

# Cost Principles, FAR Part 31 and Direct/Indirect Overhead 2024

Session 6: Cost & Pricing Analysis

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# Agenda

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- Recap
- Definitions
- Framework
- Price Analysis
- Cost Analysis
- Defective Pricing



## RECAP

# FAR Part 31 Purpose

- Establish boundaries and parameters regarding allowable costs that can be negotiated and/or claimed under government contracts or subcontracts
- Key Philosophies Embedded in Cost Principles
  - Government does not want to share in costs that it does not cause nor derive a benefit from (“causal and beneficial”)
  - Equitable allocation or identification of costs to government contracts
  - Non-government programs should absorb their share of costs
  - Selected costs in FAR 31.205-XX identified as unallowable are theoretically not created by doing business with government, nor required to sustain contract performance

# Indirect Costs

- After direct costs have been determined and charged directly to the contract or other work, indirect costs are those remaining to be allocated to intermediate or two or more final cost objectives.
- No final cost objective shall have allocated to it as an indirect cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included as a direct cost of that or any other final cost objective.
- The contractor shall accumulate indirect costs by logical cost groupings

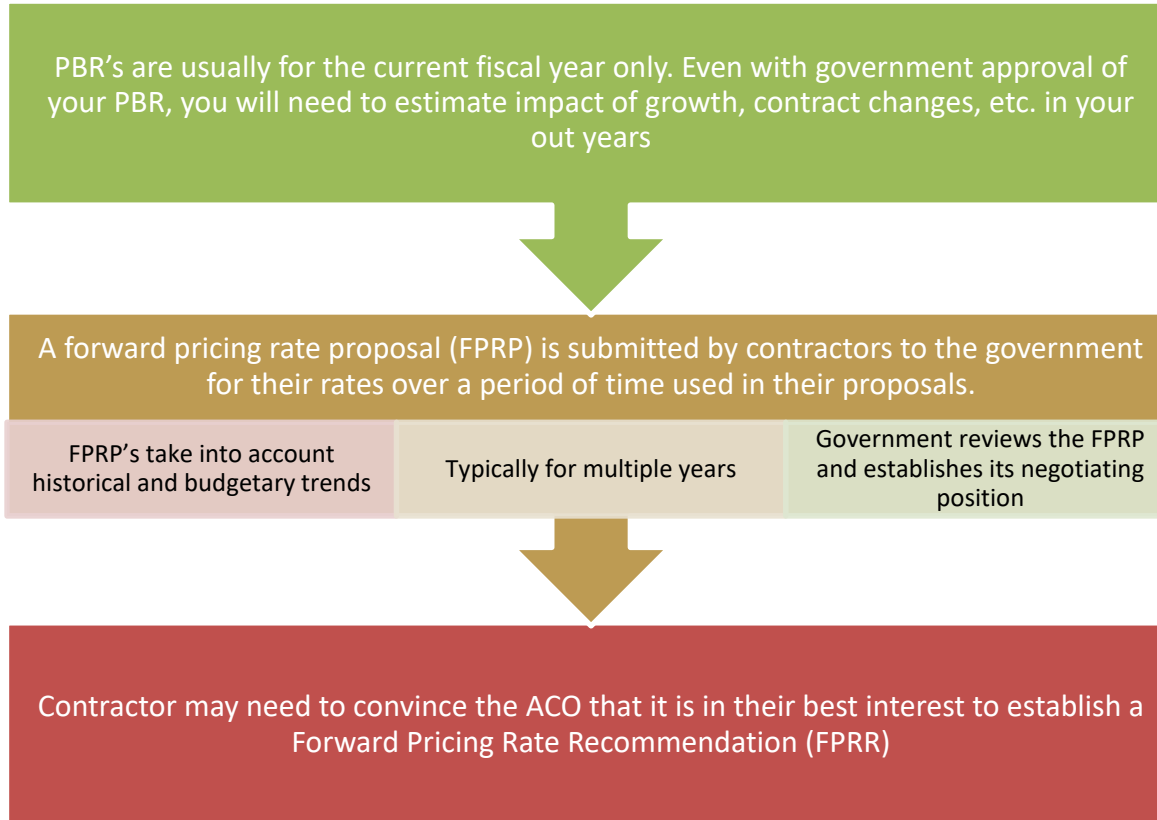
# Allocability

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship.

