

# PRICING GUIDE FOR FTA GRANTEES

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This document is intended to serve as a general guide and reference publication for FTA Grantee's requirements, and purchasing people. It is not directive in nature or all-inclusive. It is intended to be used as a tool in helping the Grantees obtain more for their contracting dollar.

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## PRICING GUIDE FOR FTA GRANTEES

### I. INTRODUCTION

**Pricing** is a word that **means a lot of things to a lot of people**. An **individual involved in Large Dollar Acquisitions** may think of pricing as **meaning cost analysis** and certified cost and pricing data. An **individual involved in smaller contracting** actions, on the other hand, may take pricing to **mean price analysis**. In other words, personnel think of pricing in terms that relate to the dollar categories and complexities of the purchases they make.

In the context of **this guide**, **pricing means** simply the **minimum actions** you must take to **determine** and document a fair and **reasonable price**. The degree and complexity of these actions vary with dollar amount and type of purchase. **This guide** is written for **purchasing and requirement personnel** that deal with purchases on a frequent basis. There is very little information provided for noncompetitive **purchases over \$500,000**. Once you reach this level, the possibility for very complex pricing is so great that you should be **dealing with a price analyst**.

**This guide** is designed to **aid contracting personnel** in solving day-to-day pricing problems. It is simple, straightforward, and easy to use. It is **not all-inclusive**. For more extensive information it is suggested you review Armed Services Pricing Manual (ASPM 1<sup>1</sup>). The guide serves as a **training aid** for the less experienced, a "**memory jogger**" for the more experienced buyer, and a **quick reference** document for everyone.

The format of the guide is structured in two ways: by dollar category and by pricing method. In each case some background is provided in addition to how to make the purchase. Appendices are provided which include examples of pricing scenarios and information for other than routine purchases.

### POLICY

Some form of **pricing is required on every contracting action**. The nature of **Sealed Bid** Purchases makes the required actions so simple that some people don't even think of them as "pricing." Award must be made to the responsible bidder submitting the lowest responsive bid. By **comparing bids** to see which is the lowest, you are accomplishing a form of price analysis. Even if you have only one bid, your job is still fairly simple. Unless you have justification for rejecting the bid and/or canceling the solicitation, you make an award, provided the price is reasonable and you have enough money. Contracting officers should exercise extreme care to insure that a mistake in bid has not occurred.

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<sup>1</sup> ASPM 1 can be purchased from the Superintendent of Documents, Government Printing Office (GPO), Washington, D.C. 20402, or the Commerce Clearing House, Inc., 4025 W. Patterson Ave., Chicago, Illinois 60646.

**Negotiated contracts** should be **based on** adequate price **competition whenever possible**. Those that are not, are subject to some other form of price analysis or a combination of price and cost analysis. You will probably be doing the pricing job without the assistance of specialists. As a result, you should know about available sources, past prices and quantities, delivery and production schedules, specifications, market prices, discounts, terms of sale, and quality (including the acceptability of past purchases to the users). **You should also know as much as possible about what you are buying**. Examine the product, look at a picture of it, and talk about it with someone who does know. You won't get this experience all at once or for a single purchase, but this kind of effort is necessary for effective pricing of negotiated purchases.

**Offers** submitted in the absence of adequate price competition are **frequently lowered** by **analysis and negotiation**. While this is a proper goal in most instances, the **attitude that every offer analyzed must be reduced is wrong**. Such an attitude is obvious and a company may anticipate it when preparing future offers. Also, it is both frustrating and ineffective to negotiate from such a position; and this bias can destroy the mutual respect (between contractor and the Grantee and among various Grantee specialists involved) which is so necessary to successful negotiations. The **objective of your analysis** of an offer is to **determine if the price offered is reasonable**.

## PRICING METHODS

There are **two accepted methods** of pricing contract actions: **price analysis**, which is simply a comparative process involving total price, and **cost analysis**, which is an element-by-element analysis of the costs which make up the total price.

## DEFINITIONS

**Acquisition Planning:** The process by which the efforts of all personnel responsible for acquisitions are coordinated and integrated through a comprehensive plan for fulfilling the Grantee's needs in a timely manner and at a reasonable cost. Includes developing the overall strategy for managing the acquisitions.

**Actual Cost:** A cost which has been incurred and can be substantiated with factual documentation.

**Adequate Price Competition:** This condition exists when two or more responsible offerors compete independently and submit proposals deemed responsive to a solicitation, and there is no evidence that competition was restricted or that the lowest price is unreasonable.

**Allocable Cost:** A cost is allocable if it is assignable or chargeable to one or more elements of work or final cost objectives (accounts, contracts, etc.) according to the relative benefits received from those objectives.

**Allowable Cost:** Cost which is reasonable, allocable, and in consonance with 48 CFR Chapter 1 Part 31 or otherwise conforms to accepted accounting principles, specific limitations, or exclusions set forth or agreed to between contracting parties.

**Commercial Item:** Any item of supply or service that is regularly used for other than Government purposes and is sold or traded in the course of conducting normal business operations.

**Competition:** An environment of varying dimensions relating to buy-sell relationships in which the buyer induces, stimulates, or relies on conditions in the marketplace that cause independent sellers to contend confidently for the award of a contract.

**Competitive Range:** The category in which the contracting officer places all offers having a reasonable chance of being selected for award. The determination as to which offers are in this range is based on price or cost, technical, and other salient factors. If there is any doubt as to whether or not an offer should be included, it should be resolved by including the offer in this range.

**Contract:** A term used to describe a variety of agreements or orders for the procurement of supplies or services.

**Contract Pricing:** A series of actions used to obtain, assess, verify, and adjust cost or pricing information and to record the steps taken to ascertain that prices agreed to have been determined fair and reasonable.

**Cost Analysis:** The evaluation of each cost element which makes up a total price. This evaluation may include obtaining certified cost or pricing data, the appropriate verification of cost data, evaluation and projection of specific cost elements to determine cost necessity, allowance for contingencies, and the basis used for allocation of overhead costs.

**Cost of Pricing Data:** Data consisting of all facts existing up to the time of agreement on price, which prudent buyers and sellers would expect to have a significant effect on price negotiations. Being factual, these data are types that can be verified. They do not reflect the accuracy of the contractor's judgment about estimated future costs or projections; they do, however, reflect the data upon which the contractor based his judgment.

**Defective Cost or Pricing Data:** Certified cost or pricing data subsequently found to have been inaccurate, incomplete, or noncurrent as of the effective date of the certificate. In this case, the Grantee is entitled to an adjustment of the negotiated price, including profit or fee, to recoup any significant sum by which the price was increased because of the defective data, provided the data were relied upon by the Grantee.

**Direct Cost:** Any cost that is specifically identified with a particular final cost objective (contract, account, etc.) but not necessarily limited to items that are incorporated in the end product as material or labor.

**Economic Price Adjustment:** An alteration permitted and specified by contract provisions for the upward or downward revision of a stated contract price upon the occurrence of certain contingencies that are defined in the contract.

**Established Catalog Price:** A price included in a catalog, price list, schedule, or other form that (1) is regularly maintained by a manufacturer or vendor, (2) is published or made available for inspection by customers, and (3) states prices at which sales are currently or were last made to a significant number of buyers from the general public.

**Fair and Reasonable Price:** A price that is fair to both parties, considering the agreed-upon conditions, promised quality, and timeliness of contract performance. Although generally a fair and reasonable price is a function of the law of supply and demand, there are statutory, regulatory, and judgmental limits on the concept.

**General and Administrative:** Expressed normally as G&A. Indirect expenses, including a company's general and executive offices, executive compensation, the cost of staff services such as legal, accounting, public relations, financial and similar expenses, and other miscellaneous expenses related to the overall business.

**Incremental Funding:** The obligation of funds to a contract containing a total price or estimated cost, in periodic installments against prescribed performance goals or objectives.

**Indirect Cost:** Any cost not directly identified with a single final cost objective but identified with two or more final cost objectives, or with at least one intermediate cost objective. Also referred to as overhead or burden.

**Learning Curve:** A tool of calculation used primarily to project resource requirements, in terms of direct manufacturing labor hours or the quantity of material (for this purpose, usually referred to as an improvement curve) required for a production run. Used interchangeably with the term improvement curve, the concept of a learner's curve was adopted from the observation that individuals who perform repetitive tasks exhibit a rate of improvement due to increased manual dexterity. Learning or improvement curve theories include the following:

- **Unit Curve Theory:** As the total quantity of units produced doubles, the cost per unit decreases.
- **Cumulative Average Theory:** As the total quantity of units doubles, the average cost per unit decreases by some constant percentage (the rate of learning).

**Multi-year Contracting:** Means contracts covering more than 1-year's, but not in excess of 5-year's, requirements. Each program year is annually budgeted and funded and, at the time of award, funds need only to have been available for the first year. The contractor is

protected against loss resulting from cancellation by contract provisions which allow reimbursement of costs included in the cancellation ceiling.

**Negotiation:** In its more formal context, one of the major methods of procurement. Employed under certain permissive circumstances when sealed bidding is determined to be infeasible and impractical. In its more general context, a bargaining process between two or more parties, each with its own viewpoints and objectives, seeking to reach a mutually satisfactory agreement on, or settlement of, a matter of common concern.

**Option:** Means a unilateral right in a contract by which, for a specified time, a Grantee may elect to purchase additional equipment, supplies, or services called for by the contract, or may elect to extend the term of the contract.

**Price:** A monetary amount given, received, or asked in exchange for property or services, expressed in terms of a single item or unit of measure for such property or services.

**Price Analysis:** The comparative process of evaluating total price without regard to the individual elements that make up the total price.

**Pricing Arrangements:** An agreement between contracting parties for the payment of amounts for specified performance. Usually expressed in terms of a specific cost reimbursement type arrangement.

**Pre-Negotiation Memorandum:** The document that identifies the steps taken by the Grantee personnel to analyze the contractor's proposal and identify issues to be discussed. Used as a test to establish the Grantee's position during negotiations. Called the PM.

**Price Negotiation Memorandum:** The document that relates the story of the negotiation. First it is a sales document that establishes the reasonableness of the agreement reached with the successful offeror. Second, it is the permanent record of the decisions the negotiator made in establishing that the price was fair and reasonable. Called the PNM.

**Reasonable Cost:** A cost is reasonable if, in its nature or amount, it does not exceed what would be incurred by an ordinarily prudent person in the conduct of competitive business.

**Value Analysis:** A systematic and objective evaluation of the function of a product and its related cost. Its purpose is to ensure optimum value. As a pricing tool, it provides insight into the inherent worth of a product.

**Visual Analysis:** The visual inspection of an item or its drawings, from which a general estimate may be made about probable value. In most instances, visual analysis deals with obvious external features.

## SECTION II

### PRICE ANALYSIS

**Price Analysis** is the most used method to determine a fair and reasonable price because it is **less complex and time consuming** than other methods. A **form of price analysis** is **used on every purchasing action**. In order of preference the accepted forms of price analysis are:

- (1) Adequate price competition
- (2) Prices set by law or regulation
- (3) Established catalog prices and market prices
- (4) Comparison to previous purchases
- (5) Comparison to a valid Grantee independent estimate
- (6) Value analysis

Each form of price analysis is discussed in the following paragraphs.

**Adequate price competition** is dependent upon the following:

- (1) **At least two** responsible **offerors** respond to a solicitation.
- (2) Each offeror must be **able to satisfy the requirements** of the solicitation.
- (3) The offerors must **independently contend** for a contract to be awarded to the **responsive and responsible** offeror submitting the lowest evaluated price.
- (4) Each offeror must submit **priced offers** responsive **to the expressed requirements** of the solicitation.

If the four conditions just outlined are met, price competition is adequate unless:

- (1) The solicitation was made under conditions that unreasonably deny one or more known and qualified offerors an opportunity to compete.
- (2) The low competitor has such an advantage over other competitors that he/she is practically immune to the stimulus of competition.
- (3) The lowest final price is not reasonable, and this finding can be supported by facts.

