Contract Costing Issues

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Policy Change Notice No. 00-108
Summary of Chapter Changes:

It is important that Procuring Contracting Officers (PCOs) and Program Managers be kept apprised of changes in Forward Pricing Rates.

To ensure Program Managers and PCOs are aware of rate changes and related program impacts, ACOs and DACOs administering major weapon program contracts must provide proposed and recommended Forward Pricing Rate information to the PCO and the DCMC Program integrator.

The DCMC Program Integrator will incorporate this information into the monthly Program Assessment Report, which is submitted to the program office.

Information should be provided whenever Forward Pricing Rates change or are expected to change.
**Contract Costing Issues**

**Discussion Topics**

- Players (Contracting Officers’ Roles)
- Emphasis on Overhead Rates
- Causes of changes in programs’ cost profile
- Illustration by Raytheon Corporate Administrative Contracting Officer
Players
Cognizant DCMA Contracting
Officers

<table>
<thead>
<tr>
<th>Corporation</th>
<th>CACO/DCE</th>
<th>Pension, Insurance, HOE, Restructuring</th>
</tr>
</thead>
<tbody>
<tr>
<td>Segment</td>
<td>DACO</td>
<td>Overhead rates</td>
</tr>
<tr>
<td>Program</td>
<td>ACO???</td>
<td>...but you might not have a “contracts” counterpart</td>
</tr>
<tr>
<td>Contract</td>
<td>ACO</td>
<td>Pricing of assigned contracts</td>
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<tr>
<td></td>
<td></td>
<td>(allocation/ allowability of estimated or incurred costs)</td>
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</tbody>
</table>

As a PI, you have multiple corporations, segments, contracts...contracting structure in typical CMO doesn’t make you
First, some background...

**Direct Cost** -- benefits a specific contract
- Examples: manufacturing labor, material, travel, testing, program support

**Indirect Cost** -- benefits more than one contract (or isn’t worth charging direct)
- Examples: supervision of manufacturing labor, H&E, purchasing, low direct

**Overhead Rate** -- way of allocating indirect costs to contracts

**Overhead Pool** -- collects similar indirect costs

**Overhead Base** -- collects similar direct costs

**Disclosure Statement** -- describes cost accounting structure
A lot of folks focus on the rates...

...You need to look at overall program costs

You’ll have more than 1 rate--some going up, some down. And multiple segments. And lots of subcontractors.
Why didn’t you give me a heads up about these rate increases?
No easy answers - No magic silver bullet

Overhead Rates are:
- Contractor specific
- Location specific
- Event specific

However:
- Awareness of contractor’s situation
- Awareness of economic trends
- Good communication link with ACO/DACO
Major Drivers for Overhead Rate Changes

• Restructuring
• Accounting Practice Changes
• Changes in Business Base Projections
• Labor Market Trends
• IR&D Expenses
• Program Problems/Issues

The challenge is to be able to quickly assess the rough impact of these factors on individual contracts/programs.
Restructuring - Impact on Overhead Rates

- Must look at total contract/program costs
- Must consider contract/program type

Savings are both Indirect and Direct

- Notional example:
  Restructuring Costs - $100M *
  Restructuring Savings - $500M *
  ($200M Indirect/$300M Direct)

Cost/Saving Ration - 5/1
## Restructuring - Impact on Overhead Rates

<table>
<thead>
<tr>
<th>Description</th>
<th>Pre-Merger Costs</th>
<th>Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>O/H Base</td>
<td>1,000</td>
<td>60</td>
</tr>
<tr>
<td>Expense Pool</td>
<td>1,200</td>
<td>20</td>
</tr>
<tr>
<td>Total Costs</td>
<td>2,200</td>
<td>100</td>
</tr>
<tr>
<td>Overhead Rate</td>
<td>120.0%</td>
<td></td>
</tr>
</tbody>
</table>

- **Post-Merger**
- Even though the Overhead Rate has increased, the total costs have decreased.
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Emphasis on Overhead Rates

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