A cost is allocable to a Government contract if it-

- Is incurred specifically for the contract (*But for rule*)
- Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received (*Causal/Beneficial relationship*)
- Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown (*G&A Expenses*)

# PBR vs Forward Pricing Rate Proposal





# Definitions

- Adequate Price Competition: two or more responsible offerors, competing independently, submit priced offers that satisfy the Government's requirements
- Market Research: Market research should be performed to support the development of an effective acquisition plan. FAR Part 7.102 requires acquisition planning and market research for all acquisitions.
- Cost Realism: 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 the requirements; and are consistent with the unique methods of performance and materials described in the *offeror's* technical proposal.

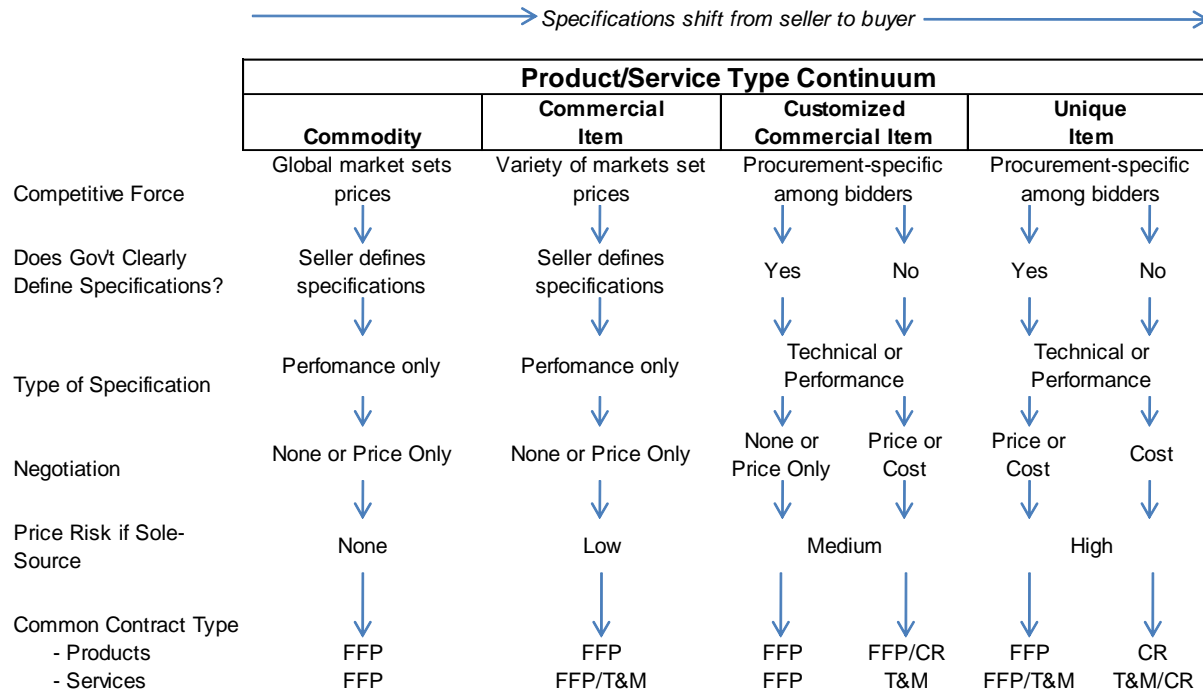
# Definitions

- Truth in Negotiations Act: Also known as TINA; technically renamed “Truthful Cost or Pricing”; requires offerors to submit certified cost or pricing data if a procurement exceeds the Truthful Cost and Pricing threshold and none of the exceptions to certified cost or pricing data requirements applies. Under the Truthful Cost and Pricing statute, the contracting officer obtains accurate, complete, and current data from offerors to establish a fair and reasonable price
- Cost or Pricing Data: pricing data, cost data, and judgmental information necessary for the contracting officer to determine a fair and reasonable price or to determine cost realism
- Certified Cost or Pricing Data: Cost or Pricing data but certified
- Cost Analysis: Used to determine the reasonableness of individual cost elements when certified cost or pricing data is required
- Price Analysis: Price analysis is the process of examining and evaluating a proposed price without evaluating its separate cost elements and proposed profit

