditor can be helpful in establishing the appropriateness of the charges as other direct costs.

Determine If the Proposed Cost Is Reasonable. To determine whether the proposed computer service cost is reasonable for contract task requirements, ask questions such as the following:

- ***Is the amount of the proposed computer effort reasonable for the contract?***

If direct computerized effort is not required, you should not accept any part of the proposed other direct cost. If a lower effort is required, the Government pricing position should reflect that adjustment.

- ***Are the proposed costs based on the computer resources that will actually be used to complete the required tasks?***

Many times offeror personnel will have multiple computer resources available to provide the same type of support. Available resources might include: a central computer service center, a local area network, stand-alone personal computers, and contract computer services. If the work will be completed in stand-alone personal computers, any other direct computer center charge would be unreasonable.

- ***Does the selected source offer the best value to the offeror and the Government?***

The required computer services may be available from an in-house service center and several outside sources. Each source will likely have different costs and benefits to the offeror and the Government.

- ***If the offeror proposes to obtain the required service as an interorganizational transfer, has the firm met the associated pricing requirements?***

The Government prefers interorganizational transfers at cost, however, a transfer at price may be acceptable when required FAR conditions are met.

8.2.3 Analyzing Professional And Consultant Service Costs

Professional And Consultant Services ([FAR 31.205-33\(a\)](#)). Professional and consultant services are services rendered by persons who are members of a particular profession or possess a special skill and who are not officers or employees of the contractor. They are generally acquired to obtain information, advice, opinions, alternatives, conclusions, recommendations, training, or direct assistance, such as studies, analyses, evaluations, liaison with Government officials, or other forms of representation.

Determine If the Cost Is Properly Proposed. To determine if professional and consultant services are properly proposed in accordance with the offeror's estimating and accounting practices, as well as accounting standards applicable to the contract, ask questions such as the following:

- ***Does the task defined for completion by consultants duplicate a task defined for in-house completion?***

An estimator preparing an estimate of direct labor cost may not know that the same task is being estimated for performance by consultants.

- ***Does a cost estimating relationship used to estimate direct labor cost include costs to perform tasks also proposed for performance by consultants?***

A task previously performed by in-house personnel may now be designated for performance by consultants. Without specific adjustment, any direct labor cost estimating relationship developed using cost data that include the cost of performing that task will include that task in direct labor estimates for future contracts.

Determine If the Proposed Cost Is Reasonable ([FAR 31.205-33](#)). As you determine whether the proposed costs are reasonable for the required professional or consultant services, ask questions such as the following:

- ***Is the proposed cost reasonable in relation to the service required?***

Generally, offerors obtain consultant labor from firms that specialize in providing related services. These firms hire or contract with individuals to work for them and then contract out to firms requiring their services. When there is competition to meet these needs, the offeror can often support the reasonableness of contract labor costs by citing price competition.

- ***Is the proposed cost necessary and reasonable considering the offeror's capability in a particular area?***

If full-time employees are available and capable of performing the required work at a lower cost, question the need for consultants. If consultants are needed, you should still examine any increased cost related to using consultants instead of in-house labor. What was the basis for deciding which type of labor would be used where?

- ***What was the past pattern of acquiring such services and what was the cost?***

Changes from past practices should be questioned if costs increased as a result of the change.

- ***Is the service of a type identified as unallowable under Government contracts?***

Professional consultant costs for the following are unallowable:

- Services to improperly obtain, distribute, or use information of data protected by law or regulation.
- Services to improperly influence the contents of solicitations, evaluation or proposals or quotations, or the selection of sources for contract award.
- Services resulting in violation of any law statute or regulation prohibiting improper business practices of conflicts of interest.
- Services performed which are not consistent with the purpose and scope of the services contract or agreement.

8.2.4 Analyzing Travel Costs

Travel Cost ([FAR 31.205-46\(a\)](#)). Travel costs include the costs for transportation, lodging, meals, and incidental expenses incurred by contractor personnel on official company business.

Dollar for dollar, travel cost estimates attract more attention than any other element of most cost proposals. Interest continues to increase in this age when travel costs are rapidly increasing and alternative means of communication (e.g., teleconferencing) are becoming more commonplace.

