Introduction to Cost and Price Analysis

Cost and price analysis is a crucial step in the contractual process. You may be asking yourself, what is cost and price analysis? We use these terms interchangeably in our everyday lives but there is a difference contractually. The contract specialist, price analyst or contracting officer uses three approaches for analyzing offeror's pricing proposal so that the Government may obtain a fair and reasonable price. They are price analysis, cost analysis and cost realism. These terms are defined below:

Price Analysis is the process of examining and evaluating a proposed price to determine if it is fair and reasonable, without evaluating its separate cost elements and proposed profit. When an offeror is not required to provide cost and pricing data, you **must** use price analysis to ensure that the overall price is fair and reasonable. We will look at several ways that you can compare the overall price to determine price reasonableness.

Cost Analysis. Cost analysis is the review and evaluation of the separate cost elements and profit/fee in an offeror's proposal (including cost or pricing data or information other than cost or pricing data) and your application of judgment. Cost analysis is also determining how well the proposed costs represent what the cost of the contract should be, assuming reasonable economy and efficiency.

Cost Realism Analysis Cost realism is the process of independently reviewing and evaluating specific elements of each offeror's proposed cost estimate to determine if 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 described in the offeror's technical proposal.

Links have been inserted throughout the text to enable you to quickly access definitions. It will help if you first click on the View portion of the toolbar, select Toolbars, and then select Web. To access a link or definition, move the cursor over the underlined expression, press and hold the Control key as you click the left mouse button. You will note that a green arrow appears on the far left of the Web toolbar. After you have accessed and read the definition of a term, you may click on the green arrow to return to the exact place in your text from where you accessed the hyperlink. This feature is being incorporated into other readings.

Objectives

1. Identify sellers' pricing goals in a market.
2. Relate the contractor's pricing objectives to the key elements of the Government's pricing objective.
3. Define the three basic approaches to contract pricing: price analysis, cost analysis and cost realism analysis.
4. Identify the role of each Acquisition Team Member in the determination of the pricing objective.

5. Explain how smart business arrangements reflect consideration of the total cost of doing business from the buyer and seller perspective.
6. Identify monetary and non-monetary motivators.
7. Distinguish among the functional team members and their roles in differing missions.
8. Explain potential impacts of functional team member's actions.
9. Explain the differences in influences affecting contractor versus Government professionals.

An important part of the contract specialist's job is to conduct the price analysis necessary to ensure that the Government purchases supplies and services from responsible sources at fair and reasonable prices. To begin this unit of instruction, we will examine the pricing environment, including;

- Definitions of price;
- Seller pricing objectives and approaches;
- The Government pricing objective
- Government approaches to contract pricing; and
- Potential participants in the acquisition process

Definitions of Price

From both work and personal business dealings, most people think of price as, "The amount of money that a buyer pays a seller for the delivery of a product for the performance of a service. The Federal Acquisition Regulation (FAR) defines price as, "Cost plus any fee or profit applicable to the contract type). Both definitions will be important in this course. Primarily, price is defined as the amount the buyer pays for a service or product. However, it is important to remember that, if prices do not cover supplier costs and provide a profit, losses will occur. When a contract is priced below cost, performance risk increases. The contractor must then finance contract performance with funds from other sources. If contractor efforts to control costs result in unsatisfactory performance, contract default is a real possibility.

Buyer/Seller Motivators

Buyers and sellers do not always have different motivations in the marketplace. It is important as a contract specialist/price analyst to identify each parties motivations and interests in developing a fair and reasonable price objective for both parties.

Seller (Contractor) Motivations

These factors are affected by the market, the seller's financial condition, economic conditions, the political environment, and as such are changing constantly. It is important to remember different sellers in the same marketplace are likely to have different motivators. Particularly on the seller side, many of the motivators are monetary in nature and are interrelated. The buyer who understands the seller's market and what motivates him, as well as his/her own motivators, is better equipped to negotiate and structure a business arrangement that capitalizes on them.

Common Seller Motivations

The following list includes common seller motivations:

Motivators	**Further defined as:**
Profitability	is essential to the success of any company. If the seller does not make a profit, he will, sooner or later, be out of business. The seller must price his products such that he covers his total costs and returns "something extra", i.e., profit, to his investors. How a seller arrives at a price structure that achieves his market objective depends on a number of factors to include competitor population, the role of supply and demand, and how much risk is associated with a particular business arrangement.
Market share	is the focus, when the seller is ultimately concerned with controlling the market. To this end developing a solid customer base and establishing long term relationships are important considerations. One strategy may be to lower prices early on, even anticipating and accepting short term losses, in order to eliminate some of the competition while establishing or strengthening the customer base.
Cash flow	serves as a strong motivation for the seller desiring to avoid taking on additional debt. Taking on additional debt may force the seller to increase revenue through increased volume and/or price increases in order to cover the interest on the additional loans. Additional debt can also cause shareholders and other lenders to lose confidence in the business. Consequently, sellers must receive timely payments from their customers to cover their costs without having to resort to borrowing more money.
Technological Leader	Achieving a technological leadership role, company survival, and image are other seller motivators. Though not as obviously monetary as others previously discussed, they also affect the pricing strategy a seller uses.

Common Buyer Motivations

On the buyer side, the primary motivators are those outlined in the Federal Acquisition Regulation (FAR) Part 1.102. They tend to be non-monetary. The following list includes common buyer motivations:

Motivators	Further defined as:
Conduct business with Fairness and openness	An important motivator for the government buyer has to do with professional ethics. Whenever the buyer is acting as an agent of the government, his/her conduct must be above reproach. In the contracting arena you must be particularly sensitive about your conduct and how others perceive you. It is absolutely essential that by your actions you do everything to earn and maintain the public's trust. That means being open, honest and fair with every member of the AT&L team: customers, technical counterparts, and contractors. Violations of these principles may result in legal action and may carry criminal and/or civil penalties.
Fulfilling Public Policy	In fulfilling public policy objectives, there are numerous socio-economic policies that are implemented through government contract vehicles. Among them are: • Advertising requirements so as to increase competition by giving everyone equal access and opportunity to obtain contracts. • Designating certain requirements as set asides exclusively for small business recognizing that sometimes small businesses are not capable of competing on an equal footing with large businesses. • Requiring government contractors to protect the environment in accordance with the law. • Stipulating that non-professional employees who perform work on government contracts be paid a minimum wage (set by the Department of Labor) and receive the benefits to which they are entitled by law.
Socio-economic Policies	When companies enter into arrangements with the government, they must comply with these policies; however, in their private sector transactions, there are no such stipulations. If they were to subscribe to such practices, it would be because it makes good business sense and not because it is required.