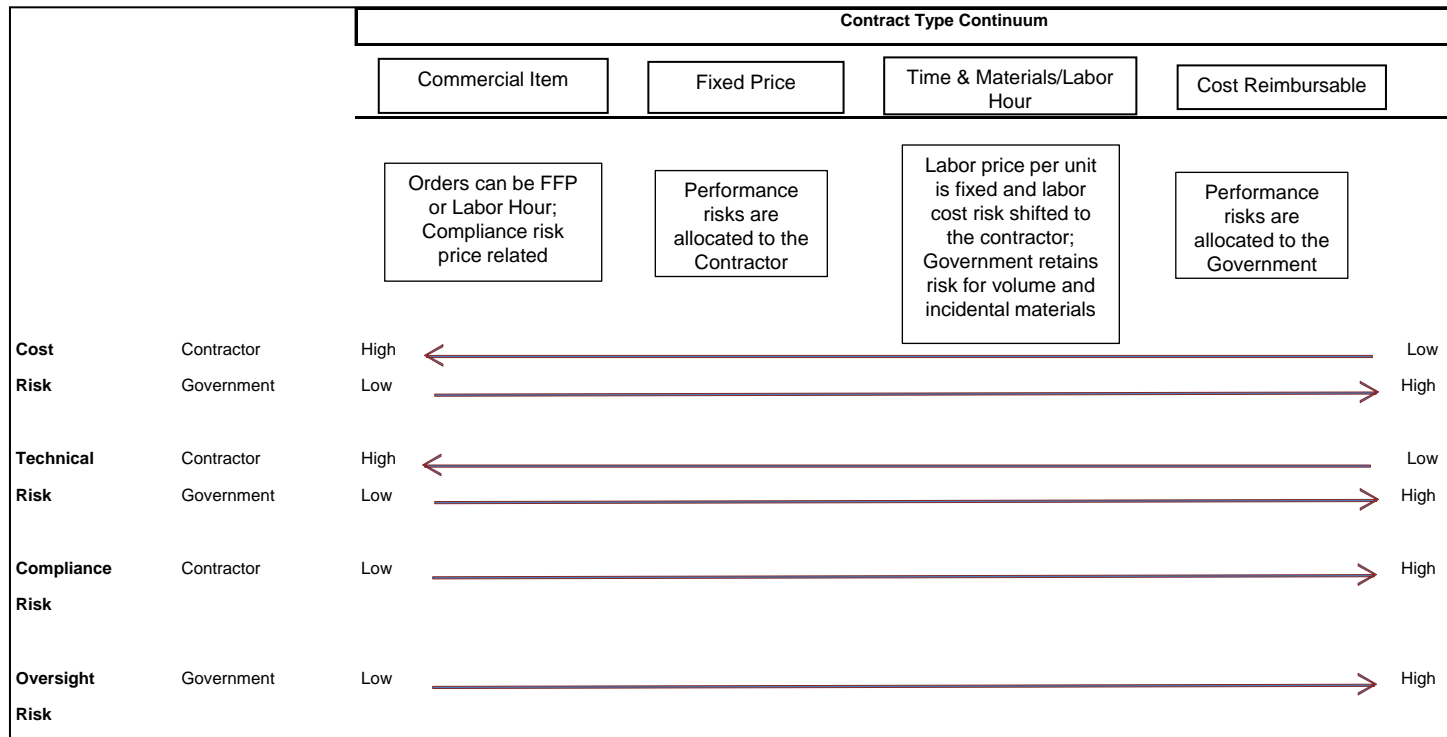
# Framework

- Determining a fair and reasonable price is the government's overall objective
  - Government does not want to overpay when negotiating overall price
  - Depending on the type of acquisition, government will place a higher level of scrutiny on the proposal cost/price
- Prime contractors share a similar responsibility when soliciting and analyzing subcontractor proposals

