

9. OTHER DIRECT COSTS

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9.1 OVERVIEW OF ODCS

This chapter addresses the terms, concepts, and issues involved in analyzing Other Direct Costs (ODCs).

ODCs are other costs charged directly to the Government that have not been included in proposed material, direct labor, indirect costs, or any other category of cost. ODCs can include but are not limited to: special tooling, travel expenses, relocation expenses, pre-production and start-up costs, packaging and transportation costs, royalties, spoilage and rework, computer expenses, federal excise taxes, and reproduction costs. In submitting a cost proposal, a contractor should list all ODCs and provide a basis for pricing.

Some costs can be both direct and indirect. When these costs can be identified with a specific cost objective (i.e., a product, function, project, or program), the contractor should charge them directly to a given effort. However, costs normally charged indirectly cannot be charged direct unless the costs will be incurred for a different purpose and/or under different circumstances than typically incurred.

When reviewing proposals or invoices, the analyst must guard against “double-counting” by ensuring that the same ODCs are not included in more than one cost category, and that all costs are classified in accordance with the company’s accounting practices. The analyst must also assess the overall reasonableness, allowability, and allocability of the proposed ODCs.

The process of reviewing a contractor’s cost and pricing data as well as the general principles of cost and price analysis is the same for ODCs as for the previously discussed cost elements. The following sections will concentrate on the proper evaluation process and techniques which can be utilized to analyze the most common ODCs: travel, pre-production costs (including special tooling and test equipment), relocation costs, royalties, and packaging and transportation costs.

9.2 TRAVEL

Travel costs usually include the costs of transportation, lodging, and meals and incidental expenses (M&IE) incurred by employees while traveling on official business. Travel estimates proposed by contractors are usually based on the potential number of trips, places to be visited, length of stay, mode of transportation, and estimated per diem, or living allowance.

When evaluating travel costs, the analyst should review proposed costs to ensure that the purpose of the trips is within the scope of the tasks to be performed. The Screening Information Request (SIR) should request that

the contractor provide the number of trips and persons per trip, as well as destination, duration, mode of travel, and purpose of travel. Costs for transportation may be based on mileage rates, actual costs incurred, or on a combination of both. Costs for lodging are based on per diem rates to the extent that they do not exceed the daily maximum rate set forth in the *Federal Travel Regulation*, prescribed by the General Services Administration, actual expenses, or a combination thereof.

A contractor's actual costs may exceed the maximum per diem expenses allowed. To be allowable, actual expenses must meet all of the following conditions: 1.) one of the conditions from the *Federal Travel Regulation* should apply (see below); 2.) there must be written justification for the use of higher amounts, approved by an officer of the contractor's organization; 3.) costs that become expenses and will in the future be incurred on a regular basis require advance approval from the contracting officer; and 4.) documentation must be provided for all supporting actual costs. The *Federal Travel Regulation* provides the following examples of travel situations which may warrant authorization or approval of actual and necessary expenses.

1. *The employee attends a meeting, conference, or training session away from the official duty station where lodging and meals must be procured at a prearranged place, and as a result the lodging costs absorb all or practically all of the applicable per diem allowance.*
2. *Travel is to an area where the applicable per diem allowance is generally adequate, but subsistence costs have escalated for special reasons during the time of travel (e.g., Mardi Gras in New Orleans.)*
3. *Based on the situation 2.) above, affordable lodging accommodations are not available or cannot be obtained within a reasonable commuting distance and transportation costs to commute to and from the less expensive lodging facility consume most or all of the savings achieved from occupying less expensive lodging.*
4. *The employee, because of special duties of the assignment, necessarily incurs unusually high expenses in the conduct of official business (e.g., a corporate recruiter may require a business suite to conduct interviews.)*
5. *The employee necessarily incurs unusually high expenses incident to his/her assignment to accompany another employee in a situation described in situation 4.).*

Similarly, there are occasions when less than the full per diem is considered reasonable and allowable. Such instances occur when no lodging costs are incurred, when actual lodging amounts to less than full per diem, and on partial travel days.

Below is a checklist of questions that the analyst should consider when reviewing travel costs.

- Is travel for a legitimate contract purpose?
- Are the number and type of personnel traveling appropriate and reasonable for the proposed trip?
- Is the duration proposed reasonable?
- Do the per diem rates proposed exceed allowable per diem rates (unless the actual cost method is used)?
- Are the proposed air fare rates projected in excess of lowest reasonably available fare? (See AMS Toolbox Guidance T3.3.2D.2-43(d), Selected Costs.)
- Are the projected transportation costs based on other than the least expensive means of transportation and/or use other than proper departure points? If so, is there a reason provided?
- Are the mileage allowances projected in excess of actual needs?
- Are the ground transportation costs at the destination reasonable?
- Are miscellaneous costs such as airport parking and taxi fares appropriate and reasonable?
- Is the proposed travel in accordance with company policy?
- Is the current estimate reasonable after comparison with prior trips of a similar nature?