Common Motivators

At this point, if you are thinking there are motivators which sellers and buyers share, you would be right. The following list includes motivations common to the buyer and seller:

Motivators	Common to the Buyer and Seller
Customer Satisfaction	Unarguably, satisfying your customer has got to be everyone's top priority. Give the customer what he wants, when he wants it, with the quality he needs, where he needs it and at a reasonable price and you have ensured his satisfaction. In short, think: Right product, right time, right quality, right place and right price.
Minimize Administrative Costs	One of the most challenging issues we all face is finding new ways to streamline processes and to trim costs. In a nutshell: Do what makes good business and economic sense; consistent with the complexity, estimated value and critical nature of the requirement. One area where we have done that is when we use performance based contracting. There, the emphasis is on telling the contractor what we need, not how to satisfy the need. In his proposal, the contractor explains how he will satisfy the need; the contract is then structured based on his proposal. That way, the contractor has more control and is encouraged to be creative and innovative. Generally, performance based contracting is characterized by less government oversight thereby reducing administrative costs for both parties.
Conduct Business with Integrity	We have already addressed the issues of ethics as a motivator for the buyer, but in fact, professional ethics is an important matter for sellers as well. They must follow a code of conduct and act in a professional manner to gain and maintain the respect and confidence of their customers and suppliers. Behavior inconsistent with those principles could jeopardize the success and very life of their business.

Socio-economic

In addition to the monetary and non-monetary motivators, which influence sellers and buyers, there are other things which blanket the process. They are the socio-economic, political, and economic factors, which can have a tremendous impact on how we shape business arrangements. Some of the socio-economic policies were already mentioned in the text on buyer motivators, for example, setting aside certain requirements to pay a minimum wage.

Political Arena

In the political arena, Congress, via legislation, imposes certain requirements on the contracting process. In the last 20 years, there have been a handful of laws passed that have had a profound influence on how we conduct business.

Competition in Contracting Act (CICA)

In 1984, the Competition in Contracting Act established full and open competition as the preferred method when contracting for the federal government. That means all responsible parties may compete. The government must make every attempt to operate in a competitive environment all the time.

Federal Acquisition Streamlining Act (FASA)

In the mid-1990s, there was another dramatic change in federal contracting. The Federal Acquisition Streamlining Act (FASA) of 1994 raised the threshold for simplified acquisitions from $25,000 to $100,000 and greatly reduced the paperwork and record keeping requirements for those purchases. It also mandated that market research be performed to determine whether a commercial item: (1) meets the requirement; (2) can be modified to meet the requirement; or (3) could meet the requirement with minor modifications. Until that legislation was passed, the federal government and the Department of Defense (DoD) in particular, was rather impervious to the commercial marketplace. Government buyers relied upon rules and regulations instead of focusing on products and markets. All of a sudden, the behemoth was no longer in charge. The federal government discovered it was merely another participant in a marketplace about which it knew very little.

Federal Acquisition Reform Act (FARA)

In 1996, the Clinger-Cohen Act, a combination of the Federal Acquisition Reform Act (FARA) and Information Technology Management Reform Act (ITMRA), further promoted the acquisition of commercial items in several ways, one of which was to exempt them from the cost accounting standards. FARA also approved a test program for using simplified procedures to buy commercial items up to $5 million dollars.

Buy American Act (BAA)

Going back a bit farther in history, you will find the Buy American Act enacted in 1933. This Act restricts the purchase of supplies that are not domestic end products, or to put it another way, the Act gives preference to products "made in the USA". Sometimes the domestic supplies may cost more, but the price is still fair and reasonable, and we are doing our part to support domestic sources.

Economic Influences

In addition to the political factors, there are also economic influences which impact buyers and sellers like the business cycle and globalization.

Business Cycle

The business cycle can have a big impact on company decisions. Whether the economy is in a recession or growth period will often determine how much a company is willing to invest and how hard they will compete for business.

Competition

Competition in the global marketplace has forced companies to become more productive. They often do this by finding ways to reduce costs. This is one of the reasons why many companies that do business with the government object to costly government rules and regulations.

DoD Customer

In the DoD, we have gone from operating in an environment where we were often the only customer, able to dictate how things should be, to the present where we may now find ourselves a rather insignificant customer, with little influence, in a global market. The challenge is to strive to shape sound business arrangements regardless of the circumstances.

Identify the Seller's Goals in the Marketplace

In the marketplace, buyers and sellers view the same price from different perspectives. Sellers in different markets often have different approaches to contract pricing. Sellers in the same market may also have different pricing objectives and approaches. It is even possible for a single firm to utilize different pricing objectives and approaches in different contracting situations.

In the market, sellers usually have two primary objectives - to cover costs and contribute to obtaining the corporate objectives. This usually translates into making a profit. The idea that a company can lose money on each unit produced but cover that loss by volume sales is not factual. A firm that consistently fails to cover its costs cannot survive.

For profit firms are mainly interested in short/long term profitability, market share, long term survival, product quality, technological leadership and high productivity. To obtain these objectives, a firm **must** cover its costs and earn an overall profit. Profits are essential for investment opportunities, product development, productivity improvement, retirement of accumulated debt and rewarding investors.

Pricing Objectives

To sellers, contract pricing has two primary, related objectives:
1. Cover costs
2. Contribute to attaining corporate operational objectives

Identify the Seller's Approaches to Pricing

In product pricing, sellers commonly use one of two basic approaches- cost based pricing or market based pricing. The table below identifies common strategies associated with each approach.

Pricing Approaches	Strategies
Cost-based Pricing	• Mark-up pricing • Margin on direct cost • Rate of return pricing
Market based pricing	• Profit maximization pricing • Market share pricing • Market skimming • Current-revenue pricing • Promotional pricing • Demand differential pricing • Market-competition pricing

The **cost based** pricing approach to pricing involves an analysis of a firm's cost to produce a product, and the addition of a reasonable profit to determine the selling price. **Seller cost** will depend on many factors including production methods and product sales volume. The seller's definition of a **reasonable profit** will also depend on many factors including:

- ✓ Competition
- ✓ Objectives of the firm
- ✓ Necessary investment; and
- ✓ Risk involved

There are three basic strategies on how profit is calculated and applied. They are:

1. Mark-up pricing
2. Margin pricing; and
3. Rate-of-return pricing

Mark-Up Pricing

Mark-Up Pricing is the establishment of a price based on its estimated direct cost or total cost plus a percentage mark-up. If the price is based on direct cost, the mark-up covers profit plus indirect cost (i.e., overhead and general and administrative). If the base is total cost, the mark-up only covers profit.

When a firm uses mark-up pricing, the following steps are taken:

1. Estimate sales volume
2. Estimate product unit cost at the estimated sales volume
3. Determine the mark-up rate to be used.
4. Calculate the unit selling price by applying the mark-up rate to the product cost.

The following example illustrates straight mark-up pricing:

GIVEN

Estimated Sales Volume	=	1,000 Units
Estimated Unit Cost	=	$80
Mark-up Rate	=	20%

Calculate the Unit Selling Price:

Unit Selling Price	=	Cost + (Mark-Up Rate x Cost)
	=	$80 + (.20 x $80)
	=	$80 + $
	=	$96

In using mark-up pricing, profit is set simply by applying a percentage of direct or total cost. The rate will depend on market factors to include your competition, tradition, and product line. Similar products are usually priced using similar mark-up rates. However, if a new company introduces a new state-of-the-art product, the mark-up rate will generally be higher than a similar product that has been on the market for a while. An example of mark up pricing would be the introduction of the new "blackberry" computer. The mark up rate on this new and improved computer would be higher than an older "palm pilot."

