INTRODUCTION TO FEDERAL CONTRACT PRICING

Acquiring the Necessary Knowledge to Improve Your Capability in Federal Contract Pricing

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SYLLABUS

Part 1 – Introduction *(20 minutes)*

Part 2 – Pre-Award Pricing – Price Proposals for New Contracts *(30 minutes)*

Part 3 – Post-Award Pricing – Adjustments in Contract Price or Estimated Total Cost *(30 minutes)*

Part 4 – Conclusion – Acquiring the Necessary Knowledge to Improve Your Capability in Pricing *(10 minutes)*

Questions – 10 minute segments after Parts 1, 2, 3

PART 1 - INTRODUCTION

Webinar Learning Goal

This webinar is intended to help participants determine what additional training and assistance they need in federal contract pricing to improve their capability to-

1. Understand government solicitations, including contract price arrangements, pricing instructions, and cost risk in proposals;

2. Apply federal regulations relevant to contract pricing;

3. Understand government actions that cause a contractor to incur additional cost under an existing contract and a contractor's entitlement to request an adjustment in contract price or total estimated cost.

Pricing Perspectives
Offeror and Contractor

1. Pre-Award Pricing – Offeror for a New Contract

- Developing and submitting a price proposal or cost proposal in response to a solicitation (RFP) for a new contract or task order;
- Knowledge of the federal regulations that control contract solicitations, pricing, and government evaluation of proposals.

"Price" refers to a Firm-Fixed-Price or Time-and-Materials contract
"Total Estimated Cost" refers to a Cost-Reimbursement contract

2. Post-Award Pricing – Contractor under an Existing Contract

- Developing a cost estimate and submitting a request for adjustment in price or total estimated cost in response to a contracting officer's action or other government action that changes the contract or causes a contractor to incur additional cost.
- Knowledge of the contract clauses that control a contractor's entitlement to request an adjustment in price or total estimated cost, recognizing government actions that cause a contractor to incur additional cost, and applying the appropriate clause to each government action.

Definitions Relevant to Contract Pricing

Cost = the sum of allowable Direct costs and Indirect costs allocable to a particular contract, incurred or to be incurred.

Fee (Profit) = the dollar amount in addition to the allowable costs paid to a contractor to motivate performance.

Direct Cost = a cost that is allocable to a single final cost objective.

Indirect Cost = a cost that is allocable to two or more final cost objectives.

Cost Objective = a contract, task order, function, entity, or other work unit for which cost is accumulated and measured in an accounting system.

Reasonable Cost = a cost is reasonable IF it-

- Is not excessive in amount;
- Is ordinary and necessary for a contractor's business or performance of a particular contract; and
- Reflects the contractor's responsibilities to the government, owners of the company, and its employees.

Definitions Relevant to Contract Pricing

Allocate = to assign a cost (Direct or Indirect) to a cost objective; A cost is allocable if it is assignable to a cost objective on the basis of benefits received or other equitable relationship between the cost and the objective.

Allowable Cost = a cost (Direct or Indirect) that can be charged to a contract IF the cost is-

- Reasonable in amount;
- Allocable to the contract;
- Necessary and customary for performance; and
- Not prohibited by regulation or the contract terms.

Allocation vs Allowability

- All costs incurred by a contractor to perform a contract are allocable to the contract, but not all allocated costs are allowable;
- A price proposal must exclude all unallowable costs;
- A contractor can charge only allowable costs to a contract for billing to the government.

Components of Contract Price

Firm-Fixed-Price contract
Price = Cost + Profit

Cost-Reimbursement contract
Total Estimated Cost + Profit
*(*no actual price in a Cost-Reimbursement contract)*

Time-and-Materials contract

- Fully-Loaded Labor Rates multiplied by number of hours for each labor category *(includes Indirect Costs + all Profit)*
- Materials Cost *(includes Indirect Costs excluded from Labor Rates, but no Profit)*
- Total Ceiling Price

Contractor's Pricing Objectives as an Offeror for a New Contract

1. Cover all costs of performing the contract

- Direct costs for performing tasks specified in the Statement Of Work (Labor; Materials; Other Direct Costs)
- Other costs for performing the whole contract other than the SOW
- Indirect costs (Overhead; G&A)

2. Attain corporate objectives

- Profitability
- Reward investors
- Market share
- Market leadership
- Other objectives

Government's Pricing Objectives as a Buyer

1. Pay a fair and reasonable price

- *Fair to the buyer*
  >Fair market value of the contract deliverable or
  >Total allowable cost of providing the contract deliverable that would be incurred by a well managed and efficient company plus a reasonable profit.
- *Fair to the seller>* Price is realistic to satisfy the contract requirements.
- *Reasonable>* Price that a competent and prudent buyer is willing to pay.

