

## TOPIC 12

# CONTRACT COST AND PRICE ANALYSIS

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### Objective

To determine whether the agency effectively conducts cost or price analysis to arrive at fair and reasonable prices for negotiated contracts.

### Sub-objectives

Specifically, determine whether the Agency:

1. Complied with the requirements for obtaining cost or pricing data or information other than cost or pricing data.
2. Had adequate policies and procedures for performing cost and price analysis.
3. Effectively conducted cost and price analysis.
4. Effectively conducted and documented price negotiations.

# CONTRACT COST AND PRICE ANALYSIS

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## INTRODUCTION

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This guide provides detailed audit steps for determining an agency's compliance with prescribed cost and price negotiation policies and procedures for pricing negotiated prime contracts (including subcontracts) and contract modifications, including modifications to contracts awarded by sealed bidding. The guide expands upon the researchable questions associated with Cost Pricing (Topic 12) identified in the *Contract Audit Guide Framework* that was released in 2009 by the Contracting Committee of the Federal Audit Executive Council. The framework provides a construct of issues and researchable questions to consider when planning audits or reviews of contracts. It is the Contracting Committee's intention to issue detailed audit guides for each issue identified in the framework. Audit teams are encouraged to modify the *Contract Price and Cost Analysis Guide* as appropriate, and to use the guide, in conjunction with other appropriate tools, to assess compliance with the Federal Acquisition Regulation Subpart 15.4-Contract Pricing and best practices for purchasing supplies and services at fair and reasonable prices. For your convenience, the guide includes relevant definitions of pricing terms, reference to appropriate regulations, and links to online resources for information referenced in the guide.

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## BACKGROUND

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FAR 15.4, Contract pricing prescribes the cost and price negotiation policies and procedures for pricing negotiated prime contracts (including subcontracts) and contract modifications, including modifications to contracts awarded by sealed bidding. The section and this audit program do not address the award of initial sealed bids or awards made using the Government purchase Card.

The objective of proposal analysis is to ensure that the final agreed-to price is fair and reasonable. The analytical techniques and procedures described in this section may be used singly or in combination with others, as needed, to ensure that the final price is reasonable. The complexity and circumstances of each acquisition should determine the level of the detail of the analysis required. Price analysis should be used when detailed cost and price data (by element of cost: labor, materials, overhead, etc.) are not required. Price analysis should always be performed to determine that the overall price offered is fair and reasonable. Cost analysis shall be used to evaluate the reasonableness of the individual cost elements when cost or pricing data is required. It may also be used to evaluate information other than cost or pricing data to determine cost reasonableness or cost realism (for competitive procurements).

The Air Force Institute of Technology (AFIT) and the Federal Acquisition Institute (FAI) jointly prepared a five-volume set of Contract Pricing Reference Guides to guide pricing and other acquisition personnel. The five guides are: Price Analysis; Qualitative techniques for

Contract Pricing; Cost Analysis; Advanced Issues in Contract Pricing; and Federal Contract Negotiation Techniques. These references provide examples on applying pricing policies to pricing problems. They are not directives and are to be used for instruction and guidance. Formal courses at the Defense Audit University and available by private vendors cover cost and pricing techniques and examples.

FAR 15.402 Pricing policy, provides that contracting officers must purchase supplies and services at fair and reasonable prices. In establishing the reasonableness of the price the contracting officer must not obtain more information from the offeror than is necessary. The following order of precedence should be used per FAR 15.402:

1. No additional information if the price is based on adequate competition, except as provided at FAR 15.403-3(b).
2. Information other than cost or pricing data: (1) information on prices (catalog, market prices, or previous contract prices), relying first on information within the Government; second on information from sources other than the offeror; and third on information obtained from the offeror.
3. Cost information that does not meet the definition of cost or pricing data.

Use of this guide is especially helpful for evaluating awards for noncompetitive (sole source) contract actions or those involving receipt of one bid. However, this guide can also help determine cost realism for competitive award actions.

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#### **DEFINITIONS**

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"Cost analysis" is the review and evaluation of the separate cost elements and proposed profit or fee of an offeror's cost or pricing data or information other than cost or pricing data and the judgmental factors applied in projecting from the data to the estimated costs.

"Cost or pricing data" means all the facts that, as of the date of price agreement, prudent buyers and sellers would reasonably expect to affect price negotiations significantly.