**Prices set by Law or Regulation are fair and reasonable.** Acquire a copy of the rate schedules set by the applicable law or regulation. Once these schedules are **obtained**, **verify that they apply** to your situation and that you are being charged the correct price. For utility contracts, this policy applies only to prices prescribed by an effective, independent regulatory body.



**Established catalog prices** are dependent on the following:

- (1) Established **catalog prices exist**.
- (2) The items are **commercial in nature**.
- (3) They are **sold in substantial quantities**.
- (4) They are sold **to the general public**.

The idea behind catalog prices is that a commercial demand exists and suppliers have been developed to meet that demand. We are just trying to **ensure** we get **at least the same price as other buyers** in the market for these items. You need to be sure that the catalog is not simply an internal pricing document. Request a copy of the document or at least the page on which the price appears.

**Established market prices** are based on the same principle as catalog prices except there is no catalog. A market price is a current price established in the usual or ordinary course of business between buyers and sellers **free to bargain**. These **prices must be verified by buyers** and sellers who are **independent of the offeror**. If you do not know the names of other commercial buyers and sellers, you may obtain this information from the offeror.

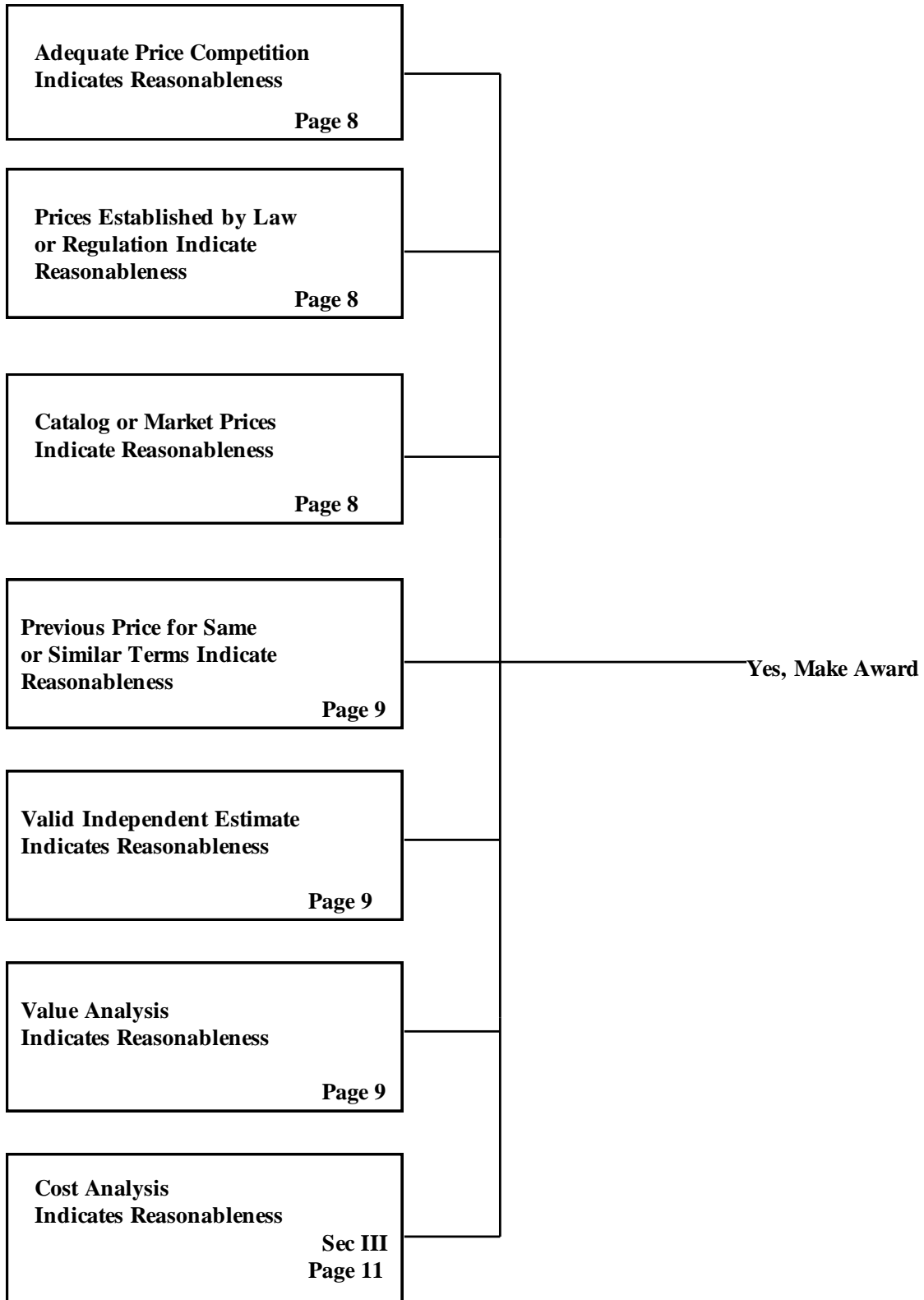
**Comparison to previous purchases.** Changes in **quantity, quality, delivery schedules,** and the economy cause price variations. Each **differing situation must be analyzed** through trend analysis. Also ensure that the previous price was fair and reasonable. This determination must be based upon a physical review of the documentation contained in the previous files.

**Comparison to a valid independent estimate.** **Verify the facts, assumptions,** and **judgments** used. Have the estimator give you the method and data **used in developing the estimate**. For example, did prices come from current catalogs or industry standards? Be sure that you feel comfortable with the estimate before relying on it as a basis for determining a price to be fair and reasonable.

**Value analysis requires you** to look at the item and the function it performs so you can **determine its worth**. The decision of price reasonableness remains with the contracting officer. Also, contact the requiring activity for their expertise so they can participate in making the decision.

Use the chart on page 10 for making your decision that the price is fair and reasonable.

**"BASIS FOR DETERMINING FAIR[NESS] AND REASONABLENESS"**



## SECTION III

### COST ANALYSIS

Cost Analysis. **Cost analysis is more complex and time-consuming** than price analysis. As such, it should be used when price analysis alone is not sufficient in determining the price to be fair and reasonable. Essentially, **cost analysis**, as distinguished from price analysis, is the **process of**:

1. **Obtaining cost or pricing** data (a breakdown of costs) from prospective contractors or subcontractors,
2. **Verifying and evaluating** the accuracy and allowability of cost data; and
3. **Projecting cost data** from known to estimated costs to show the effect on overall prices.

A contractor's proposal should include comparisons of current estimated costs with:

- (1) Actual costs previously incurred.
- (2) The most recent cost estimate for the same or similar items or with a series of prior estimates.
- (3) Current cost estimates from other possible sources providing the same or similar product or service.
- (4) Independent forecasts of future costs.

In doing a cost analysis you may only want to **analyze selected cost elements** of a contractor's offer. For example, you may want to take a look at costs for material and overhead, but not labor. **First obtain a breakdown of cost elements** from the offeror. Determine which ones you want to analyze, and then **secure assistance** from the using activity. After receiving these inputs you can proceed to analyze these selected costs using the pricing tools in section IV. **Your analysis will result** in a determination of **fair and reasonable price** or serve as a **basis for negotiations**.

## SECTION IV

### PRICING TOOLS

Certain tools help accomplish pricing tasks. In doing price analysis you use competitors' catalogs, current newspaper advertisements, or almost anything that will give you a basis for comparison. In doing cost analysis you use technical evaluations, audits, certified or noncertified cost and pricing data.

#### TOOLS FOR PRICE ANALYSIS

**Tools used for comparing prices are:**

- (1) **Competitors' Catalogs.** (Penney's, Sears, or Ward's, etc.) Be sure you are comparing catalogs for the same time frame.
- (2) **Newspaper Advertisements.** Make sure the ad is current.
- (3) **Government Catalogs.** Federal Supply Schedules may be used for price comparison even though you may not be able to fulfill your requirement through them.
- (4) **Industrial Catalogs.** The National Mechanical Contractor Estimator (NMCE) is an excellent source for pricing mechanical items.
- (5) **Government Price Index.** Use this method as a comparison approach to price and cost analysis. An index can be used with historical prices to analyze, compare, and predict current prices for a specific product or service.

#### TOOLS FOR COST ANALYSIS

In addition to the tools for price analysis, use the following tools for cost analysis.

**Technical Evaluation.** You can use this method when evaluating offers by either price or cost analysis. While the technical evaluation is not directly related to price, it involves your assessment of quantitative and qualitative factors which influence the offered price. Technical evaluations **allow you to evaluate the functions that cause costs.** Technically trained and experienced personnel are in the **best position to assist** you in the **analysis of hours, quantities, tooling, testing, head counts, productivity,** and similar factors.

**Accounting records** can tell you the cost of a job but **are of limited value in determining reasonableness.** Technical skills and judgments are required to determine reasonableness and necessity of those costs.

When a **technical evaluation** is required prior to negotiations, it **should address** such things as:

- (1) An estimate of **necessary labor-hours** with an indication as to where adjustments are desirable.
- (2) **Reasonableness of proposed material** type, quantity, and necessity.
- (3) The **need for acquiring equipment** and which equipment should be considered as general purpose or unique to the performance of a particular contract.
- (4) The **possibility** and availability of **Grantee Furnished Property**.
- (5) Number, location, and **need for** any Grantee funded **trips** by contractor personnel.
- (6) A summary statement as to whether or not **labor, material, travel**, and other cost elements **are reasonable** along with the evaluator's rationale.

**Auditor Pricing Support** provides **verification of proposed costs** and an examination of the vendor's estimates; for example, certain categories of materials, salaries of contractor personnel, or the actual cost **elements** may have **contributed** to an **overhead rate**. The auditor should also tell you of all **prohibited costs** included in the contractor's proposal.

## SECTION V

### UNDER \$2,500 MICRO-PURCHASE

#### POLICY

Purchases below this threshold may be made without obtaining competitive quotations if the grantee determines that the price is fair and reasonable. Such purchases are exempt from the Buy America requirements. There should be equitable distribution among qualified suppliers (in the local area) and no splitting of procurements to avoid competition.

#### PRICING

Normally small purchases should follow this format:

- (1) Receive requirement and ensure funds are available.
- (2) Request quotation from vendor/supplier.
- (3) Make determination that price is fair and reasonable.
- (4) Place order.

There are times, however, when these purchases vary from the norm. When these instances occur, judgment must be exercised in choosing a course of action. Action to verify price reasonableness need be taken only if the contracting officer or buyer suspects or has reason to believe the price may not be reasonable. **If a price is suspect, award should not be made until all doubt is removed.**

#### DOCUMENTATION

Minimum documentation is required. A determination that the price is fair and reasonable and how this determination was made.

## SECTION VI

**\$2,500-\$100,000**

### **POLICY**

If small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources.

### **PRICING**

Normal purchase action should follow these steps:

- (1) Receive funded requirement.
- (2) Obtain quotation/proposal.
- (3) Analyze quotation/proposal(s).
- (4) Award based on fairness and reasonableness.

See page 8 for assistance in making your decision that the price is fair and reasonable.

### **DOCUMENTATION**

Be sure the **rationale** for your **purchase price is well documented**. Documentation may **range from annotating abstracts** when award is based on competition **to developing a formal price negotiation memorandum (PNM)**.

## SECTION VII

### \$100,000-OVER

#### POLICY

Cost/price analysis is required to the extent necessary to ensure a fair and reasonable price.

#### PRICING

Some form of analysis is necessary to determine a fair and reasonable price. The order of preference for this analysis is as follows:

Price Analysis (see page 8 of this guide).

- (1) Adequate price competition.
- (2) Prices set by law or regulation.
- (3) Established catalog or market prices.
- (4) Comparison to previous prices.
- (5) Comparison to valid independent estimate.
- (6) Value analysis.

