

Contract Formation

Activity 21: Cost Analysis

The review and evaluation of the separate cost elements and profit or fee in an offeror's or contractor's proposal to determine a fair and reasonable price or to determine cost realism.

Related Flow Charts: [Flow Chart 21](#)

Related Courses: CLC 056: Analyzing Contract Costs; CLC 058: Introduction to Contract Pricing

Related Tools: [Acquisition Gateway Hallways](#), [GSA Contract-Awarded Labor Category \(CALC\)](#), [GSA Dashboards and Prices Paid Tools](#), [GSA eLibray](#), [Contract Pricing Reference Guides](#)

Tasks	FAR Reference(s)	Additional Information
1. Based on the solicitation requirements and type of contract, determine if cost analysis is appropriate.	FAR 15.404-1(c) Cost analysis [proposal analysis techniques]. FAR Table 15-2—Instructions for submitting cost/price proposals when certified cost or pricing data are required.	Cost analysis is: <ul style="list-style-type: none">• The review and evaluation of any of the separate cost elements and profit or fee in an offeror's or contractor's proposal as needed to determine a fair and reasonable price or to determine cost realism; and• The application of judgment to determine how well the proposed costs represent what the cost of the contract should be, assuming reasonable economy and efficiency.

Tasks	FAR Reference(s)	Additional Information
<p>2. Collect and review government cost estimates, reports, analyses, and other data related to the cost analysis.</p>	<p>FAR 15.404-1(c)(2)(iii) Cost analysis [proposal analysis techniques]</p>	<p>Identify and collect all relevant data relating to each major cost element, such as but not limited to:</p> <ul style="list-style-type: none"> • Historical data and actual costs; • Data from previous estimates from the offeror or other offerors for the same or similar items; • Technical evaluation reports; • Any applicable forward pricing rate agreements; • Any applicable forward pricing rate recommendations; • Audit reports, including any audit of contractor indirect cost rates within the last 12 months (if any; and • Any reports from Government monitoring of actual contract costs for similar work.
<p>3. Determine the level of cost analysis required to evaluate the reasonableness of cost elements or cost realism.</p>	<p>FAR 15.305(a)(1) Cost or price evaluation [proposal evaluation]. FAR 15.404-1(c) Cost analysis [proposal analysis techniques].</p>	<p>The Government may use various cost analysis techniques and procedures to ensure a fair and reasonable price, given the circumstances of the acquisition. Such techniques and procedures include the following:</p> <ul style="list-style-type: none"> • Verification of cost data or pricing data and evaluation of cost elements, including: <ul style="list-style-type: none"> ○ The necessity for, and reasonableness of, proposed costs, including allowances for contingencies; ○ Projection of the offeror’s cost trends, on the basis of current and historical cost or pricing data; ○ Reasonableness of estimates generated by appropriately calibrated and validated parametric models or cost-estimating relationships; and ○ The application of audited or negotiated indirect cost rates, labor rates, and cost of money or other factors.

Tasks	FAR Reference(s)	Additional Information
		<ul style="list-style-type: none"> • Evaluating the effect of the offeror’s current practices on future costs. In conducting this evaluation, ensure that the effects of inefficient or uneconomical past practices are not projected into the future. In pricing production of recently developed complex equipment, perform a trend analysis of basic labor and materials, even in periods of relative price stability. • Comparison of costs proposed by the offeror for individual cost elements with: <ul style="list-style-type: none"> ○ Actual costs previously incurred by the same offeror; ○ Previous cost estimates from the offeror or from other offerors for the same or similar items; ○ Other cost estimates received in response to the Government’s request; ○ Independent government cost estimates by technical personnel; and ○ Forecasts of planned expenditures. • Verification that the offeror’s cost submissions are in accordance with the contract cost principles and procedures in FAR Part 31 and, when applicable, the requirements and procedures in 48 CFR Chapter 99 (Appendix to the FAR looseleaf edition), Cost Accounting Standards. • Review to determine whether any cost data or pricing data, necessary to make the offeror’s proposal suitable for negotiation, have not been either submitted or identified in writing by the offeror. If there are such data, the contracting officer must attempt to obtain and use them in the negotiations or make satisfactory allowance for the incomplete data. • Analysis of the results of any make-or-buy program reviews, in evaluating subcontract costs (see FAR 15.407-2).

Tasks	FAR Reference(s)	Additional Information
4. Evaluate each cost element.	FAR 15.404 Proposal analysis [contract pricing].	<p>Price each contract separately and independently, and do not:</p> <ul style="list-style-type: none"> • Use proposed price reductions under other contracts as an evaluation factor; or • Consider losses or profits realized or anticipated under other contracts. <p>Do not include in a contract price any amount for a specified contingency to the extent that the contract provides for a price adjustment based upon the occurrence of that contingency.</p>
4a. Evaluate direct labor costs.	<p>FAR 15.408 Solicitation provisions and contract clauses [contract pricing].</p> <p>FAR Table 15-2—Instructions for submitting cost/price proposals when certified cost or pricing data are required.</p>	<p>For direct labor, provide a time-phased (e.g., monthly, quarterly, etc.) breakdown of labor hours, rates, and cost by appropriate category, and furnish bases for estimates.</p> <p>A direct labor cost is any labor cost that can be identified specifically with a final cost objective (e.g., a particular contract).</p> <p>Labor costs identified specifically with a particular contract are direct costs of the contract and must be charged to that contract.</p> <p>Labor costs must not be charged to a contract as a direct cost if other labor costs incurred for the same purpose in like circumstances have been charged as an indirect cost to that contract or any other contract.</p> <p>All labor costs specifically identified with other contracts are direct costs for those contracts and must not be charged to another contract directly or indirectly.</p> <p>Identify and evaluate the methodology used by the offeror to estimate direct labor cost.</p>
4b. Evaluate labor hours.	FAR 15.408 Solicitation provisions and contract clauses [contract pricing].	<p>Determine whether the estimating method is appropriate for the estimating situation.</p> <p>Determine whether the estimating method was properly applied.</p>

