

# International Cost Estimating & Analysis Association

## Supplier Cost/Price Analyses

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David Eck and Todd W. Bishop  
Dixon Hughes Goodman LLP  
Government Contract Consulting Services Group



# Agenda

- Why Supplier Price Cost Analysis?
- Cost or Pricing Data Requirements
- What is Cost or Pricing data?
- Data Other than Cost or Pricing Data
- Price Analysis Considerations
- Cost Analysis Considerations
- Cost or Pricing Data
- Exceptions to Requiring Cost or Pricing Data
- What is a Cost and Applicable Regulations
- Accounting and Estimating Systems
- DHG Supplier Cost Analysis Review Plan
- Examples of Working Papers
- Obtaining and Analyzing Supplier Data
- Common Supplier Proposal Deficiencies

# Why Supplier Cost and Price Analysis?

- Flexibly priced Prime (or upper tier) Contract
- Government will audit procurement actions and files
- Federal Acquisition Regulation (FAR) Part 15, Contract Pricing
- FAR 15.408, Table 15-2, Subcontractor requirements for Prime proposal submissions
- FAR 52.215-12, Subcontractor Cost or Pricing Data.
- Reduce overall costs to the contract and customer

# Why Cost or Pricing Data?

- 15.403-4 Requiring certified cost or pricing data

(a)(1) The contracting officer shall obtain certified cost or pricing data only if the contracting officer concludes that none of the exceptions in [15.403-1\(b\)](#) applies. However, if the contracting officer has reason to believe exceptional circumstances exist and has sufficient data available to determine a fair and reasonable price, then the contracting officer should consider requesting a waiver under the exception at [15.403-1\(b\)\(4\)](#). The threshold for obtaining certified cost or pricing data is \$700,000. Unless an exception applies, certified cost or pricing data are required before accomplishing any of the following actions expected to exceed the current threshold or, in the case of existing contracts, the threshold specified in the contract:

- (i) The award of any negotiated contract (except for undefinitized actions such as letter contracts).
- (ii) The award of a **subcontract** at any tier, if the contractor and each higher-tier subcontractor were required to furnish certified cost or pricing data (but see waivers at [15.403-1\(c\)\(4\)](#)).
- (iii) The modification of any sealed bid or negotiated contract

# WHAT IS COST OR PRICING DATA?

- FAR 2.101 Definition states
  - Facts that, as of the date of price agreement or, if applicable, another date agreed upon between parties that is as close as practicable to the date of agreement on price, prudent buyers and sellers would reasonable expect to affect price negotiations significantly.
    - Factual, not judgmental, and therefore verifiable
    - Include the data that form the basis for the prospective offeror's judgment about future cost projections.
      - The data do not indicate the accuracy of the prospective contractor's judgment
    - Are more than historical accounting data. They are the facts that can be reasonably expected to contribute to the soundness of estimates of future costs and to the validity of determinations of costs already incurred.

# CERTIFIED COST OR PRICING DATA?

## –FAR 2.101

- Are pricing data, cost data, and judgmental information necessary for the contracting officer to determine a fair and reasonable price or to determine cost realism that are not required to be certified as accurate, complete, and current, in accordance with FAR 15.406-2.
- May include sales data and any data reasonably required to explain the offeror's estimating process including but not limited to
  - The judgmental factors applied and the mathematical or other methods used in the estimate, including those used in projecting from known data
  - The nature and amount of any contingencies included in the proposed price
- Includes “cost or pricing data” but for which certification is not required

# CONTRACT PRICING IN FEDERAL PROCUREMENT

- Cost analysis shall be used to evaluate the reasonableness of individual cost elements when certified cost or pricing data are required.
- Price analysis shall be used when certified cost or pricing data are not required. Price analysis should be used to verify that the overall price offered is fair and reasonable.

# Price Analysis Considerations

- Definition of Price Analysis
  - 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.
  - Price Analysis may be, when necessary, supplemented by evaluation of cost elements.
- Price Analysis must be performed for ALL procurement to ensure that the overall price is fair and reasonable.