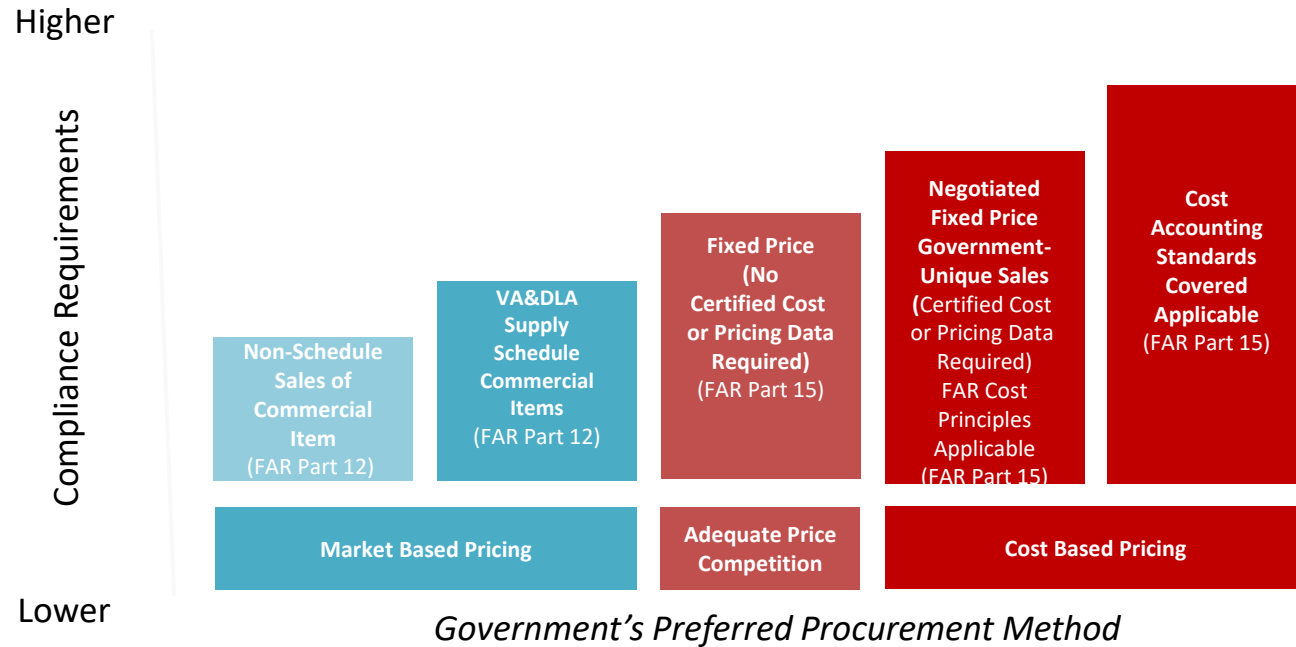
# Framework: Contract Risk



# Framework: Contract Risk



- Contracts for the sale of commercial items impose relatively few regulatory requirements on the contractor
- Contracts to sell the government uniquely designed products or services, or that are based on costs, require adherence to significantly more regulatory requirements.



# Framework

- FAR 15.404 (Proposal Analysis):
  - The contracting officer is responsible for evaluating the reasonableness of the offered prices. The analytical techniques and procedures described in this subsection may be used, singly or in combination with others, to ensure that the final price is fair and reasonable. The complexity and circumstances of each acquisition should determine the level of detail of the analysis required.
  - Price analysis shall be used when certified cost or pricing data are not required (see paragraph (b) of this subsection and [15.404-3](#)).
  - Cost analysis shall be used to evaluate the reasonableness of individual cost elements when certified cost or pricing data are required. Price analysis should be used to verify that the overall price offered is fair and reasonable.
  - Cost analysis may also be used to evaluate data other than certified cost or pricing data to determine cost reasonableness or cost realism when a fair and reasonable price cannot be determined through price analysis alone.

# Price Analysis

- SHALL be used when certified cost or pricing data is not required
- Process of evaluating a proposed PRICE without evaluating its separate cost elements OR profit
- Price analysis MAY include evaluating data other than certified cost or pricing data
  - Theoretically only when there is no other price analysis technique which can be used to determine that a price is fair and reasonable
  - This applies to commercial acquisitions



# Price Analysis

- FAR does not define FAIR
- Fair and Reasonable may look different depending which side of the negotiating table you are on BUT Remember:
  - FAR does recognize the importance of profit to incentivize contractors to perform
  - Reasonableness of profit depends upon risks taken by seller
- Goal is to avoid paying a price that is too high OR too low
  - Too low could increase risk OR
  - Mean the seller is “Buying in”
- Reasonable: Prudent person would pay the price

# Price Analysis Techniques

PREFERRED

- Price Competition
  - Comparison of prices received in a solicitation
  - Adequate price competition is usually deemed sufficient to establish a fair and reasonable price
- Comparison to previously paid prices
  - Appropriate for commercial acquisitions
  - Including those of a type or requiring minor modifications
- Use of parametric estimating methods
  - These are “rough yardsticks”
  - \$ per pound
- Comparison to published price lists
- Independent Government Cost Estimates
- Comparison of prices with prices identified in market research
- Analysis of other than cost or pricing data

# Price Analysis – Previously Paid Prices

- Government must take into account circumstantial changes when comparing to previously paid prices:
  - Time lapse
  - Terms and conditions
  - Reasonableness of prior price must not be uncertain
- Prior price may need to be adjusted for the analysis
  - Materially differing terms and conditions
  - Quantities
  - Market and economic factors
  - Similar items – adjust for material differences
- Solicit expert technical advice on magnitude of changes and pricing assistance where appropriate

# Pricing Commercial Items

- Government responsibility to perform adequate price analysis of commercial items
- Contractor must support commercial pricing requests
  - If the offeror declines to submit the requested information to support CIDs or price reasonableness determinations, contracting officer contracting officers should request the offeror to assert its position in writing along with associated rationale for not providing the requested information.
  - Offeror has obligation to support the reasonableness of its proposed prices if it chooses to supply goods and services to DoD.
  - Offerors are commonly asked for pricing data as well as commercial sales data