"Cost realism" means that the costs in the offeror's proposal (1) are realistic for the work to be performed; (2) reflect a clear understanding of the requirements; and (3) are consistent with the various elements of the offeror's technical proposal.

"Price" means cost plus any fee or profit applicable to the contract type.

"Price analysis" is the process of examining and evaluating a proposed price to determine whether it is fair and reasonable, without evaluating its separate cost elements and proposed profit. Price analysis always involves some form of comparison with other prices.

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#### **APPLICABLE LAWS AND REGULATIONS**

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The following laws and regulations prescribe the criteria applicable to acquisition planning:

- FAR 15.4, “Contract Pricing” provides guidance on price negotiation policies and procedures for pricing negotiated contracts.

Because the agency/department you are auditing may have FAR supplements or other implementing guidance in addition to the criteria identified above, you will also need to identify and become familiar with the requirements and criteria in those documents.

The Government's Pricing policy for most Federal agencies is covered in FAR 15.402 and requirements for obtaining cost or pricing data are covered in FAR 15.403. Proposal analysis techniques for new pricing actions are addressed at FAR 15.404-1.

The requirements for obtaining and evaluating detailed cost or pricing data are provided in 10 U.S.C. 2306a and 41 U.S.C. 254b. The contracting officer is responsible for obtaining information that is adequate for evaluating the reasonableness of the price or determining cost realism, when detailed cost breakdowns (cost or pricing data) is not required.

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## AUDIT STEPS

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NOTE: Determining whether the agency developed and implemented an effective acquisition plan can be a challenge. High employee turnover rates, vague and outdated requirements, combined with poor documentation practices increases the chance that your audit trail is missing relevant documentation.

A universe of negotiated contract actions data can be identified from the Federal Procurement Data System-Next Generation (FPDS-NG) or the agency's procurement system.

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### **SUBJECTIVE 1: DETERMINE WHETHER THE AGENCY COMPLIED WITH THE REQUIREMENTS FOR OBTAINING COST OR PRICING DATA OR INFORMATION OTHER THAN COST OF PRICING DATA.**

- A. Determine whether the contracting officer received the required proposal and support based on the type of procurement (competition, commercial item, sole source, simplified acquisition, etc.). Determine whether sufficient supporting information was obtained by the contracting officer in the circumstance as required in Items B. and C. below.
- B. **Cost or pricing data** (detailed breakdown by cost elements and profit or fee) is generally required for sole source procurements, other than commercial items. It typically includes all the facts that, as of the date of price agreement, that prudent buyers and sellers would reasonably expect to affect price negotiations significantly. The data requires certification in accordance with FAR 15.406-2 that the data are factual, not judgmental, and are verifiable. They include data forming the basis for the contractor's judgment about future estimated costs. They include historical accounting data and information on actual labor and overhead rates and quotes for materials costs. The threshold for cost or pricing data submissions is currently \$650,000. When cost

or pricing data is submitted and relied on, contractors' proposals typically include a detailed breakdown of cost elements and rates to support this information. Table 15-2 in FAR provides the details for required for submitting proposals by cost element when cost or pricing data are required. A contracting officer must obtain cost or pricing data if it is determined that none of the exemptions in FAR 15-403-1(b) apply. Acquisitions below the simplified acquisition threshold are exempt from cost or pricing data. Exceptions from submitting cost or pricing data include:

1. Adequate price competition;
2. Prices set by law or regulation;
3. Commercial items (Commercial procurements for services of more than \$16 million are not considered as commercial items.);
4. When a waiver is granted by the head of the contracting activity in exceptional cases. (The Head of the Contracting Activity may waive the requirement when he considers the price fair and reasonable without submission of cost or pricing data.) (FAR 15-403.1 (c) (4.))
5. When modifying a contract or subcontract for commercial items.

Additionally, an exception for waiving submission because of use of competition occurs when only one bid. FAR 14-403.1(c) (ii) (B) provides that the proposed price must be found reasonable in this circumstance, to still be considered as based on competition. Accordingly, at a minimum, some form of price analysis is required when only one bid is received in response to a competitive solicitation.

- C. **Information Other Than Cost or Pricing Data.** When determining the reasonableness of a price or determining cost realism (for a competitive award) and the contracting officer lacks information or cannot obtain sufficient information from other sources, the contracting officer must require *information other than cost or pricing data* from the offeror that is adequate to determine a fair and reasonable price (FAR 15.403-3 (a) (1)). At a minimum this should include appropriate information on the prices at which the same item or similar items have been previously sold. Otherwise, some cost data (i.e. historical costs or quotes) may be obtained.

