SESSION GUIDE
SEASON 2023, EPISODE TEN
May 17, 2023
FAR PART 15.4:
SPECIAL FOCUS ON CONTRACT PRICING

I. Introduction

Last chapter, we introduced contracting by negotiation in **Part 15**. A lot of you smart folks probably noticed that we did not include any reference to **Subpart 15.4** and its guidance regarding how and when the Government should perform a price or cost analysis during the evaluation of proposal submitted by interested parties. That's because this aspect of contracting by negotiation is so important that we give it its own entire chapter! **FAR 15.4** ("Contract Pricing") sets forth the policies and procedures for "pricing" negotiated prime contracts (including subcontracts) and contract modifications.

Some important questions that we should ask when reviewing **FAR 15.4** are:

- Is there a difference between "cost" and "price?" and
- How does the Government determine what is "fair and reasonable" when evaluating cost or price?

In oversimplified terms, cost is the money a contractor must pay to perform a contract. For example, if a contractor is constructing a building, it must acquire the materials it needs to build. The money the contractor pays for those materials is part of its contract costs. So is the money the contractor must pay to its employees or subcontractors for their services. In contrast, price is the amount the contractor charges to the Government. To be successful, contractors must make sure that all costs, both direct and indirect factors such as overhead and G&A plus a reasonable profit are included in the selling price.

As a side note, "profit" is not a bad word in government contracting! **FAR 15.404-4** clearly states that it is in the Government's interest to offer a contractor sufficient profit opportunities that are sufficient to stimulate efficient contract performance, attract the best qualified large and small businesses and to maintain a viable industrial base. Profit is a motivator of efficient and effective contract performance. The FAR states that "Negotiations aimed merely at reducing prices by reducing profit, without proper recognition of the function of profit, are not in the government's interest." **FAR 15.404-4(a)(3)**. Optimum contract performance is not properly motivated through negotiating extremely low profits, the use of historical averages, or an automatic application of a predetermined percentage to total estimated costs.

II. Cost and Pricing Data

Contracting officers are generally the ones who determine whether costs and prices are "fair and reasonable." How do they make that determination? The FAR suggests that they follow the guidance set forth at **FAR 15.404**.

A. What in the World is "Cost or Pricing Data?"

First of all, we need to know what "cost or pricing data" means. **FAR 2.101** tells us that "cost or pricing data" are

> "All facts that, as of the date of price agreement, or, if applicable, an earlier date agreed upon between the parties that is as close as practicable to the date of agreement on price, prudent buyers and sellers would reasonably expect to affect price negotiations significantly."

The FAR notes that cost or pricing data are not just "SWAGs" or spitball figures based on someone's judgment; they are verifiable facts. **FAR 2.101** also notes that "[cost] or pricing data are more than historical accounting data." Contractors can't just toss old accounting ledgers at the Government and expect that to be sufficient. Instead, cost or pricing data includes "all the 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."

Exercise 1 – Identify three types of information that the FAR Council deems to be "cost or pricing data". Explain how the Government uses this supplemental information during its evaluation of cost/price proposals. [Hint: Check out **FAR 2.101**]

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FAR 15.402 tells us that Government contracting officers should only request the disclosure of "certified cost or pricing data" to the extent necessary to establish a "fair and reasonable price." The pricing guides referenced in the FAR state that the FAR does NOT define the term "fair and reasonable price," but instead implies two separate tests:

- What is fair?
- What is reasonable?

What Is Fair? Buyers and sellers may have different perceptions on what price is fair.

- **Fair to the Buyer**. To be fair to the buyer, a price must be either the fair market value of the contract deliverable (if that can be ascertained through price analysis) or the total allowable cost of providing the contract deliverable that would have been incurred by a well-managed, responsible firm using reasonably efficient and economical methods of performance plus a reasonable profit.

- **Fair to the Seller.** To be fair to the seller, a price must reflect the fair market value of the item/service requested by the Government which takes into account competitive prices in the marketplace which include amounts needed to satisfy the terms and conditions of the contract without losing money.

What Is Reasonable? A reasonable price is a price that a prudent and competent buyer would be willing to pay, given available data on market conditions. Economic forces such as supply, demand, general economic conditions, and competition change constantly. Hence, a price that is reasonable today may not be reasonable tomorrow.

Question 1 – **FAR 15.403** describes several situations where requiring “certified” cost or pricing data is not needed. Name three situations where certified cost or pricing data is not necessary.

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B. How to Certify Cost or Pricing Data

You’re probably wondering how cost or pricing data is certified. Fortunately, the FAR addresses that well and in detail. In fact, **15.406-2** tells us the exact language that must be submitted to the Government when such a certificate is required. When reading the language, you will note that a contractor must certify that the cost or data provided are *current*, *accurate*, and *complete* as of the date of the final price agreement between the offeror and the Government, or on some earlier date (sometimes called the “handshake date”) upon which the parties have agreed.

