

# CHANGE REQUEST COVER SHEET

**Change Request Number:** 12-80

**Date Received:** 6/27/2012

**Title:** Audits under \$100M

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**Policy OR Guidance:** Guidance

**Section/Text Location Affected:** T3.3.1

**Summary of Change:** This changes reassigns responsibility from the COCO to AAP-500 to identify the 15% of cost reimbursement contracts under \$100M to be audited.

**Reason for Change:** AMS policy requires an audit for 15% of cost contracts under \$100M; the COCO identifies the 15% population of cost contracts. The Cost/Price Services Division (AAP-500) is now managing audit services for ACQ and agreed to also perform this function for AMQ. This change aligns guidance with AAP- 500's functional responsibility.

**Development, Review, and/or Concurrence:** AAP-100, AMQ-1, AAP-500

**Target Audience:** Contracting workforce

**Potential Links within FAST for the Change:** None

**Briefing Planned:** No

**ASAG Responsibilities:** None

**Potential Links within FAST for the Change:** None

**Links for New/Modified Forms (or) Documents (LINK 1)**

**Links for New/Modified Forms (or) Documents (LINK 2)**

**Links for New/Modified Forms (or) Documents (LINK 3)**

## SECTIONS EDITED:

### Procurement Guidance:

*T3.2.3 - Cost and Price Methodology*

*Cost and Price Methodology*

**Section 1 : Proposal Analysis** [[Old Content](#)][[New Content](#)] [[RedLine Content](#)]

## SECTIONS EDITED:

### **Section 1 : Proposal Analysis**

#### **Old Content:** Procurement Guidance:

*T3.2.3 - Cost and Price Methodology*

*Cost and Price Methodology*

#### **Section 1 : Proposal Analysis**

##### a. *Cost or Pricing Data.*

(1) *Decision to Require.* A Contracting Officer (CO) has discretion to require cost or pricing data to assure negotiated prices are fair and reasonable. Certified cost and pricing data must be requested *only* when the CO does not have reasonable assurance that costs or prices are fair and reasonable based on price analysis or other means of evaluation. When deciding the extent to which cost and pricing data may be required, the CO should consider the cost and schedule burden on the contractor to provide the information.

(a) When the CO determines adequate price competition exists, certified cost or pricing data must not be requested.

(b) Adequate price competition may exist when:

(i) Two or more responsible offerors competing independently submit priced offers responsive to FAA's expressed requirement;

(ii) There was a responsible expectation based on market research or other assessment that two or more responsible offerors competing independently would submit priced offers responsive to the screening information request's expressed requirement even though only one offer is received from a responsible responsive offeror; or

(iii) Price analysis clearly demonstrates that the proposed price is reasonable in comparison with current or recent prices for the same or similar items purchased in comparable quantities, and under comparable terms and conditions under contracts that resulted from adequate price competition.

(c) If the CO determines that the level of competition does not support the determination of price reasonableness, or the offeror's price cannot be determined to be reasonable from price analysis in accordance with T3.2.3 1(c), then the CO may require certified cost or pricing data or non-certified cost or pricing data to the extent necessary to support a determination of a fair and reasonable price. The CO, within his or her discretion, may based on price analysis alone determine that an offeror's price is not fair and reasonable without requesting additional cost data.

(d) In situations where adequate price competition does not exist, the decision to require certified or non-certified cost or pricing data and the level of data required should be based on the specific circumstances of the procurement taking into account the factors for consideration described in subparagraph (3) "Factors to Consider" below.

(2) *Types of Information and Evaluation Method.* The CO may require information to support proposal analysis in any of the following degrees of detail:

- (a) No cost data, in which case a price analysis is conducted,
- (b) Non-certified cost or pricing data, in which a price analysis and cost analysis appropriate to the data submitted are conducted; or
- (c) Certified cost or pricing data, where the offeror certifies to the accuracy, completeness and currency of the data and both price and cost analyses are conducted.

(3) *Factors To Consider.*

- (a) The CO has the flexibility to determine:
  - (i) Whether or not to require non-certified cost or pricing data;
  - (ii) To what degree or level of detail data should be requested; and
  - (iii) Whether or not the data should be certified, except for situations where adequate price competition exists, where the CO must not require cost or pricing data.
- (b) The CO may consider the following factors to determine the appropriate data requirement:
  - (i) *Recent Pricing Data.* Availability of information on prices for the same or similar goods or services procured on a competitive basis.

(ii) *Degree of Competition Attained.* Level to which competitive market forces can be expected to influence submission of reasonable prices.

(iii) *Uncertainty of the Market Place.* How volatile market prices or technological changes may impact vendor prices or costs.

(iv) *Availability of Independent Cost Estimate/Data.* The degree of confidence the CO has in the internal estimate or other data which would provide an effective means to objectively evaluate proposed costs or prices.

(v) *Technical Complexity of Procurement.* The degree to which developmental effort or technical complexity is inherent in the requirement.

(vi) *Contract Type.* The degree to which the decision of contract type mitigates the risk to the agency.

(4) *Requirement for Certified Cost or Pricing Data.* When certified cost or pricing data are necessary, AMS Clauses 3.2.2.3-38, Requirements for Certified Cost or Pricing Data or Other Information, and 3.2.2.3-39, Requirements for Certified Cost or Pricing Data or Other Information – Modifications, must be inserted in the SIR. The clauses require the contractor to submit the information contained in the Appendix "Instructions for Submitting Cost/Price Proposals When Certified Cost or Pricing Data are Required."

