PRICING

1. INTRODUCTION. A primary objective of Government contracting is to acquire supplies and services at a fair and reasonable price. Since taxpayer money is being used, considerable scrutiny is devoted to Government expenditures; in addition, many Government projects have no counterpart in the private sector. Therefore, determining that a Government contract price is fair and reasonable is often more time consuming and difficult than in the commercial world. Special policies and techniques have evolved to assist in the determination of a fair and reasonable price for a Government contract. Those involved with the Government acquisition process must have a basic understanding of the concepts, and general rules and procedures that are used in pricing Government contracts.

2. OBJECTIVES. After completion of this block of instruction, the student should be able to:

a. Identify the basic Government pricing policy and the people and activities responsible for implementing that policy.

b. Compare the two basic techniques used in determining a fair and reasonable price: price analysis and cost analysis.

c. Define cost or pricing data.

3. GOVERNMENT PRICING POLICY.

a. The basic Government pricing policy charges contracting officers to purchase supplies and services from responsible sources at fair and reasonable prices. The contracting officer is responsible for determining whether or not a price is fair and reasonable. ***Fair and reasonable*** describes a conclusion that the price is fair to both the Government and the offeror, considering the promised quality and timeliness of contract performance. This term should be considered in three dimensions: fair under current market conditions; reasonable to the offeror; and reasonable to the Government. In making this determination, the contracting officer is allowed to obtain no more information from the offeror than is necessary. Obtaining additional information is allowed only if there is no other way to make the fair and reasonable determination.

b. Even though final responsibility for determining that a price is fair and reasonable rests with the contracting officer, this by no means implies that he should not seek assistance from anyone who might be able to help. Technical specialists, price analysts, quality assurance personnel, auditors, and maintenance personnel are typical sources of assistance. Using others for assistance is a normal procedure except for very simple procurements. Depending upon the circumstances, the contracting officer will use the technique of price analysis, cost analysis, or both to determine whether a proposed price is fair and reasonable.

4. PRICE ANALYSIS.

a. Price analysis is the process of examining and evaluating a price **without looking at the individual cost elements and proposed profit** of the offeror whose price is being evaluated. The price being analyzed may be a unit price, a job or lot price, or a lump-sum price. Price analysis is the preferred method of determining price reasonableness principally because it is the least burdensome on both the offeror and the Government. Price analysis is fundamentally a **comparison process**. Price analysis alone is used in preference to any other type of analysis. When price analysis is done, the Government neither knows nor cares what the proposed costs and profit are. All comparisons are made strictly on the prices offered.

b. One or more of the following **general techniques** described in the FAR is usually used to perform price analysis:

(1) Comparison of competitive price offers received.

(2) Comparison of proposed prices with prior offers or contract prices for the same or similar supplies or services.

(3) Application of rough yardsticks or parametric relationships (such as dollars per pound or per horsepower, or other units) to highlight significant inconsistencies.

(4) Comparison with competitive published price lists, published market prices of commodities, similar indexes, and discount or rebate arrangements.

(5) Comparison of proposed prices with independent Government estimates.

(6) Comparison of proposed prices with prices for the same or similar items obtained through market research.

c. When assembling and analyzing price information, contracting officers rely on primary comparisons when they are available. There are two types of **primary comparisons**. The first, competitive evaluation, is a comparison of current offers with each other. The second, comparison with published prices, is an evaluation of offered prices against prices established by catalogs, advertisements, laws, or regulations. These two evaluations can be used to reinforce each other and they can be supplemented, as necessary, by secondary comparisons.

d. **Secondary comparisons** involve data other than competing offers or published prices. This data may be earlier quotes, previous contract prices, pricing data for similar requirements, cost estimating relationships, Government estimates, and general market data. Secondary comparisons are often used to support tentative conclusions reached through primary comparisons. When no primary comparison is available, a combination of secondary comparisons may validate the reasonableness of an offered price.

c. Price analysis is the pricing technique used when market forces determine offeror's pricing strategies. Goods and services available in the commercial marketplace that are offered to the Government will be subject to price analysis only. Similarly, price analysis is the only technique applied when offerors compete on a price basis for production of DoD-unique items. Price analysis is the only pricing technique that can be used when the contracting method is sealed bidding.