# Pricing Commercial Items

- DFARS 212.209, Determination of Price Reasonableness: market research shall be used, where appropriate, to inform price reasonableness determinations.
  - The phrase “where appropriate” allows the contracting team flexibility in determining when and to what extent to conduct market research.
  - However, the contracting team should perform market research to the extent practicable
- In a FAR Part 12 acquisition, government should exhaust other information sources before requesting information from the offeror.
- Order of preference for obtaining information:
  - Government Resources
  - Sources other than the offeror (Public Resources)
  - Information from the offeror

# Price Analysis

## Recent and Relevant Sales History

Item No.	Sales Price per unit	Age of data	Customer	Lot Size	Warranty	Packaging	Testing
1	\$ 450,000	60 days	Army	12,000	Standard	Increased	Standard
3	\$ 300,000	61 days	Air Force	6,000	Standard	Standard	Standard
4	\$ 300,000	125 days	Commercial	15,000	Extended	Standard	Standard
5	\$ 600,000	65 days	Air Force	10,000	Standard	Standard	Increased
6	\$ 580,000	103 days	Marine Corps	7,000	Extended	Standard	Increased
7	\$ 400,000	400 days	Army	10,000	Extended	Standard	Standard
9	\$ 610,000	315 days	Air Force	9,500	Standard	Standard	Increased

# Polling Question 1

Scenario: The Government team is acquiring simplified surveillance systems at a quantity lot of 1,000. The CID market research revealed that the simplified surveillance systems is substantially similar to a version that is commercially available. The modification necessary to the surveillance system entailed welding a part to the box and use of stronger screws in another part. Otherwise, the items are identical.

Analysis: The Government team leveraged the market research conducted for the CID. The Government team started with conducting pricing market research on the commercially available surveillance system and found there were multiple sources with published price catalogs. The catalogs had similar pricing ranges. The catalog prices were updated and many included quantity ranges and options for minor customization/options with minimal impact to prices. The Government team concluded that the modification did not require a significant change to the manufacturing line in order to weld the part and use heavy duty screws

# Polling Question 1

Question: Does the government need to request cost or pricing data from the contractor to establish a fair and reasonable price?

YES

NO



# Cost Analysis

- Required when certified cost or pricing data is submitted
- Focuses on reasonableness of each individual cost element
  - Generally does not account for the fact that the total cost may be greater than the value of the work performed THEREFORE price analysis should still be performed to determine that the overall price is fair and reasonable
- Cost elements and fee/profit are analyzed separately but do not have to be negotiated separately

# Cost Analysis Techniques

- Verification of cost data and evaluation of cost elements
  - Are the costs necessary?
  - Are they reasonable?
  - Evaluation of contingencies
  - Are estimates appropriate?
  - Are indirect cost rates applied correctly?
- Evaluation of the effect of the current practices on future costs
  - Trend analysis of Labor & Material
- Comparison of costs proposed for the individual cost elements with actual costs, previous cost estimates, other cost estimates received, independent government estimates or forecasts
- Compliance with contract cost principles (FAR 31) and Cost Accounting Standards

# Cost Realism

- Cost realism analysis (FAR 15.404-1(d)(1))
  - proposal analysis technique where the agency determines if the proposed costs are realistic for the work to be performed.
  - In a cost reimbursement contract, an offeror's proposed costs are not controlling because agencies are responsible for all actual and allowable costs.
  - Therefore the government needs to determine if an offeror is proposing unrealistically low costs to secure award.
  - An agency cost realism analysis evaluates each offeror's proposed cost elements (*e.g.*, direct costs, overhead, G&A, material and subcontracting, etc.) for the unique technical approach proposed to determine the expected cost of performance.
  - If the agency determines a proposed cost element is unrealistic, the agency can adjust the offeror's evaluated cost, typically upward. This is evaluated cost is the basis for best value.
  - The contract award reflects the awardee's proposed total cost NOT the evaluated cost.