(5) *Requesting Information.* When requesting non-certified cost or pricing data, the information should be limited to the extent necessary to determine price reasonableness or the cost realism. The level of detail and format of the data requested will be determined by the CO. Generally this will be a modified version of information requested in subparagraph (4), "Requirement for Certified Cost or Pricing Data" above.

(6) *Subcontracts.* Contractors are required to submit certified cost or pricing data for proposed subcontracts or subcontract modifications only when necessary to determine the reasonableness of the proposed contract or subcontract price, including negotiated final pricing actions. The contractor is responsible for performing cost or price analysis when determining price reasonableness on subcontract proposals and for submitting the subcontract cost or pricing data if requested by the CO.

b. *Proposal Analysis.* The procurement team is responsible for evaluating proposals using the methods of price and cost analysis appropriate to the procurement. Price and cost analysis are used to determine if prices or costs are allowable, reasonable and realistic. The CO is responsible for determining whether contract prices are fair and reasonable.

c. *Price Analysis.* Price analysis is a process of examining and analyzing a proposed price without evaluating separate cost elements and proposed profit/fee. Price analysis is the most commonly used method of proposal analysis and should be performed on all contractor

proposals. Even when cost analysis is performed to evaluate individual cost elements of a contractor's proposal, some form of price analysis is needed to ensure that the proposed price is fair and reasonable. There are several techniques that may be used in performing price analysis:

- (1) Comparison of proposed prices received in response to the screening information request.
- (2) Comparison of prior proposed prices and contract prices with current proposed prices for the same or similar end items and services in comparable quantities.
- (3) Application of rough yardsticks (such as dollars per pound or per horsepower, or other units) to highlight significant inconsistencies that warrant additional pricing inquiry.
- (4) Comparison with competitive published catalogs or lists, published market prices or commodities, similar indexes, and discount or rebate arrangements.
- (5) Comparison of proposed prices with independent cost estimates.
- (6) Ascertaining that the price is set by law or regulation.

d. *Cost Analysis.*

(1) Cost analysis is the review and evaluation of the separate cost elements and proposed profit/fee of an offeror's proposal. The CO will determine whether cost analysis is appropriate. Cost analysis is not required to evaluate established catalog or market prices, prices set by law or regulation, and commercial items. If there are significant disparities in proposed prices, a limited form of cost analysis may be used to investigate the cause of the disparities. Cost analysis involves examining data submitted by the contractor and the judgmental factors applied in projecting estimated costs. Cost analysis also includes:

- (a) Verification that the contractor's cost submissions are according to disclosed cost accounting procedures;
- (b) Comparisons with previous costs; and
- (c) Forecasts of future costs based on historical cost experience.

(2) Cost analysis may be used to determine cost reasonableness or cost realism when a fair and reasonable price cannot be determined through price analysis alone for commercial or non-commercial items, and/or the agency needs an understanding of the cost buildup of the proposal to verify cost realism and reasonableness. The data required to perform the cost analysis should be limited to those cost elements that are necessary to ensure a fair and reasonable price determination.

(3) Cost analysis involves the following techniques and procedures:

- (a) Verification of cost or pricing data and evaluation of cost elements.
- (b) Evaluating the effect of the offeror's current practices on future costs.
- (c) Comparison of the costs proposed by the offeror with historical and actual costs, and previous cost estimates for the same or similar items.
- (d) Analysis of the contractor's evaluation in determining the reasonableness of the subcontract costs.
- (e) Verification of the offeror's proposed cost to ensure that it reflects cost realism and reasonableness.
- (f) Review to determine whether any cost or pricing data that is necessary to make the contractor's proposal accurate, complete, and current has been submitted or identified in writing.

*e. Field Pricing Support.*

Field pricing support is independent support intended to give the CO a detailed analysis and report of the contractor's cost proposal or other areas related to contract pricing. Field pricing support personnel include, but are not limited to, COs, auditors, price analysts, quality assurance personnel, and engineers. The CO may request field pricing support when necessary.

*f. Pre- and Post-Award Audits.*

(1) The CO must request pre-award and post-award audits on all cost reimbursement contracts estimated to exceed \$100 million (including all options or ceiling amounts). In addition, FAA must request audits on at least 15% of all cost reimbursement contracts under \$100 million; the Chief of the Contracting Office (COCO) determines which contracts under \$100 million require an audit. At the discretion of the CO, audits may also be requested on other types of contracts.

(2) Program offices fund required pre- and post-award audits. The COCO, coordinating with headquarters Cost/Price Analysis Services (AAP-500), will track and manage requested and completed audits. Although Defense Contract Audit Agency (DCAA) provides audit support for civilian agencies, FAA may also obtain support from other public or private audit organizations as necessary.