Cost Base Used in Applying the Rate

Mark-up on Direct Cost – A firm that bases its mark-up on direct cost will have a higher mark-up than the firm that bases the mark-up on full cost. Why? Because a mark-up based on direct cost must cover overhead costs, as well as profit. A mark-up rate of 100 percent or more may be quite reasonable.

Mark-Up on Total Cost – A firm that bases its mark-up on full costs should have a lower mark-up rate than the firm that bases the mark-up on direct cost only. A mark-up rate of 100 percent on full cost would normally be considered excessive.

The use of mark-up pricing varies by industry and by product. Mark-up pricing is particularly common in industries where the customers are expected to negotiate sales price. Examples of these would be automobile agencies and furniture stores. The profit represented in the mark-up is enough to provide the seller room to negotiate. A good buyer will be knowledgeable of industry mark-up practices. This can be a tremendous advantage in negotiating prices. Mark-up pricing is common for unique items or services provided for a single customer or a small group of customers. Mark-up will vary dependent upon the type of work and the risk involved.

Margin Pricing

Margin Pricing is similar to mark-up pricing in that the price is based on the relationship between cost and profit. Margin pricing based on direct costs must cover both indirect cost and profit. Margin pricing based on total cost must only provide for profit.

Instead of adding a mark-up based on a percentage of cost, margin pricing uses cost to calculate a price that will provide a profit margin that is an established percentage of the price. Many commercial firms use this technique because it matches their accounting reports where costs and profits are reported as a percentage of sales.

When a firm uses margin pricing, the following steps are taken:

1. Estimate the sales volume.
2. Estimate cost at the estimated sales volume
3. Determine the margin rate to be used.
4. Calculate the selling price by applying the margin rate to the product cost.

The following is an example of margin pricing:

GIVEN

Estimated Sales Volume	=	1,000 Units
Estimate Unit Cost	=	$80
Margin Rate	=	40%

Calculate Unit Selling Price

Unit Selling Price $\dfrac{\textbf{Cost}}{(1 - \text{Margin Rate})}$

$$= \frac{\mathbf{\$80}}{(1 - .40)}$$

$$\frac{\mathbf{\$80}}{.60}$$

$$= \$133$$

Margin rates also depend upon the product line, tradition and competition. Similar products usually are priced with similar mark-up rates. A firm's senior management is often rated by the margin rate that they are able to obtain and maintain. It is always wise to be aware of the industry's margin mark-up rates to obtain an advantage in the negotiation process, especially when buying in the commercial market.

Rate of Return Pricing

Rate of Return Pricing is similar to mark-up pricing in that profit dollars are added to estimated costs. However, profit dollars are not calculated based on the cost of labor and material required to provide the product. Profit is calculated based on the financial investment required to provide the product, the return needed to attract investment and the estimated sales volume.

When using Rate of Return pricing, a firm must following the following steps:

1. Determine the desired rate on investment
2. Estimate investment required
3. Estimate level of sales
4. Estimate unit cost at the project sales level
5. Calculate desired unit profit
6. Calculate unit selling price (estimated cost + desired profit)

The following is an exercise demonstrating Rate of Return Pricing:

Given:

Desired Rate of Return	=	15%
Estimated Investment Required	=	$600,000
Estimated Sales	=	5,000 units
Estimated Unit Total Cost	=	$80

Calculate Unit Selling Price:

Calculate Desired Unit Profit	=	$\frac{\text{15\% of \$600,000}}{\text{5,000 units}}$
	=	$\frac{90{,}000}{\text{5,000 units}}$
	=	$18 per unit
Calculate Unit Selling Price	=	$80 + $18
(Unit Cost + Unit Profit)	=	$98

Firms that choose to use this pricing methodology are usually more sensitive to changes in sales volume than other pricing methods. They are not only concerned about mark-up or margin rate but the rate of return. Lower priced items coupled with higher sales volume can actually increase their rate of return. However, a higher priced item coupled with lower sales volume can lower the rate of return.

As a buying agent for the government, you should be aware of the investment required to make different products. If the seller is able to reduce their investment or spread the investment over more products, this should reduce the profit that must be earned on any one product to maintain a required rate of return on investment.

Seller's Market Based Pricing Strategies

In a competitive market, the seller must consider the four "P"s of marketing: Price, product, place and promotion. Firms must develop pricing strategies to accomplish overall marketing objectives based on their assessment of market conditions. It will be beneficial to you as the government's buyer to become familiar with the seller's strategies and formulate your own. There are seven basic strategies used by the seller. They are:

1. Profit-Maximization Pricing;
2. Market-Share Pricing;
3. Market Skimming;
4. Current-Revenue Pricing
5. Promotional Pricing
6. Demand-Differential Pricing; and

7. Market-Competition Pricing

Profit Maximization Pricing

In profit maximization pricing the seller assumes that demand falls as prices increase and grows as prices decrease. A business that uses this type of strategy carefully analyzes the market to find the combination of price per unit and quantity of sales that maximizes profit. The seller must be aware of the point of profit maximization. They must ask the questions: As price increases, does demand decrease and as price decreases, does demand increase?

It is imperative to be aware of the relationship between price and quantity in the marketplace. Taking advantage of price breaks can save the government and your organization dollars. Unfortunately, most of the time the quantities needed by the government are fixed. Prices for multiple award Federal Supply Schedules are the possible exception. Another exception may be the prices for inventory items, when the amounts ordered by inventory managers vary from one period to the next based in part on price/quantity trade-offs.

Market Share Pricing

Market Share Pricing is based on the assumption that long-run profitability is associated with market share. The goal, when using this pricing strategy, is to dominate the market through market penetration. Firms “low-ball” their prices hoping to win customers and discourage competition. Their strategy is that early losses may appear but they will eventually increase volume, cost per unit will decrease and long term profit will be achieved.

When using this strategy, the offeror will attempt to build efficient operations, lower prices as costs drop and set prices at or below the competitor’s prices to win the market share.

As the buyer for the government, if at all possible or practicable, you should encourage mass production efficiencies that reduce contractor costs and provide them with a reasonable profit. You should discourage contractor “**buy-in**” (bidding below cost to win a contract and exclude others from the market) when there is evidence that the contractor may not be able to perform the contract because the contractor’s price will not cover costs. You should be particularly concerned with sellers having limited financial resources or are apparently gambling on capturing a larger share of the market than they are likely to achieve.

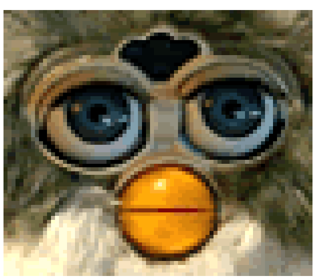
Market Skimming

Using **Market Skimming**, prices are set to achieve a high profit on each unit by selling to buyers who are willing to pay a higher price for a product of perceived higher value. After the demand of these buyers is satisfied, or competitors produce similar products at lower prices, prices may be reduced to increase volume and maintain overall profitability. A firm that uses this strategy must consider establishing a high price to achieve a high profit margin at relatively low volume and decreasing price over time to attract buyers not willing to pay the price premium. A good example of this pricing strategy is the story of IBM and Apple Macintosh computer companies. Prices remained relatively high for years and firms catered to buyers who wanted only the "best". As quality competition increased, prices began to drop. As a buying agent for the government, you should resist the "best" when the best is more than the government needs or has a requirement for.