2. Price each contract separately

- No balancing of losses & profit between federal contracts for an offeror
- Each contract stands alone

(different from commercial pricing)

3. Exclude contingency amounts from the contract price

- Pricing must exclude contingency amounts for events that are not foreseeable and cannot be estimated with reasonable accuracy;
- Government will not pay extra money for something that may not happen.

(different from commercial pricing)

Federal Government Regulations for Contract Pricing

1. Federal Acquisition Regulation (FAR)

2. Defense Federal Acquisition Regulation (DFARS)

3. Each federal agency has it own acquisition regulation

4. Contract Pricing Reference Guide (5 volumes)

- Issued by the Federal Acquisition Institute *(part of General Services Administration)* and Air Force Institute of Technology
- Not a regulation, but is the *most comprehensive* reference book on all areas of federal contract pricing
- Available for free download at https://www.dau.edu/tools/p/cprg or you can purchase a paper version from *Wolters Kluwer Company* (850 pages)

QUESTIONS
(10 minutes)

Every question in federal contracting can be answered with one of the following 3 answers-

1. It depends on the situation; or

2. Yes and No, depending on the situation; or

3. Because it's in the Federal Acquisition Regulation (or DFARS or some other regulation)

PART 2 – PRE-AWARD PRICING

What is Cost Risk?

For the Government

- The contractor may not be able to complete the work within the proposed (or required) schedule for the proposed price or total estimated cost;
- The government's perception of risk is based on analysis of an offeror's price proposal and technical proposal.

For the Offeror

- *Pre-Award>* The proposal may not capture all costs for performing a contract, resulting in a post-award cost overrun; Offeror is prohibited from including a contingency amount in its proposal.
- *Post-Award>* Analysis of a its solicitation reveals that a contractor's entitlement to request an adjustment in price or total estimated cost is limited by the contract clauses or absence of a relevant contract clause.

Causes of Cost Risk for an Offeror in a Price Proposal
How do you recognize and reduce cost risk in your proposal?

1- Insufficient understanding of the solicitation

- Statement of Work (explicit requirements vs. assumptions)
- Price proposal instructions
- Contract price arrangement (FFP; Cost-Reimbursement; T&M)
- Improper pricing instructions in solicitation

2- Insufficient knowledge of the FAR and DFARS

- Price arrangements, allowable costs, government evaluation of proposals, etc.
- Contract clauses controlling post-award adjustments in price or total estimated cost.

3- Inadequate cost estimate

- Quality of the cost estimate (which becomes the price proposal) depends on estimating skill, understanding the solicitation, and knowledge of the FAR and DFARS