Pay close attention to the words “current, accurate, and complete.” The Certificate of Current Cost or Pricing Data will be violated if the contractor has failed to provide last-minute costing information (not *current*), or has provided inaccurate information, or has chosen not to provide supplier pricing information that it plans to use (not *complete*).

FAR 15.408 (Table 15-2) contains the format for submitting this data. Offerors submit cost or pricing data to the “cognizant CO.” That just means offerors must submit the data to whichever CO is overseeing this stage of the procurement. (Some agencies have the same CO oversee the entire contracting process, and others have different COs for each contract stage.)

Exercise 2 – For Shame!

Sometimes offerors submit defective certified cost or pricing data. Like most people, the Government really dislikes being misled, particularly about money. Unlike most people, though, the Government has powerful tools it can use to sanction those who mislead it. **15.407-1** lays out four different consequences—in order from least severe to most severe—that an offeror might experience if they submit defective certified data. What are those four consequences?

1. ____
2. ____
3. ____
4. ____

If, after contract award, a CO learns or suspects that a contractor or offeror has submitted defective cost or pricing data, **15.407-1(c)** says that the CO should request a certified cost or pricing data audit. The procedures for requesting and conducting such an audit are in **15.407-1(c)** through **15.407-1(f)**.

III. Evaluating Cost and Price

Contracting officers can evaluate whether contract pricing is fair and reasonable in two ways: by conducting a price analysis or by conducting a cost analysis. We will examine both these methods below.

A. Price Analysis

The Government's first line of defense in any evaluation/negotiation of a contractor's proposed price is a price analysis. COs can conduct price analysis in situations that *do not* require certified cost or pricing data. As you probably suspected, a price analysis looks at whether the price an offeror offers is fair and reasonable, without having to consider the contractor's underlying costs. **15.404-1(b)(1)** puts it this way: "Price analysis is the process of examining and evaluating a proposed price without evaluating its separate cost elements and proposed profit." There are many ways a CO can conduct a price analysis. The FAR lists seven different ways in **15.404-1(b)(2)**, but also notes that the list is not exhaustive. You can find additional rules governing price analysis in **15.403-3** and **15.403-5(b)(2)**.

Question 2 – Describe three types of procurement situations that would cause the contractor to use the price-analysis method described in **15.404-1(b)(2)(ii)** as opposed to the methods described at **15.401-1(b)(i). [Hint: For two of the situations, check out FAR Parts 12 and 6].**

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B. Cost Analysis

Sometimes a price analysis cannot be performed. This often occurs when a CO is procuring a completely new product and only received one bid on the solicitation there isn't enough information in the commercial marketplace or in SAM to determine whether the overall price is fair and reasonable. In that case, a CO should perform a cost analysis instead. **15.404-1(a)(4)**. COs should also perform a cost analysis when a procurement requires the disclosure of certified cost or pricing data. **15.404-1(a)(3)**.

FAR 15.404-1(c)(1) defines cost analysis as

> "The review and evaluation of any of the separate cost elements and profit or fee in an offeror's or contractor's proposal as needed to determine a fair and reasonable price or to determine cost realism, and the application of judgment to determine how well the proposed costs represent what the cost of the contract should be, assuming reasonable economy and efficiency."

This definition is *much* more complicated than the price analysis definition, but if we break it down into bite-size chunks, we can understand it better.

- "Review and evaluation" is fairly self-explanatory. A CO looks over the data and then makes a determination based off the review.
- "Any of the separate cost elements" means anything—and we mean *any*thing—the contractor has to buy to fulfill the contract. Cost elements include all direct (e.g., labor, travel, materials, etc.) and indirect costs (e.g., G&A, overheard, etc.). The CO must evaluate each of these costs separately.
- "Profit or fee" is again pretty much what it sounds like. Since profit (or any fee) is included in the final price, a CO should determine that the profit or fee charged is fair and reasonable. While it is not a cost incurred by the contractor, the CO must still evaluate it when performing a cost analysis.
- "In an offeror's or contractor's proposal" should be pretty clear to us now, since we discussed proposals at length in Chapter 9! If you need a refresher, go back there and take a peek.
- "To determine a fair and reasonable price" is fairly clear too. If you want to refresh that definition, go back up to the introduction of this chapter.
- "To determine cost realism" is a new term for us. What is cost realism? We're going to ask for your patience – we'll talk about that in the next section! For now, think of it literally and you'll be okay.
- "The application of judgment to determine" refers to the CO's judgment, not the judgment of some outside source.
- "How well the proposed costs represent what the cost of the contract should be" is a bit of a mouthful. Broadly, it just means that the costs an offeror is offering should match the costs that a regular person (or agency) would normally pay for something.
- "Assuming reasonable economy and efficiency" is a very accountancy term. Basically, it just means that a CO is directed to evaluate what a contract "should" cost based on current market trends, without fluffing prices or padding hours or gross inefficiencies.