*Review to determine whether acquisition staff requested and obtained sufficient information to determine price reasonableness. For example, if there were no comparative procurements or rates available, did the acquisition team request sales or cost information from the offeror?* To determine the information an offeror should be required to submit, acquisition staff should consider the guidance in Section 3.3, Chapter 3, Volume 1, of the Contract Pricing Reference Guide cited at FAR 15.404-1(a)(7). The format for submitting this information is at FAR 15.403-5(b) (2). As specified in Section 808 of Public Law 105-261, a contractor or subcontractor that does not comply with the requirement to submit the information as specified in FAR 15.403-3(a) (1) is generally considered ineligible for the award.

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**SUBJECTIVE 2: DETERMINE WHETHER THE AGENCY HAS ADEQUATE POLICIES AND PROCEDURES IN PLACE FOR PERFORMING COST OR PRICE ANALYSIS**

- A. Does the agency have a cost and pricing guide or a policy that includes procedures from or refers to the use of the five-volume set of Contract Pricing Reference Guides prepared by the Air Force Institute of Technology (AFIT) and the Federal Acquisition Institute (FAI)?
- B. Determine whether the Agency has established procedures implementing all significant areas of its pricing policy.
- C. Does the agency have internal controls that include oversight of the quality of price and cost analysis for negotiated pricing actions? Is compliance with pricing policy or general procedures for awarding negotiated contracts tested? Are the compliance reviews performed by staff from either the Head of the Buying Command or Office of the Senior Procurement Executive? Are the compliance reviews independently performed?

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**SUBJECTIVE 3: DETERMINE WHETHER COST AND PRICE ANALYSIS WAS EFFECTIVELY CONDUCTED.**

- A. **Price Analysis.** Some form of price analysis is required for all negotiated procurements. Determine whether the contract files documented one or more of the following price analysis techniques or procedures:
  - 1. Comparison of proposed prices received in response to the solicitation. Normally, adequate price competition establishes price reasonableness and no other techniques are required. (FAR 15-403-1(c)(1))
  - 2. Comparison of previously proposed prices and previous Government and commercial contract prices with current proposed prices for the same or similar items and services. This method is effective provided the validity of the comparison (similar items, categories, quantities, quality, qualifications, and/or circumstances) and the reasonableness of the previous price(s) can be established.<sup>1</sup>
  - 3. Application of rough yardsticks (such as dollars per pound) to highlight inconsistencies that warrant additional pricing inquiry.
  - 4. Comparison with competitive published price lists, published market prices or commodities, similar indexes, and discount or rebate arrangements. A common practice is to compare proposed prices to those offered on the General Administration Service's (GSA) Federal Supply

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<sup>1</sup> The five-volume set of Contract Pricing Reference Guides state that contracting officers can sometimes repeatedly rely on rates and prices from the existing contract without determining whether the rates were ever reviewed. This can result in continuously awarding contract prices without determining whether the rates and prices are valid.

Schedule or blanket purchase agreements (BPAs) created based on the schedule.<sup>2</sup> Ensure that the agency considered the volume of the purchase and using discounts, based on the nature of the BPA, when conducting price analysis.<sup>3</sup> Also, buyers must request discounts from Published GSA scheduled rates when the offeror's order limitation ceiling amount is exceeded and are encouraged to request discounts for all other procurements. *Determine whether comparisons to either schedule or BPA rates requested or considered discounts.*

5. Comparison of proposed prices with independent government cost estimates (IGCEs). Best practices in agency pricing handbooks require that the source and methodology used in IGCEs be documented. IGCEs are frequently completed by program managers or technical specialists. Many agencies establish guidance for completing reliable IGCEs, including using cost or pricing data, or information other than cost or pricing data, for estimating prices for cost elements and evaluating rates. The reliability of the IGCE should be considered when determining the usefulness of this technique. IGCEs should be completed before receipt of the contractor's price proposal.
6. Comparison of proposed prices with prices obtained through market research for the same or similar items.
7. Analysis of pricing information provided by the offeror. This includes information, such as historical sales, rates, or quotes for specific purchase parts.

The first two techniques above are the preferred methods. However, if the contracting officer determines that information on competitive proposed prices or previous contract prices is not available or is insufficient to determine that the price is fair and reasonable, the contracting officer may use any of the remaining techniques as applicable to the circumstances. Prices can also be established by law or regulation and would not require additional review.