# BASIS FOR PRICE ANALYSIS

- Price analysis always involves some form of comparison with other prices
  - 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 both the validity of the comparison and the reasonableness of the proposed price can be established
  - Parametric estimates or estimates developed using rough yardsticks
  - Independent Government Estimates
  - Prices obtained through market research for the same or similar items

# COST ANALYSIS CONSIDERATIONS

- Definition of Cost Analysis
  - The review and evaluation of the separate cost elements and a proposed profit/fee of:
    - An offeror's or contractor's cost or pricing data or information other than cost or pricing data
    - 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 PERFORM COST ANALYSIS

- Perform cost analysis in either of the following situations:
  - When the Truth in Negotiations Act (TINA) applied and the offeror is required 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/fees.
  - When the offeror is required to submit cost information other than cost or pricing data to support the decision on price reasonableness or cost realism.

***Require only the information necessary to determine price reasonableness or cost realism!***

# WHEN TO PERFORM COST ANALYSIS

- Definition of Cost Realism Analysis
  - 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
    - Are consistent with the unique methods of performance and materials described in the offeror's technical proposal
- When to Use Cost Realism Analysis
  - All cost-reimbursement contract offers to determine the probable cost of contract performance
  - Evaluating competitive offers for fixed-price incentive contracts or, in exceptional cases, on other fixed-price contracts

# COST OR PRICING DATA THAT SUPPORTS COSTS

- Include such documents and Analysis as:
  - Vendor quotations
  - Nonrecurring costs
  - Information on changes in production methods and in production or purchasing volume
  - Data supporting projections of business prospects and objectives and related operations costs
  - United-cost trends such as those associated with labor efficiency
  - Make-or-buy decisions
  - Estimated resources to attain business goals
  - Information on management decisions that could have a significant bearing on costs
  - Actual cost data from prior efforts (very important!)

# EXCEPTIONS FROM SUBMISSION OF COST OR PRICING DATA

- A price is based on adequate price competition if
  - Two or more responsible offerors, competing independently, submit priced offers that satisfy the Government's expressed requirement and if
    - Award will be made to the offeror whose proposal represents the best value where price is a substantial factor in source selection
    - There is no finding that the price of the otherwise successful offeror is unreasonable. Any finding that the price is unreasonable must be supported by a statement of the facts and approved at a level above the contracting officer.

# EXCEPTIONS-ADEQUATE PRICE COMPETITION CONT.

- There was a reasonable expectation, based on market research or other assessment, that two or more responsible offerors, competing independently, would submit priced offers, even though only one offer is received from a responsible offeror, and if
  - Based on the offer received, the contracting officer can reasonably conclude that the offer was submitted with the expectation of competition, e.g. circumstances indicate that
    - The offeror believed that at least one other offeror was capable of submitting a meaningful offer
    - The offeror had no reason to believe that other potential offerors did not intend to submit an offer
  - The determination that the proposed price based on adequate price competition and is reasonable has been approved at a level above the contracting officer.

# EXCEPTIONS-PRICES SET BY LAW OR REGULATION

- Pronouncements in the form of periodic rulings, reviews, or similar actions of a governmental body, or embodied in the laws, are sufficient to set a price.



# EXCEPTIONS-COMMERCIAL ITEMS

- Any acquisition of an item that the contracting officer determines meets the commercial item definition in 2.101, or any modification, as defined in paragraph (3)(i) of that definition, that does not change the item from a commercial item to a noncommercial item, is exempt from the requirement for certified cost or pricing data.
- If the contracting officer determines that an item claimed to be commercial is, in fact, not commercial and that no other exception or waiver applies, the contracting officer shall require submission of certified cost or pricing data.

# FORMAT FOR DATA SUBMISSION

- CCPD – FAR Table 15-2
- Data Other than CCPD
  - May require only limited cost information from the offeror/contractor
  - May contain similar types of data as CCPD but does not require a Certificate of Current Cost or Pricing Data and does not require submission of data in the format at Table 15.2
- Under TINA requirements, the offeror must disclose all facts that a prudent buyer or seller expects would have a significant impact on price

# TRACEABILITY

- Auditable format
- Cost breakdowns & methodology
- Top – down traceability (summary schedule to subsidiary schedules)
- Basis of estimate
  - What is being estimated?
  - How is it being estimated?
  - What empirical data were used to derive the estimate?
  - Why is the estimate reasonable?