Current Revenue Pricing

The emphasis on this method of pricing is the maximization of current revenue rather than profit or long term revenue. Firms using this strategy are typically concerned about long-term market uncertainty or the firm's financial instability.

When using this strategy, the seller must determine the price/quantity combination that maximizes revenue. As a buyer you need to be aware that this strategy predominates when risk is high. Action to reduce risk will most likely be rewarded with lower prices and a more stable business environment. Long-term demand must be considered for these products. A good example of revenue pricing was the "hula hoop.". Demand may be high one day and disappear the next. Near term cash recovery is more important than long-term profitability. Another example of this strategy was the era of "mood rings" and "pet rocks".



Mood Ring

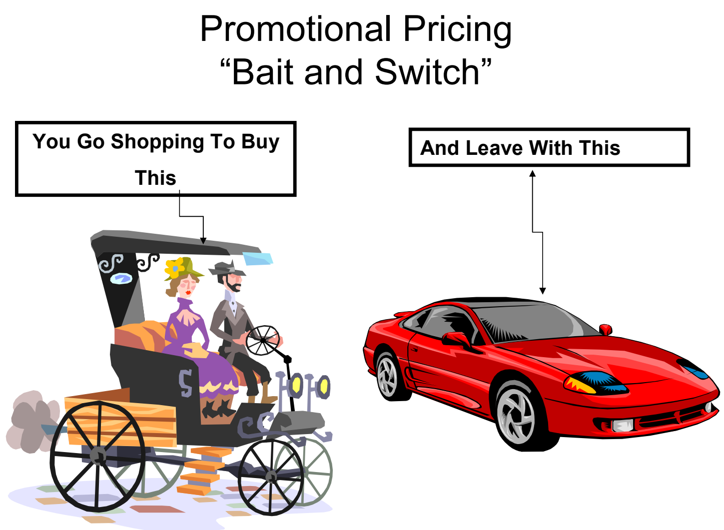
As the buyer, you must ensure Government contractors are responsible." Firms with limited financial resources may employ this strategy. If near term cash needs are not met, there will be no long term for the firm. Unfortunately, concentration on the near-term may also jeopardize the long-term future of the firm

Promotional Pricing

In using promotional pricing, products are priced to enhance the sales of the overall product line rather than to assure the profitability of each product.

When using this strategy, the seller should determine whether selling a product at a loss will increase the sale of related products and increase profit and whether selling a product at a high (prestige) price will improve the product line quality image and increase profit. This strategy can be used for pricing a wide range of consumer and industrial products from groceries to electronics and services. Government personnel evaluating offers for a delivery-order or task-order contract with multiple line items should be particularly alert to offers prepared using this strategy.

Promotional pricing can take many forms to include the **"bait and switch, loss-leader and prestige pricing."** The **bait and switch strategy** lures the buyer using a low priced item then switches the buyer to a more expensive item. Many department stores will offer great sales deals. This will lead you to make a trip to their store and then be guided into buying a more expensive item. The **loss leader strategy** reduces the price of one, or a group of items, to near cost or below. Customers are attracted to buy the low priced items and buy other related items at the same time. Prestige Pricing uses a high quality, high priced item to enhance the image of an entire product line and attract more buyers. BMW is an example of this type of pricing. In other words, it can be impossible to evaluate qualifications so high price equals high quality.



Demand-Differential Pricing

Products or services sold in different market segments are priced in a way that is not consistent with the marginal costs related to segment differences. When using this strategy the seller should consider identifying the segmentation factors that may affect pricing to include the customer, product form, place and time. They should determine the demand intensity in each segment, identify actual and potential competitors and assure that the demand-differential will not breed customer resentment.

As the buyer, you should be aware of the effect of the various segmentation factors on different products. Customers may pay different prices based on buying power or negotiation skills. We all know that different people leave an automobile dealership paying differing prices for the same automobile. A product form (an assembled product) may warrant a higher price than the price of the component plus assembly. The location of the sales transaction may affect the price. Items sold in New York may be substantially higher than the price of an identical item sold in Alabama plus the shipping charge to New York. Time may also affect pricing. This is particularly true in Industries such as Utilities Departments which may offer lower prices for "off peak" hours.

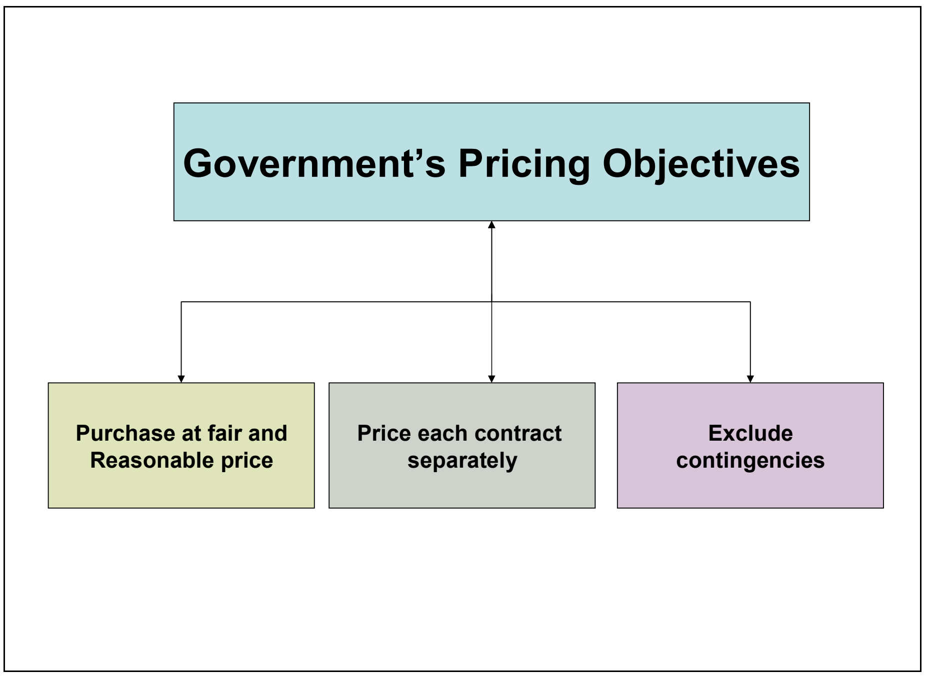
Market Competition Pricing

Emphasis in this type of pricing is placed on competitive action or reaction to pricing actions that competitors have taken or are expected to take. Firms' base their prices on what they think other firms in their market are using. The seller must investigate and ensure that their prices are in line with their competitors' prices. Applications for this type of pricing include:

Sealed bidding, which is often used for government contracting, forces the seller to estimate what their competitors will bid, determine what they can bid and still maintain a profit and submit the bid knowing that further discussions or negotiations are allowed. The Going Rate pricing requires the seller to determine what the competitors are charging and establish their product price within an established range of their competition.