Determine If the Cost Is Properly Proposed ([FAR 31.205-46](#)). To determine if travel cost is properly proposed in accordance with the offeror's estimating and accounting practices, as well as accounting standards applicable to the contract, ask questions such as the following:

- ***Will the traveler charge labor effort to a direct or indirect labor account during travel?***

Normally, if the traveler's wages during travel are charged to an indirect labor account, the traveler's travel expenses are also charged as an indirect cost. If the traveler's wages during travel are charged direct to a contract, then the traveler's expenses for travel in connection with the contract are generally charged as a direct cost.

- ***What is the purpose of the travel?***

If an employee who normally charges direct to contracts attends a stress management course, the travel expenses will normally be charged against an indirect training account. If an employee who normally charges time to an indirect cost account travels to a Government office to present a contractually-required demonstration, the travel costs will normally be charged to the contract requiring the demonstration.

Determine If the Proposed Cost Is Reasonable. Costs for travel transportation may be based on mileage rates, actual costs incurred, or on a combination thereof, provided the method used results in a reasonable charge. Costs for lodging, meals, and incidental expenses may be based on per diem, actual expenses, or a combination thereof, provided the method used results in a reasonable charge. To determine if the proposed costs are reasonable based on contract requirements, ask questions such as the following:

- ***Is the proposed travel really necessary?***

Sometimes, travel is proposed to meet a contractual requirement on the assumption that the contractor will send someone from the contracting location to the specified location. If the offeror appears to have on-site field representatives who can fulfill the contractual requirement, question whether the travel cost is necessary.

If the contract requires a temporary field office, the proposal may include costs for personnel to travel to the field location and return to the home location at the end of the contract. Sometimes, you will find that the field representative has been at the remote location for several years and has no intention of leaving! Don't accept the argument that the travel moneys are really additional compensation "to keep the reps happy." If the contractor

wants to pay them additional money, the funds should be classified as compensation, not travel.

- ***Can fewer longer trips replace the proposed travel schedule?***

A few long trips generally cost less than the equivalent number of days in travel spread over a larger number of short trips.

- ***Can multiple tasks be accomplished on the same trip?***

Often contractor personnel can accomplish several tasks in one trip. If there is a separate travel estimate for each task, determine:

- Whether the estimate is predicated on taking a separate trip for each task; and
- Whether the traveling personnel will likely be able to accomplish several tasks during the same trip.

- ***Is the proposed number of travelers reasonable?***

Many trips involve teams of travelers. The offeror must support the need for each traveler, as well as the need for the trip.

- ***Is the proposed mode of transportation the most likely actual mode of transportation?***

This point is best explained with an example. A travel proposal is based on four employees flying to a nearby city using a commercial airline. In reality, the company usually sends employee groups to nearby cities in a single rental car. While the rental car may be an appropriate means of travel, the cost of travel will not be the same as airline travel.

- ***Do the proposed transportation, lodging, meal rates comply with FAR travel cost restrictions?***

Due to the high visibility of contractor travel on Government business, the FAR restricts travel expenses to the same levels that would pertain to Government employees if they were to make the same trip. Remember, the cost principle sets a maximum limit on these expenses. The cost principle does not set a floor below which the contractor

cannot go. If travel rates are available to the contractor below those set in the Government travel regulations, you should use those rates as the most fair and reasonable available.

8.2.5 Analyzing Federal Excise Tax Costs

Common Federal Excise Taxes ([FAR 29.201\(a\)](#)). Federal excise taxes are levied on the sale or use of particular supplies and services. The most common excise taxes are:

- Manufacturer's excise taxes imposed on certain motor-vehicle articles, tires, and inner tubes, gasoline, lubricating oils, coal, fishing equipment, firearms, shells, and cartridges sold by manufacturers, producers or importers
- Special-fuels excise taxes imposed at the retail level on diesel fuel and special motor fuels.

Determine If the Cost Is Properly Proposed ([FAR 31.205-41](#)). To determine if Federal excise tax costs are properly proposed in accordance with the offeror's estimating and accounting practices, as well as accounting standards applicable to the contract, ask questions such as the following:

- ***What items are being assessed a Federal excise tax?***

The other direct cost proposal should identify what items are being taxed.