(3) The CO should appropriately scope audit requests based on circumstances of the procurement, such as data to be reviewed, recent audits, and the contractor to be audited. Audits may cover one or more of the following:

### *Pre-award*

- Pre-award survey (new contract)
- Proposal audit (full or selected portions)
- Forward pricing rates or billing rates
- Rate verification (direct and indirect)
- Cost Accounting Standards compliance review
- Cost accounting system adequacy (labor, indirect and other direct cost systems)
- Earned value management system audit
- Contractor purchasing system review
- Billing system review
- Estimating system review
- Information technology system review
- Material management and accounting system review
- Basis of estimate
- Bill of material and long lead items

### *Post-award*

- Proposal for contract modification
- Defective pricing
- Incurred cost
- Invoice reviews for allowability or improper payment
- Claims and request for equitable adjustment
- Final price submission
- Termination
- Closeout

(4) COs should use good business judgment consistent with applicable AMS guidance when deciding whether to obtain audits. If a CO decides not to obtain an audit, the file must be documented with a rational basis as to why the audit was not obtained. The cost of the audit compared to the expected payback must be considered.

### *g. Defective Pricing.*

(1) Defective certified cost or pricing data is data which was provided to FAA in support of a proposal and which was not current, accurate, or complete. It may only occur when certified cost or pricing data is provided. If, before agreement in price, the CO learns that any certified cost or pricing data the contractor provided are inaccurate, incomplete, or not current, the contractor must be notified immediately to determine if the defective data increase or decrease the contract price. The CO must then negotiate using any new data submitted or making allowance for the incorrect data.

(2) If, after award, certified cost or pricing data are found to be inaccurate, incomplete, or noncurrent as of the date of agreement, the CO should give the contractor an opportunity to support the accuracy, completeness, and currency of the questioned data. In addition,

the CO may obtain an audit to evaluate the accuracy, completeness, and currency of the data. The contractor should reimburse FAA for any payments issued based on defective cost or pricing data during the contract period. The reimbursement should include the amount identified by the CO including profit or fee and interest accrued from the date of the payment. If defective pricing is determined to exist, this fact should be noted in future past performance evaluations.

(3) If a contractor and subcontractor submitted certified cost or pricing data, the CO has the right, under the clause prescribed in the contract to reduce the contract price if it significantly increased due to contractor submitted defective data. This right applies whether the data supported subcontractor cost estimates or firm agreements between subcontractors and contractors. In order to afford an opportunity for corrective action, the CO should give the contractor reasonable advanced notice before determining to reduce the contract price when:

(a) A contractor includes defective subcontract data in arriving at the price but later awards the subcontract to a lower priced subcontractor (or does not subcontract for work). Any adjustment in the contract price due to defective subcontract data is limited to the difference, plus applicable indirect cost and profit/fee, between the subcontract price used for pricing the contract and either the actual subcontract or the actual cost to the contractor.

(b) Under cost-reimbursement contracts and fixed price incentive contracts, payments to subcontracts that are higher than they would be had there been no defective subcontractor cost or pricing data will be the basis for disallowance or non-recognition of costs.

#### *h. Profit/Fee Analysis.*

(1) When price analysis techniques are sufficient to ensure a fair and reasonable price, analysis of profit/fee is not appropriate.

(2) When cost analysis is required for price negotiation, profit/fee must be analyzed.

(a) Profit/fee should be analyzed with the objective of rewarding contractors for:

(i) Financial and other risks they assume;

(ii) Resources they use; and

(iii) Organization, performance, and management capabilities they employ.

(b) Consideration should be given to the:

(i) Ratio of indirect costs to direct costs;

- (ii) Extent of subcontracting;
- (iii) Complexity of materials requirements; and
- (iv) Commitment of capital investments to contract performance.

(3) For the purposes of establishing a negotiation position the CO may use some structured method (e.g. agency-mandated weighted guidelines) for determining the profit/fee appropriate for the work to be performed. The CO is encouraged to establish a structured mechanism under cost reimbursable contracts which relates performance to fee amounts earned.

i. *Cost Realism.*

(1) Cost realism means the costs in an offeror's proposal:

- (a) Are realistic for the work to be performed;
- (b) Reflect a clear understanding of the requirements; and
- (c) Are consistent with the various elements of the offeror's technical proposal.

The emphasis of a cost realism analysis is to determine whether costs may be overstated or understated. Cost realism helps to ascertain the potential risk to FAA as a result of the offeror being unable to meet contract requirements.

(2) Cost realism analysis is an objective process of identifying the specific elements of a cost estimate or a proposed price and comparing those elements against reliable and independent means of cost measurement. This analysis judges whether or not the estimates under analysis are verifiable, complete, and accurate, and whether or not the offeror's estimating methodology is logical, appropriate, and adequately explained. This verifies that the cost or prices proposed fairly represent the costs likely to be incurred for the proposed services under the offeror's technical and management approach.

(3) A practical example of the need for cost realism analysis is the tendency of some contractors to "buy-in" to a contract award. "Buying-in" refers to an offeror submitting an offer below anticipated contract costs. Contractors may "buy-in" for purely business reasons or may expect to recover losses through an increase of the contract price after award or through receiving follow-on contracts at artificially high prices. Buying-in may decrease competition or result in poor contract performance. The CO should minimize the opportunity for buying-in through the following appropriate actions:

- (a) Use cost analysis in evaluating proposals for follow-on contracts and change orders;

(b) Price contract options for additional quantities together with the firm contract quantity, that equal program requirements;

(c) Develop an estimate of the proper price level or value of the supplies or services to be purchased; and

(d) Verify that contract type and price are consistent with the uncertainty and risk to FAA and contractor while at the same time providing the contractor with the greatest incentive for efficient and economical performance.