Tasks	FAR Reference(s)	Additional Information
4c. Analyze labor rates for each labor category listed in each proposal.	FAR 15.408 Solicitation provisions and contract clauses [contract pricing].	<p>Consider the following questions when determining labor rates fair and reasonable:</p> <ul style="list-style-type: none"> • Is the proposed labor rate and related compensation reasonable based on comparisons with the compensation practices of other firms of the same size? • Is the proposed labor rate and related compensation reasonable based on comparisons with the compensation practices of other firms in the same industry? • Is the proposed labor rate and related compensation reasonable based on comparisons with the compensation practices of other firms in the same geographic area? • Is the proposed labor rate and related compensation reasonable based on comparisons with the compensation practices of firms engaged in predominantly nongovernment work? • Is the proposed labor cost reasonable based on comparisons with the cost of comparable services from other sources? <p>Consider the effect of the following factors on those comparisons:</p> <ul style="list-style-type: none"> • Government labor-rate requirements; • Skill mix of labor effort; • Time period of labor effort; and • Company-unique labor factors.

Tasks	FAR Reference(s)	Additional Information
<p>4d. Analyze the indirect costs in each proposal.</p>	<p>FAR 15.408 Solicitation provisions and contract clauses [contract pricing].</p>	<p>Indirect costs are costs that cannot be specifically identified with the production or sale of a particular product or completion of a single contract. Indirect costs normally fall into two categories: overhead and general and administrative costs</p> <p>Overhead costs are indirect costs related to support of specific operations.</p> <p>General and administrative (G&A) expenses costs are management, financial, and other expenses related to the general management and administration of the business unit as a whole. To be considered a G&A expense of a business unit, the expenditure must be incurred by, or allocated to, the general business unit.</p> <p>In analyzing indirect costs consider how the costs were computed and applied, including cost breakdowns. Verify the trends and budgetary data provided as a basis for their reasonableness rates. Ensure that an appropriate explanation for each rate was provided. Use the following questions to assist in the evaluation of the indirect rates.</p> <ul style="list-style-type: none"> • Is the type of cost generally recognized as necessary in conducting the contractor's business? • Is the cost consistent with sound business practice, law, regulation, and the principles of "arm's-length" bargaining? • Does the contractor's action reflect a responsible attitude toward the Government, other customers, the owners of the business, the employees, and the public at-large? • Are the contractor's actions consistent with the contractor's established practices?

Tasks	FAR Reference(s)	Additional Information
4e. Analyze other direct costs in each proposal.	FAR 15.408 Solicitation provisions and contract clauses [contract pricing].	<p>Other costs are costs not otherwise included in the categories described above (e.g., special tooling, travel, computer and consultant services, preservation, packaging and packing, spoilage and rework, and Federal excise tax on finished articles) and provide bases for pricing.</p> <p>In evaluating the other direct costs, determine if other direct costs are:</p> <ul style="list-style-type: none"> • Properly proposed in accordance with the offeror's estimating and accounting practices, as well as accounting standards applicable to the contract; and • Determine if the proposed other direct cost is reasonable, considering any points identified for special emphasis.
5. Develop a prenegotiation position.	FAR 15.406-1 Prenegotiation objectives	<p>The prenegotiation objectives establish the Government's initial negotiation position. They assist in the contracting officer's determination of fair and reasonable price. They should be based on the results of the contracting officer's analysis of the offeror's proposal, taking into consideration all pertinent information including field pricing assistance, audit reports and technical analysis, fact-finding results, independent Government cost estimates and price histories.</p> <p>The contracting officer must establish prenegotiation objectives before the negotiation of any pricing action. The scope and depth of the analysis supporting the objectives should be directly related to the dollar value, importance, and complexity of the pricing action. When cost analysis is required, the contracting officer must document the pertinent issues to be negotiated, the cost objectives, and a profit or fee objective.</p>

Tasks	FAR Reference(s)	Additional Information
6. Negotiate.	FAR 15.405 Price negotiation.	<p>The purpose of performing cost or price analysis is to develop a negotiation position that permits the contracting officer and the offeror an opportunity to reach agreement on a fair and reasonable price. A fair and reasonable price does not require that agreement be reached on every element of cost, nor is it mandatory that the agreed price be within the contracting officer's initial negotiation position. The contracting officer is responsible for exercising the requisite judgment needed to reach a negotiated settlement with the offeror and is solely responsible for the final price agreement.</p> <p>When significant audit or other specialist recommendations are not adopted, provide rationale that supports the negotiation result in the price negotiation documentation.</p>
7. Document the contract file.	FAR 15.406 Documentation [contract pricing].	When cost analysis is required, document the pertinent issues to be negotiated, the cost objectives, and a profit or fee objective.