ABC Company has proposed an “ODC” of \$13,769 for travel costs. ABC Company must provide justification. The following paragraphs and tables detail how ABC Company furnished its travel estimate.

In Table 9-1, ABC Company divides the total cost into three groups of trips. ABC Company then provides the number of personnel per trip, time period of travel, duration, mode and cost of transportation, departure and destination points, lodging costs, and other associated costs such as ground transportation (car rental). Although a copy of ABC Company’s travel policy is not provided in the example, the policy should be provided in the proposal.

Table 9-1. ABC Company Travel Estimate (\$)

Time Period	Departure/ Destination	# of Trips	# of People	# of Days	Air Fare	Room	M&IE	Car	Per Day w/o AF	Total
7/09	Wash. DC/ Atlantic City	3	3	1	0	0	342	102	444	3,996
8/09	Wash. DC/ Oklahoma City	2	2	2	2092	224	208	140	572	\$12,944
8/09	Wash. DC/ Denver	1	5	5	4000	1540	950	175	2665	\$86,625

In Table 9-2, ABC Company provides justification for the proposed trips. This allows the analyst and technical evaluator to determine if proposed travel costs are necessary and within the scope of the efforts proposed.

Table 9-2. ABC Company Travel Justification

Proposed Travel	Justification
Atlantic City	Three trips for bi-weekly meetings with all key personnel prior to Operational Test & Evaluation (OT&E)
Oklahoma City	Two trips for the senior hardware engineers to meet the FAA Technical Center personnel on the critical design for MCP-2.
Denver	One trip with all the key personnel for initial system delivery.

Utilizing the information provided in Table 9-1, Table 9-2, and the company policy, the analyst can assess the reasonableness, allowability, and allocability of proposed costs. The analyst can check the proposed lodging and M&IE for reasonableness by using the allowable lodging and M&IE rates published in the *Federal Travel Regulation* by General Services Administration. Proposed airfare can be verified with a travel agent, travel websites, through the airline, or through the Office of Adjunct General (OAG) Desktop Flight Guide. The car rental costs can be cross-checked using a quote from a rental car agency for a vehicle that is adequate in size and type for the number of people and the purpose of the trip. The Government technical review should include an evaluation of the necessity and appropriateness of the proposed trips as well as their duration and the time period of travel. The number and skill levels of traveling personnel should also be reviewed by the technical evaluator for necessity and reasonableness.

9.3 PRE-PRODUCTION COSTS

Generally, these costs are nonrecurring costs to be incurred early in the life of a contract. These costs may include pre-production engineering, **special tooling** and **special test equipment**, special plant rearrangement, training programs, initial rework or spoilage, and pilot runs. Most often, special tooling and special test equipment form the majority of pre-production costs. Proposals should clearly identify any pre-production and startup costs allocated to the contract.

Evaluating Special Tooling and Special Test Equipment

Below is a list of guidelines the analyst should follow when examining special tooling or equipment.

1. The tooling or test equipment must be usable only on the proposed contract.
2. General purpose equipment or tools can not accomplish the necessary task.
3. The tools or test equipment must be reviewed to ensure the proper type and number of tools or equipment are proposed.
4. Verify that the government does not already own or have available similar tooling or test equipment that can do the job.
5. When the above points have been reviewed a cost analysis of the proposed costs should be performed.

Special tooling includes jigs, dies, fixtures, molds, patterns, taps, gauges, and other equipment and manufacturing aids, all related components, and replacement of these items, which are of such specialized nature that without considerable modification or alteration their use is limited to the development or production of particular supplies or parts thereof or to the performance of particular services. It does not include material, special test equipment, general or special machine tools, or similar capital items.

Special test equipment includes either single or multipurpose integrated test units engineered, designed, fabricated, or modified to accomplish special-purpose testing in the performance of a specific contract. It consists of equipment or assemblies of equipment including standard or general purpose items or components that are interconnected and interdependent so as to become a new functional entity for testing purposes. It does not include material, special tooling, facilities, and plant equipment items used for general testing purposes.

Special Tooling

The analyst should focus on understanding the estimating procedure used to develop the tooling costs and perform a detailed review of the contractor's cost estimate for selected items. As part of the review process, the analyst can compare the estimates for a selected group of tools with actual costs or actual hours expended for similar tools utilized in previous production. Analysis of the selected tooling requires the analyst to evaluate proposed labor and materials in accordance with the cost and price analysis principles applicable to each cost element.