(4) The foregoing does not mean that the CO should refuse to award a contract when a buy-in is apparent. The CO should evaluate the attendant risks of costs escalating out of control or the contractor not being able to successfully complete performance. FAA reserves the right to make an informed judgment and decide whether to award or not based on downstream consequences emanating from potential change orders, etc.

j. *Unbalanced Offer.* Offeror proposals should be analyzed to determine whether they are unbalanced with respect to prices or separately priced line items. This is particularly important when evaluating the prices for options in relationship to the prices for the basic requirements. An offer is mathematically unbalanced if it is based on prices which are significantly less than the cost of some contract line items and significantly overstated in relation to cost for others. An offer is materially unbalanced if it is mathematically unbalanced and if there is reasonable doubt that the offer would result in the lowest overall cost to FAA (even though it is the lowest evaluated offer); or the offer is so grossly unbalanced that its acceptance would be tantamount to allowing an advance payment. Offers that are materially unbalanced may be rejected. Depending on the nature of the procurement, price analysis or cost analysis should be used in determining whether offers are materially unbalanced.

**New Content: Procurement Guidance:**

*T3.2.3 - Cost and Price Methodology*

*Cost and Price Methodology*

**Section 1 : Proposal Analysis**

a. *Cost or Pricing Data.*

(1) *Decision to Require Data.* A Contracting Officer (CO) has discretion to require cost or pricing data to assure prices are fair and reasonable. Certified cost and pricing data must be requested *only* when the CO does not have reasonable assurance that costs or prices are fair and reasonable based on price analysis or other means of evaluation. When deciding the extent to which cost and pricing data may be required, the CO should consider the cost and schedule burden on the contractor to provide the information.

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(b) Adequate price competition may exist when:

(i) Two or more responsible offerors competing independently submit priced offers responsive to FAA's expressed requirement;

(ii) There was a reasonable expectation, based on market research or other assessment, that two or more responsible offerors competing independently would submit priced offers responsive to the screening information request's expressed requirement, although only one offer is received from a responsible responsive offeror; or

(iii) Price analysis clearly demonstrates that the proposed price is reasonable compared to current or recent prices for the same or similar items purchased in comparable quantities, and under comparable terms and conditions under contracts that resulted from adequate price competition.

(c) If the CO determines that the level of competition does not support the determination of price reasonableness, or the offeror's price cannot be determined to be reasonable from price analysis according to subparagraph c. below, then the CO may require certified cost or pricing data or non-certified cost or pricing data to the extent necessary to support a determination of a fair and reasonable price. The CO within his or her discretion may, based on price analysis alone, determine that an offeror's price is not fair and reasonable without requesting additional cost data.

(d) In situations where adequate price competition does not exist, the decision to require certified or non-certified cost or pricing data and the level of data required should be based on the specific circumstances of the procurement taking into account the factors described in subparagraph (3) "Factors to Consider" below.

(2) *Types of Information and Evaluation Method.* The CO may require information to support proposal analysis in any of the following degrees of detail:

(a) No cost data, in which case a price analysis is conducted;

(b) Non-certified cost or pricing data, in which a price analysis and cost analysis appropriate to the data submitted are conducted; or

(c) Certified cost or pricing data, where the offeror certifies to the accuracy, completeness and currency of the data and both price and cost analyses are conducted.

(3) *Factors To Consider.*

(a) The CO has the flexibility to determine:

- (i) Whether or not to require non-certified cost or pricing data;
- (ii) To what degree or level of detail data should be requested; and
- (iii) Whether or not the data should be certified, except for situations where adequate price competition exists (and the CO must not require certified cost or pricing data).

(b) The CO may consider the following factors to determine the appropriate data requirement:

- (i) *Recent Pricing Data.* Availability of information on prices for the same or similar goods or services procured on a competitive basis.
- (ii) *Degree of Competition Attained.* Level to which competitive market forces can be expected to influence submission of reasonable prices.
- (iii) *Uncertainty of the Market Place.* How volatile market prices or technological changes may impact vendor prices or costs.
- (iv) *Availability of Independent Cost Estimate/Data.* The degree of confidence the CO has in the internal estimate or other data which would provide an effective means to objectively evaluate proposed costs or prices.
- (v) *Technical Complexity of Procurement.* The degree to which developmental effort or technical complexity is inherent in the requirement.
- (vi) *Contract Type.* The degree to which the decision of contract type mitigates the risk to the agency.

(4) *Requirement for Certified Cost or Pricing Data.* When certified cost or pricing data are necessary, AMS Clauses 3.2.2.3-38, Requirements for Certified Cost or Pricing Data or Other Information, and 3.2.2.3-39, Requirements for Certified Cost or Pricing Data or Other Information – Modifications, must be inserted in the SIR. The clauses require the contractor to submit the information contained in the Appendix "Instructions for Submitting Cost/Price Proposals When Certified Cost or Pricing Data are Required."

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(6) *Subcontracts*. Contractors are required to submit certified cost or pricing data for proposed subcontracts or subcontract modifications only when necessary to determine the reasonableness of the proposed contract or subcontract price, including negotiated final pricing actions. The contractor is responsible for performing cost or price analysis when determining price reasonableness on subcontract proposals and for submitting the subcontract cost or pricing data if requested by the CO.