Required on Cost Reimbursement contracts

# Cost Realism vs. Price Realism

	<b>Cost Realism</b>	<b>Price Realism</b>
<b>FAR/GAO Required Analysis</b>	Yes	No, unless required by agency RFP (e.g., 52.222-46)
<b>Applicable Contract Type</b>	Cost Reimbursement	Fixed-price
<b>Purpose of Proposal Analysis Technique</b>	Guard agency against unrealistically low proposed costs	Guard agency against risk of poor performance for fixed-price
<b>Adjust Proposed Cost/Price</b>	Yes	No
<b>Results of Analysis Used In</b>	Potential cost adjustments to evaluated cost	Technical risk finding or responsibility determination

# Cost or Pricing Data

- The term “cost or pricing data” means all facts that, as of the date of agreement on the price of a contract (or the price of a contract modification), or, if applicable consistent with subsection (e)(1)(B), another date agreed upon between the parties, a prudent buyer or seller would reasonably expect to affect price negotiations significantly. Such term does not include information that is judgmental, but does include the factual information from which a judgment was derived.
- Cost or pricing data are more than historical accounting data; they are all facts that can be reasonably expected to contribute to the soundness of estimates of future costs and to the validity of determinations of costs already incurred.

# Cost or Pricing Data

- Examples:
  - Vendor quotations
  - Nonrecurring costs
  - Changes in production methods and in production or purchasing volume
  - Data supporting projections of business prospects and objectives and related operations costs
  - Unit-cost trends such as those associated with labor efficiency
  - Make-or-buy decisions
  - Estimated resources to attain business goals
  - Information on management decisions that could have a significant bearing on costs
  - For commercial items, sales data

# Cost or Pricing Data

- Offerors (especially commercial item offerors) are often reluctant to provide other than certified cost or pricing data
- Commercial customers and government customers often don't speak the same language, i.e., "actual costs", "labor distribution", etc.
- Focus on specific elements of price that are difficult for the price evaluator to grasp
  - Workload statistics
  - Blended labor rate estimates
  - Combine indirect rates with profit to estimate markup
  - What CAN you provide without giving away proprietary data?
  - Can you do market research of your own?

# Cost or Pricing Data

- No penalty for failure to provide other than cost or pricing data except for derailment of procurement BUT
  - Contracting Officers are required to coordinate with the DITCO-Scott, Cost and Pricing Branch (PL842) if a contractor refuses to provide Data Other than Certified Cost and Pricing Data.
  - Refusals to provide this data is considered a “Denial of Requests for Data Other than Certified Cost and Pricing Data” and is reportable to DPC in accordance with DFARS PGI 215.403-3(6) Reporting requirements.
  - The Cost and Pricing Branch will consolidate any denials that are not resolved through the elevation process at DFARS PGI 215.404-1(a)(i)(A) and report those actions quarterly to the PL21, Contract Policy Branch.



# Polling question

Price analysis should not be performed when cost analysis is required

TRUE

FALSE

# Certified Cost or Pricing Data

- Certified cost or pricing data is required for certain procurements greater than \$2 million. Prior to 2018, the threshold was \$750,000
  - Non-competitive procurements
  - Cost-type procurements
  - Includes sole source modifications
- Competition is not available to guide fair and reasonable determination, therefore additional information from the contractor about their costs must be given to the government

# Certified Cost or Pricing Data Exceptions

- FAR 15.403-1(b) prohibits the PCO from requiring Offerors to submit certified cost or pricing data:
  - If the price is based on adequate competition (As of July 2019, two bids must actually be received. Presumption of competition no longer sufficient.)
  - If the price is set by law or regulation
  - For the acquisition of a commercial item
  - When the head of the contracting activity grants a waiver
  - For modifications to contracts or subcontracts for commercial items

# Certified Cost or Pricing Data

- It is not sufficient to make data available.
  - “There is a clear distinction between submitting certified cost or pricing data and merely making available books, records, and other documents without identification. The requirement for submission of certified cost or pricing data is met when all accurate certified cost or pricing data reasonably available to the offeror have been submitted, either actually or by specific identification, to the Contracting Officer or an authorized representative.”
  - Data submitted by specific identification should be readily available and waiting for review.
  - All certified cost or pricing data or other information submitted with or referenced or otherwise utilized in providing the proposal, must be identified on a separate index

# Certified Cost or Pricing Data

- Data must be updated
  - As later data come into your possession, it should be submitted promptly to the Contracting Officer in a manner that clearly shows how the data relate to the offeror's price proposal. The requirement for submission of certified cost or pricing data continues up to the time of agreement on price, or an earlier date agreed upon between the parties if applicable.