Government policy on competition and market pricing is designed to encourage sellers to establish prices using market competition pricing. This is only one method of market pricing. Many businesses are reluctant to compete in a market where success is achieved by low price alone.

Identifying Government's Pricing Objectives



When buying for the Government, our primary pricing objective for all contract actions is to acquire the supplies and services from responsible sources at a fair and reasonable price.

In conducting our price analysis, how do we determine what is "fair and reasonable?" The answer may mean different things to different people. The Federal Acquisition Regulation (FAR), which is our regulatory guide as buyers for the Government, does not specifically define "fair and reasonable." It does, however, ask two questions Is it fair? Is it reasonable? Buyers and sellers also have very different perceptions as to what is fair and reasonable.

To be fair to the buyer a price must be in line with (or below) the fair market value of the contract deliverable (if that can be ascertained through price analysis). Expect to pay the fair market value, given the prices of market transactions between informed buyers and sellers under similar competitive market conditions for deliverables with similar product, quality and quantity requirements. It is also fair to the buyer if 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 method of performance plus obtaining a reasonable profit. As a buyer for the government, you should be responsible in evaluating price. If you pay too much for the item or service you have failed to fulfill your responsibility as a contract specialist or contracting officer.

The price must also be fair to the seller. To be fair to the seller a price must be realistic in terms of the seller's ability to satisfy the terms and conditions of the contract. Why should you care as a buyer if the low offer is unrealistic? An unrealistic price puts both parties at risk. The risk to the Government is that the firm, in trying to cut losses, might:

- Cut corners on product quality;
- Deliver late;
- Default, forcing a time consuming reprocurement; or
- Refuse to deal with the Government in the future or be forced out of business entirely.

Situations for Special Consideration

Fairness to the seller can be a concern in both competitive and non-competitive situations. Below cost prices are not necessarily unfair to the seller. A bidder, for various business reasons, may decide to submit a below cost bid. This does not make the bid invalid. Whether the awardee can perform the job at the price offered at the bid price is a matter of responsibility. Be on guard against the practice of buying-in (submitting offers below anticipated costs expecting to increase the contract after award of receive follow-on contracts). FAR 3.501 presents a number of techniques to prevent a contractor from recovering buy-in losses. It also refers you to FAR 15.405 for guidance on treatment of unreasonable price quotations.

Mistakes

The offered price may be unexpectantly low because the seller has made gross mistakes in estimating costs or is otherwise nonresponsible. The award of a contract to a supplier based on lowest evaluated price alone can be false economy if there is subsequent default, late deliveries, or other unsatisfactory performance resulting in additional contractual or administrative costs. While it is important that Government purchases be made at the lowest price, this does not require an award to a supplier solely because that supplier submits the lowest bid. A prospective contractor must affirmatively demonstrate its responsibility, including, when necessary, the responsibility of its proposed subcontractors. If the vendor offers a price that is far below other offered prices or your estimate of the probable price, treat the offer as a potential mistake. In such cases, both FAR Part 14 and 15 authorize fact-finding to determine whether the offeror understands the work and can perform at the offered price.

Single-source procurements

Do not force a below-cost price on the offeror even if you believe that the offeror has the financial ability to absorb the probable loss. Instead, negotiate a contract of a type and a price that is likely to cover all allowable costs of performance, assuming reasonable economy and efficiency, and provide a reasonable profit (consistent with FAR profit policies). Even your opening position in non-competitive negotiations should not be a "below cost" number. Rather, your opening position should be based on a more optimistic reading of the potential production improvements, risks, and costs of providing the contract deliverable than that of the target position on price.

What is a reasonable price**?** 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.

- **Supply and Demand.** The forces of supply and demand can have a significant effect on product prices:

    - If demand is constant, decreasing supply usually results in higher prices, while increasing supply usually results in lower prices.

    - If supply is constant, decreasing demand usually results in lower prices, while increasing demand usually results in higher prices.

- **General Economic Conditions.** General economic conditions affect the prices of all products, but the effect will not be the same for every product. Inflation and deflation affect the value of the dollar. Boom, recession, and depression affect available production capacity.

- **Competition.** When competition does not exist, the forces of supply and demand may not work effectively. The buyer or seller may have an advantage in the pricing decision process.

    - Markets can be defined by considering: the number of buyers, the number of sellers, product homogeneity, and ease of market entry and exist.

    - The buyer's relative pricing power compared with that of sellers changes in different market situations. The table below examines the relative pricing in each situation:

Level	Buyers	Sellers	Market Entry/Exit	Relative Pricing Power
Perfect competition	Many independent	Many independent	Relatively easy	Pricing balance between buyers and sellers
Effective Competitive	Limited Independent	Limited Independent	Relatively easy	Relative pricing balance between buyers and sellers
Oligopoly	Many Independent	Few Independents	Restrictions	Relatively greater pricing advantage to sellers
Oligopsony	Few Independents	Many Independent	Relatively easy	Relatively greater pricing power to buyers
Monopoly	Many Independent	One	Restrictions	Considerable pricing power to sellers
Monopsony	One	Many Independent	Relatively easy	Considerable pricing power to buyers
Bilateral Monopoly	One	One	Restrictions	Pricing power established by negotiation(as in sole source Government negotiation)

Alternatives for Meeting the Requirement

In making any acquisition, you should consider the alternatives. In a competitive acquisition, you should first consider how an offered price compares with competitive offers. However, your analysis should not end there. You should also consider other alternatives for acquiring the product or service. For example, sealed bidding procedures permit the agency head to cancel a solicitation when otherwise acceptable bids are at unreasonable prices and negotiation procedures permit the source selection authority to reject all proposals if doing so is in the best interest of the Government.

Price Related Evaluation Factors.

A prudent buyer will consider differences in the cost of acquiring and owning a deliverable that are not covered by the contract price. To consider these price-related factors in a competitive acquisition, the solicitation must provide for such consideration. For example:

- **Direct Costs Not Included in the Contract Price.** The solicitation allowed offers to submit offers for offerors either for f.o.b. destination or f.o.b. origin. FAR requires that offer evaluation criteria provide for consideration of the shipping costs from f.o.b. origin points to destination.

- **Costs of Ownership Not Included in the Contract Price.** Your market research indicates that several products could satisfy your requirement. However, the products differ substantially in maintenance and repair costs. Offer evaluation criteria should provide for consideration of the related costs to the Government.

- **Costs of Contract Award and Administration.** In a competitive contracting situation, you may solicit line item prices and an aggregate price for all solicitation line items. The contracting officer could split the line items among five offerors, or award all line items to the single firm that offered the lowest aggregate price. To determine which method of award would provide the best value to the Government, offer evaluation criteria must provide for consideration of cost to the Government for awarding and administering multiple contracts.