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

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

(6) Ascertaining that the price is set by law or regulation.

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(b) Comparisons with previous costs; and

(c) Forecasts of future costs based on historical cost experience.

(2) Cost analysis may be used to determine cost reasonableness or cost realism when a fair and reasonable price cannot be determined through price analysis alone for commercial or non-commercial items, and/or the agency needs an understanding of the cost buildup of the proposal to verify cost realism and reasonableness. The data required to perform the cost analysis should be limited to those cost elements that are necessary to ensure a fair and reasonable price determination.

(3) Cost analysis involves the following techniques and procedures:

(a) Verification of cost or pricing data and evaluation of cost elements.

(b) Evaluating the effect of the offeror's current practices on future costs.

(c) Comparison of the costs proposed by the offeror with historical and actual costs, and previous cost estimates for the same or similar items.

(d) Analysis of the contractor's evaluation in determining the reasonableness of the subcontract costs.

(e) Verification of the offeror's proposed cost to ensure that it reflects cost realism and reasonableness.

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*e. Field Pricing Support.*

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*f. Pre- and Post-Award Audits.*

(1) The CO must request pre-award and post-award audits on all cost reimbursement contracts estimated to exceed \$100 million (including all options or ceiling amounts). In addition, FAA must request audits on at least 15% of all cost

reimbursement contracts under \$100 million; headquarters Cost/Price Analysis Services (AAP-500) determines which contracts under \$100 million require an audit. At the discretion of the CO, audits may also be requested on other types of contracts.

(2) Program offices fund required pre- and post-award audits. Headquarters Cost/Price Analysis Services (AAP-500) tracks and manages requested and completed audits. Although Defense Contract Audit Agency (DCAA) provides audit support for civilian agencies, FAA may also obtain support from other public or private audit organizations as necessary.

(3) The CO should appropriately scope audit requests considering the nature of the procurement, data to be reviewed, recent audits, and the contractor to be audited. Cost/Price Analysis Services (AAP-500) can advise the CO about scoping the request. Audits may cover one or more of the following:

*Pre-award*

- Pre-award survey (new contract)
- Proposal audit (full or selected portions)
- Forward pricing rates or billing rates
- Rate verification (direct and indirect)
- Cost Accounting Standards compliance review
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*Post-award*

- Proposal for contract modification
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(4) The CO should use good business judgment consistent with applicable AMS guidance when deciding whether to obtain audits. If a CO decides not to obtain an audit, the file

must be documented with a rational basis as to why the audit was not obtained. The cost of the audit compared to the expected payback must be considered.

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(2) If, after award, certified cost or pricing data are found to be inaccurate, incomplete, or noncurrent as of the date of agreement, the CO should give the contractor an opportunity to support the accuracy, completeness, and currency of the questioned data. In addition, the CO may obtain an audit to evaluate the accuracy, completeness, and currency of the data. The contractor should reimburse FAA for any payments issued based on defective cost or pricing data during the contract period. The reimbursement should include the amount identified by the CO including profit or fee and interest accrued from the date of the payment. If defective pricing is determined to exist, this fact should be noted in future past performance evaluations.

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(a) A contractor includes defective subcontract data in arriving at the price but later awards the subcontract to a lower priced subcontractor (or does not subcontract for work). Any adjustment in the contract price due to defective subcontract data is limited to the difference, plus applicable indirect cost and profit/fee, between the subcontract price used for pricing the contract and either the actual subcontract or the actual cost to the contractor.

(b) Under cost-reimbursement contracts and fixed price incentive contracts, payments to subcontracts that are higher than they would be had there been no defective subcontractor cost or pricing data will be the basis for disallowance or non-recognition of costs.

*h. Profit/Fee Analysis.*

(1) When price analysis techniques are sufficient to ensure a fair and reasonable price, analysis of profit/fee is not appropriate.

(2) When cost analysis is required for price negotiation, profit/fee must be analyzed.

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- (i) Financial and other risks they assume;
- (ii) Resources they use; and
- (iii) Organization, performance, and management capabilities they employ.

(b) Consideration should be given to the:

- (i) Ratio of indirect costs to direct costs;
- (ii) Extent of subcontracting;
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- (iv) Commitment of capital investments to contract performance.

(3) For the purposes of establishing a negotiation position the CO may use some structured method (e.g. agency-mandated weighted guidelines) for determining the profit/fee appropriate for the work to be performed. The CO is encouraged to establish a structured mechanism under cost reimbursable contracts which relates performance to fee amounts earned.

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- (b) Reflect a clear understanding of the requirements; and
- (c) Are consistent with the various elements of the offeror's technical proposal.

The emphasis of a cost realism analysis is to determine whether costs may be overstated or understated. Cost realism helps to ascertain the potential risk to FAA as a result of the offeror being unable to meet contract requirements.

(2) Cost realism analysis is an objective process of identifying the specific elements of a cost estimate or a proposed price and comparing those elements against reliable and

independent means of cost measurement. This analysis judges whether or not the estimates under analysis are verifiable, complete, and accurate, and whether or not the offeror's estimating methodology is logical, appropriate, and adequately explained. This verifies that the cost or prices proposed fairly represent the costs likely to be incurred for the proposed services under the offeror's technical and management approach.