Tooling may require both engineering and manufacturing labor. Labor hour estimates will generally vary from detailed, time-phased estimates to a very broad approach in which the tooling cost is estimated as a percentage of the

effort required to produce the end-product. The latter method is rarely used and should only be accepted when detailed information is not available.

Because the issues surrounding special tooling are so complex, the analyst may need to rely on information provided from the Government technical team regarding the need for and the extent of proposed tooling costs. The evaluation must determine if expensive tools are justified and whether a sufficient number of skilled employees are available to use them.

Allowability of Special Tooling and Test Equipment:

The cost of special tooling and special test equipment used in performing one or more Government contracts is allowable and allocable to the specific Government contract for which acquired, except that the cost of 1.) items acquired by the contractor before the effective date of the contract (or replacement of such items), whether or not altered or adapted for use in performing the contract, and 2.) items which the contract schedule specifically excludes, are allowable only as depreciation or amortization. [FAA AMS Procurement Guidance T3.3.2D.2.37 (Contract Cost Principles)]

Special Test Equipment

The analyst should evaluate special test equipment in the same manner as special tooling. A review must establish whether proposed special test equipment is adequately justified.

9.4 RELOCATION COSTS

When related to work on a specific contract, relocation is often listed as an ODC. The most common **relocation costs** are travel costs for an employee and members of the immediate family and all associated transportation costs of the household and personal goods to move to a new location. Other examples of relocation costs which are generally allowable are outlined below. [FAA AMS Procurement Guidance T3.3.2D.2.32 (Contract Cost Principles)]

Relocation costs include costs incident to the permanent change of duty of assignment (for a period of 12 months or more) of an existing employee or upon recruitment of a new employee. [FAA AMS Procurement Guidance T3.3.2D.2.32 (Contract Cost Principles)]

1. **Costs of finding a new home**, such as advance trips by employees and spouses to locate living quarters, and temporary lodging during the transition periods not exceeding separate cumulative totals of 60 days for employees and 45 days for spouses and dependents, including advance trip time.
2. **Closing costs** incident to the disposition of the actual residence owned by the employee when notified of transfer. These costs

when added to the continuing costs described in 3.) should not exceed 14% of the sales price of the property sold.

3. **Continuing costs** of ownership of the vacant former actual residence being sold, such as maintenance of building and grounds, utilities, taxes, property insurance, and mortgage interest. These costs added to 2.) above should not exceed 14% of the sales price of the property sold.
4. **Costs incurred from acquiring a new home**, except when costs are for employees or newly recruited employees who were not prior homeowners. The total costs should not exceed 5% of the purchase price of the new home.
5. **Mortgage interest differential payments**, except when costs are for existing or newly recruited employees who were not prior homeowners. Payments are limited to an amount determined as follows: (i) the difference between the old and new mortgage rates times the current balance of the old mortgage times 3 years, or (ii) when mortgage differential payments are made on a lump sum basis and the employee leaves again in less than 3 years, the amount initially recognized shall be proportionately adjusted to reflect payments only for the actual time of the relocation.
6. **Other necessary and reasonable expenses** normally incident to relocation, such as disconnecting and connecting household appliances, automobile registration, driver's license fees etc.
7. **Costs of canceling an unexpired lease** are generally allowable when shown to have been caused by the relocation. The cost of canceling a lease is normally allowable when the claimed cost of cancellation does not exceed the value of the lease payments for the contract period. Employees should make all reasonable efforts to assign, settle, or otherwise reduce the cost of the lease.
8. **Rental differential payments** covering situations where relocated employees retain ownership of a vacated home in the old location and rent at the new location. The rented quarters at the new location must be comparable to those vacated. The allowable differential payments should not exceed the actual rental costs for the new home, less the fair market rent for the vacated home times 3 years.

The analyst must evaluate the relocation costs to determine if proposed costs are reasonable and allowable. The contractor will generally provide the basis of estimate for the proposed cost. The contractor must also provide reason-

able justification for the relocation of an employee and demonstrate that relocation costs were in accordance with an established company policy or practice.

Relocation costs should not exceed the employee's actual expenses, except expenses for miscellaneous costs. Depending upon a specific relocation agreement or company policy a flat amount not to exceed \$1,000 may be used, in lieu of actual costs for such miscellaneous expenses as the connection and disconnection of household appliances, driver's license, utility fees and deposits etc.

Some companies have Advance Agreements on Relocation costs with their cognizant government agency ACOs (usually DOD). The analyst should request copies and verify proposed costs are consistent with the Agreement.

Unallowable Relocation Costs:

(FAA AMS Procurement Guidance T3.3.2D.2.32)

- 1.) Loss on sale of a home.
- 2.) Costs incident to acquiring a home in a new location as follows: (i) real estate broker's fees and commission, (ii) cost of litigation, (iii) real estate and personal property insurance against damage or loss of property, (iv) mortgage life insurance, and (v) property taxes and operating or maintenance costs.
- 3.) Continuing mortgage principal payments on residence being sold
- 4.) Cost incident of furnishing equity or nonequity loans to employees or making arrangements with lenders for employees to obtain lower-than-market rate mortgage loans.

