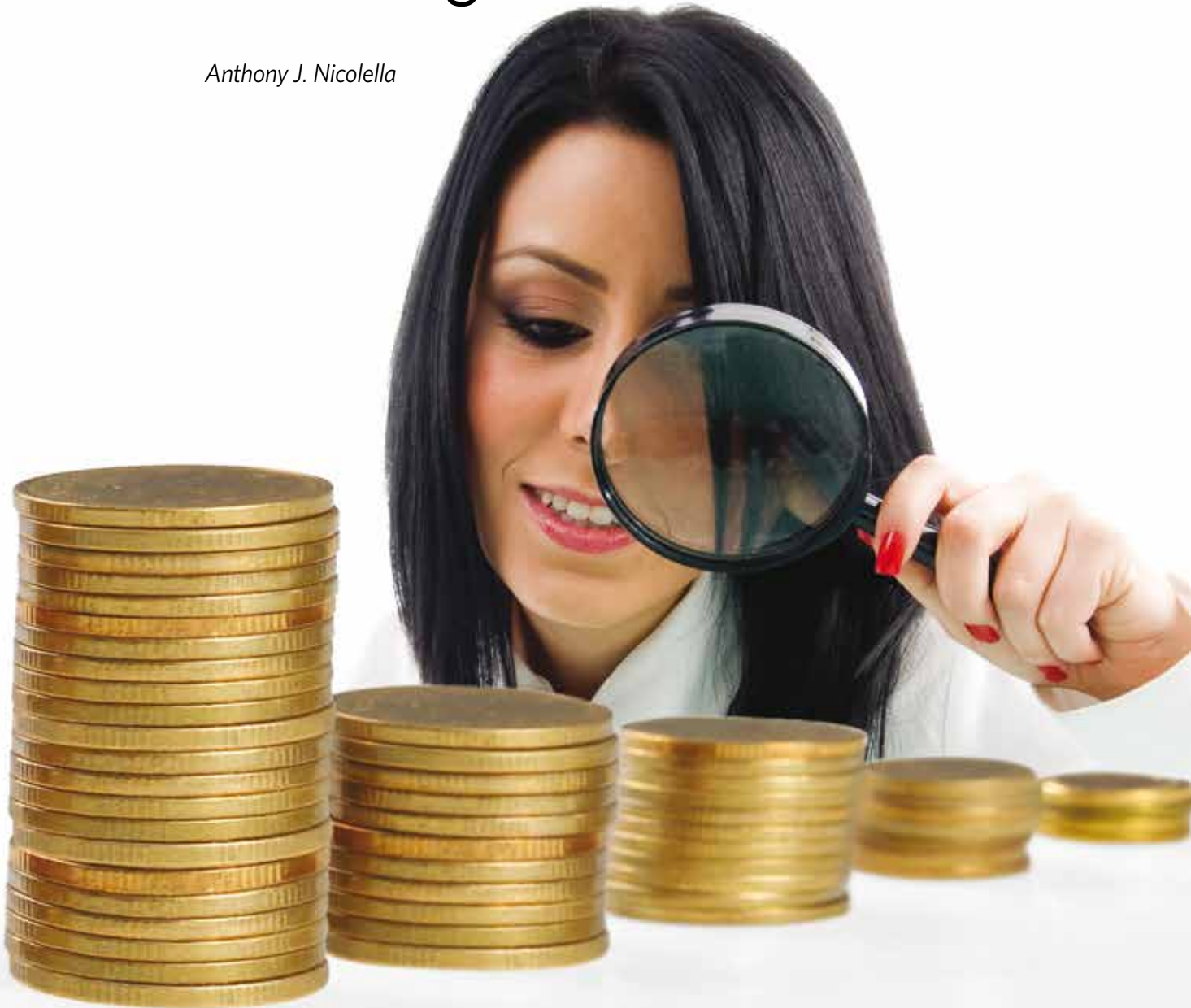


# Determining the Probable Cost

*Anthony J. Nicolella*



**Y**our organization has just issued a Request for Proposal (RFP), and, in response, you have received several proposals. In your RFP, you stated that the government was contemplating the award of a cost-reimbursement contract.