(3) A practical example of the need for cost realism analysis is the tendency of some contractors to "buy-in" to a contract award. "Buying-in" refers to an offeror submitting an offer below anticipated contract costs. Contractors may "buy-in" for purely business reasons or may expect to recover losses through an increase of the contract price after award or through receiving follow-on contracts at artificially high prices. Buying-in may decrease competition or result in poor contract performance. The CO should minimize the opportunity for buying-in through the following appropriate actions:

(a) Use cost analysis in evaluating proposals for follow-on contracts and change orders;

(b) Price contract options for additional quantities together with the firm contract quantity, that equal program requirements;

(c) Develop an estimate of the proper price level or value of the supplies or services to be purchased; and

(d) Verify that contract type and price are consistent with the uncertainty and risk to FAA and contractor while at the same time providing the contractor with the greatest incentive for efficient and economical performance.

(4) The foregoing does not mean that the CO should refuse to award a contract when a buy-in is apparent. The CO should evaluate the attendant risks of costs escalating out of control or the contractor not being able to successfully complete performance. FAA reserves the right to make an informed judgment and decide whether to award or not based on downstream consequences emanating from potential change orders, etc.

j. *Unbalanced Offer.* Offeror proposals should be analyzed to determine whether they are unbalanced with respect to prices or separately priced line items. This is particularly important when evaluating the prices for options in relationship to the prices for the basic requirements. An offer is mathematically unbalanced if it is based on prices which are significantly less than the cost of some contract line items and significantly overstated in relation to cost for others. An offer is materially unbalanced if it is mathematically unbalanced and if there is reasonable doubt that the offer would result in the lowest overall cost to FAA (even though it is the lowest evaluated offer); or the offer is so grossly unbalanced that its acceptance would be tantamount to allowing an advance payment. Offers that are materially unbalanced may be rejected. Depending on the nature of the procurement, price analysis or cost analysis should be used in determining whether offers are materially unbalanced.

**Red Line Content: Procurement Guidance:**

*T3.2.3 - Cost and Price Methodology*

*Cost and Price Methodology*

**Section 1 : Proposal Analysis**

a. *Cost or Pricing Data.*

(1) *Decision to Require **Data**.* A Contracting Officer (CO) has discretion to require cost or pricing data to assure ~~negotiated~~ prices are fair and reasonable. Certified cost and pricing data must be requested *only* when the CO does not have reasonable assurance that costs or prices are fair and reasonable based on price analysis or other means of evaluation. When deciding the extent to which cost and pricing data may be required, the CO should consider the cost and schedule burden on the contractor to provide the information.

(a) When the CO determines adequate price competition exists, certified cost or pricing data must not be requested.

(b) Adequate price competition may exist when:

(i) Two or more responsible offerors competing independently submit priced offers responsive to FAA's expressed requirement;

(ii) There was a ~~responsible~~**reasonable** expectation<sub>2</sub> based on market research or other assessment<sub>2</sub> that two or more responsible offerors competing independently would submit priced offers responsive to the screening information request's expressed requirement~~-even though, although~~ only one offer is received from a responsible responsive offeror; or

(iii) Price analysis clearly demonstrates that the proposed price is reasonable ~~in comparison~~**compared with**~~to~~ current or recent prices for the same or similar items purchased in comparable quantities, and under comparable terms and conditions under contracts that resulted from adequate price competition.

(c) If the CO determines that the level of competition does not support the determination of price reasonableness, or the offeror's price cannot be determined to be reasonable from price analysis ~~in accordance~~**according with**~~to~~ ~~T3.2~~**subparagraph c.3 1(e)**~~below~~, then the CO may require certified cost or pricing data or non-certified cost or pricing data to the extent necessary to support a determination of a fair and reasonable price. The CO<sub>7</sub> within his or her discretion<sub>7</sub> may<sub>2</sub> based on price analysis alone<sub>2</sub> determine that an offeror's price is not fair and reasonable without requesting additional cost data.

(d) In situations where adequate price competition does not exist, the decision to require certified or non-certified cost or pricing data and the level of data required should be based on the specific circumstances of the procurement taking into account the factors ~~for consideration~~ described in subparagraph (3) "Factors to Consider" below.

(2) *Types of Information and Evaluation Method.* The CO may require information to support proposal analysis in any of the following degrees of detail:

- (a) No cost data, in which case a price analysis is conducted;
- (b) Non-certified cost or pricing data, in which a price analysis and cost analysis appropriate to the data submitted are conducted; or
- (c) Certified cost or pricing data, where the offeror certifies to the accuracy, completeness and currency of the data and both price and cost analyses are conducted.

(3) *Factors To Consider.*

(a) The CO has the flexibility to determine:

- (i) Whether or not to require non-certified cost or pricing data;
- (ii) To what degree or level of detail data should be requested; and
- (iii) Whether or not the data should be certified, except for situations where adequate price competition exists, ~~where~~ and the CO must not require certified cost or pricing data).

(b) The CO may consider the following factors to determine the appropriate data requirement:

- (i) *Recent Pricing Data.* Availability of information on prices for the same or similar goods or services procured on a competitive basis.
- (ii) *Degree of Competition Attained.* Level to which competitive market forces can be expected to influence submission of reasonable prices.
- (iii) *Uncertainty of the Market Place.* How volatile market prices or technological changes may impact vendor prices or costs.
- (iv) *Availability of Independent Cost Estimate/Data.* The degree of confidence the CO has in the internal estimate or other data which would provide an effective means to objectively evaluate proposed costs or prices.