- ***What type of Federal excise tax is being proposed?***

The other direct cost proposal should also identify the Federal excise tax rate that is being used in the estimate and the reason for using that rate.

Determine If the Proposed Cost Is Reasonable ([FAR 29.201\(c\)](#), [29.202](#), and [29.203](#)). As you determine whether the proposed Federal excise tax costs are reasonable based on contract requirements, ask questions such as the following:

- ***Is there a Federal excise tax exemption that is applicable to the current acquisition situation?***

Offerors can often obtain a Federal excise tax exemption certificate for products delivered under Government contracts. For example:

- o No special-fuels excise taxes are imposed under many contracting situations.
 - o No communications excise taxes are imposed when the supplies and services are for the exclusive use of the Government.
 - o No highway vehicle use tax will be imposed when vehicles are owned or leased by the Government.
- ***Should you attempt to take advantage of an available Federal excise tax exemption?***

FAR requires you to take maximum advantage of available Federal excise tax exceptions. If you believe that costs related to pursuing the exemption outweigh the corresponding benefits to the Government, contact the cognizant Government legal counsel for advice before accepting any proposed Federal excise tax expense.

- ***Did the offeror use the proper Federal excise tax rate in estimating other direct cost?***

If necessary, contact the cognizant Government legal counsel for advice.

- ***Did the offeror use the proper base for calculating Federal excise taxes?***

Assure that the rate is applied to the proper cost or price base for tax calculation.

8.2.6 Analyzing Royalty Costs

Royalties ([FAR 52.227-9\(b\)](#)). Royalties are fees paid by the user to the owner of a right, such as a patented design or process. In Government contracting, the term includes any costs or charges in the nature of royalties, license fees, patent or license amortization costs, or the like for the use of or for rights in patents and patent applications in connection with performing a contract or subcontract.

Determine If the Cost Is Properly Proposed ([FAR 52.227-6](#)). To determine if royalty cost is properly proposed in accordance with the offeror's estimating and accounting practices, as well as accounting standards applicable to the contract, ask questions such as the following:

- ***Does the proposal include information required to identify the royalties included in the proposal?***

If a proposal includes royalties totaling more than \$250, the proposal should identify the name and address of the licensor, date of license agreement, patent numbers or patent application serial numbers, description of the patented item or process, and related pricing information.

- ***Has the offeror provided license agreements to support specific claims in connection with the proposed contract?***

A copy of the license agreement will normally be necessary to determine proper pricing and Government rights under the agreement.

- ***Is the proposed royalty specifically identified with the proposed contract?***

Do cognizant Government technical, audit, and patent personnel confirm that the proposed costs are directly related to one or more items of the contract. If the costs are indirectly related to a number of the firm's products, the related costs should be proposed as indirect costs. If the contract items do not benefit from the identified patents, question whether the contract should bear any related expense.

Determine If the Proposed Cost Is Reasonable ([FAR 27.206](#), [31.205-37](#), and [52.227-9](#)). As you determine whether the proposed royalty cost is reasonable, ask questions such as the following:

- ***Do Government technical personnel confirm that the patented design or process is required to complete the proposed contract?***

You will normally need technical assistance to determine if the identified process or design is necessary to complete the contract.

- ***Does the Government possess a license or right to free use of the patent?***

If the patented design or process resulted from work on a Government contract, the Government should hold a royalty-free license to use the patent. Consult the Government office with cognizance over patent matters for assistance.

- ***Has the patent expired or been found to be invalid or unenforceable?***

Consult the Government office with cognizance over patent matters for assistance.

- ***Is there a Government license rate for the required patent?***

There may already be a Government license rate established for the required patent. Consult the Government office with cognizance over patent matters for assistance.

- ***Is the proposed rate otherwise fair and reasonable?***

Compare the proposed fee with any royalties that the offeror pays for similar commercial production. Consider the related cost of any possible alternatives. Consult the Government office with cognizance over patent matters for assistance.

- ***Does the contract require the contractor to reimburse the Government the amount of questionable warranties if they are not paid by the contractor?***

If the contract is fixed-price and it is questionable whether the contractor or subcontractor will make substantial royalty payments as a result of the contract, insert the FAR clause Refund of Royalties in the contract.