So how does a CO perform a cost analysis? **15.404-1(c)(2)** lists six ways a CO could perform a cost analysis. As with price analysis, the list is not exhaustive.

Question 3 –Identify the six techniques a CO could use to perform a cost analysis? What two approaches can a contracting officer take if the contractor has failed to include or identify requested "cost or pricing data" in its proposal?

C. Cost Realism and Other Issues of Cost Analysis

FAR 15.404-1(d)(1) defines cost realism as "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 the requirements; and are consistent with the unique methods of performance and materials described in the offeror's technical proposal." This is another long definition, but with what we've learned so far, you should be able to get it down if you read it a few times. Cost realism is not always a part of cost analysis; in fact, generally, it is only supposed to be used in certain circumstances.

Question 4 – The FAR says that cost realism analysis “shall” be used for only one type of contract. What type of contract is that? Why do you think the Government only uses cost realism analysis for this type of contract? [Hint: check out **15.404-1(d)**]

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Discussion Questions

1. What is price realism? Identify the type of contract that the Government most often uses this analysis. [**Hint**: Check out those GAO bid protest decisions that have been included in the original sources].

2. Identify the type of information that a contracting officer may use to support a fair and reasonable price determination in a commercial item procurement. Identify the specific type of information that needs to be included if the item requested is also available under a GSA Federal Supply Schedule. [**Hint**: Check out FAR **52.215-20(a)(ii)**]

3. A written adequate price competition "determination" provides an exception to certified cost or pricing disclosure requirements. What facts must a contracting officer "find" to support such a determination? [**Hint**: Check out **FAR 15.403-1(c)**.]

4. Procurements valued below a certain dollar threshold are exempt from certified cost or pricing data disclosure requirements. What is that dollar threshold. [**Hint**: Check out **FAR 15.403-4**]

5. Unless specifically deemed inappropriate or not applicable, what six factors must be considered by a contracting officer to support a reasonable profit determination. [**Hint**: Check out **FAR 15.404-4(d)**]

6. What is a “should cost review” and how is it different from a traditional cost analysis?

7. Where in the FAR can you find instructions on how to create and present information that requires the submission of certified cost or pricing data?

8. **FAR Question**: During the performance of a cost analysis, a contracting officer is permitted to call upon Government auditors for assistance in assessing estimated subcontractor costs. Who is responsible for establishing the depth and scope of the audit required? [**Hint**: Check out **FAR 15.404-2**]

Answer Key

Exercise 1 – Three (3) types of information that the FAR Council deems to be "cost or pricing data" are Vendor quotations, Nonrecurring costs, and Unit-cost trends such as those associated with labor efficiency. The Government factors in this supplemental information in their efforts to determine that what the offeror is presenting is fair and reasonable, allowing them optimum contract performance while still making sufficient profit.

Answer 1 –

(1) When the contracting officer determines that prices agreed upon are based on adequate price competition; (2) When the contracting officer determines that prices agreed upon are based on prices set by law or regulation; (3) When a commercial item is being acquired.

Exercise 2 –

1. Recovery of overpayment plus interest and fees

2. Payment of a penalty, if knowing submission of defective cost or pricing data

3. Potential civil (False Claims Act) or criminal (False Statements Act) liability, if knowing submission of defective cost or pricing data

4. Suspension or debarment

Answer 2 – Full & Open Competition

Acquisition of Commercial Items

Simplified Acquisition

Answer 3 –

1) Verification of cost data or pricing data and evaluation of cost elements, including:

--The necessity for, and reasonableness of, proposed costs, including allowances for contingencies

--Projection of the offeror's cost trends, on the basis of current and historical cost or pricing data

-- Reasonableness of estimates generated by appropriately calibrated and validated parametric models or cost-estimating relationships

--The application of audited or negotiated indirect cost rates, labor rates, and cost of money or other factors

2) Evaluating the effect of the offeror's current practices on future costs

3) Comparison of costs proposed by the offeror for individual cost element with-

--Actual costs previously incurred by the same offeror

--Previous cost estimates from the offeror or from other offerors for the same or similar items

--Other cost estimates received in response to the Government's request

--Independent Government cost estimates by technical personnel

--Forecasts of planned expenditures

4) Verification that the offeror's cost submissions are in accordance with the contract cost principles and procedures in part 31 and, when applicable, the requirements and procedures in 48 CFR chapter 99, Cost Accounting Standards

5) Review to determine whether any cost data or pricing data, necessary to make the offeror's proposal suitable for negotiation, have not been either submitted or identified in writing by the offeror

6) Analysis of the results of any make-or-buy program reviews, in evaluating subcontract costs

The 2 approaches are the CO shall attempt to obtain the data not submitted or identified or writing or make satisfactory allowance for the incomplete data.

