15.407-4 Should-cost review.

(a) General.

(1) *Should*-cost reviews are a specialized form of cost analysis. *Should*-cost reviews differ from traditional evaluation methods because they do not assume that a contractor's historical costs reflect efficient and economical operation. Instead, these reviews evaluate the economy and efficiency of the contractor's existing work force, methods, materials, equipment, real property, operating systems, and management. These reviews are accomplished by a multi-functional team of Government *contracting*, contract administration, *pricing*, audit, and engineering representatives. The objective of *should*-cost reviews is to promote both short and long-range improvements in the contractor's economy and efficiency in order to reduce the cost of performance of Government contracts. In addition, by providing rationale for any recommendations and quantifying their impact on cost, the Government will be better able to develop realistic objectives for negotiation.

(2) There are two types of *should*-cost reviews-program *should*-cost review (see paragraph (b) of this subsection) and overhead *should*-cost review (see paragraph (c) of this subsection). These *should*-cost reviews *may* be performed together or independently. The scope of a *should*-cost review can range from a large-scale review examining the contractor's entire operation (including plant-wide overhead and selected major subcontractors) to a small-scale tailored review examining specific portions of a contractor's operation.

(b) Program *should*-cost review.

(1) A program *should*-cost review is used to evaluate significant elements of *direct costs*, such as material and labor, and associated *indirect costs*, usually associated with the production of *major systems*. When a program *should*-cost review is conducted relative to a contractor proposal, a separate audit report on the proposal is required.

(2) A program *should*-cost review *should* be considered, particularly in the case of a *major system acquisition* (see part 34), when-

(i) Some initial production has already taken place;

(ii) The contract will be awarded on a sole source basis;

(iii) There are future year production requirements for substantial quantities of like items;

(iv) The items being acquired have a history of increasing costs;

(v) The work is sufficiently defined to permit an effective analysis and major changes are unlikely;

(vi) Sufficient time is available to plan and adequately conduct the *should*-cost review; and

(vii) Personnel with the required skills are available or can be assigned for the duration of the *should*-cost review.

(3) The *contracting officer should* decide which elements of the contractor's operation have

the greatest potential for cost savings and assign the available personnel resources accordingly. The expertise of on-site Government personnel *should* be used, when appropriate. While the particular elements to be analyzed are a function of the contract work task, elements such as manufacturing, *pricing* and accounting, management and organization, and *subcontract* and vendor management are normally reviewed in a *should*-cost review.

(4) In *acquisitions* for which a program *should*-cost review is conducted, a separate program *should*-cost review team report, prepared in accordance with agency procedures, is required. The *contracting officer shall* consider the findings and recommendations contained in the program *should*-cost review team report when negotiating the contract *price*. After completing the negotiation, the *contracting officer shall* provide the ACO a report of any identified uneconomical or inefficient practices, together with a report of correction or disposition agreements reached with the contractor. The *contracting officer shall* establish a follow-up plan to monitor the correction of the uneconomical or inefficient practices.

(5) When a program *should*-cost review is planned, the *contracting officer should* state this fact in the *acquisition* plan or *acquisition* plan updates (see subpart 7.1) and in the *solicitation*.

(c) Overhead *should*-cost review.

(1) An overhead *should*- cost review is used to evaluate *indirect costs*, such as fringe benefits, shipping and receiving, real property, and equipment, *depreciation*, plant maintenance and security, taxes, and general and administrative activities. It is normally used to evaluate and negotiate an FPRA with the contractor. When an overhead *should*-cost review is conducted, a separate audit report is required.

(2) The following factors *should* be considered when selecting contractor sites for overhead *should*-cost reviews:

(i) Dollar amount of Government business.

(ii) Level of Government participation.

(iii) Level of noncompetitive Government contracts.

(iv) Volume of proposal activity.

(v) *Major system* or program.

(vi) Corporate reorganizations, mergers, *acquisitions*, or takeovers.

(vii) Other conditions (*e.g.,* changes in accounting systems, management, or business activity).

(3) The objective of the overhead *should*-cost review is to evaluate significant *indirect cost* elements in-depth, and identify and recommend corrective actions regarding inefficient and uneconomical practices. If it is conducted in conjunction with a program *should*-cost review, a separate overhead *should*-cost review report is not required. However, the findings and recommendations of the overhead *should*-cost team, or any separate overhead *should*-cost review report, *shall* be provided to the ACO. The ACO *should* use this information to form the basis for the Government position in negotiating an FPRA with the contractor. The ACO *shall* establish a follow-up plan to monitor the correction of the uneconomical or inefficient practices.

Parent topic: 15.407 Special cost or pricing areas.