(v) *Technical Complexity of Procurement.* The degree to which developmental effort or technical complexity is inherent in the requirement.

(vi) *Contract Type.* The degree to which the decision of contract type mitigates the risk to the agency.

(4) *Requirement for Certified Cost or Pricing Data.* When certified cost or pricing data are necessary, AMS Clauses 3.2.2.3-38, Requirements for Certified Cost or Pricing Data or Other Information, and 3.2.2.3-39, Requirements for Certified Cost or Pricing Data or Other Information – Modifications, must be inserted in the SIR. The clauses require the contractor to submit the information contained in the Appendix "Instructions for Submitting Cost/Price Proposals When Certified Cost or Pricing Data are Required."

(5) *Requesting Information.* When requesting non-certified cost or pricing data, the information should be limited to the extent necessary to determine price reasonableness or ~~the~~ cost realism. The level of detail and format of the data requested will be determined by the CO. Generally this will be a modified version of information requested in subparagraph (4), "Requirement for Certified Cost or Pricing Data" above.

(6) *Subcontracts.* Contractors are required to submit certified cost or pricing data for proposed subcontracts or subcontract modifications only when necessary to determine the reasonableness of the proposed contract or subcontract price, including negotiated final pricing actions. The contractor is responsible for performing cost or price analysis when determining price reasonableness on subcontract proposals and for submitting the subcontract cost or pricing data if requested by the CO.

b. *Proposal Analysis.* The procurement team is responsible for evaluating proposals using the methods of price and cost analysis appropriate to the procurement. Price and cost analysis are used to determine if prices or costs are allowable, reasonable and realistic. The CO is responsible for determining whether contract prices are fair and reasonable.

c. *Price Analysis.* Price analysis is a process of examining and analyzing a proposed price without evaluating separate cost elements and proposed profit/fee. Price analysis is the most commonly used method of proposal analysis and should be performed on all contractor proposals. Even when cost analysis is performed to evaluate individual cost elements of a contractor's proposal, some form of price analysis is needed to ensure that the proposed price is fair and reasonable. There are several techniques that may be used in performing price analysis:

(1) Comparison of proposed prices received in response to the screening information request.

(2) Comparison of prior proposed prices and contract prices with current proposed prices for the same or similar end items and services in comparable quantities.

(3) Application of rough yardsticks (such as dollars per pound or per horsepower, or other units) to highlight significant inconsistencies that warrant additional pricing inquiry.

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

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

(6) Ascertaining that the price is set by law or regulation.

d. *Cost Analysis.*

(1) Cost analysis is the review and evaluation of the separate cost elements and proposed profit/fee of an offeror's proposal. The CO will determine whether cost analysis is appropriate. Cost analysis is not required to evaluate established catalog or market prices, prices set by law or regulation, and commercial items. If there are significant disparities in proposed prices, a limited form of cost analysis may be used to investigate the cause of the disparities. Cost analysis involves examining data submitted by the contractor and the judgmental factors applied in projecting estimated costs. Cost analysis also includes:

(a) Verification that the contractor's cost submissions are according to disclosed cost accounting procedures;

(b) Comparisons with previous costs; and

(c) Forecasts of future costs based on historical cost experience.

(2) Cost analysis may be used to determine cost reasonableness or cost realism when a fair and reasonable price cannot be determined through price analysis alone for commercial or non-commercial items, and/or the agency needs an understanding of the cost buildup of the proposal to verify cost realism and reasonableness. The data required to perform the cost analysis should be limited to those cost elements that are necessary to ensure a fair and reasonable price determination.

(3) Cost analysis involves the following techniques and procedures:

(a) Verification of cost or pricing data and evaluation of cost elements.

(b) Evaluating the effect of the offeror's current practices on future costs.

(c) Comparison of the costs proposed by the offeror with historical and actual costs, and previous cost estimates for the same or similar items.

(d) Analysis of the contractor's evaluation in determining the reasonableness of the subcontract costs.

(e) Verification of the offeror's proposed cost to ensure that it reflects cost realism and reasonableness.

(f) Review to determine whether any cost or pricing data that is necessary to make the contractor's proposal accurate, complete, and current has been submitted or identified in writing.

e. *Field Pricing Support.*

Field pricing support is independent support intended to give the CO a detailed analysis and report of the contractor's cost proposal or other areas related to contract pricing. Field pricing support personnel include, but are not limited to, COs, auditors, price analysts, quality assurance personnel, and engineers. The CO may request field pricing support when necessary.

f. *Pre- and Post-Award Audits.*

(1) The CO must request pre-award and post-award audits on all cost reimbursement contracts estimated to exceed \$100 million (including all options or ceiling amounts). In addition, FAA must request audits on at least 15% of all cost reimbursement contracts under \$100 million; ~~the Chief of the~~ headquarters Contracting Cost/Price Analysis Office Services (COCO AAP-500) determines which contracts under \$100 million require an audit. At the discretion of the CO, audits may also be requested on other types of contracts.