Review to determine whether the price analysis was adequately completed and documented in the contract file.

Determine whether the information used to support price negotiations was sufficiently current, to permit negotiation of a fair and reasonable price. If prior prices are escalated, ensure that valid scientific (based on consumer price index or other studies) or approved (historical) methods were used. As a best practice, prior

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<sup>2</sup> Office of Management and Budget Memorandum, "Achieving Better Value from Our Acquisitions," December 22, 2009, recommends establishing BPAs (such as among GSA schedule vendors). OMB recommends seeking discounts when establishing BPAs; and, as appropriate, when placing orders. The memorandum also states that obtaining competition at the order level is critical for the acquisition of services where initial prices are based on fixed hourly rates, rather than prices for specific tasks.

<sup>3</sup> GSA guidance states it is a best practice that ordering activities should seek additional price reductions when requirements warrant. Agencies can leverage requirements to take advantage of quantity or spot discounts available in a fluid, commercial pricing atmosphere for circumstances such as technological changes; labor conditions; supply and demand; industry sales goals; and inventory reductions.

rates should not be escalated over long periods as technology and market forces may render prior prices as no longer valid.

When using prior prices, ensure that those prices were found to be reasonable based on price analysis or competition before accepting prior rates for determining the reasonableness of rates used in the current proposal.

- B. **Cost Analysis.** Contractors' proposals submitted using (certified) cost or pricing data generally require cost analysis. However, the Government may use various cost analysis techniques and procedures, given the circumstances of any acquisition. For example, cost information may be requested or submitted when reasonableness of price cannot be determined using price analysis alone.

Determine whether the contract files documented one or more of the following cost analysis techniques or procedures, if cost analysis was applicable to the acquisition. Determine whether the analysis was effectively completed as referenced in FAR 15.404-1(c) and FAR 15.404-4. Procedures include:

1. Verification of costs or pricing data and evaluation of cost elements as described in FAR 14.404-1(c)(2)(i), including:
  - a. The necessity for, and reasonableness of, proposed costs, including allowances for contingencies;
  - b. The application of audited or negotiated indirect cost rates, labor rates, cost of money rates and other factors.
2. Evaluating the effect of the offeror's current practices on future costs as documented in FAR 14.404-1(c) (2) (ii). Effects of inefficient or uneconomical past practices should not be projected into the future. For example, for recurring production of complex equipment the contracting office should perform a trend analysis of labor (hours and costs) and materials and consideration of improvements should be considered to reduce these costs.
3. Comparison of costs proposed by the offeror for individual cost elements (labor, materials, overhead, etc.) with:
  - a. Actual costs previously incurred by the offeror;
  - b. Previous cost estimates from the offeror or other offerors for the same or similar items;
  - c. Other cost estimates received in response to the Government's request;
  - d. IGCEs; and
  - e. Forecasts of planned expenditures. Supporting data, such as recent quotations from vendors for materials and other direct costs that had not been previously or recently procured should also be reviewed.

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 in Cost Accounting Standards 48 CFR Chapter 99.
  5. Determine whether the profit or fee portion of the Government pre-negotiation objective was established in accordance with the guidance in FAR 15.404-1. The contracting officer must not negotiate a profit that exceeds the statutory limits of 10 U.S.C. 2306(d) and 41 U.S.C. 254(b). When not based on cost analysis, contracting officers are not required to review profit. However, when based on cost analysis ensure that the agency followed either a structured approach, such as the application of the weighted guidelines method to analyze profit, or FAR 15.404-4(d) profit analysis factors, which consider factors, such as, contractor effort, contract cost risk, capital investments, and independent development efforts.
- C. **Subcontract pricing considerations.** The contracting officer is responsible for determining the price reasonableness of subcontract costs. Determine whether the contracting officer determined whether the contractor or subcontractor has an approved purchasing system, has performed cost or price analysis of the proposed subcontractor prices, or has negotiated the subcontractor prices before negotiation of the prime contract price. This does not relieve the contracting officer of the duty to analyze the contractor's submission, including subcontractor's cost or pricing data. Review to determine whether the contractor or subcontractor (higher tier) conducted cost or price analysis to establish the reasonableness of proposed subcontract prices and included the results of these analysis in the price proposal, and, if required, submitted subcontractor cost or pricing data to the Government as part of its own cost or pricing data. Ensure that the contracting officer reviewed the subcontractor cost or pricing data or ensured that the contractor conducted an adequate review as documented in the contract file. Specific requirements are identified in FAR 15.404-3 (c) of when cost or pricing data should be submitted for subcontractors.
- D. **Technical assistance.** For technically complex acquisitions, determine whether the contracting officer requested that personnel having specialized knowledge, skills, experience or capability in engineering, science, or management perform a technical analysis of the proposed types and quantities of materials, labor, processes, special tooling, equipment, reasonableness of scrap and spoilage, and other factors identified in the proposal in order to determine the need for the proposed resources, assuming reasonable economy and efficiency. Determine whether the technical analysis examined, at a minimum, the types and quantities of materials proposed and the need for the types and quantities of labor hours and labor mix. If not done, discuss with technical, program, and/or contracting staff to determine the reasons that this was not done.
- E. **Field Pricing Assistance.** The contracting officer should request field pricing assistance when the information available at the buying activity/contracting officer is inadequate to determine a fair and reasonable price (FAR 15.404-2). The contracting officer must tailor requests to reflect the minimum essential information needed to conduct a technical analysis or cost or pricing analysis. When field pricing assistance