5. COST ANALYSIS.

a. The contracting officer uses cost analysis to establish the basis for negotiating contract prices only when the techniques of price analysis will not reliably result in a fair and reasonable price. Cost analysis is the **review and evaluation of the separate cost elements and profit in a proposal**. When the Government performs a cost analysis, the offeror must submit information to support all or part of its proposal. The information needed for this kind of in-depth analysis may be voluminous, intrusive, and expensive to produce. When this technique is used, proposal preparation costs and acquisition lead-time increase. Therefore, cost analysis is to be used only when there is no other means available to determine a fair and reasonable price.

b. Cost analysis requires that offerors explain in complete or partial detail just how they arrived at their proposed costs or prices. The Government uses cost analysis to establish the cost or price negotiation objective for the contract. Since the Government does not normally produce weapon systems in Government facilities, it is usually very difficult to estimate fair and reasonable contract prices for these projects in any other way. Therefore, the **purpose** of this requirement is to try to equalize contractor and Government knowledge at the time of negotiations so that a fair and reasonable price can be reached or, at least, cost realism can be assured. Both parties are privy to the same information, although each may have drawn different conclusions.

c. Cost analysis is performed by accountants, auditors, price/cost analysts, negotiators, engineers, and production specialists, as well as by the contracting officer. The personnel and/or skills needed to assist the contracting officer depend upon the nature of the supplies or services being acquired and the dollar amount. This support will usually be found locally. Field pricing assistance is the term used to describe information obtained from Defense Contract Management Agency (DCMA) and/or from Defense Contract Audit Agency (DCAA).

6. COST REALISM ANALYSIS.

a. Cost realism analysis is the process of independently reviewing and evaluating specific elements of an offeror's cost estimate to determine whether the estimated proposal 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.

b. The contracting officer performs this analysis on competitive cost-reimbursement contracts to determine the probable cost of performance for each offeror. The probable cost is then used for purposes of evaluation to determine best value. The contracting officer also performs a cost realism analysis on competitive fixed-price incentive contracts.

7. COST OR PRICING DATA.

a. When the contracting officer expects to apply cost analysis on complete proposals, the offerors must submit cost or pricing data. **Cost or pricing data are <u>all facts</u>** that, as of the date of price agreement, prudent buyers and sellers would reasonably expect to affect price negotiations significantly. This data supports the offeror's estimated cost or his price. Cost analysis, when applied to cost or pricing data, is the review and evaluation of both the cost or pricing facts and the judgment applied by the offeror in projecting from the data to the estimated costs.

b. Cost or pricing data are not information that contractors normally release to others. The Government can obtain cost or pricing data from potential contractors because of Public Law (PL) 87-653, also known as the Truth in Negotiation Act (TINA). This law, as amended, stresses that cost or pricing data is to be obtained only as a last resort. Contracting officers are to use every means available to ascertain a fair and reasonable price prior to requesting cost or pricing data.

8. PROFIT/FEE ANALYSIS. Based upon the results of the cost analysis, the contracting officer sets the prenegotiation cost objective for each offeror. The Government cost objective provides the basis for the application of the "weighted guidelines" technique to determine the Government's prenegotiation goal for profit or fee. The **weighted guidelines method** is the structured DoD technique for analysis and evaluation of profit or fee in negotiated procurements when cost analysis is used. The contracting officer assigns values to each profit factor. Each profit factor has a normal value and a designated range of values which are described in DFARS 215. Using this method of profit/fee analysis provides the Government with a rational approach for the development of a profit/fee objective. The weighted guidelines method is designed to: (1) reward the contractor who undertakes more difficult work; (2) allow the contractor to earn a profit commensurate with cost risk; (3) encourage contractors to use their own facilities and invest in capital equipment that can be used on DoD contracts; and (4) reward contractors for productivity increases.

9. SUMMARY. Government pricing policy is to pay a fair and reasonable price. The contracting officer makes the final decision for the Government, although his decision is often influenced heavily by the input of others. In making that decision, the contracting officer uses price analysis, cost analysis, or a combination of both. The weighted guidelines method is a formalized way for contracting officers to arrive at a fair and reasonable profit/fee for a contract where cost analysis is used.