Cost Analysis.

- Cost Analysis (see page 11 of this Guide). First, **ask the offeror for a breakdown** of all **proposed costs**. Have him group cost breakdown items by major category (i.e., direct and indirect). Likewise, when your contracting officer thinks it's best, ask for a **detailed Grantee independent cost breakdown**. Also **get supporting data** on those **elements** you think are **questionable**. The last step is to perform cost analysis on those elements you found questionable.
- **In-Depth Cost Analysis**. Use this method **when you can't determine a fair and reasonable price any other way**. Obtain cost and pricing data from the offeror. In performing in-depth cost analysis you may require certified cost or pricing data for contracts and modifications in excess of \$100,000. You should **ask for an audit pricing** report for pricing **larger purchase actions**, (i.e., in excess of \$500,000). You can also request audit pricing support when you believe it is necessary.

#### -TIPS-

**Get Grantee and offerors cost breakdowns in the same format** for ease of comparison.

Check breakdown to **verify** if:



- the **elements add up** to the total price
- you **understand the need** for each element of cost
- the **same thing does not appear in more than one** statement of cost
- the general format **compares** with breakdown for **similar items** or services from the same source.

Don't disclose offers received from contractors on negotiated buys.

# APPENDIX A

## OPTIONS AND MULTI-YEAR CONTRACTING

FTA Circular 4220 1D states Grantees may included options in contracts under certain circumstances (see FTA C 4220.1D, paragraph. 9g).

This **ensures continuity of operation** and avoids the costs of disrupted support. In addition, multi-year contracts may be written for certain types of requirements such as computer maintenance, bus service, and vehicle purchases. In either case, there are some **special pricing techniques that you must consider in the second and subsequent years** of option year and multi-year contracts. Contract option and multi-year pricing should be covered in the price adjustment clauses. The **option years** and the **out years of multi-year** contracts should be **evaluated in the award process** and prices established or fixed at award time.

A Grantee may **exercise an option** only after making a **written determination**, signed by the appropriate official and placed in the contract file, that the exercise of the option is the **most advantageous method of fulfilling the Grantee's need**, considering price and other factors. Likewise to fund the out years or a multi-year contract a similar determination should be made.

The multi-year and option contract clause on price adjustment may be applicable to the base period as well as subsequent periods when: (1) an increased or decreased wage determination is issued by the Department of Labor or (2) an amendment to the Fair Labor Standards Act which affects the minimum wage is enacted after the contract is awarded.

## PRICE ADJUSTMENT

There are **several characteristics of price adjustment** provisions that should be considered in adjustments. Normally, a price is established for the base and subsequent years of both option and multi-year contracts. Therefore, in the subsequent years, the **contractor is only allowed adjustments to clearly defined cost areas**. Any adjustment is limited to increases and decreases identified in the contract, such as wages or fringe benefits and accompanying increases and decreases in social security (FICA), unemployment taxes, and workmen's compensation insurance. No general and administrative expense, overhead, or profit shall be allowed for any adjustment.

## WAGES

Wages are hourly labor rates multiplied by hours worked. The wage increase or decrease is the **difference** between the former hourly labor rate actually paid and the new hourly labor rate in the new wage determination for affected employees or skills. Remember that we are only concerned with the difference, not adding the old wage and the new

wage rate together to arrive at adjustment cost. For example, if the hourly wage rate in the base year was \$4.50 and the new wage rate is \$5.25, the adjustment is \$.75, not \$5.25 per hour. The **purpose** here is to permit payment to contractors who have experienced labor **increases directed by the Government**.

### **FRINGE BENEFITS**

Fringe benefits include such items as health and welfare, expenses, vacations, holidays, sick leave, birthday leave, etc., which are usually shown in the Department of Labor Wage Determination or union agreement. For example, if the base year includes nine holidays and the option year includes nine holidays, the only adjustment is the difference in hourly wage rates. However, if the number of holidays in the base year is eight and the option year has nine, one day consisting of eight hours for each full-time employee must be added to the option cost at the new hourly rate.

### **SOCIAL SECURITY (FICA)**

Social security contributions by the contractor under a wage determination adjustment are limited to a certain **annual** base wage of total earnings for each employee. For example, in calendar year 1995, the FICA base is \$61,200 and the FICA tax rate is 6.2%. The contractor is not obligated to contribute social security beyond the \$61,200 per **calendar year**. If an employee's wages have exceeded the base salary when the option year starts, then the employer is not required to pay additional taxes. Consequently, **no adjustment** is due on that employee's salary **that has not reached the base salary and will still require** payment by the contractor.

### **UNEMPLOYMENT**

State and Federal unemployment taxes are paid by the contractor using certain base cost and rate. The base and rate may **vary from state to state**. However, **the Federal rate remains constant for all contractors**, while the state rate will **fluctuate depending** on the contractor's **employment experience**. The lower the employee turnover, the lower the rate. For example, if the base salary is \$6,000, then an employee working 2,080 hours annually at a wage of \$3.00 per hour would earn \$6,240 (2,080 x 3.00). The unemployment taxes would only be applied to the first \$6,000. Remember, don't pay unemployment taxes above the base salary in any calendar year.

### **WORKMEN'S COMPENSATION**

**Workmen's compensation** insurance **rates vary** from state to state and from contractor to contractor. Usually the total wage increase is covered by either a fixed insurance cost or an experience rate developed by insurance companies based on accident occurrence records by type of employment. **Contractors should** be required to **provide** their **current rates**, in option years, to ensure that the prevailing workmen's compensation rate is the applied wage increase only.

## **EXCLUSIONS**

**Liability insurance is not adjusted** in option years. Although liability insurance is usually included in the basic contract, it is not a cost that is adjusted in option years. Therefore, no allowance is considered in the wage increase/decrease adjustment.

## **ALLOWANCES**

**Allowances for tools or uniforms** are generally identified in the wage determination. These allowances are **not subject to adjustment**. Both items are contract requirements and are included in the wage determination to put the contractor on notice. The contractor, at his discretion, provides the uniform cleaning and/or tools or will pay the employee the stipulated allowance in the wage determination.

## APPENDIX B

### CONTRACT COST PRINCIPLES

The code of Federal Regulations, 48 CFR, Chapter 1, Part 31, contains general **cost principals** for pricing contracts and modifications when cost analysis is performed. It is also used for the determination, negotiation, or allowance of costs when required by a contract provision. 48 CFR Chapter 1 Part 31 **should not be confused** with the requirements of the Internal Revenue Service or the Cost Accounting Standard Board under P.L. 100-679.

The purpose of the **Internal Revenue Service** guidelines is to **determine taxable earnings** of individuals and companies to ascertain what taxes are due the Government. Therefore, the relationship to contract pricing is limited. **Commercial accounting recognizes customary costs** of doing business. 48 CFR Chapter 1 Part 31 accounting allows those costs that contribute **directly or indirectly** to contract performance without regard to the contractor's tax consequences.

By comparison, the **objective** of Cost Accounting Standards (CAS), 48 CFR Chapter 1 Part 30, is to ensure that **contractors maintain consistent accounting practices in estimating, accumulating, reporting, and allocating contract costs**. Although basically related to 48 CFR Chapter 1 Part 31, system consistency rather than the evaluation of each cost proposal is its objective.

**Cost principles** are concerned with the **allowability, allocability, and reasonableness** of proposed costs. The total costs of a contract are the sum of allowable direct and indirect costs allocable to the contract. **Direct cost** is any cost which is identified specifically with a particular contract. A direct cost could be material, labor, and any other charges specifically identified with the product or service. **Indirect costs** are any costs not directly identified with a single contract but identified with two or more contracts. Indirect costs are generally referred to as overhead and general and administrative expense.

A cost is **allowable** if it is **reasonable, allocable**, and not prohibited by 48 CFR Chapter 1 Part 31, and conforms to generally accepted accounting principles or practices. A cost is **reasonable** if by its nature and amount, it **does not exceed** that which would be **incurred by a prudent business person** in the conduct of a **competitive business**. An **allocable** cost is one which is **assignable or chargeable** to one or more contracts based on the relative benefits received or other equitable relationship. A cost is allocable to a Grantee contract if it: (1) is incurred specifically for the contract; (2) benefits both the contract and other work; (3) can be distributed to them in reasonable proportion to the benefits received; and (4) is necessary to the overall operation of the business, even though a direct relationship to any particular element of work cannot be shown. To illustrate, suppose a contractor uses the straight-line depreciation method on a depreciable piece of equipment. If the equipment is used on a contract and other commercial

business, and the depreciation cost is allocated accordingly, then the cost meets the contract cost principles.

48 CFR Chapter 1 Part 31 **lists selected costs** applicable to Government contracts which are classified as **allowable or unallowable**. This list **does not** cover every element of cost and every situation that might arise in a particular case.

## APPENDIX C

### NEGOTIATION AND DOCUMENTATION

The **objective of negotiation** is to **reach an understanding** and agreement on **all terms and conditions** of the contract including the work to be done and the price to be paid.

Successful negotiation, the achievement of a **mutual agreement** that is in the best interests of both parties, is a **product of many factors**. These include:

- (1) The **fairness** of the aims and positions of each party.
- (2) The **thoroughness** with which each party prepares its position.
- (3) The **clarity and completeness** with which each party presents its own position and evaluates that of the other party.
- (4) The **skill, experience, motivation**, and open-mindedness of the two negotiators or negotiating groups.
- (5) The **willingness** of both parties to compromise when a genuine impasse occurs.
- (6) Perhaps most importantly, the **relative power or bargaining position** of each of the parties.

### COMPETITIVE NEGOTIATION PROCESS

The process of reaching final contract negotiations after the receipt of proposals or offers **generally involves** these steps:

- (1) **Evaluate and rank offers** using the evaluation criteria specified in the RFP.
- (2) **Identify** those **offerors** whose proposals are determined to be within a competitive range.
- (3) **Identify and eliminate** unacceptable proposals (those containing such deficiencies in price and/or technical merit as to preclude further meaningful negotiations).
- (4) **Conduct** written or oral **discussions** with the offerors and, if necessary, **permit revision** of individual proposals in order to correct isolated deficiencies. If significant changes are allowed, all offerors must be given an opportunity to submit a new offer.
- (5) **Notify each eligible offeror** in writing of a final, common cutoff date for submission of written "**best and final**" offers.
- (6) **Select** the source or sources for award.

## NON-COMPETITIVE NEGOTIATIONS PROCESS

Although the contracting officer is charged with the responsibility for making the final decision on the pricing arrangement and the terms and conditions of the contract, for negotiation purposes, the contracting officer may designate any member of the negotiation team as speaker for the group.

The **most important prerequisite** to effective negotiation is **through preparation**. No amount of experience, skill, or persuasion on the part of the negotiator can compensate for poor preparation. This is true for **one very obvious reason**: Every prospective **contractor** starts with the **inherent advantage** of knowing more about his own proposal than the Grantee does. He **knows the assumptions** underlying his cost estimates; the actual cost or price level at which he will be willing to accept the contract. **One of the Grantee representative's** primary tasks is to **try to uncover** as much of this as possible and thus minimize the contractor's initial advantage. **Seek out** any areas of **error** or potential **disagreement** in the contractor's offer. **No one likes surprises**; they can be costly. Decide in advance the terms that will produce the best overall arrangement for the Grantee. NOTE: The contractor has the advantage of knowing his proposal, but you have an advantage of knowledge gained by dealing with many proposals and knowing what other contractors do.