# COST ANALYSIS DEFINITION

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

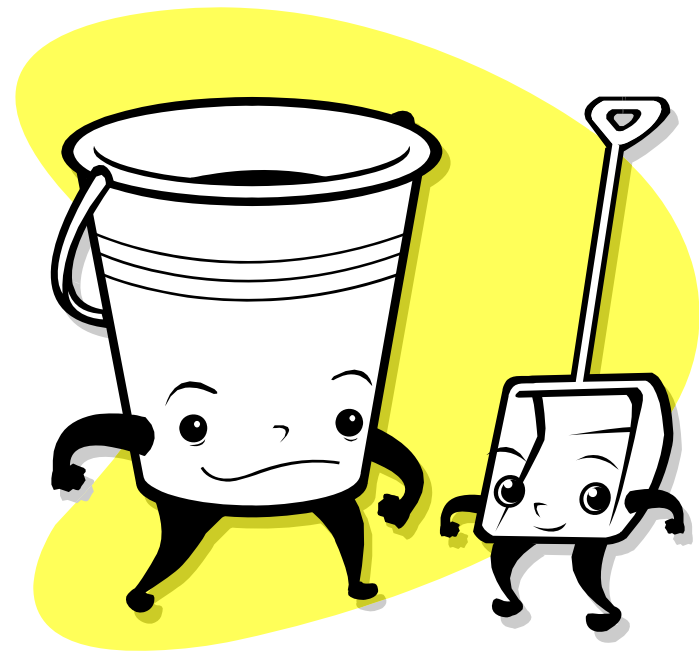
# WHAT IS COST?

- Direct Cost
  - Direct Labor
  - Direct Material
  - Other Direct Costs
  - Subcontracts
- Indirect Cost
  - Overhead
  - G&A Cost
  - Cost of Money

# COMPOSITION OF TOTAL COST

## – FAR 31.201-1

- Direct Cost – FAR 31.202
- Indirect Cost – FAR 31.203
- Cost of Money – FAR 31.205-10



# THE D.O.G CONCEPT

- Direct
- Overhead
- General and Administrative Cost



# DIRECT COST – FAR 31.202

- A direct cost can be specifically identified with a particular final cost objective
- Rule of 5. To be a direct cost, it must
  - Able to be measured
  - Capable of being accumulated
  - Worth tracking
  - Able to be estimated
  - Able to be sold to the customer
- Similar costs incurred for the same purpose must also be a direct cost
- Insignificant direct costs can be treated as indirect costs





# INDIRECT COST – FAR 31.203

- A cost not directly identified with a single final cost objective. Left over after all direct costs are assigned.
- Includes overhead and G&A.
- Rule of 4. For indirect costs, you must be able to:
  - Track pool and base
  - Generate timely reports
  - Project the rates with some certainty
  - Sell the rates to a customer
- Similar costs incurred in similar circumstances must also be indirect
- Must select an allocation base with a casual or beneficial relationship to the pooled costs



# POOLS AND BASES

- Supervision and management of
  - Direct labor hours or cost
  - Direct material cost, weight, quantity
- Service Centers
  - Input or output measures
- G&A
  - Single element
  - Value-added base
  - Total cost input

# HOME OFFICE EXPENSES

- Costs need to be allocated on a base that reflects a casual or beneficial relationship
- Three steps to the allocation process
  - Specific identification
  - Homogenous cost pools
  - Three factor formula

# FAR COST PRINCIPLES ARE USED:

- When cost or pricing data is submitted
- When cost analysis is performed
- When cost is used to establish a price for a contract or contract modification



# COST ALLOWABILITY – FAR

## 31.201-2

### 5 Part Test for Cost Allowability

- Reasonableness
- Allocability
- Standards of the CASB or GAAP
- Terms of the Contract
- Cost Principle Limitations

# REASONABLENESS – FAR 31.201-3

- Definition
  - A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business.
- Contractor has burden of proving reasonableness
- Normal concepts of reasonableness do not apply



# ALLOCABILITY – FAR 31.201-4

- Definition
  - Is incurred specifically for the contract
  - Benefits both the contract and other work and can be reasonably distributed
  - Is necessary for overall operation of the business
- Often draws improper disallowances
- Titles such as “Commercial Selling” lead to misunderstandings

# ALLOWABILITY REQUIREMENTS

- Contractor must maintain adequate accounting records
  - FAR 31.201(2)(c)
- Contractor must apply consistent practices
  - FAR 31.201(2)(b)
- Often subject to improper challenges due to poor chart of accounts or inadequate procedures.