(2) Program offices fund required pre- and post-award audits. ~~The COCO, coordinating with headquarters~~ Headquarters Cost/Price Analysis Services (AAP-500), ~~will track~~ tracks and ~~manage~~ manages requested and completed audits. Although Defense Contract Audit Agency (DCAA) provides audit support for civilian agencies, FAA may also obtain support from other public or private audit organizations as ~~necessary~~ necessary.

(3) The CO should appropriately scope audit requests ~~based on~~ considering the circumstances nature of the procurement, ~~such as~~ data to be reviewed, recent audits, and the contractor to be audited. Cost/Price Analysis Services (AAP-500) can advise the CO about scoping the request. Audits may cover one or more of the following:

*Pre-award*

- Pre-award survey (new contract)
- Proposal audit (full or selected portions)
- Forward pricing rates or billing rates
- Rate verification (direct and indirect)

- Cost Accounting Standards compliance review
- Cost accounting system adequacy (labor, indirect and other direct cost systems)
- Earned value management system audit
- Contractor purchasing system review
- Billing system review
- Estimating system review
- Information technology system review
- Material management and accounting system review
- Basis of estimate
- Bill of material and long lead items

*Post-award*

- Proposal for contract modification
- Defective pricing
- Incurred cost
- Invoice reviews for allowability or improper payment
- Claims and request for equitable adjustment
- Final price submission
- Termination
- Closeout

(4) ~~COs~~ The CO should use good business judgment consistent with applicable AMS guidance when deciding whether to obtain audits. If a CO decides not to obtain an audit, the file must be documented with a rational basis as to why the audit was not obtained. The cost of the audit compared to the expected payback must be considered.

*g. Defective Pricing.*

(1) Defective certified cost or pricing data is data which was provided to FAA in support of a proposal and which was not current, accurate, or complete. It may only occur when certified cost or pricing data is provided. If, before agreement in price, the CO learns that any certified cost or pricing data the contractor provided are inaccurate, incomplete, or not current, the contractor must be notified immediately to determine if the defective data increase or decrease the contract price. The CO must then negotiate using any new data submitted or making allowance for the incorrect data.

(2) If, after award, certified cost or pricing data are found to be inaccurate, incomplete, or noncurrent as of the date of agreement, the CO should give the contractor an opportunity to support the accuracy, completeness, and currency of the questioned data. In addition, the CO may obtain an audit to evaluate the accuracy, completeness, and currency of the data. The contractor should reimburse FAA for any payments issued based on defective cost or pricing data during the contract period. The reimbursement should include the amount identified by the CO including profit or fee and interest accrued from the date of the payment. If defective pricing is determined to exist, this fact should be noted in future past performance evaluations.

(3) If a contractor and subcontractor submitted certified cost or pricing data, the CO has the right, under the clause prescribed in the contract to reduce the contract price if it significantly increased due to contractor submitted defective data. This right applies whether the data supported subcontractor cost estimates or firm agreements between subcontractors and contractors. In order to afford an opportunity for corrective action, the CO should give the contractor reasonable advanced notice before determining to reduce the contract price when:

(a) A contractor includes defective subcontract data in arriving at the price but later awards the subcontract to a lower priced subcontractor (or does not subcontract for work). Any adjustment in the contract price due to defective subcontract data is limited to the difference, plus applicable indirect cost and profit/fee, between the subcontract price used for pricing the contract and either the actual subcontract or the actual cost to the contractor.

(b) Under cost-reimbursement contracts and fixed price incentive contracts, payments to subcontracts that are higher than they would be had there been no defective subcontractor cost or pricing data will be the basis for disallowance or non-recognition of costs.

*h. Profit/Fee Analysis.*

(1) When price analysis techniques are sufficient to ensure a fair and reasonable price, analysis of profit/fee is not appropriate.

(2) When cost analysis is required for price negotiation, profit/fee must be analyzed.

(a) Profit/fee should be analyzed with the objective of rewarding contractors for:

- (i) Financial and other risks they assume;
- (ii) Resources they use; and
- (iii) Organization, performance, and management capabilities they employ.

(b) Consideration should be given to the:

- (i) Ratio of indirect costs to direct costs;
- (ii) Extent of subcontracting;
- (iii) Complexity of materials requirements; and
- (iv) Commitment of capital investments to contract performance.

(3) For the purposes of establishing a negotiation position the CO may use some structured method (e.g. agency-mandated weighted guidelines) for determining the profit/fee appropriate for the work to be performed. The CO is encouraged to establish a structured mechanism under cost reimbursable contracts which relates performance to fee amounts earned.

i. *Cost Realism.*

(1) Cost realism means the costs in an offeror's proposal:

- (a) Are realistic for the work to be performed;
- (b) Reflect a clear understanding of the requirements; and
- (c) Are consistent with the various elements of the offeror's technical proposal.

The emphasis of a cost realism analysis is to determine whether costs may be overstated or understated. Cost realism helps to ascertain the potential risk to FAA as a result of the offeror being unable to meet contract requirements.

(2) Cost realism analysis is an objective process of identifying the specific elements of a cost estimate or a proposed price and comparing those elements against reliable and independent means of cost measurement. This analysis judges whether or not the estimates under analysis are verifiable, complete, and accurate, and whether or not the offeror's estimating methodology is logical, appropriate, and adequately explained. This verifies that the cost or prices proposed fairly represent the costs likely to be incurred for the proposed services under the offeror's technical and management approach.

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