**Preparation** for negotiation involves several major steps:

- (1) **Understanding the requirement.** Perhaps the most important thing the negotiator must do in the **fact-finding** and **analytic process** that precedes negotiation is to gain a clear and comprehensive understanding of what is being bought. The **requirement is**, of course, the **foundation of all procurement action**, and it vitally affects most steps in the procurement process. To some degree, the nature of the requirement and available time control the price, contract type, terms, and bargaining position. The better the negotiator understands the supplies or services to be purchased, and their intended use, the better the job can be done throughout the entire contracting process, especially at the negotiating table.
- (2) **Analyzing the facts** and the **various intangibles** that might affect the negotiation, such as personalities, motives, strengths, and weaknesses.
- (3) Establishing the Grantees **negotiating objectives** on the basis of this analysis.
- (4) **Planning ways to achieve these objectives** at the negotiating table, in other words, plan negotiating strategy.

**Some ideas on preparation** for negotiation are furnished for your consideration. Some of these may be applicable to your case. You may wish to **add ideas from your own experiences**, from time to time, and maintain such a list to meet your own needs.

- (1) Determine and **select team members**, if you have this option.
- (2) **Determine the timing** involved in the **negotiation**.



- (3) **Determine the type and extent of the agreement** you are seeking.
- (4) Make a **list of every single point** to be negotiated.
- (5) Make a list of all points or topics which should be avoided in the negotiations.
- (6) Determine, and **clearly categorize**, which of the **negotiating points** are **"MUST"** points and which are **"GIVE"** points.
- (7) Determine and **reduce to writing** your **maximum and minimum positions** for each point to be negotiated, both "MUST and "GIVE" points. Put dollar values whenever you can on your points or issues.
- (8) Determine and **obtain** your **authority** levels **to settle issues** or to settle the whole package under negotiation. Sometime you may need to touch base with your supervisor during negotiating recesses.
- (9) **Realistically evaluate your bargaining position** both for individual points and overall possibilities of success.
- (10) Work out when you propose to present the various points on your list to achieve the best results on the important points.
- (11) **Try to anticipate** opposing views and reactions on each point and prepare to rebut those views, if necessary.
- (12) Put yourself through a **"Devils Advocate" exercise**, whereby you test each of your points and positions to see if it is fair and reasonable to both sides.
- (13) **Research** your **opposition's background**, reputation, history, and performance record on previous agreements, contracts, etc.

### **PREPARATION DOCUMENTATION: THE PM**

Some form of pre-negotiation document should be prepared for all negotiated procurements. The format, content and extent of detail will depend on your requirement and the magnitude and complexity of the negotiation. The purpose of the pre-negotiation memorandum (PM) is to assist in preparing for and conducting the negotiation. The following sample PM may be tailored to any negotiation and if followed you should feel fairly confident that you have considered almost all aspects of any negotiations.

**SAMPLE DOCUMENT:**

**PRE-NEGOTIATION MEMORANDUM (PM) FORMAT**

1. Grantee Contracting Activity \_\_\_\_\_ 2. Date \_\_\_\_\_  
3. RFP/IFB or Contract Number \_\_\_\_\_  
4. Modification Number \_\_\_\_\_  
5. This acquisition is being accomplished by (check one)  
    Full and Open Competition \_\_\_\_\_  
    Other than Full and Open Competition \_\_\_\_\_

State reasons for other than full and open competition.

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

6. Contract Type \_\_\_\_\_  
7. Offeror's (Name, Address)

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

8. Business Size and Type (Small, Large, DBE, WOB)

\_\_\_\_\_

9. Offeror's Proposed Amount \_\_\_\_\_

10. Procurement Description (briefly describe the procurement)

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

11. Pricing Structure Prenegotiation Objective

Cost \$ \_\_\_\_\_

Fee/Profit ( \_\_\_\_\_ %) \$ \_\_\_\_\_

Total Price \$ \_\_\_\_\_

12. Delivery of Performance Period

\_\_\_\_\_

13. Points of Contact for this Document (name and phone number)

a. Contracts \_\_\_\_\_

b. Technical \_\_\_\_\_

**PART A                    INTRODUCTION**

1. In this paragraph, describe the acquisition, including a brief history of the requirement, the place of performance, and any other pertinent information. Questions to be answered include: What is it? Why is it needed? What is it for? Quantity? If this is a contract modification, what events or circumstances contributed to the needed change? State the Grantee's estimated amount of the proposed acquisition.
2. In this paragraph, address the extent of competition under the acquisition. Is the acquisition being accomplished under full and open competition? If other than full and open, include a statement regarding sole source approval. Additionally, was the requirement publicized in accordance with Grantee's procedures? (If not, cite the exception.) How many requests for solicitations were received? How many offers were received?
3. In this paragraph, include your planned negotiation schedule, and identification of the Grantee's negotiating team members by name and position.

**PART B                    SPECIAL FEATURES, REQUIREMENTS AND PRENEGOTIATION COMPLIANCE**

The following items should be addressed for all negotiated acquisitions:

1. The use of sealed bid procedures is not appropriate for this acquisition because  
\_\_\_\_\_  
\_\_\_\_\_.
2. The prospective contractor(s) has/have been determined to be responsible technically and are financially stable. Yes \_\_\_\_\_ No \_\_\_\_\_
3. The prospective contractor(s) is/are not on the list of "Parties Excluded from Procurement and Nonprocurement Programs."

The following items should be included when applicable:

4. Pre-contract cost in the amount of \$ \_\_\_\_\_ for the period \_\_\_\_\_ were approved by (name of individual).
5. Authority to enter into a letter contract was approved by (name of individual).
6. Justification for inclusion of option provisions is included in the contract file (FTA C 4220.1B, Chapter I, paragraph 9).

7. The offeror has submitted "Cost or Pricing Data." Yes \_\_\_\_\_ No \_\_\_\_\_
8. "Cost or Pricing Data" for major subcontract(s) has been submitted.  
Yes \_\_\_\_\_ No \_\_\_\_\_
9. Written waiver of the audit was granted by (name of individual).
10. The offeror(s) has/have an adequate accounting system as determined by (name of individual). (Cost reimbursement contracts, fixed price with price redetermination, incentive types and contracts containing progress payment provisions.)
11. EEO compliance has been requested or obtained.  
Yes \_\_\_\_\_ No \_\_\_\_\_
12. In the event Grantee property is to be furnished to the offeror, has the Contracting Officer determined that the contractor has an acceptable property control system?  
Grantee furnished equipment estimated value \$ \_\_\_\_\_ consisting mainly of \_\_\_\_\_.  
Grantee furnished material estimated value \$ \_\_\_\_\_ consisting mainly of \_\_\_\_\_.
13. Address any deviations, special clauses or conditions anticipated.
14. The offer has \_\_\_\_\_ has not \_\_\_\_\_ submitted a subcontracting plan. Briefly discuss the subcontracting plan if applicable.

**OPTIONAL PART C      EVALUATION RESULTS**

**Note:      Include this Optional Part C only when the acquisition has been accomplished under full and open competition. When the acquisition is single source, incorporate the technical evaluation results within the cost and profit/fee analysis discussions.**

1. List the evaluation criteria.
2. Identify the offerors with their corresponding proposal amounts in tabular format. For example:
 

a. ABC Company	\$526,000.00
b. DEF, Inc.	\$501,497.00
c. GHI Corporation	\$422,398.00
3. Identify any proposals found to be so deficient that they were not capable of being evaluated. Include the date you notified the offeror.

4. Identify the offerors determined to be included within the competitive range. Also identify the offerors not included in the competitive range, including the basis for elimination.

**Note:** The evaluation of each offeror's proposal should be fully documented and included as an attachment to your PM. Each proposal must be evaluated against the evaluation criteria set forth in your solicitation, and should be in sufficient detail to permit a formal debriefing of an unsuccessful offeror.

**Note:** When the acquisition is being accomplished under full and open competition, and adequate price competition exists, price reasonableness may be established by application of price analysis alone. However, when cost or pricing data are required, the contracting officer shall make a cost analysis to evaluate the reasonableness of individual cost elements. In addition, the contracting officer shall perform price analysis to ensure that the overall price offered is fair and reasonable.

**PART C      COST AND PROFIT/FEE ANALYSIS**

In this Part C, compare, in summary, the offeror's proposal, the audit and/or other recommendations, and the Grantee's Prenegotiation objective. For example:

<u>Cost Element</u>	<u>Offeror's Proposal</u>	<u>Audit/Technical Recommendation *</u>	<u>Prenegotiation Objective</u>	<u>Numbered Notes **</u>
Direct Labor	\$	\$	\$	(1)
Labor Overhead	\$	\$	\$	(2)
Direct Material	\$	\$	\$	(3)
Mat'l Overhead	\$	\$	\$	(2)
Other Direct Costs	\$	\$	\$	(4)
Subtotal	\$	\$	\$	
G&A	\$	\$	\$	(2)
Subtotal	\$	\$	\$	
Profit/Fee	\$	\$	\$	(5)
Total	\$	\$	\$	(6)

The above is an example of the various cost elements that should be reviewed when analyzing a proposal. These elements are not to be interpreted as all encompassing because the cost elements of each offeror may be different.

**\*Audit/Technical Recommended:**

In general, an audit report will not include recommendations on direct labor hours or the validity of material and other direct costs. The technical evaluation/analysis generally will not include rate recommendations. Therefore, this column should be a combination of your two reports (audit and technical). In

cases where you have not obtained an audit, you need only reflect the "Offeror's Proposal" and "Prenegotiation Objective" columns. The technical evaluation results can be addressed in your discussions, and would normally be used in the establishment of your objective.

For your information, "Technical Analysis" is defined as the examination and evaluation by personnel having specialized knowledge, skills, experience, or capability in engineering, science, or management of proposed quantities and kinds of materials, labor, processes, special tooling, facilities, and associated factors which have been set forth in a proposal. In order to determine and report on the need for the reasonableness of the proposed resources assuming reasonable economy and efficiency, special knowledge is required. Therefore, a technical evaluation that doesn't address individual elements of cost (i.e., labor categories, labor hours, material, other direct costs, etc.), but merely states that the proposal is acceptable, is not considered adequate.

**\*\*Numbered Notes:**

**(1) Direct Labor**

Compare, in detailed discussion, the proposal, the audit and/or technical recommendations, and the prenegotiation objective direct labor categories, hours and rates.

For example:

<u>Labor Category</u>	<u>Offeror's Proposal</u>			<u>Audit/Technical Recommendation</u>			<u>Prenegotiation Objective</u>		
	<u>Hours</u>	<u>Rate</u>	<u>Amt.</u>	<u>Hours</u>	<u>Rate</u>	<u>Amt.</u>	<u>Hours</u>	<u>Rate</u>	<u>Amt.</u>
Engineer	xx	\$	\$	xx	\$	\$	xx	\$	\$
Programmer	xx	\$	\$	xx	\$	\$	xx	\$	\$
Clerical	xx	\$	\$	xx	\$	\$	xx	\$	\$
<b>Total</b>			\$			\$			\$

### Offeror's Proposal

First subparagraph. Summarize the offeror's rationale for the proposed labor categories, hours and rates. Questions you can consider are: Are the proposed labor rates the result of a negotiated forward pricing rate agreement (FPRA)? Are they unaudited bidding rates which have been approved at a corporate level? Are they current actual rates for specific employees or a composite rate for personnel under each labor category? If the labor rates are developed on a specific base rate, what escalation factor (if any), has the offeror applied to the base rate? Is that a reasonable factor? Are the proposed labor categories and hours based upon the offeror's previous experience? What evidence of historically incurred hours has the offeror provided? Or, is the proposal an engineering estimate of the projected labor and expertise to accomplish the requirements of the acquisition? Do the proposed hours correspond to the performance period?

### Audit/Technical Recommendation

Second subparagraph. Summarize the basis of the audit or other recommendations. How have the recommended labor rates been developed? For instance, audit reports generally use the Data Resources Indices in developing labor rate recommendations. This has been proven to be a reliable escalation predictor for labor rates and material items. If you have an audit report, the information for this subparagraph will be within the audit report. In the event you have not obtained an audit, it is advisable to contact your state audit office and request current rate recommendations. The recommendations of the technical evaluation should also be addressed under this subparagraph. It is important that the evaluation includes complete and factual support for any exceptions taken to proposed direct labor categories and hours.