Answer 4 – A cost realism analysis shall only be performed on cost-reimbursement contracts. This allows the Government to break down and determine the probable cost of performance for each offeror.

Discussion Questions Answer Key

1. The stated purpose for price realism is to determine whether an offeror's price is “too low.” This type of analysis is most often used in fixed priced contracts. Note that a contracting officer may perform a “price realism” analysis only if contractors are notified of this evaluation method in the solicitation or the RFP otherwise expressly states that the agency will review prices to determine whether they are so low that they reflect a lack of technical understanding, and the RFP states that a proposal can be rejected for offering low prices.

2. A) For catalog items, a copy of or identification of the catalog and its date, or the appropriate pages for the offered items, or a statement that the catalog is on file in the buying office to which the proposal is being submitted. Provide a copy or describe current discount policies and price lists (published or unpublished), e.g., wholesale, original equipment manufacturer, or reseller. Also an explanation of the basis of each offered price and its relationship to the established catalog price, including how the proposed price relates to the price of recent sales in quantities similar to the proposed quantities; (B) For market-priced items, the source and date or period of the market quotation or other basis for market price, the base amount, and applicable discounts. In addition, describe the nature of the market; (C) For items included on an active Federal Supply Service Multiple Award Schedule contract, proof that an exception has been granted for the schedule item.

3. The contracting officer must support his/her adequate price competition determination with the following findings: (i) Two or more responsible offerors, competing independently, submit priced offers that satisfy the Government’s expressed requirement, (ii) Award will be made to the offeror whose proposal represents the “best value” where price is a substantial factor in source selection, and (iii) There is no finding that the price of the otherwise successful offeror is unreasonable.

4. The threshold for obtaining certified cost or pricing data is $750,000 for prime contracts awarded before July 1, 2018, and $2 million for prime contracts awarded on or after July 1, 2018.

5. 1) Contractor effort
   2) Contract cost risk
   3) Federal socioeconomic programs
   4) Capital investments
   5) Cost-control and other past accomplishments
   6) Independent development

6. 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.

7. **FAR 15.408**, Table 15-2 - Instructions for Submitting Cost/Price Proposals When Certified Cost or Pricing Data Are Required.

8. The auditor is responsible for the scope and depth of the audit. Copies of updated information that will significantly affect the audit should be provided to the auditor by the contracting officer.

APPENDIX

All of the following materials are linked below to PCI's website or to an online link.

Puglia Engineering of California, Inc, B-297413

GAO bid protest alleging that the SSA did not perform a reasonable price/technical tradeoff.

IBM Corporation, B-299504

GAO bid protest where the GAO sustained a challenge to the agency's evaluation of offerors' price and cost proposals when the agency improperly adjusted upward portions of the protestor's fixed-price proposal.

Ball Aerospace & Technologies Corporation, B-402148

GAO bid protest challenging the agency's evaluation of awardee's price and technical quotes.

DCMA Proposal Adequacy Checklist

An adequacy checklist created by DCMA as a useful tool designed to assist the DCMA Cost/Price Analyst to determine the adequacy of a contractor's proposal. The checklist can be used for sole source proposals that are over the TCoPD (f/k/a TINA) threshold and no exception to the submission of certified cost and pricing data exists.

GSA Price Negotiation Memorandum Template

This is a template prepared by GSA to be used as a sample of a Price Negotiation Memorandum. It has various section headers including Requirement/ Purpose of Negotiation, Background, Method, Negotiation Objectives, Description of Acquisition, Summary of Negotiations, Final Revised Proposals, Offer Comparison, and Award Determination.

Guide to Writing a Good Price Negotiation Memorandum

Guidance document published by Air Force Material Command to provide a comprehensive and standardized source for writing pricing memorandums. The guide covers "how-to" of writing a PNM, PCM, and Specialized Negotiation Memorandum representing AFMC implementation of negotiation documentation as identified in AFMCFARS 5315.406-3(a)(90).

Price Reasonableness Form (Navy)

Fillable form provided by the Navy for the Memorandum to Contract File on the Price Reasonableness Determination.

FUN WITH THE FAR
Episode 10
FAR Part 15.4
<u>Summary Outline</u>

I. Introduction

II. <u>FAR PART 15.4</u>

A. General Observations

B. Definitions of Terms

C. Exceptions to Disclosure of Certified Cost and Pricing Data

D. Determining “Fair and Reasonable”

E. How to Perform a Price Analysis

F. How to Perform a Cost Analysis

G. Defective Pricing and Adverse Consequences

IV. Closing Remarks