9.5 ROYALTIES

Occasionally, certain processes or designs which involve payment of **royalties** are required for contract performance. If royalties are more than \$250, the contractor should provide the following information on a separate page for each separate royalty or license fee: name and address of licensor; date of license agreement; patent numbers, patent application serial numbers, or other basis on which the royalty is payable; brief description (including any part or model numbers of each contract item or component on which the royalty is payable); percentage or dollar rate of royalty per unit; unit price of contract item; number of units; and total dollar amount of royalties. In addition, if specifically requested

Royalties are fees paid for the use of some right, such as a copyright or patent.

Royalties are allowable unless:

- The Government has a license or the right to free use of the patent;
- The patent has been adjudicated to be invalid, or has been administratively determined to be invalid;
- The patent is considered to be unenforceable; or
- The patent is expired.

[FAA AMS Procurement Guidance T3.3.2D.2.34 (Contract Cost Principles)]

by the contracting officer, the contractor should provide a copy of the current license agreement and identification of applicable claims of specific patents.

Although analysis is limited due to the nature of the cost, the analyst is still responsible to ensure the Government is not paying undue costs. The analyst must determine if royalties should be included in the price of a contract and determine if proposed costs are reasonable for the value received. A verification that the Government does not already have rights to the patent or copyright under another contract must be performed. It will probably be necessary for the analyst to seek legal advice concerning the royalty cost. A determination must also be made as to whether the contract will include royalty reporting requirements and royalty escrow or recapture provisions.

When determining the reasonableness of the proposed royalty costs, the analyst must verify that the royalty costs have not been a result of less than an arm's length bargaining agreement. Situations the analyst should review closely include: payment of royalties to persons and corporations affiliated with the contractor; payments to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a Government contract would be awarded; or payments under an agreement entered into after the contract award.

9.6 PACKAGING & TRANSPORTATION COSTS

Packaging instructions will be provided to the contractor and included in the Screening Information Request (SIR) and the resulting contract. These instructions usually detail any special treatments required. Transportation costs are treated similarly. Specific directions are generally provided by the Government as to how, when, and where items will be transported by the contractor.

The two most important issues regarding transportation are: 1.) who bears the cost of transportation and 2.) who bears the risk of loss? Two terms are used in contracts to address these issues: **F.O.B. (Free on board) Origin** and **F.O.B. Destination**. F.O.B. Origin means that the contractor is responsible only up to the point the goods leave their loading dock. At this point, the responsibility transfers to the Government and the Government assumes all risk and costs for shipment of the property. F.O.B. Destination means the contractor is responsible until the property is delivered to the Government's stated location and accepted by the Government (The F.O.B. points usually signify when and where the Government (buyer) actually takes title.)

When evaluating packaging and transportation costs, the analyst should compare a contractor's cost estimate with costs incurred for similar packaging and transportation expenses in order to determine the reasonableness of

the proposed cost. Additionally, the analyst can compare these costs to current market prices. Packaging estimates are sometimes derived from a percentage of total manufacturing costs or are based on averages experienced for prior years. Often, when packaging estimates are based on complex technical determinations and the dollar value is significant, the assistance of a Government packaging specialist is necessary. Transportation costs can be checked against quotes from various freight companies.

9.7 COST REALISM AS RELATED TO ODCS

Cost realism refers to the existence of factual, verifiable, and predictable data whose use in an estimating methodology equates to the costs most likely to be incurred by a contractor, given their proposed technical and management approaches. A measure of cost realism is the extent to which a proposal factually states anticipated contract costs and related performance and technical risks.

Outlined below are many of the tests for assessing realism as it relates to ODCs that have been discussed in this chapter.

- Are the costs proposed consistent with the management and technical approaches prescribed by the contractor? Have they followed company policy and procedures?
- Has the contractor duplicated any costs which are included in other cost elements?
- Has the offeror included all ODCs which may be necessary to perform the scope and efforts required?
- Have all ODCs been adequately justified?
- Are special tooling and special test equipment proposed currently in the contractor's inventory or available from the Government?

9.8 SUMMARY

Differences between company accounting practices and contractual circumstances explain why firms categorize costs differently. There are no hard and fast rules to apply to the evaluation of ODCs. ODCs must be evaluated on a contractor-by-contractor and situation-by-situation basis. The analyst must verify that the proposed costs are consistent with advance agreements between government and contractor (if any) and with the company's accounting practices, that costs are not included in other cost elements, and that costs are reasonable and allowable.