### Pre negotiation Objective

Third subparagraph. Discuss the Grantee's negotiation objective. What is it based upon? Did you rely on the audit recommendations? Did you rely on the technical evaluation in development of your objective labor categories and hours? An excellent resource for additional considerations during analysis of a proposal is the Armed Services Pricing Manual, ASPM. Additionally, the evaluation considerations in evaluating manufacturing labor in lieu of engineering labor differ greatly. In a manufacturing environment, other considerations may include application of learning curve theory, efficiency factors, recurring versus non-recurring labor, etc.

It is your responsibility to establish a reasonable objective after considering and analyzing all of the available data. Statements to the effect, " THE OFFEROR HAS PROPOSED THE SAME RATES ON OTHER CONTRACTS," are not adequate without discussion of how price reasonableness was determined under the other contracts.

**(2) Labor Overhead, Material Overhead, and G&A.**

Compare, in detailed discussion, the offeror's proposal, the audit and/or other recommendations, and the Grantee's objective for labor overhead, material overhead, and G&A. For example:

<u>Category</u>	<u>Offeror's Proposal</u>		<u>Technical/Audit Recommendation</u>		<u>Prenegotiation Objective</u>	
	<u>Rate</u>	<u>Amt.</u>	<u>Rate</u>	<u>Amt.</u>	<u>Rate</u>	<u>Amt.</u>
Labor Overhead	x%	\$	x%	\$	x%	\$
Material Overhead	x%	\$	x%	\$	x%	\$
G&A	x%	\$	x%	\$	x%	\$

Offeror's Proposal

First subparagraph. Describe how the offeror developed the proposed indirect rates. Does a forward pricing rate agreement exist? If so, what is the period covered by the agreement? This information should be provided by the offeror.

Audit/Other Recommendation

Second subparagraph. Explain what the audit's recommendations are based upon. This may include exception taken to some cost elements within the overhead pool, such as fringe benefits, unemployment taxes, rent, depreciation, etc. This information should be reflected in the audit report. If you do not obtain an audit report, you can request current rate recommendations and/or historical actual rates from your state audit office. Comparing the offeror's proposed rates to the actual rates can provide a good measure on how accurate the offeror's proposed rates have been.

Prenegotiation Objective

Third paragraph. Address how you developed the Grantee's prenegotiation objective, and upon what information you relied. Are your objective rates based upon recommendations? Occasionally, you may experience a situation where you haven't obtained an audit report, and your state audit office has no information on a specific offeror. In such cases, it may be to your advantage to request an audit of the offeror's rates. Absent this information, you will need to evaluate the offeror's proposed rates in detail (i.e., cost elements included in the indirect pools) for allowability and allocability. Comparing one offeror's rates with those of another offeror's is not an acceptable method in any case. Also, comparing this year's proposed rates to last year's rates is not a basis for establishing reasonableness of the currently proposed rate.



**(3) Direct Material.**

Provide a detailed breakdown and compare, in detailed discussions, the offeror's rates. It is not an acceptable method to compare rates with other offerors nor is it acceptable to compare the offeror's current proposed rates with last year's proposed rates to establish the reasonableness of the proposed rates.

<u>Material</u>	<u>Offeror's Proposal</u>			<u>Technical/Audit Recommendation</u>			<u>Prenegotiation Objective</u>		
	Qty	UP	Amt	Qty	UP	Amt	Qty	UP	Amt
Pwr Sup	xx	\$	\$	xx	\$	\$	xx	\$	\$
CM Chips	xx	\$	\$	xx	\$	\$	xx	\$	\$
Wire	xx	\$	\$	xx	\$	\$	xx	\$	\$
Other	xx	\$	\$	xx	\$	\$	xx	\$	\$
<b>Total</b>			\$			\$			\$

Offeror's Proposal

First subparagraph. Address the basis of the offeror's proposed direct material (engineering estimate? based upon history?, etc.) and costs associated with the material (catalog prices? oral quotes? written quotes? historical prices escalated by \$?, competitive?, etc.) Will there be any scrap, attrition or variance factors to consider? If applicable, has the offeror included an analysis for large dollar items? Is the analysis meaningful?

Audit/Technical Recommendation

Second subparagraph. Address the audit/technical recommendations. Has the auditor/originator taken exception to any of the proposed material items, quantities or associated prices? Have exceptions been adequately supported?

Prenegotiation Objective

Third subparagraph. Support the Grantee's prenegotiation objective. If you have taken exception to any material items and/or quantities, what information have you relied upon to reach your conclusions? If you have taken exception to any pricing aspects of the offeror's proposal, explain fully how you arrived at your objective. In cases where you have no audit report, the importance of a thorough technical evaluation is increased. You must make a determination of price reasonableness for the direct material items. When challenging a cost, explain the basis for your position. "Appears too high," without rationale, is not sufficient.

**(4) Other Direct Costs (ODC).**

Compare, in detail discussions, the offeror's proposal, the audit and/or technical recommendation, and the prenegotiation objective for other direct costs. For example:

<u>Cost Element</u>	<u>Offeror's Proposal</u>	<u>Technical/Audit Recommendation</u>	<u>Prenegotiation Objective</u>
Computer Support	\$	\$	\$
Freight	\$	\$	\$
Air Travel	\$	\$	\$
Per Diem	\$	\$	\$
Consultant	\$	\$	\$
<b>Total ODC</b>	\$	\$	\$

Offeror's Proposal

First subparagraph. Summarize the offeror's rationale for proposing the various expenses. The elements above are examples of the types of costs generally included as other direct costs (ODC).

Technical/Audit Recommendation

Second subparagraph. Summarize the audit and/or technical recommendations. Address all the items included under this element. Any exceptions taken must be fully explained.

Prenegotiation Objective

Third paragraph. Provide an analysis of the items included under this cost element. For instance, are the number of trips scheduled considered reasonable by audit or your technical evaluation? Are the costs per trip reasonable?

You can check air travel rates with commercial airlines. How does the offeror's proposed costs compare with previous history? Did the contractor apply an escalation factor? Is it reasonable? In your analysis, you may need to show a lower level breakdown (i.e., a breakdown of the number and location of proposed trips).

(5) **Profit/Fee Analysis.**

Provide a summary which compares the offeror's proposal and the Grantee's prenegotiation objective. For example:

<u>Offeror's Proposal</u>		<u>Prenegotiation Objective</u>	
Rate	Amt	Rate	Amt
xx%	\$	xx%	\$

Offeror's Proposal

First subparagraph. State the offeror's proposed profit/fee rate, that amount, and any other information provided by the offeror to support the proposed rate.

Prenegotiation Objective

Second subparagraph. Address the Grantee's prenegotiation objective profit/fee rate which should be based upon application of your structured approach.

- Structured approaches for determining profit or fee prenegotiation objectives provide a discipline for ensuring that all relevant factors are considered.
  - Grantees should use a structured approach for determining the profit or fee objective in those acquisitions that require cost analysis; and
  - May prescribe specific exemptions for situations in which mandatory use of a structured approach would be clearly inappropriate.
- Profit or fee prenegotiation objectives do not necessarily represent net income to contractors. Rather, they represent that element of the potential total remuneration that contractors may receive for contract performance over and above allowable costs. This potential remuneration element and the Grantee's estimate of allowable costs to be incurred in contract performance together equal the Grantee's total prenegotiation objective. Just as actual costs may vary from estimated costs, the contractor's actual realized profit or fee may vary from negotiated profit or fee, because of such factors as efficiency of performance, incurrence of costs the Grantee does not recognize as allowable and contract type.

It is in the Grantee's interest to offer contractors opportunities for financial rewards sufficient to (1) stimulate efficient contract performance, and (2) attract the best capabilities of qualified large and small business concerns to Grantee contracts.

Both the Grantee and contractor should be concerned with profit as a motivator of efficient and effective contract performance. Negotiations aimed merely at

reducing prices by reducing profit, without proper recognition of the function of the profit, are not in the Grantee's interest.

**PART D TYPE OF CONTRACT CONTEMPLATED**

Explain the type of contract contemplated and the rationale for selection. If this prenegotiation memorandum is being written for a modification to an existing contract, you must also address the contract type.

**PART E MAJOR DIFFERENCES**

Identify any anticipated problem areas, exceptions taken by the offeror(s) to the solicitation terms and conditions, or major differences which may interfere with negotiations, and your intended negotiation strategy.

**PART F NEGOTIATION APPROVAL SOUGHT**

Give your specific recommendation similar to the following:  
"Approval of this Pre-Negotiation Memorandum is recommended based upon the information set forth herein and authority to negotiate and enter into a contract is requested. It is considered the opinion of the negotiator that the Grantee's prenegotiation objectives are realistic and can be achieved."

Prepared by: \_\_\_\_\_ Date: \_\_\_\_\_  
(Signature and Title)

Reviewed by: \_\_\_\_\_ Date: \_\_\_\_\_  
(Signature and Title)

Approved by: \_\_\_\_\_ Date: \_\_\_\_\_  
\_\_\_\_\_  
(Name and Title)

My Approval is: (check one) \_\_\_\_\_ a. Unconditional  
\_\_\_\_\_ b. Conditional (See attached exceptions.)

## SCENE

In facing the contractor's representatives, a very important facet for the negotiator to remember is that **only one person** is to address the contractor, and all other negotiation team members will participate **only upon request from the speaker**. The technical advisors, e.g., auditor, project officer, price analyst, etc., may pass notes to the negotiator and vice versa without interrupting the negotiations. This is an acceptable practice. The following are certain points to be followed in negotiations.

Selling the position. The **negotiator** must be sufficiently **convincing to sell the position**, it will not sell itself. In beginning negotiations, the following is desirable.

**Determine** who has the **authority** on the **contractor's** negotiating **team** to bind the firm to the agreed to price. Acknowledge the contractor's proposal and elaborate on the terms and conditions before discussing the price. A meeting of the minds is very important. **Attempt to settle any differences** in understanding of the specific requirements before proceeding to discuss the proposal cost elements. Recess if necessary to obtain any additional data. This process of defining requirements is referred to as "**fact finding**."

**Be systematic** in your approach. Determine in what order you will discuss the proposal; that is, resolve the high dollar items before the small dollar items or vice versa. By the same token, you may want to address the supportable items first and discuss the judgmental areas (estimates) last. In a nutshell, **being well prepared with verifiable facts** and/or **well-reasoned opinion** is a critical item of negotiation.

**Don't underestimate the contractor.** Most contractors have spent many hours developing their proposal and may be able to refute what appear to be firm or solid facts.

**Always encourage a fact-finding session** to instill confidence between the Grantee and the contractor that this is an arms-length transaction. Such discussions may well bridge the gap between the known and the projected data.

**Never knowingly let the contractor make a critical mistake.** For example, if engineering overhead or one of the other important cost elements is inadvertently omitted from the contractor's proposal causing an unrealistically low price, remaining silent, while accepting the defective price, will result in a bad contract with bad results. The Grantee should seek a price fair and reasonable for both parties (contractor and Grantee).

**Avoid the deadlock.** In conducting negotiations, avoid a deadlock. Sometimes the negotiators' tempers flare and create an atmosphere of animosity and ill-feeling on both sides. An alert negotiator will **conduct a meaningful negotiation** and exercise prudent judgment. The following are critical points.

**Be polite but firm** in negotiations. Emotional strains may provide the contractor with a sign of weakness or uncertainty on your part. This is no different than a good card player. Don't light up like a Christmas tree when you have a good hand! **Always listen** to

the contractor's position and do not interrupt abruptly but, rather, ask if what you understand is correct or to please repeat the statement.