  In a noncompetitive acquisition, you should be alert to potential risks and costs NOT covered in the offered price. A price that seems reasonable on the surface may be unreasonable if proposed terms and conditions shift costs to the Government. For instance, an offered price may seem reasonable until you discover that the proposed terms and conditions have shifted responsibility for furnishing the necessary tooling from the firm (per the RFP) to the Government (per the proposal). Likewise, a contractor's proposed price, regardless of amount, might be unreasonable if conditioned on the use of a cost-reimbursement contract that transfers an inappropriate portion of the risk of cost growth to the Government.

- **Non-Price Evaluation Factors.** In some acquisitions, the test of reasonableness requires a trade-off analysis between price, price-related factors, and non-price factors such as past performance and relative technical capabilities of the competing firms. In particular, do **not** compete cost-reimbursement contracts primarily on the basis of lowest proposed costs. That would only encourage offerors to submit unrealistically low estimates and increase the likelihood of cost overruns

Apply Judgment. Your determination of whether an offer is fair and reasonable is a matter of judgment. There is no simple formula in which you can just plug in a few values and receive a firm answer of fair and reasonable. Determining what is fair and reasonable depends on market conditions, your alternatives for meeting the requirement, price-related factors, and the non-price evaluation factors that relate to each procurement. It also depends on what price you can negotiate with an offeror. FAR states that:

"A fair and reasonable price does not require that agreement be reached on every element of cost, nor is it mandatory that the agreed price be within the contracting officer's initial negotiation position. Taking into consideration the advisory recommendations, reports of contributing specialists, and the current status of the contractor's purchasing system, the contracting officer is responsible for exercising the requisite judgment needed to reach a negotiated settlement with the offeror and is solely responsible for the final price agreement."

There may be times when you find it impossible to reach agreement on a price that you consider fair and reasonable. If that happens, follow the FAR guidance at FAR 15.405(d).

> "If, however, the contractor insists on a price or demands a profit or fee that the contracting officer considers unreasonable, and the contracting officer has taken all authorized actions (including determining the feasibility of developing an alternative source) without success, the contracting officer shall refer the contract action to a level above the contracting officer. Disposition of the action should be documented."

Price Each Contract Separately

The second element of the Government's pricing objective is that every contract be priced separately. It is human nature to tray to balance one contract against another in terms of financial results. A seller's position might be that the firm lost money on the last contract; therefore, an effort should be made to make up for that loss on the next contract. The buyer's position might be that the contractor made too much profit on the last contract; therefore, the next contract should be structured to restrict profit.

While these attitudes may be understandable in a personal sense, they are not valid in Government contracting. Government contracting is very complex because:

- Buyers and sellers do not have perfect knowledge of all transactions between a contractor and the Government.
- The market forces of competition, supply and demand change.
- Business conditions change.

Because of these reasons, you must price each contract separately and independently to ensure that all proposed prices are fair and reasonable to all involved parties.

Exclude Contingencies

The third element of the Government pricing objective requires that contracts exclude contingencies that cannot be reasonably estimated at the time of award. A **contingency** is a possible future event or condition arising from presently known or unknown causes, the outcome of which is not determinable at the present time. There are two types of contingencies that are important in Government contracting:

1. Contingencies that may arise from presently known and existing conditions, the effects of which are foreseeable within reasonable limits of accuracy; and

2. Contingencies that may arise form presently known or unknown conditions, the effects of which cannot be measured to precisely as to provide equitable results to the contractor and the Government.

The following table shows you how to handle each type of contingency in terms of the contract price.

CONTINGENCY	EXAMPLES	CONTRACT PRICE
Foreseeable within reasonable limits of accuracy	Cost of rejects Cost of defective work	Contingencies of this type should be included in contract cost estimates to make those estimates as accurate as possible.
CANNOT be measured so precisely as to provide equitable results to the contractor and to the Government	Results of pending litigation Costs of volatile material price changes	Contingencies of this type should be excluded from the cost estimates under the several items of cost, but should be disclosed separately (including the basis on which the contingency is computed) to facilitate the negotiation of appropriate contract coverage.

Identifying Government Approaches to Contract Pricing

As a contract specialist, your primary objective as a Government buyer is to acquire supplies and services from responsible sources at fair and reasonable prices. You can use three basic approaches to attain this objective:

1. Price Analysis;
2. Cost Analysis;
3. Cost Realism Analysis

This section defines each type of analysis, when it is used and the key elements to consider.

As defined earlier**, price analysis** is the process of examining and evaluating a proposed price to determine if it is fair and reasonable, without evaluating its separate cost elements and proposed profit. When an offeror is not required to provide cost or pricing data, you must use price analysis to ensure that the overall price is fair and reasonable. When an offeror is required to provide cost or pricing data, use cost analysis to evaluate the reasonableness of individual cost elements. Use price analysis to verify that the overall price offered is fair and reasonable.

Price analysis **always** involves some form of comparison with other prices. As the contracting officer, you are responsible for selecting the bases for comparison that you will use in determining if a price is fair and reasonable, such as:

- Proposed prices received in response to the solicitation;
- Commercial prices including competitive published price lists, published commodity market prices, similar indexes, and discount or rebate arrangements;
- Previously-proposed prices and contract prices for the same or similar end items, if you can establish both the validity of the comparison and the reasonableness of the proposed price;
- Parametric estimates or estimates developed using rough yardsticks;
- Independent Government Estimates; or
- Prices obtained through market research for the same or similar items. [1]

The order in which the bases for price analysis are presented on this list represents the general order of desirability. However, the order is NOT set in concrete. For example:

- Comparisons with commercial catalog, market, or regulated prices can be just as desirable as comparisons with competitive offers. After all, the prices of commercial products are defined by commercial market competition.
- Independent Government estimates are normally considered to be the least desirable comparison base for price analysis. However, in cases (e.g., construction) where estimates are based on extensive detailed analysis of requirements and the market, the Government estimate can be one of the best bases for price analysis.

Moreover, you should use all bases for which you have recent, reliable, and valid data. For instance, you would be well advised to consider the last price paid in addition to current competitive prices -- especially if the prior contract was awarded at a reasonable price last month.

Buyer Evaluation and Documentation

Price analysis is a subjective evaluation. For any given procurement, different bases for price analysis may give you a different view of price reasonableness. Even given the same information, different buyers/contracting officers might make different decisions about price reasonableness. It is the cognizant contracting officer who must be satisfied that the price is fair and reasonable. You must document the file concerning the rationale used in making the pricing decision. Otherwise, the individuals who may review your file later may not know or understand the factors that affected your decision.

Cost Analysis

Cost Analysis is the review and evaluation of the separate cost elements and proposed profit/fee of:

- An offeror’s or contractor’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.

The purpose of the evaluation is to form an opinion on the degree to which the proposed costs represent what the cost of the contract should be, assuming reasonable economy and efficiency.

When to Use Cost Analysis

Perform cost analysis in either of the following situations:

- When you require an offeror to submit cost or pricing data. In this situation, the offeror must provide complete, accurate, and current data to support all proposed costs and profit/fee.
- When you require an offeror to submit cost information other than cost or pricing data to support your decision on price reasonableness or cost realism. In this situation, require only the information necessary to determine price reasonableness or cost realism.