You are preparing to perform your analysis. Before starting, you go to the Federal Acquisition Regulation (FAR), specifically FAR Part 15.404-1(d), and realize that the FAR requires you to perform cost realism analysis to determine the probable cost of performance for each offeror. You start asking yourself a series of questions such as: What is cost realism analysis? When does cost realism need to be done? How do I determine the probable cost? What resources are available to assist me in developing a probable cost? Does the government get many protests regarding cost realism analysis? It is hoped that this article will help answer these questions and more.

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## Report Documentation Page

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Per FAR 2.101 and 15.404-1(d) and Contract Pricing Reference Guides (CPRG), Volume 4, Chapter 8, Paragraph 8.1, cost realism analysis is “the process of independently reviewing and evaluating specific elements of each offeror’s proposed cost estimate to determine whether the estimated proposed cost elements are realistic for the work to be performed; reflect a clear understanding of contract requirements; and are consistent with the unique methods of performances and materials described in the offeror’s technical proposal.”

Let’s dissect the above definition a little bit more by focusing on several key terms. First, it is an “independent process,” which means that as a contracting professional you have to do the reviewing and evaluating. This does not mean you cannot solicit input or help from other government personnel (contracting officer representatives—CORs; Technical

Now that we know what cost realism analysis is, we need to answer the next question: When does it need to be done? FAR Part 15.404-1(d)(2) states that cost realism analysis shall be performed on cost-reimbursement contracts to determine the probable cost. All contracting professionals should know that the word “shall” means “must.” So as a contracting professional, you must perform cost realism analysis on all cost-reimbursement contracts. It does not get any clearer than that.

The next two questions—“How do I determine the probable cost, and what resources are available to assist me in developing a probable cost?”—kind of go hand and hand because you cannot do one without doing the other. Knowing what sources of information are available to you when trying to determine the probable cost will make your job much easier. As a government contracting professional, there are numerous sources of information you can use to help you determine the probable



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Points of Contact—TPOCs; engineers, etc.), or agencies like the Defense Contract Audit Agency (DCAA). However, it does mean that you, the contracting officer, will make the judgment independent of any of the before mentioned personnel or agencies. Second, cost realism analysis includes the “reviewing and evaluating process of specific elements.” The elements to which this definition refers are cost elements as defined in FAR Part 15.408, Table 15-2, Roman Numeral II (Cost Elements), such as direct labor, indirect costs, other costs, etc. Does that mean you have to look at each cost element when performing cost realism analysis? Not necessarily. If a cost element appears reasonable based on your preliminary review and analysis, you may not have to analyze it any further. Also, reviewing and evaluating specific cost elements can be limited to substantial costs (Controller General Case: B-271302.2).

Finally, the cost realism definition further states that in doing your analysis you must look at each “offeror’s proposed cost estimate.” This is important. You must analyze and develop a probable cost for each offeror. You cannot simply do one analysis and one probable cost and apply it to all offerors’ proposals. If you did this, you would not be in compliance with FAR Part 15.404-1(d)(2) and CPRG. Also, realize that each offeror will have a different technical approach and accounting system, so using a single probable cost and applying it across the board to all proposals would be impractical. By defining cost realism analysis and then breaking down its key terms, we were able to answer the question “What is cost realism analysis?”

cost, including an Independent Government Estimate (IGE), cost estimating relationships, wage determinations, technical evaluations, audit reports, forward pricing rate agreements (FPRA), and results from cost estimating system reviews, just to name a few. In addition, you can obtain assistance from other members of the government acquisition team like your technical specialists (CORs/TPOCs) and personnel from both DCAA and the Defense Contract Management Agency (DCMA). Each of these members is uniquely qualified to assist you in evaluating technical and pricing proposals. For example, an in-house technical expert, COR, can provide you with valuable input regarding how realistic an offeror’s proposed cost estimate is with regard to material costs, labor mix, and labor hours. DCAA is familiar with offerors’ accounting systems and indirect rates and can help you determine if indirect rates are significantly lower than projected rates. DCMA can provide you with an array of experts (Quality Assurance Specialists, Engineers, Cost/Price Analysts, Industrial Specialists, etc.), that can help answer any questions that your in-house technical personnel may have about a proposal. DCMA also can help answer any questions regarding FPRAs or Forward Pricing Rate Recommendations (FPRRs).

Table 1 shows sources and resources that may help illustrate how one can determine the probable cost.