In addressing technical matters, that is, the quantitative and qualitative aspects of a proposal, **do not commit yourself without the advice of your technical advisor.** The same is true when discussing cost information. Do not let the contractor take advantage of the "Divide and Conquer Technique" which is prevalent when negotiation team members **disagree in front of the contractor.** Recess, if necessary, but never let this situation fully develop.

**Negotiate using reasoning** on the allocability and reasonableness of cost **rather than haggling or horse-trading.** Always keep in mind that convincing justification for including costs different from your objective must be reflected in the Price Negotiation Memorandum. The **PNM is a permanent record** subject to further review.

If a deadlock on price is apparent, and an immediate solution is not available, suggest that both sides recess for the day and reconsider their positions. If necessary, present your best offer with the stipulation that you will consider any new data justifying the contractor's position. However, whenever possible, always **let the contractor be the first to submit a new offer.** Occasionally, the new offer may actually be below the Grantee objective. Remember offers should normally be on a total price basis, not element of cost.

Never give the appearance that you are closing the door on any negotiations. Seek alternatives to threats of terminating discussions. Again, it must be emphasized that the Grantee's objective is agreement on total price not specific cost elements or profit. **FTA C 4220.1D** supports the premise that the Grantee is primarily concerned with the **reasonableness of price** it ultimately pays and only secondarily with the eventual cost and **profit to the contractor.** Said another way, there will frequently be occasions where the contractor and the Grantee have the same "bottom line" price objective, even though they disagree on some underlying cost elements.

**Mutual Concessions.** Because the object of negotiations is to reach an agreement, concessions/compromises may be appropriate. **Concessions should not be treated as giveaways.** These are points to be earned by both parties and relinquishment will be made after thorough consideration. It's very important that the negotiator **take stock of the strong and weak issues** to be presented; the important and irrelevant, and the major and minor points to concede. When we speak of issues, it means to recognize how types, quantities, and costs of material, labor, overhead, and other factors were developed and to attempt to reconcile the proposal elements with the prospective contract requirements.

The negotiator should recognize that concessions do not necessarily mean the Grantee or contractor's integrity or intelligence is being challenged. To the contrary, **neither party's position is infallible.** If possible, give the contractor a way out (preferably your way). Here is where the total price approach will permit the contractor to concede on a crucial point without loss of dignity.

**Conclusion.** Realistically, not all negotiations are done in an atmosphere of complete satisfaction. The contracting officer should **strive to obtain maximum performance**, that is, quality, quantity and timely delivery, for the negotiated price. **Do not belittle, regret, or criticize the final settlement after all is said and done.**

**Close the negotiation with a gesture of understanding** and an indication of **mutual respect** for the positions taken by both parties. Express a desire to work with the contractor for a meaningful relationship. **Encourage a liberal line of communications** between the contractor's representatives, the Grantee contracting office, and the customer receiving the goods or services.

### **NEGOTIATION DOCUMENTATION: THE PNM**

When the **negotiations** have been **concluded**, it is necessary to **reduce the outcome to writing**. This is done by developing the PNM. It depicts the elements that were discussed in negotiations and explains the basis for determination that the price is fair and reasonable.

Oftentimes negotiators find it difficult to prepare a PNM. They feel it is just an opinion of what transpired in negotiations and, in addition, the PNM format may seem unwieldy. However, it must be remembered that the **PNM is a very important document**. The PNM should **state the facts and judgmental areas** and should clearly demonstrate the fairness and reasonableness of the final agreement. The memorandum is important because it is **written evidence** (the story) **of what transpired** in negotiations. Also it is a permanent record supporting the contract price decision. The memorandum should be explicit enough to:

- (1) **Reflect the most significant issues** affecting the (initial or revised) proposed and negotiated prices.
- (2) **Explain** the Grantee's **price objective** and the costs supporting that objective. In addition, state what Grantee activity/offices assisted in developing price.
- (3) **Indicate** what **cost or pricing data** submitted was or was not relied upon to reach a decision. Stipulate the degree of reliance placed on the factual data and why.
- (4) **Determine** if all **data submitted** was **accurate, complete, and current**; if not, what action did the contracting officer take?
- (5) **Determine** whether a **profit objective** was developed and the method used to develop the profit rate.
- (6) Explain how the negotiated price was **determined as fair and reasonable**.

Simply Stated:

- Who assisted in the evaluations?

- What was proposed and negotiated?
- When was action taken?
- Where do we stand on price, terms, conditions, and delivery that is expected?
- How was price fairness and reasonableness justified?

A post negotiation memorandum (PNM) format is provided to assist you in documenting your negotiation efforts.



**SAMPLE DOCUMENT:**

**POST-NEGOTIATION MEMORANDUM (PNM) FORMAT**

1. Contracting Activity \_\_\_\_\_ 2. Date \_\_\_\_\_
3. Contract Number \_\_\_\_\_
4. Modification Number \_\_\_\_\_
5. Contractor (Name, Address) \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

6. Negotiated Amount \_\_\_\_\_
7. Results of Negotiations

	<u>Prenegotiation</u> <u>Objective</u>	<u>Negotiated</u> <u>Amount</u>
Cost	\$ _____	\$ _____
Total Cost	\$ _____	\$ _____
Fee/Profit (xx%)	\$ _____ (xx%)	\$ _____
<b>Total</b>	<b>\$ _____</b>	<b>\$ _____</b>

8. Funding Availability  
Cite funds approved for this acquisition. State whether or not the funds are presently available. If there is a shortage of approved funds, state what arrangements have been made to acquire adequate funds. When applicable, if this is to be incrementally funded, state the total estimated cost, the amount of funds provided, and the estimated period to be covered by the available funds.
9. A synopsis of award will be published. Yes \_\_\_\_\_ No \_\_\_\_\_  
If no, cite reason.

**PART A NEGOTIATIONS**

1. Negotiations were conducted with the offeror(s) from \_\_\_\_\_ through \_\_\_\_\_  
\_\_\_\_\_. The following persons participated in the negotiations: (cite name, title, and organization)  
\_\_\_\_\_  
\_\_\_\_\_
2. In this paragraph, update any events since Prenegotiation Memorandum (PM) approval. Also address any conditions of the approval, how the conditions were resolved and where in the PM these conditions are discussed.
3. In this paragraph, reflect the results of negotiations in summary format and compare, in detailed discussions, your prenegotiation objective and the amount negotiated. For example:

<u>Cost Element</u>	<u>Prenegotiation Objective</u>	<u>Amount Negotiated</u>	<u>Numbered Notes **</u>
Direct Labor	\$	\$	(1)
Labor Overhead	\$	\$	(2)
Direct Material	\$	\$	(3)
Mat'l Overhead	\$	\$	(2)
Other Direct Costs	\$	\$	(4)
Subtotal	\$	\$	
G&A	\$	\$	(2)
Subtotal	\$	\$	
Profit/Fee	\$	\$	(5)
Total	\$	\$	(6)

**\*\*Numbered Notes:**

- (1) Direct Labor. Compare, in detailed discussion, the proposed, the audit and/or technical recommendations, and the prenegotiation objective direct labor categories, hours and rates. For example:

<u>Labor Category</u>	<u>Prenegotiation Objective</u>			<u>Amount Negotiated</u>		
	<u>Hours</u>	<u>Rate</u>	<u>Amt.</u>	<u>Hours</u>	<u>Rate</u>	<u>Amt.</u>
Engineer	xx	\$	\$	xx	\$	\$
Programmer	xx	\$	\$	xx	\$	\$
Clerical	xx	\$	\$	xx	\$	\$
<b>Total</b>	xx		\$	xx		\$

**NOTE:**

The extent of detail under the comparison should be directly related to the difference between the prenegotiated objective and the negotiated amount. The larger the difference, the more explanation is needed.

In this next paragraph, explain the basis for increases (or decreases) in direct labor categories, hours or rates that have been agreed to in negotiations. For instance, during negotiations you may have received information that would revise your position in any one of the labor areas. Perhaps the offeror may present arguments which more adequately support the proposed labor hours, such as previous actuals, etc. As a result of the information presented, contact your requiring activity, hold discussions, and determine that an increase (or decrease) in the number of direct labor hours is appropriate. In this case, you would address the information the offeror presented, your subsequent discussions with the requiring activity, and the reasons for an increase (or decrease) in the direct labor hours. The information should clearly present a logical series of events which result in the final negotiated settlement.

- (2) Labor Overhead, Material Overhead, and G&A. Compare, in detailed discussion, the offeror's proposal, the audit and/or other recommendations, and the Grantee's objective for labor overhead, material overhead, and G&A. For example:

<u>Category</u>	<u>Prerenegotiation Objective</u>		<u>Amount Negotiated</u>	
	<u>Rate</u>	<u>Amt</u>	<u>Rate</u>	<u>Amt.</u>
Labor Overhead	x%	\$	x%	\$
Material Overhead	x%	\$	x%	\$
G&A	x%	\$	x%	\$

In this paragraph, address any differences in the indirect rate(s) and the reasons for any changes. If the negotiated rate remains the same as your prerenegotiation objective, but the amount changed due to a revised base, include a statement such as "The difference in amount is attributed to a difference in base." This explains why the negotiated and prerenegotiation objective differ when the rates have remained unchanged. An example of a basis for changes in overhead rates would be an audit providing updated rate recommendations during negotiations.

- (3) Direct Material. Compare, in detailed discussions, the prerenegotiation objective and the negotiated direct material. For example:

<u>Description</u>	<u>Prerenegotiation Objective</u>			<u>Amount Negotiated</u>		
	<u>Qty</u>	<u>U/P</u>	<u>Amt</u>	<u>Qty</u>	<u>U/P</u>	<u>Amt</u>
Power Sup	xx	\$	\$	xx	\$	\$
CM Chips	xx	\$	\$	xx	\$	\$
Wire	xx	\$	\$	xx	\$	\$
Other	xx	\$	\$	xx	\$	\$
<b>Total</b>			\$			\$

Again, address any differences in material, quantities or amount. For example, since the time of establishing your prerenegotiation objective there have been changes in the metals market which have resulted in increased (or decreased) costs of one or more direct material items. This would be explained within this paragraph. The circumstances contributing to changes under this cost element could be any number of things. If the offeror's proposal was based upon a verbal quote and they have now obtained a firm written quote, or your previous experience indicates this contractor will obtain a discount when they place an order for the material, etc. Any information which caused an increase (or decrease) should be clearly explained.

- (4) Other Direct Costs (ODC). Compare in detailed discussions, the prenegotiation objective and the negotiated other direct costs. For example:

<u>Cost Element</u>	<u>Prenegotiation Objective</u>	<u>Amount Negotiated</u>
Computer Support	\$	\$
Freight	\$	\$
Air Travel	\$	\$
Per Diem	\$	\$
Consultant	\$	\$
<b>Total ODC</b>	\$	\$

In this paragraph, address any differences in the items which comprise indirect costs. Explain fully, your reasons for increases (or decreases) in each item. As under direct materials, the reasons for changes under this cost element could be many.

- (5) Profit/Fee Analysis. Compare, in detail, the prenegotiation objective and the negotiated profit/fee. For example:

<u>Prenegotiation Objective</u>		<u>Amount Negotiated</u>	
Rate	Amt	Rate	Amt
xx%	\$	xx%	\$

In this paragraph, address any differences in the profit/fee rate. If you achieve your objective rate, or the amount has changed due to a different base, make a statement to that effect. If you have negotiated a different rate, discuss the increasing (or decreasing) rate. An increased profit may be due if the offeror is assuming an increased risk. If the offeror draws your attention to facts you hadn't considered in your initial analysis which would increase the offeror risk. The facts introduced by the offeror would be presented thereunder as well as your rationale for changing the profit/fee rate. Include a summary to explain the agreed upon profit.

**PART B OTHER**

1. Describe any protests received since the prenegotiation memo was written, and their disposition. Also describe any potential protests based on your knowledge of the procurement and the participants.
2. Address any other issues or information which could have an impact on the proposed award.