Contract Cost Definitions.

Contract cost is the sum of the allowable **direct and indirect costs** allocable to a particular contract, incurred or to be incurred, less any allocable credits, plus any allocable cost of money.

Direct cost is any cost that can be identified specifically with a final cost objective, such as a contract.

Indirect cost is any cost that cannot be directly identified with a single, final cost objective, but is identified with two or more final cost objectives or an intermediate cost objective.

Profit/fee is the dollar amount **over and above allowable costs** paid to the contractor to motivate contractor performance. Together contract cost and contract profit/fee total contract price. Thus contract profit is an important element of contract price and must be considered in cost analysis. Each agency must establish a structured approach for analysis of proposed profit/fee.

Identifying Contract Costs

Not all contract costs as cash expenditures during the contract period. Major contract costs can fall in the following categories:

- **Cash expenditures.** The actual outlay of dollars in exchange for goods and services.
- **Expense accrual.** Expenses are recorded for accounting purposes when the obligation incurred, regardless of when cash is paid out for the goods and services.

- **Draw down on inventory.** The use of goods purchased and held in stock for production and/or direct sale to customers. The term refers to both the number of units and the dollar amount of items drawn out of inventory.

For example, both direct and indirect costs result from a draw down of inventory and many indirect costs are accrual expenses.

Type of Contract Cost	Example
Cash expenditure	Payment by cash, check, or electronic funds transfer to a vendor for raw materials.
Expense accrual	Incurring of an obligation in the current year to pay an employee a retirement pension at some point in the future.
Draw down of inventory	Electronic components purchased in large volume against anticipated total demand and held in inventory until drawn out to fill a specific order. While the components were paid for in the past, the drawing out of a component to meet a contract need is a reduction of the assets of the firm and therefore a cost to the contract.

Cost Analysis Supplements Price Analysis

Cost analysis is not a substitute for effective price analysis. Cost analysis should provide insight into what it will cost the firm to complete the contract using the methods proposed. However, cost analysis does not necessarily provide a picture of what the market is willing to pay for the product involved. For that you need price analysis.

For example, suppose that you wanted to procure a custom-made automobile identical to a Pontiac Trans Am. At your request, your neighborhood mechanic agrees to build you such a car. In building the car, the mechanic gets competitive quotes on all the necessary parts and tooling, pays laborers only the minimum wage, and asks only a very small profit.

How do you think the final price will compare to a car off an assembly line? Probably at least ten times more expensive. Parts alone may be five times more expensive. The entire cost of tooling will be charged to one car. Labor, although cheaper, will likely not be as efficient as assembly-line labor. Is the price reasonable? That decision can only be made through price analysis.

Cost Realism Analysis

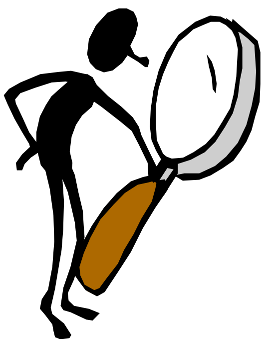
Cost realism analysis is the process of independently reviewing and evaluating specific elements of each offeror's proposed cost estimate to determine whether the estimated proposed cost elements:

- 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

When To Use Cost Realism Analysis

COST REALISM ANALYSIS



- Are cost elements realistic?
- Does the offeror understand contract and work requirements?
- Is the cost estimate consistent with technical proposal?

(Applies to competitive cost-reimbursement or fixed-price incentive contracts)

Perform a cost realism analysis of each cost-reimbursement contract offer to determine the probable cost of contract performance and use that estimate in your evaluation of the best value to the Government.

- The probable contract cost related to a cost-reimbursement contract offer may differ substantially from the proposed cost. Your most probable cost estimate should reflect your best estimate of the cost of any contract that is most likely to result from the offeror's proposal.
- Determine the probable cost for each offer by adjusting the proposed cost, and fee when appropriate, to reflect any additions or reductions in cost elements to realistic levels based on the results of the cost realism analysis.

You may also use cost realism analysis in evaluating competitive offers for fixed-price incentive contracts or, in exceptional cases, on other competitive fixed-price contracts.

Give special consideration to using cost realism analysis to evaluate offers for fixed-price contracts when:

◊ New requirements may not be fully understood by competing offerors;
◊ There are quality concerns, or
◊ Past experience indicates that contractors' proposed costs have resulted in quality or service shortfalls.

When using cost realism analysis to evaluate offers for a fixed-price contract, you may use the results of your analysis in performance risk assessments and responsibility determinations. However, proposals must be evaluated using the criteria in the solicitation, and the offered prices must not be adjusted as a result of the analysis.

Business Arrangements

Contracting professionals must also consider financial management when developing contract strategies. It is important for the Government buyer to understand why companies choose to do business with the DoD.

In general, people invest in companies to make a profit-in the form of income for the sole-proprietor or partner, or as dividends and increasing stock prices for a stockholder. As a result, companies strive to maximize the wealth of the business owners. They do this by balancing the drive for profits with the risks associated with obtaining those profits. For example, a company may accept a lower profit on a contract if there are favorable financing provisions that increase their cash flow. Why? Because increasing their cash flow means they need to borrow less money which reduces their risk.

Measures of Return

Companies use many measures to decide whether or not to bid on a Government project. Some of the more common measures include:

1. Return on equity (ROE) – a financial ratio used to measure how effectively stockholder investments are being managed. This is also called return on investment.

2. Return on assets (ROA) – a financial ratio designed to measure how well a company is using its assets in the generation of operating profit. This may also be known as return on capital or return on capital employed.

3. Return on sales (ROS) – a financial ratio calculated by dividing net profit by net sales or revenue.

Hurdle Rate

Many companies use what is called a “hurdle rate”. That is, they will not bid on a project unless it provides some minimum return on their investment. Unless it clears this investment “hurdle”, they will not compete for the business. The objective in using these measures is to quantify risk versus return when making business investment decisions.

Importance of Measures of Return

Why are measures of return important to the government buyer? Good buyers are always looking for ways to increase competition and encourage more businesses to compete for Government business. Because cash flow and investment returns are so critical to industry, buyers need to understand how financial terms and conditions affect the business arrangement and whether or not they are a positive or negative incentive for industry to do business with the DoD. One of the primary positive incentives available to the DoD buyer is contract financing.

Contract Financing

The basic rule in Government contracting is that Government agencies do not pay for goods and services until they are delivered and accepted. However, Congress permits agencies to provide contract financing to vendors. Since the Government is able to borrow money at lower interest rates than a business, it is cheaper for the Government to loan the vendor the money than it is for the vendor to get a bank loan. The Government prefers not to finance; however, the Government may as a means of increasing competition or as a bargaining tool in reducing the price of the award.

Identifying Potential Acquisition Team Members

The Acquisition Team includes everyone involved in the acquisition -- beginning with the customer and ending with the contractor providing the product or service. This text refers to Government participants in the acquisition process as the Government Acquisition Team.