8.2.7 Analyzing Preservation, Packaging, And Packing Costs

Preservation, Packaging, and Packing ([FAR 14.201-2\(d\)](#) and [15.204-2\(d\)](#)). Each solicitation and contract must describe any necessary preservation, packaging, and packing requirements. These requirements must be adequate to

prevent deterioration of supplies and damage due to the hazards of shipping, handling, and storage.

Determine If the Cost Is Properly Proposed. To determine if preservation, packaging, and packing costs are properly proposed in accordance with the offeror's estimating and accounting practices, as well as accounting standards applicable to the contract, ask questions such as the following:

- ***Does the offeror normally treat the costs of preservation, packaging, and packing as indirect costs under similar circumstances?***

If the offeror normally treats preservation, packaging, and packing costs as indirect costs under similar circumstances, the offeror should offer the same treatment for the proposed contract.

- ***Are the contract preservation, packaging, and packing requirements of the proposed contract unique?***

If the preservation, packaging, and packing requirements are different than other contracts with the offeror, the related costs should probably be other direct costs.

Determine If the Proposed Cost Is Reasonable. As you determine whether the proposed preservation, packaging, or packing costs are reasonable, ask questions such as the following:

- ***Does the proposal include adequate information for analysis of preservation, packaging, and packing costs?***

The other direct cost proposal should include a description of proposed preservation, packaging, and packing procedures and materials, as well as the per unit/item cost involved.

- ***Does the proposed cost appear reasonable when compared with costs incurred for similar packaging?***

Government transportation specialists should be able to provide substantial support for your analysis.

8.2.8 Analyzing Preproduction Costs

Preproduction Costs. Preproduction costs, also known as start-up or non-recurring costs, can be characterized as out of the ordinary costs associated with the initiation of production under a particular contract or program. Examples of preproduction costs include:

- Preproduction engineering;
- Special tooling;
- Special plant rearrangement;
- Training programs;
- Initial rework or spoilage; and
- Pilot production runs.

Solicitation Requirement. When these costs may be a significant cost factor in an acquisition, consider requiring in the solicitation that the offeror provide:

- An estimate of total preproduction and startup costs;
- The extent to which these costs are included in the proposed price; and
- The intent to absorb, or plan for recovery of, any remaining costs.

Determine If the Cost Is Properly Proposed. To determine if preproduction costs are properly proposed in accordance with the offeror's estimating and accounting practices, as well as accounting standards applicable to the contract, ask questions such as the following:

- ***Is there a mutual understanding between the offeror and the Government concerning what costs should be proposed as preproduction costs?***

This should be clearly described in the solicitation. Note that preproduction costs may include other direct costs examined earlier in this chapter (e.g., special tooling) Assure that the same other direct cost is not included in the proposal more than once.

- ***Is this cost proposed as an other direct cost in accordance with the contractor's accounting practices?***

The proposal must conform with applicable Cost Accounting Standards (CAS) and Generally Accepted Accounting Practices (GAAP).

- ***Do other estimates of direct and indirect cost, specifically exclude all costs proposed as a preproduction cost?***

If this type of cost is not specifically excluded from other categories of direct or indirect cost, the offeror may propose the same cost more than once.

Determine If the Proposed Cost Is Reasonable. As you determine whether the proposed preproduction costs are reasonable, ask questions such as the following:

- ***Are proposed costs reasonable for the required preproduction effort?***

In most cases, preproduction costs will include a combination of material and labor. The techniques of analysis are the same as those described in previous sections for direct material and direct labor.

- ***If appropriate, is there an agreement to defer preproduction costs in whole or in part to subsequent contracts?***

Since preproduction costs are nonrecurring costs, the contractor may agree to spread the costs across the total projected Government requirement.

- ***If a successful offeror has indicated an intent to absorb any portion of these costs, does the contract expressly provide that such costs will not be charged to the Government in any future noncompetitive pricing action?***

If a successful offeror has indicated an intent to absorb any portion of these costs, assure that the contract expressly provides that such portion will not be charged to the Government in any future noncompetitive pricing action.