**PART C CONTRACTING OFFICER'S DETERMINATION OF PRICE REASONABLENESS (And, When Applicable, Source Selection Decision)**

1. Set forth an affirmative statement that the negotiated price is fair and reasonable, and give the basis for the determination. If this PNM supports a source selection decision, this part should include a statement that the price is fair and reasonable, and that acceptance of the agreement, price and other factors considered, is in the best interest of the Grantee.

Prepared by: \_\_\_\_\_ Date: \_\_\_\_\_  
(Signature and Title)

Reviewed by: \_\_\_\_\_ Date: \_\_\_\_\_  
(Signature and Title)

Approved by: \_\_\_\_\_ Date: \_\_\_\_\_  
\_\_\_\_\_  
(Name and Title)

My Approval is: (check one)  a. Unconditional  
 b. Conditional (See attached exceptions.)

## **APPENDIX D**

### **MODIFICATIONS**

**Modifications** are issued for the purpose of **making contract changes**. They can be accomplished either **unilaterally** (by the Grantee) or **bilaterally** (by the Grantee and the Contractor). The most important thing to remember about modifications is that **each one must stand on its own merit**, just like a contract. Therefore, you must have a **reason** (requirement) **for the change, funds to support the change, evidence that prices are fair and reasonable**, and documentation which tells the story of the purchase.

### **TYPES**

Although there are at least five recognized types of modifications, this guide deals with only the types that are most often used in Grantee contracting. These are Supplemental Agreements, Administrative Changes, and Change Orders. The **Supplemental Agreement** is the only one of the three which is accomplished **bilaterally**. This is also the **preferred type** because both parties, by signing the modification, agree to all the changes specified. **Administrative changes** are accomplished unilaterally and **do not affect the substance of the contract**. For instance, changing the paying office (administrative change) does not change the amount paid under the contract. **Change orders** are also **unilateral actions**, but these changes do affect the substance of the contract. In addition, by issuing a change order you automatically invoke the disputes procedures in the event an agreement on equitable adjustment for the change cannot be reached. By issuing a change order you are telling the contractor to "work now, we'll decide on terms and conditions later." **If at all possible** you should **agree on terms and conditions before the work is started** and issue a supplemental agreement which specifies the agreements made.

### **AUTHORIZED CHANGES**

**Supplemental Agreements.** **Almost anything** within the scope of the contract may be changed as long as the change is in the **best interest of the Grantee**. Remember, this is where both parties show agreement with the changes and adjustments by signing the agreement.

**Administrative Changes.** Only changes which do not affect the substance of the contract may be made.

**Change Orders.** All changes must be **within the general scope of the contract**. The kind of contract will govern the specific changes that can be made. For supply contracts you can only make changes in drawings, designs, specifications, method of shipment or packing, and place of delivery. For service contracts you can only make changes in the definition of services to be performed, the time (hours of the day, days of the week, etc.), and the place of performance. For construction you may make any change in the work.

## PROCEDURES

### Supplemental Agreements:

1. **Determine** the required **change**.
2. **Obtain** Grantee **estimate and funding** document from the using agency.
3. **Inform the contractor in writing** of the proposed change and obtain a proposal from her/him.
4. Determine the pricing method which is most appropriate for analyzing the contractor's proposal. Depending on the dollar amount, you may use any or all of the methods discussed in this guide. See Section II for Price Analysis, and Section III for Cost Analysis.
5. Inform the using activity of what the contractor has proposed and the results of your analysis.
6. If necessary, **conduct negotiations** (Don't forget the PNM).
7. **Prepare the modification**. Be sure all changes are a part of the document. This includes any adjustments which are made, by either party, as consideration for making the change.
8. **Obtain the contractor's signature**.
9. **Obtain the contracting officer's signature**.
10. Double-check your modification file to be sure it is complete and documented well enough to tell the story of the purchase.
11. Obtain a **legal review** if appropriate.
12. Obtain **clearance from the Transit Board**, if appropriate.
13. Obtain signature from the manual approval authority, if appropriate.
14. **Issue the Supplemental Agreement**.

### Administrative Changes:

1. **Determine** the required **change**.
2. Be sure that the change **does not affect the substance of the contract**.
3. **Prepare the modification**. Be sure the change is specific.
4. Obtain the **Contracting Officer's signature**.
5. **Issue the modification**.

### Change Orders:

1. **Determine** the required **change**.
2. **Obtain** Grantee **estimate and funding** document from the using agency.
3. Be sure that a supplemental agreement cannot be used instead. Document why it cannot be used.
4. Be sure that the contract contains the "**changes**" **clause** or another clause which invokes it. If not, and if you cannot issue a supplemental agreement which incorporates the "changes" clause, you are in a "new" procurement situation. In other words, you need to establish a contract based on the new requirement.
5. **Prepare the modification** which specifies the change.

6. Be sure to insert a "**not to exceed**" dollar amount in the modification.
7. Double-check your document to ensure it is complete and explains why the change order must be issued. Also ensure that no higher or other review is required. If required, obtain them.
8. Obtain the **contracting officer's signature**.
9. **Issue the change order.**
10. **Obtain the contractor's proposal** (claim) for equitable adjustment for making the change.
11. **Determine the pricing method** which is most appropriate for analyzing the contractor's proposal. Depending on the dollar amount you may use any or all of the methods discussed in the guide. See Section II for Price Analysis and Section III for Cost Analysis.
12. Inform the requiring agency what the contractor has proposed and the results of your analysis.
13. If necessary, **conduct negotiations** (don't forget the PNM).
14. If agreement can be reached between the Grantee and the contractor, prepare a modification which specifies the changes, spells out the consideration for making those changes, and incorporates a "**release of claims**" from any additional adjustment resulting from the changes.
15. Obtain the **contractor's signature**.
16. Double-check your document to be sure it is complete and tells the full purchase story.
17. Obtain the **contracting officer's signature**.
18. Issue the supplemental agreement. Remember, this is the term used for a modification which is agreed to by both contracting parties.
19. If you went through the first 13 steps of the change order procedures and the Grantee and contractor **cannot reach an agreement**, you have a dispute concerning a question of fact. This will necessitate the contracting officer issuing a "**final decision.**"
20. At this point, you should review the modification file to be absolutely sure that this **action is fully documented**, all required actions were taken in a timely manner, and there was a sound basis for the Contracting Officer's "final decision." Since the "disputes" clause provides the contractor with the right of appeal, it is possible that final settlement of this transaction may be at the direction of your final resolution board. Be sure you **obtain the appropriate legal** review before issuing a final decision.

### SUMMARY

Use modifications to make changes in existing contracts. **Conclude negotiations prior to commencement of the work** required by the modification **whenever possible**. In fixed-price contracts, the profit is based on the contractor assuming all risk. In **after-the-fact negotiations**, the **Grantee assumes the risks** and ultimately all the costs. **Supplemental agreements** are **preferred** because they are bilateral actions. Administrative changes are used when the substance of the contract is unaffected. Change orders should never be used unless they are absolutely necessary. Even when



change orders are issued, they must be followed up with a supplemental agreement. If this agreement can't be reached, the "disputes" clause comes into effect.

# APPENDIX E

## PRICING EXAMPLES

Price Analysis Examples:

**1. Price Based on Adequate Price Competition;**

a. Proper pricing --

- (1) Solicitation issued for custodial services estimated to cost \$8,500.00.
- (2) Services area is in two sections: A - 500 square feet and B - 1,500 square feet.
- (3) Proposals are allowed for area A, B, or both and administrative cost of \$300.00 is included as an evaluation factor for split awards.
- (4) Four responses are received as follows:

Joe's Inc.		Chapman Inc.		Jan Inc.		Jerry Inc.	
A	B	A	B	A	B	A	B
\$1,900	\$5,700	No Bid	No Bid	\$1,800	No Bid	\$2,000	\$5,400

- (5) All proposals are responsive and award is appropriately made to Jerry Inc., based on adequate price competition. In addition, considering the evaluation factor of \$300.00, total award to Jerry, Inc. results in lower overall cost to the Grantee.

This is substantiated as follows:

Jan Inc.	\$1,800 Area A	Jerry Inc.	\$2,000 Area A
Jerry Inc.	\$5,400 Area B	Jerry Inc.	\$5,400 Area B
Evaluation Factor:	<u>\$ 300 Split Award</u>	Evaluation Factor	<u>N/A</u>
	\$7,500 Total Cost		\$7,400 Total Cost

b. Improper Pricing --

- (1) Identical solicitation.
- (2) Four responses are received as follows:

Joe's Inc.		Chapman Inc.		Jan Inc.		Jerry Inc.	
A	B	A	B	A	B	A	B
No Bid	No Bid	No Bid	No Bid	No Bid	\$5,500	\$2,000	\$5,400

- (3) While the award may go to Jerry, Inc., the price cannot be based on adequate price competition for area A, as Jerry, Inc. is the only price received. Some other form of pricing must be used.

## **2. Price Based on Previous Purchases;**

### **a. Proper Pricing --**

- (1) Solicitation issued for 1,000 optical split-screws estimated to cost \$10.00 each.
- (2) One response received from Joe's Inc., with a price of \$9.95 each.
- (3) Review of Order #M5505, which was for 2,000 optical screws reveals the following:
  - (a) The award price was \$9.85 each.
  - (b) The vendor was Joe's Inc., who offered a 10% quantity discount for purchases of 1,200 or more screws.
  - (c) The order was placed six months previously.
  - (d) Four responses were received, ranging in unit price from \$9.85 to \$10.00, and price was determined to be fair and reasonable based on competition.
- (4) No major fluctuations in the optical split-screw industry have occurred since the previous purchase.
- (5) Considering the circumstances of each requirement, award is rightly made to Joe's Inc., and price determined to be fair and reasonable based on previous purchases.

### **b. Improper Pricing --**

- (1) Identical situation and response.
- (2) The only known previous purchase, which is six months old, reveals the following:
  - (a) Award was made to Joe's Inc., at a unit price of \$9.85 with competition being stated as the basis for price reasonableness.
  - (b) A close review of the order file indicates that while four responses were received from the previous solicitation, one was nonresponsive and two were "no bids."
- (3) Award cannot yet be made to Joe's Inc., as it is impossible to determine price reasonableness of previous purchases. While the previous price paid is close to the instant price, the previous price was not accurately determined to be fair and reasonable because competition did not, in fact, exist. Therefore, some other form of pricing must be used in the instant case.

## **3. Prices Based on Published Catalogs or Price Lists;**

### **a. Proper Pricing --**

- (1) Solicitation issued for 2,000 widgets estimated to cost \$10.00 each.

(2) Two responses are received as follows:

Key Co., Inc.	Shafer Co., Inc.
No Bid	\$9.75

- (3) Shafer Co. Inc. states the price is published in the firm's current public sales catalog and attaches a copy of the page on which widgets appear at \$9.75 each.
- (4) Award is rightly made to Shafer Co. Inc., and price determined to be fair and reasonable based on catalog prices.

b. Improper Pricing --

- (1) Identical situation and response.
- (2) Shafer Co. Inc. states their price of \$9.75 is quoted from the current Widget Division Pricing Bulletin which is not releasable to the public.
- (3) Award should not be made, as price cannot be determined fair and reasonable. Based on the information available, the price list in question is probably an internal document which does not accurately reflect the price at which widgets are normally sold to the general public.