# Certified Cost or Pricing Data

- First page of proposal must include:
  - (1) Solicitation, contract, and/or modification number;
  - (2) Name and address of offeror;
  - (3) Name and telephone number of point of contact;
  - (4) Name of contract administration office (if available);
  - (5) Type of contract action (that is, new contract, change order, price revision/redetermination, letter contract, unpriced order, or other);
  - (6) Proposed cost; profit or fee; and total;
  - (7) Whether you will require the use of Government property in the performance of the contract, and, if so, what property;
  - (8) Whether your organization is subject to cost accounting standards
    - whether your organization has submitted a CASB Disclosure Statement,
    - if it has been determined adequate
    - whether you have been notified that you are or may be in noncompliance with your Disclosure Statement or CAS (other than a noncompliance that the cognizant Federal agency official has determined to have an immaterial cost impact)
    - if yes, an explanation; whether any aspect of this proposal is inconsistent with your disclosed practices or applicable CAS,
    - if so, an explanation; and whether the proposal is consistent with your established estimating and accounting principles and procedures and FAR part 31, Cost Principles
    - if not, an explanation
  - (9) The following statement: This proposal reflects our estimates and/or actual costs as of this date and conforms with the instructions in FAR 15.403-5(b)(1) and Table 15-2. By submitting this proposal, we grant the Contracting Officer and authorized representative(s) the right to examine, at any time before award, those records, which include books, documents, accounting procedures and practices, and other data, regardless of type and form or whether such supporting information is specifically referenced or included in the proposal as the basis for pricing, that will permit an adequate evaluation of the proposed price.
    - (10) Date of submission
    - (11) Name, title and signature of authorized representative

# Certified Cost or Pricing Data

- Include an index, appropriately referenced, of all the certified cost or pricing data and information accompanying or identified in the proposal. In addition, you must annotate any future additions and/or revisions, up to the date of agreement on price, or an earlier date agreed upon by the parties, on a supplemental index.
- Details of the judgmental factors applied, and mathematical or other methods used in the estimate, including those used in calculating projections
- The nature and amount of any contingencies
- Relationships between line item prices and total contract price
- Supporting breakdowns for each cost element
- Identify costs incurred for work performed before proposal submission
- Forward pricing rate agreements – include copy and describe its nature

# Certified Cost or Pricing Data

- Common errors/omissions:
  - Proposals not containing an index of certified cost or pricing data or other information included or referenced in the proposal, submitted actually or by specific identification, utilized in preparing the proposal. This index should identify each separate item, identify what it pertains to, whether or not it is actually in the proposal, and its location in the proposal or other location at the Offeror's facility where it can be found, as applicable.
  - Inadequate Bases of Estimate that do not tell the story
  - Bills of Material that do not contain the appropriate required information and/or supporting documentation
  - No consolidated summary of material costs, typically called a Consolidated Bill of Material (CBOM)
  - First page (Pricing Proposal Cover Sheet) does not contain all the required information



# Certified Cost or Pricing Data

- Common errors/omissions:
  - Pricing templates are either missing or do not add to the total proposed value
  - Pricing summaries required by Section III of FAR 15.408, Table 15- 2 are missing
  - Cost breakdowns that do not provide time-phasing of hours, rates and factors, etc. by category

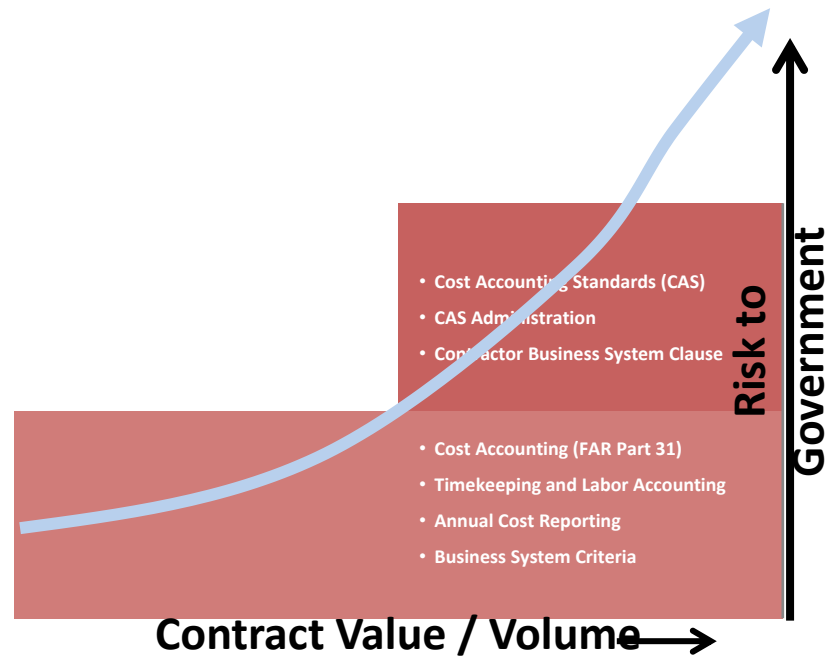
# Polling Question

The contractor includes a detailed index of cost or pricing data with its proposal which includes details of its accounting data, budgets & projections, forward pricing rate agreement, significant sales quotes and subcontractor bids, judgmental factors and contingencies. It does not attach this information to the proposal. Is the contractor's disclosure compliant?