The Government is committed to providing training, professional development, and other resources necessary for maintaining and improving the knowledge, skills, and abilities of all Government Acquisition Team participants. This commitment applies both to the individual's particular area of expertise within the Government and the individual's role as a Team member.

In addition to the team members listed in the illustration, you might also obtain assistance from one or more of the following:

- ✓ Inventory manager
- ✓ Technical specialist
- ✓ Transportation, property or logistics managers
- ✓ Administrative Contracting Officer (ACO)

The table below summarizes the role that potential Government Acquisition Team members might play in making or supporting the contract pricing decision.

Potential Members	Typical Role in Contract Pricing
Contracting Officer	The contracting officer is the person with authority to enter into, administer, and/or terminate contracts and make related determinations and findings. The term includes certain authorized representatives of the contracting officer operating within the limits of their authority as delegated by the contracting officer.
Contract Specialist	A contract specialist may be responsible for performing a wide variety of contracting activities under the authority of the contracting officer assigned to the contract. In this capacity, a contract specialist will likely provide key input to the pricing decision, but the ultimate decision on price reasonableness rests with the contracting officer.
Requirements Manager	Requirements managers initiate acquisitions by preparing purchase requests. Purchase requests specify the requirement and generally include an Independent Government Estimate. After you receive the purchase request, requirements managers often can help: • Review alternatives for improving the solicitation, • Identify potential price-related factors for award, • Account for significant discrepancies between different comparison bases used in price analysis, and Provide advice and information for price-related decisions.
End User	The end user may or may not be the requirements manager. If the requirements manager is not the end user, you may find it useful to consult the end user when building the solicitation and making price-related decisions. In addition, the end user may be more knowledgeable about the product and a better source for an Independent Government Estimate than the requirements manager.
Commodity Specialist	Some organizations have dedicated commodity specialists who, among other things, heavily research the markets for their respective commodities
Inventory Manager	Inventory managers keep track of large stocks of products in Government warehouses and other such facilities. Among other things, inventory managers generate purchase requests for replacement supplies as users draw on the Government stocks. They tend to be especially concerned about the solicitation/contract, in terms of its potential impact on delivery, inventory levels, and inventory costs.
Auditor	Auditors are accountants with specialized training and experience in examining and analyzing cost or pricing data provided by offerors and contractor records (particularly accounting records). Their support can be invaluable in cost proposal analysis. In the Department of Defense, contract auditors are assigned to the Defense Contract Audit Agency (DCAA). In other agencies, auditors are typically assigned to the agency Inspector General.
Technical Specialist	These specialists generally write specifications or statements of work and technical evaluation factors and evaluate technical proposals. In many acquisitions, the requirements manager acts as the technical specialist. Larger acquisitions, however, may involve teams or panels of technical experts (who, depending on the specific deliverable, may be engineers, scientists, or other similar professionals). From a pricing standpoint, technical specialists may have a good understanding of the costs necessary to build a deliverable and also of the types and sources of commercial products that may be available to satisfy a requirement.

Potential Members	Typical Role in Contract Pricing (Cont)
Transportation, Property, or Logistics Mangers	These specialists can help you select and apply price-related factors that involve transportation costs, Government-furnished property, and ownership costs. All may be involved if you plan to solicit based on a full life-cycle cost model.
Legal Counsel	Lawyers may play a role in clearing contracts and reviewing justifications for such price-related decisions as cancellation of an IFB after opening. Look to them for advice on the solicitation and on making the price-related decisions.
Competition Advocate	Competition advocates review acquisition plans and analyze specifications to identify and, where possible, remove "barriers" to full and open competition. They also review justifications for other than full and open competition. From a pricing standpoint, they can be valuable allies in maximizing price competition.
Administrative Contracting Officers and Administration Specialist	Some Federal agencies have dedicated contract administration offices. These offices are often involved in preaward reviews of contract pricing proposals because contract administrators have more complete information on the production and pricing practices of specific offerors. Administrative contacting officers may also be responsible for pricing certain kinds of contract modifications.
Cost/Price Analyst	Some contracting activities have dedicated cost/price analysts who can assist in performing the tasks described in this book. However, such analysts are typically only available for higher dollar, more complex procurements.
Business Advisor	Contracting Professional who knows and understands their customer's mission as well as their own organizational mission. Exercises personal initiative whenever appropriate and practices sound business judgment. Selects most appropriate strategy and proper tools to shape the best possible win-win business arrangement.

Introduction Review Questions

1. List the sellers' pricing goals in a market. (Answer)
2. Relate the contractor's pricing objectives to the key elements of the Government's pricing objective. (Answer)
3. Define the three basic approaches to contract pricing: price analysis, cost analysis and cost realism analysis. (Answer)
4. What is the role of each Acquisition Team Member in the determination of the pricing objective (Answer)
5. Explain how smart business arrangements reflect consideration of the total cost of doing business from the buyer and seller perspective (Answer)
6. Identify monetary and non-monetary motivators (Answer)
7. Distinguish among the functional team members and their roles in differing missions (Answer)
8. Explain the potential impacts of functional team members actions (Answer)
9. Explain the differences in influences affecting contractor versus Government professionals. (Answer)

Definitions

Aggregate	A whole considered with reference to its constituent parts.
Contracting Officer	A US military officer or civilian employee who has a valid appointment as a contracting officer under the provisions of the Federal Acquisition Regulation. The individual has the authority to enter into and administer contracts and determinations as well as findings about such contracts.
Cost-Plus-Fixed Fee Contract	A cost reimbursement contract that provides for the initially negotiated fee to be adjusted later by a formula based on the relationship of total allowable costs to total target costs. This contract type specifies a target cost, target fee, minimum and maximum fees, and a fee adjustment formula.
Cost-reimbursement contract	A contract that provides for payment of allowable incurred costs, to the extent prescribed in the contract. These contracts establish an estimate of total cost for the purpose of obligating funds and establishing a ceiling that the contractor may not exceed (except at its own risk) without the approval of the Contracting Officer (FAR 16.301)
Fair and reasonable price	To be fair to the buyer a price must be in line with (or below) the fair market value of the contract deliverable (if that can be ascertained through price analysis). A reasonable price is a price that a prudent and competent buyer would be willing to pay, given available data on market conditions, general economic conditions and competition.
Fixed-price incentive contract	A contract that specifies a target cost, a target profit, a price ceiling (but not a profit ceiling or floor), and a profit adjustment formula. These elements are all negotiated at the outset. The price ceiling is the maximum that may be paid to the contractor, except for any adjustments under other contract clauses.
Going-rate	The price that is deemed to be the current market rate of a specific commodity or service.
Parametric Estimate	An estimate in which a constant in a mathematical expression whose values determine the specific form or characteristics of the expression.
Profit/fee	The dollar amount over and above allowable costs paid to the contractor to motivate contractor performance.
Sealed Bidding	A method of contracting that employs competitive bids, public bid openings and awards. Award is made to that responsible bidder whose bid, conforming to the invitation for bids, will be most advantageous to the Government considering only price and price-related factors included in the invitation.