# ESTIMATING SYSTEM

- A contractor's cost estimating system is the policies, procedures, and practices for generating cost estimates and other data included in cost proposals, including
  - Organizational structure
  - Established lines of authority, duties, and responsibilities
  - Internal controls and managerial reviews
  - Flow of work, coordination, and communication
  - Estimating methods, techniques, accumulation of historical costs, and other analyses used to generate cost estimates
- An acceptable estimating system should provide for the use of appropriate source data, utilize sound estimating techniques and good judgment, maintain a consistent approach, and adhere to established policies and procedures.

# ESTIMATING METHODS

- Round Table
  - Experts are brought together to develop cost estimates by exchanging views and making judgments based on knowledge and experience.
  - Most commonly used when there is little or no cost experience or detailed product information (e.g specifications, drawings, or bills of material)
- Comparison
  - Costs for a new item are estimated using comparisons with the cost of completing similar tasks under past or current contracts.
  - Adjustments may be made for possible upward or downward cost trends.
  - Most commonly used when specifications for the item being estimated are similar to other items already produced or currently in production and for which actual cost experience is available.

# ESTIMATING METHODS CONT.

- Detailed
  - Characterized by a thorough review of all components, processes, and assemblies.
  - Requires detailed information to arrive at estimated costs
  - Typically uses cost data derived from the accounting system, adjunct statistical records, and other sources
  - Most commonly used when the required information is available and future production potential warrants the cost of the detailed analysis required.
  - Most accurate of the three methods for estimating direct cost.
  - Most time-consuming and expensive.

# PROFIT/FEE ANALYSIS

- Statutory Limitations
- General Factors Affecting Profit or Fee
- Weighed Guidelines Profit Analysis

# EXAMPLES OF WORKING PAPERS

- Request for cost/price analysis
- Supplier proposal/quote and supporting data
- Comparison of overall proposed prices to historical prices
- Summary working papers
- Review of direct labor costs and rates
- Review of materials/subcontracts
- Review of indirect costs and rates
- Review of other direct costs
- Review of profit/fee

# OBTAINING SUPPLIER DATA

- Data Adequacy Checklist
- Pro-forma letter requesting additional data
- Follow-up is important

# **ANALYZING MATERIAL AND SUBCONTRACT COSTS**

- Adequacy of supplier analysis of proposals and quotes
- Purchase Order/Subcontract price history
- Applying decrement factors
- Analysis of quantities

# ANALYZING FORWARD PRICING RATES

- Comparing proposed rates to historical rates
- Comparison of proposed pool expenses to operating and other budgets
- Analysis of forecasted sales data and development of forecasted base data
- Comparison of proposed pool expenses by major grouping to relevant historical data, and analyzing differences



# ANALYTICAL TECHNIQUES

- Regression Analysis
- Statistical Sampling and Analysis
- Learning/Improvement Curves
- DCAA EZ Quant – Show best practices on using this software, especially downloading spreadsheets

# ANALYZING DIRECT LABOR COSTS

- Rates/Hours
- Recurring vs. Non-Recurring
- Engineering vs. Manufacturing

# COMMON PROPOSAL DEFICIENCIES

- Costs from prior efforts are not disclosed
- Basis of direct labor rates/hours not included
- Comparison of proposed labor rates to historical rates not included
- Bill of material not included
- References to material pricing not included
- Comparison of proposed material prices to historical prices not included
- Subcontract proposals and cost/price analyses of those proposals not included

# COMMON PROPOSAL DEFICIENCIES

- Basis of indirect rates/COM factors not included
- Out-year forecasts of rates not included
- Comparison of proposed rates to historical rates not included
- Budgetary data to support the rates not included

# INADEQUATE PROPOSALS/UNSUPPORTED DATA

- Causes rework
- Increased government involvement
- Significant recommended reductions to supplier proposed costs
- Loss of negotiation power/loss of business
- Seek another supplier

# SUPPLIER REVIEWS

- Prime contractor generally reviews supplier proposals according to FAR requirements (no more/no less)
- Option for suppliers to disclose certain data directly to the government (e.g., direct/indirect rate information)

# RESOURCES AVAILABLE TO SUPPLIERS

- Small Business Administration
- Local Procurement Technical Assistance Center (PTAC)
- Applicable contracting offices
- Prime Contractor Supplier Development Team
- DCAA Guide for Contractors, audit programs, adequacy checklists, etc. ([www.dcaa.mil](http://www.dcaa.mil))
- Armed Services Pricing Manual (ASPM)
- Contract Pricing Reference Guide

# Questions?