YES

NO

# Contract Value/Volume vs. Risk Continuum



***Active Government Oversight  
&  
False Claims Act Allegations***

# Defective Pricing

- If, after award, certified cost or pricing data are found to be inaccurate, incomplete, or noncurrent as of the date of final agreement on price or an earlier date agreed upon by the parties given on the contractor's or subcontractor's Certificate of Current Cost or Pricing Data:
  - the Government is entitled to a price adjustment, including profit or fee, of any significant amount by which the price was increased because of the defective data.
  - This entitlement is ensured by including in the contract one of the clauses prescribed in [15.408](#)( In addition to the price adjustment, the Government is entitled to recovery of any overpayment plus interest on the overpayments. The Government is also entitled to penalty amounts on certain of these overpayments. Overpayment occurs only when payment is made for supplies or services accepted by the Government. Overpayments do not result from amounts paid for contract financing, as defined in [32.001](#).

# Defective Pricing

- In arriving at the amount due for penalties on contracts where the submission of defective certified cost or pricing data was a knowing submission, the contracting officer shall obtain an amount equal to the amount of overpayment made. Before taking any contractual actions concerning penalties, the contracting officer shall obtain the advice of counsel.
- Submission of false cost or pricing data could be considered a violation of the false claims act, which includes a provision for *TREBLE* damages.

# TransDigm

- On February 25, 2019, the Office of Inspector General (OIG) for the Department of Defense (DoD) issued an [audit report](#) analyzing the prices of spare aviation parts purchased by the Defense Logistics Agency (DLA) and the Army from TransDigm Group, Inc.
- The audit was conducted in response to letters from certain Members of Congress, who had inquired whether the spare parts were sold at fair and reasonable prices and in compliance with the TINA
- The OIG's audit confirmed that both TransDigm and the responsible DoD contracting officers fully complied with the Act and related regulations governing the price negotiations
- But the OIG nonetheless concluded that the contractor earned excess profit on the majority of parts sold.
- OIG recommended that DoD request a “voluntary refund” from TransDigm of its allegedly “excessive” profits
- OIG also recommended a number of changes to statutory, regulatory, and administrative policies governing the provision of cost or pricing data.

# TransDigm

- At the request of U.S. Representatives Ro Khanna and Tim Ryan and Senator Elizabeth Warren, the OIG reviewed the price reasonableness of 47 spare aircraft parts DoD procured from TransDigm between January 2015 and January 2017.
- Using uncertified cost or pricing data that it collected during the audit, the OIG calculated the apparent profit realized by the contractor on the sale of each part, and concluded that the contractor realized “unreasonable” profits (defined as profits of greater than 15% in the report) on all but one of the parts
- The OIG arrived at the 15 percent profit percentage, in part, by looking at maximum profit percentages allowed in the FAR for three different types of contracts, ***none of which were fixed price.***)
- The OIG applied this finding to a broader sampling of contracts held by TransDigm, and concluded that the contractor had earned \$16.1 million in “excess profit” (*i.e.*, profit over 15 percent) for the parts at issue.

# TransDigm

- TransDigm was the only manufacturer for the majority of spare parts, which the OIG stated allowed TransDigm to set the market price for these parts. According to the OIG, this dominant market position prevented contracting officers from relying on historical price analysis or competition to ensure price reasonableness because the price of some parts “appeared to be” excessive at the time the part was first sold to the Government, and because other competitors had to buy their parts from TransDigm before reselling to DLA.
- OIG concluded that “performing a cost analysis using certified or uncertified cost data is the most reliable way to determine whether a price is fair and reasonable,” but the FAR does *not* require contractors to furnish cost or pricing data in some circumstances. Various statutory and regulatory policies actually *discourage* contracting officers from requesting uncertified cost data when evaluating price reasonableness.
- OIG also waded into the policy arena, expressing concern about recent legislative changes to TINA. OIG claimed that these legislative changes had the effect of “making it easier for contractors to avoid providing cost data.



QUESTIONS?

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# APPENDIX

# Cost or Pricing Resources

- [Certified cost or pricing guidance from Raytheon: Table 15-2 Proposal Guide \(rtx.com\)](#)
- Commercial Pricing Guidebook:  
[Guidebook Part B Commercial Item Pricing 20180126.pdf \(osd.mil\)](#)
- Table 15-2, FAR 15.408 (Certified Cost or Pricing Requirements): [15.408 Solicitation provisions and contract clauses. | Acquisition.GOV](#)