(including audits) is requested, contracting officers are encouraged to team with appropriate field experts throughout the acquisition process, including negotiations.<sup>4</sup>

1. Based on your review, did it appear that sufficient cost or pricing information was available to determine whether the offer's price or costs were fair and reasonable?
2. If sufficient relevant information was unavailable at the buying command, did the contracting officer obtain and utilize field pricing information, including audit support from the Defense Contract Audit Agency (DCAA)?

F. **Task Orders and/or Contract Modifications.** If included in the audit scope. Determine whether the agency sufficiently completes price or cost analysis for task orders or contract modifications. Did the procedures appropriately include separate procedures in addition to merely relying on rates accepted from existing contract? For large dollar task orders or when significant time elapsed since award of the base contract, did the agency sufficiently consider competing the effort as a new award, rather than awarding a task order?

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#### **SUBJECTIVE 4: DETERMINE WHETHER PRICE NEGOTIATIONS WERE EFFECTIVELY CONDUCTED AND DOCUMENTED.**

The purpose of performing cost or price analysis is to develop a *negotiation position* that permits the parties an opportunity to reach agreement on a fair and reasonable price (FAR 15.405 (a)). A fair and reasonable price does not require that the agreement be reached on every element of cost, nor is it required that the price be within the contracting officer's initial negotiation position.

A. **Prenegotiation Objectives and Documentation.** The prenegotiation objectives establish the Government's initial position and assist the contracting officer's determination of a fair and reasonable price. They should be based on the results of the contracting officer's analysis of the offeror's proposal, taking into consideration all pertinent information, such as pricing and technical reports.

1. Did the contracting officer establish reasonable prenegotiation objectives based on pertinent information and include the objective in the contract file?
2. Was the scope and depth of the analysis supporting the objective appropriately related to the dollar value and complexity of the pricing action?
3. If cost analysis was required, did the contracting officer appropriately address and document the pertinent issues to be negotiated, the cost objectives, and the profit and fee objectives?

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<sup>4</sup> The need for some field pricing assistance, such as telephone rate confirmations or audits from the Defense Contract Audit Agency (DCAA) may be particularly needed for large price proposals for noncompetitive procurements that include the submission of detailed cost information.

4. If cost or pricing data were required, did the contracting officer require that the contractor execute a Certificate of Current Cost or Pricing Data, using the format in FAR 15.406-2?

**B. Documenting the Negotiation.**

1. Does the contract file include the principal elements of the negotiated agreement as listed in FAR 15.406-3 (a)?
2. Is there a documentation of the fair and reasonable pricing as determined with adequate explanation?
3. Does the documentation include a summary of the most significant facts or considerations controlling the establishment of the prenegotiation objectives and the negotiated agreement, including a reasonable explanation of any significant differences between the two positions? Is the decision reasonable based on supporting documentation?
4. Is there documentation of the basis for the profit or fee prenegotiation objective and the profit or fee negotiated? Is the fee reasonable based on the structured analysis?
5. If the contractor continually insisted on a price or demanded a profit or fee that the contracting officer considered unreasonable, did the contracting officer refer that contract action to a level above the contracting officer as required by FAR 15.405 (d) and was the disposition sufficiently documented?