**4. Established Market Prices;**

a. Proper Pricing --

- (1) Solicitation issued for 20,000 standard or equal 2" ringers estimated to cost \$.60 each.
- (2) Only one quote received: Joe's Hardware, at \$.58 each.
- (3) When questioned, Joe states that while his quote is for standard ringers. There are numerous manufacturers and suppliers of ringers equal to the ones he quoted. In fact, he even provides copies of invoices for the four most recent large sales of various manufactured ringers to various commercial firms.
- (4) Award is rightly made to Joe's Hardware and the price determined to be fair and reasonable based on established market prices.

b. Improper Pricing --

- (1) Identical situation, except that the specification is for 2" ringers estimated to cost \$.60 each.
- (2) The only known use for this item is on a unique piece of equipment owned by the using activity and the estimated cost is \$.75 each.
- (3) One quote is received: Joe's Hardware at \$.68 each.
- (4) Joe is unable to produce any record of commercial sales and can only locate one source for them.
- (5) Award should not be made without further analysis, as price cannot be determined to be fair and reasonable based on established market price. This does not appear to be a commercial item sold in substantial quantities to the general public.

**5. Prices Set by Law or Regulation;**

a. Proper Pricing --

- (1) Solicitation issued for temporary refuse collection at a remote transfer site for a period of three months. Estimated tonnage is 1,000 tons at an estimated cost of \$6,000.00.
- (2) One quote received from P.U. Garbage for a price of \$5.00 per ton.
- (3) The local utility regulatory commission has set refuse collection rates based on mileage from city hall for a radius which includes the transfer site. (The regulated rate for the site is \$5.00 per ton.)
- (4) Award is made to P.U. Garbage and the price determined to be fair and reasonable, based on the local utility regulatory commission's rate schedule for refuse collection.

b. Improper Pricing --

- (1) Identical situation and response.
- (2) The local utility regulatory commission has set refuse collection rates for a radius 30 miles from city hall with the highest rate being \$3.00 per ton at the 30 mile point.
- (3) The transfer site is 50 miles from city hall.
- (4) Award should not be made without further analysis, because refuse collection prices for the area in question (the transfer site) are not controlled by law or regulation.

**6. Prices Based on Comparison with Grantee Estimate;**

a. Proper Pricing --

- (1) Solicitation issued for one roll (10,000 Linear Feet) of #2 copper wiring, estimated to cost \$.60 per foot.

(2) Two responses are received as follows:

Hackett Electric, Inc.  
\$570

Kemp Light Corp.  
No Bid

(3) The Grantee estimate must be used for price analysis in this case as all other forms of price analysis have failed.

(4) The buyer contacts the estimator and learns the following:

- (a) The wiring is to be used for an in-house construction job and the electrical engineer provided the figure of \$.60 per linear foot.
- (b) The electrical engineer stated this figure came from the current issue of Electrical Estimating Magazine, a trade journal, and the same price is currently included in a Corps of Engineers contract for which the Grantee engineering division has received a copy.
- (c) The Corps of Engineers contract number and a copy of the trade journal are provided to the buyer.

(5) Award is rightly made to Hackett Electric, Inc., and the price determined fair and reasonable through comparison with the validated Grantee estimate.

b. Improper Pricing --

(1) Identical situation and response, with all other forms of price analysis failing to provide a valid pricing basis.

(2) Upon contacting the estimator, the buyer learns the following:

- (a) The electrical engineer had used this figure in a recent in-house construction estimate and, when questioned, was fairly certain this was the price that had been paid in a recent contract, but he could not remember the contract number, when it was accomplished, or exactly what it was for.
- (b) Since the electrical engineer had provided the price, the estimator had simply passed it on to contracting, as the engineer is considered an expert in electrical wiring.

(3) Award should not be made without further analysis, as the estimate (pricing basis) cannot be validated and therefore cannot be used to determine price reasonableness.

**Cost Analysis Examples:**

**1. Limited Cost Analysis;**

a. Proper Pricing --

- (1) Solicitation issued for construction of two concrete ramps estimated to cost a total of \$32,106.00.
- (2) Two responses are received as follows:

Bob Co. Inc.	Concrete Builders Corp.
No Bid	Lump Sum \$35,000.00

- (3) Detailed cost estimates are obtained from the Grantee and the contractor (see figures 1 and 2).
- (4) Negotiation results in a compromise figure of \$34,000.00 based on revised material costs.
- (5) File is documented to fully explain how the negotiated price was established.

b. Improper Pricing --

- (1) Identical solicitation and response.
- (2) Contractor provides a cost breakdown delineating total cost for labor, material, profit, and overhead, and offers a voluntary price reduction resulting in a proposal of \$34,000.00.
- (3) The Grantee estimator concurs in this price and forwards a Purchase Request to increase funds to the amount of \$34,000.00.
- (4) Award is made and the file is documented to show that price reasonableness is based on the Grantee's acceptance of the voluntary price reduction.
- (5) This is improper because nothing has been done to insure the price is actually fair and reasonable.

**FIGURE 1:  
 COST ESTIMATE PREPARED BY REQUIRING ACTIVITY  
 PROJECT No. NNSVEG XX-31  
 CONSTRUCT CONCRETE RAMPS, Sol. No. NUNSVEG XX-P-3101**

**LABOR:**

Carpenter:	- 40 hrs	@ \$17.50	= \$ 700.00
Concrete Mason	- 100 hrs	@ \$20.00	= \$ 2,000.00
Apprentices	- 140 hrs	@ \$10.00	= \$ 1,400.00
Laborer	- 560 hrs	@ \$ 7.00	= \$ 3,920.00
Project Manager	- 140 hrs	@ \$25.00	= <u>\$ 3,500.00</u>
		<b>TOTAL:</b>	<b>\$11,520.00</b>

**MATERIAL:**

Concrete	- 140 cu.yd.	@ \$55.00	= \$ 7,770.00
Reinforcing Rods	- 560	@ \$10.00	= \$ 5,600.00
Wood	- 80 pieces	@ \$ 7.00	= <u>\$ 560.00</u>
		<b>TOTAL:</b>	<b>\$13,860.00</b>
Overhead (Including G&A) @ 15%			= \$ 3,807.00
Profit @ 10%			= <u>\$ 2,918.70</u>

TOTAL ESTIMATE: = \$32,105.70  
 SAY: = \$32,106.00



**FIGURE 2**  
**COST ESTIMATE PREPARED BY CONCRETE BUILDERS INC.**  
**Sol. No. NUNSVEG XX-P-3101, CONSTRUCT CONCRETE TARGETS**

**LABOR:**

Concrete Mason	- 100 hrs	@ \$25.00	= \$ 2,500.00
Mason's Apprentice	- 50 hrs	@ \$12.50	= \$ 625.00
Carpenter:	- 50 hrs	@ \$20.00	= \$ 1,000.00
Carpenter's Apprentice	- 25 hrs	@ \$10.00	= \$ 250.00
Laborer	- 840 hrs	@ \$ 5.00	= \$ 4,200.00
Project Manager	- 150 hrs	@ \$30.00	= \$ <u>4,500.00</u>
		<b>TOTAL:</b>	<b>\$13,075.00</b>

**MATERIAL:**

Concrete Mix	- 200 bags	@ \$ 5.00	= \$ 1,000.00
Sand	- 10 loads	@ \$ 25.00	= \$ 250.00
Small Stone	- 30 loads	@ \$ 50.00	= \$ 1,500.00
Reinforcing Rods	- 560	@ \$ 10.00	= \$ 5,600.00
Mixer Rental	- 8 days	@ \$150.00	= \$ <u>1,200.00</u>
		<b>TOTAL:</b>	<b>\$ 9,550.00</b>

G&A @ 25%	= \$ 5,656.25
Other Overhead @ 10%	= \$ 2,262.50
Profit @ 15%	= \$ <u>4,581.56</u>

TOTAL ESTIMATE: = \$35,125.31  
SAY: = \$35,000.00

**2. Cost Analysis with Certified Cost or Pricing Data;**

a. Proper Pricing --

- (1) Sole source requirement received for 100 Bus transmissions estimated to cost \$5,500.00 each, or \$550,000.00 total.
- (2) RFP issued to BUSCO and proposal of \$580,000.00 received along with all data required to justify the proposal.
- (3) An audit is requested and the Grantee price analyst is asked to review BUSCO's proposal.

- (4) The audit report verifies the correctness of BUSCO's accounting systems and estimating methods but recommends close scrutiny of the production costs included in the proposal.
- (5) The price analyst finds a possible error in the application of variable manufacturing overhead costs and recommends a proposal reduction of \$400.00 per unit.
- (6) During negotiations BUSCO revised the proposal to \$542,000.00 based on an administrative error in the application of overhead cost. Material overhead was too low and manufacturing too high.
- (7) The final negotiated price was \$5,420.00 per unit and BUSCO submitted revised cost and pricing data to support this price. This data was certified as of the date the agreement was reached.
- (8) Award was made to BUSCO and the file was documented by a PNM.

b. Improper Pricing --

- (1) Identical solicitation and response.
- (2) Identical audit report but price analyst is not used.
- (3) During negotiations the Contracting Officer questioned BUSCO's production costs and the BUSCO negotiator explained that material overhead had been figured close to the minimum but the company could offer a \$100.00 per unit decrease in order to reach a fast agreement. Considering this the only area of contention, the Contracting Officer accepted this offer.
- (4) Award was made in the amount of \$5,700.00 per unit and the file documented by a PNM. The cost and pricing data was only submitted verbally and was certified at the commencement of negotiations.
- (5) This award is questionable because the Contracting Officer did not analyze the proposal sufficiently to ensure all areas of contention were recognized before negotiations; obtained certification of cost or pricing data prior to reaching agreement on price; and did not obtain cost and pricing data in writing.

## **APPENDIX F**

### **EVALUATION AND NEGOTIATION OF FIXED PRICE ARCHITECT-ENGINEER CONTRACTS**

#### **Guidelines:**

The evaluation of Architect-Engineer contracts is governed by the same requirements as a non-competitive contract. It is essential to have a good in-house estimate and a complete and accurate cost proposal from the A&E contractor.

The requirement for an audit examination of the contractor's proposal is highly encouraged to ascertain the salaries and wages for each labor discipline and establish whether the proposed General and Administrative (G&A) expense and overhead costs or rates are reasonable and allocable within the purview of 48 CFR, Chapter I, Part 31. However, where the contracting officer has determined that sufficient and adequate information is available to establish a reasonableness determination, the audit examination may not be necessary.

Under the presumption that an acceptable proposal has been received by the contracting officer, an audit examination was conducted or waived based on available information, and a technical evaluation has been received, the contracting officer should proceed as follows:

- Assure that all labor categories and/or disciplines as proposed by the contractor are compared with the Grantee estimate.
- If any discrepancies are detected in the type and quantity of personnel and labor hours, coordinate with the Grantee technical estimator to establish the reason for any differences. The cost reasonableness of overhead and G&A, as well as the rate of profit, is the contracting officer's responsibility.
- Attempt to resolve any differences on design engineering, drafting, and ancillary requirements such as type and quantity of blueprints, reproduction, transportation, per diem, and site explorations, etc., before any negotiation on price is initiated.

Once the technical requirements are resolved or reconciled with the proposed efforts, proceed as follows:

- (1) Verify the validity of the proposed salaries and/or hourly labor rates for each labor category.
- (2) Ascertain that the labor categories, cost, and quantity are properly computed.
- (3) Verify that any principal(s) (Architect-Partner/Owner) salaries are not included both as direct labor and indirect labor (Overhead and G&A) costs.

- (4) Check for any transposition of labor hours and costs between the two most common areas, drafting and technician. Drafting normally should be higher in hours but lower costs.
- (5) Verify the proposed overhead and/or G&A cost elements (if itemized) for compliance with 48 CFR Chapter I, part 31. If the elements are not itemized, request that the contractor substantiate the proposed rate(s). In either case, the contracting officer should determine that the Grantee absorbs only its fair share in relation to the contractor's commercial business. The contracting officer should request the auditor to conduct an examination of the contractor's records. If this is not feasible, contact other public/Government activities with whom the contractor has had A-E contracts or similar undertakings. In the absence of auditable data, the contractor must justify any proposed costs or rates, or be persuaded to accept the contracting officer's best judgment.