FAR Part 15.404-1(d)(2)(i) states that the probable cost may differ from proposed cost and should reflect the government’s best estimate. Section (ii) of the same reference further states that the probable cost is determined by adjusting each

**Table 1. Match-up of Source and Resource with Cost Elements**

Cost Elements	Proposed	Probable Cost	Resources and Sources Available
1. Material	\$13,000	\$10,000	COR—Technical Evaluation
2. Eng. Direct Labor	\$1,000,000	\$1,250,000	Contract Specialist—Wage Determination
3. Eng. OH	\$1,250,000	\$1,250,000	DCMA—Forward Pricing Rate Agreement (FPRA)
4. ODC (Travel)	\$2,000	\$2,000	Contract Specialist—Joint Travel Reg. (JTR)
5. Subtotal Production	\$2,265,000	\$2,512,000	DCAA—Total Cost Input or Value Added
6. G&A	\$226,500	\$251,200	Cost Price Analyst—Regression Analysis

Note: Some elements may have more than one source or resource.

offeror’s proposed cost to reflect any additions or reductions in cost elements to realistic levels based on the cost realism results. As you can see from the above diagram, a reduction to the cost element of material was made and then additions to Engineering Direct Labor and general and administrative expenses were made. The former reduction was made based on feedback from the COR, and the latter additions were made based on Contract Specialist and Cost Price Analysts input.

Other sources and resources were used to evaluate the best value of the remaining cost elements. But, since these cost elements (Engineering Overhead [OH] and Other Direct Costs [ODC]) appeared realistic, the contract specialist determined that no adjustments were necessary.

The process outlined above would need to be repeated in order to determine the government’s probable cost of each offeror’s proposal. This simple but fairly accurate illustration demonstrates the process a contracting professional should go through when trying to determine the probable cost of performance. In our illustration, we had sources and resources identified to assist us in determining the probable cost, but this may not always be the case. FPRAs, historical data for regression analysis, and wage determinations may not always be available or in existence. In these circumstances, it makes determining the probable cost more difficult but not impossible. You will need to improvise (use other methods) to determine the government’s probable cost.

So at this point some of you are undoubtedly thinking cost realism analysis and especially determining the probable cost sounds like a judgmental process and must lead to numerous protests filed against the government. This takes us to our last question, “Does the government get a lot of protests regarding cost realism analysis?” The cost realism analysis bid protest results of the last 3 years, listed in Table 2, may provide a pleasant surprise.

According to the Government Accountability Office (GAO) official website, [www.gao.gov/legal/bids/bidprotest.html](http://www.gao.gov/legal/bids/bidprotest.html), from Jan. 1, 2010, to Dec. 31, 2012, DoD received 501 bid protests. Of the 501 protests, only 42, or 8.4 percent, were cost realism related. For 2012 and the 17 protests received

(not including the three that are still open), the sustained vs. denied ratio was one-fourteenth, or 7 percent. The one protest that was sustained was due to the government not following one of the cardinal rules of FAR 15.404-1(d) and Volume 4, Chapter 8 of the CPRG. Instead of developing a probable cost for each offeror’s proposal, the agency compared one offeror’s proposal to the median price proposed by other offerors, some of which already were deemed unacceptable due to unreasonably high prices.

This rationale was unsound, and taking a one-size-fits-all approach is not in accordance with the FAR or CPRG and can lead to a protest and a subsequent victory for the protester. However, the number of bid protests is remarkably low and indicates that the majority of the government agencies are performing cost realism analysis and determining the probable cost in accordance with FAR and CPRG guidance and solicitation criteria.

With cost realism analysis now being taught in the contracting curriculum in such Defense Acquisition University (DAU) courses as CON 170 (Fundamentals of Cost and Price Analysis), CON 270 (Intermediate Cost and Price Analysis), and CON 280 (Source Selection and Administration of Service Contracts) and with more government contracting professionals receiving such training earlier in their careers, it would be reasonable to expect the number of cost realism analysis protests to steadily decline in the future. &

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**Table 2. GAO Protests Relating to Cost Realism, DoD**

CY 2010	CY 2011	CY 2012	Total	Breakdown by Service
8	17	17	42	Air Force - 13 Army - 10 Navy - 9 Other - 8 Marines - 2

Current as of 11/08/2012