Causes of Cost Risk for an Offeror in a Price Proposal

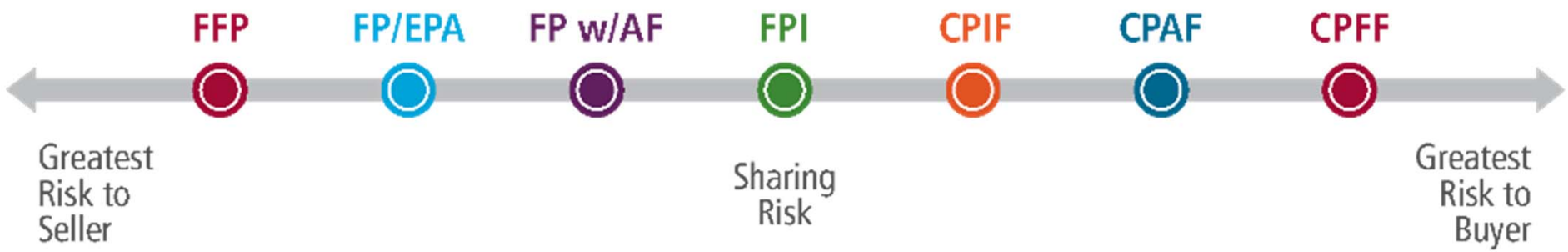
4. "Hidden" costs in a solicitation

- Contract clauses in every solicitation that require a contractor to perform post-award work other than the explicit tasks in the SOW;
- A solicitation contains many post-award clauses (sometimes several hundred) that are incorporated by reference only into the subsequent contract;
- "Hidden" costs are attributable to requirements embedded in various contract clauses, such as submitting reports, employee training, warranties, contract administration, compliance with federal statutes/regulations;
- Offerors commonly neglect these costs.

Examples

FAR 52.246-21 – Warranty of Construction (FFP construction)
FAR 52.222-50 – Combating Trafficking in Persons (all contracts)
FAR 52.221-41 – Service Contract Labor Standards (service contracts)
FAR 52.222-26 – Equal Opportunity
FAR 52.222-6 – Construction Wage Rate Requirements (construction contracts)
FAR 52.223-6 – Drug-Free Workplace

Contract Type and Risk



Comparison of Major Contract Types

	Firm-Fixed-Price (FFP)	Fixed-Price Economic Price Adjustment (FPEPA)	Fixed-Price Incentive Firm Target (FPIF)	Fixed-Price Award-Fee (FPAF)	Fixed-Price Prospective Price Redetermination (FP^3R)	Cost-Plus-Incentive-Fee (CPIF)	Cost-Plus-Award-Fee (CPAF)	Cost-Plus-Fixed-Fee (CPFF)	Cost or Cost-Sharing (C or CS)	Time & Materials (T&M)
Principal Risk to be Mitigated	None. Thus, the contractor assumes all cost risk.	Unstable market prices for labor or material over the life of the contract.	Moderately uncertain contract labor or material requirements.	Risk that the user will not be fully satisfied because of judgmental acceptance criteria.	Costs of performance after the first year because they cannot be estimated with confidence.	Highly uncertain and speculative labor hours, labor mix, and/or material requirements (and other things) necessary to perform the contract. The Government assumes the risks inherent in the contract, benefiting if the actual cost is lower than the expected cost, or losing if the work cannot be completed within the expected cost of performance.				
Use When . . .	The requirement is well-defined. •Contractors are experienced in meeting it. •Market conditions are stable. •Financial risks are otherwise insignificant.	The market prices at risk are severable and significant. The risk stems from industry-wide contingencies beyond the contractor's control. The dollars at risk outweigh the administrative burdens of an FPEPA.	A ceiling price can be established that covers the most probable risks inherent in the nature of the work. The proposed profit sharing formula would motivate the contractor to control costs and to meet other objectives.	Judgmental standards can be fairly applied by the fee determining official. The potential fee is large enough to both: •Provide a meaningful incentive. [1] •Justify related administrative burdens.	The Government needs a firm commitment from the contractor to deliver the supplies or services during subsequent years. The dollars at risk outweigh the administrative burdens of an FPRP.	An objective relationship can be established between the fee and such measures of performance as actual costs, delivery dates, performance benchmarks, and the like.	Objective incentive targets are not feasible for critical aspects of performance. Judgmental standards can be fairly applied. Potential fee would provide a meaningful incentive.	Relating fee to performance (e.g., to actual costs) would be unworkable or of marginal utility.	The contractor expects substantial compensating benefits for absorbing part of the costs and/or foregoing fee or the vendor is a non-profit entity.	No other type of contract is suitable (e.g., because costs are too low to justify an audit of the contractor's indirect expenses).
Elements	A firm-fixed-price for each line item or one or more groupings of line items.	•A fixed-price, ceiling on upward adjustment, and a formula for adjusting the price up or down based on: •Established prices. •Actual labor or material costs. •Labor or material indices.	•Ceiling price •Target cost •Target profit •Delivery, quality, or other performance targets (optional) •Profit sharing formula •120 % ceiling and 50/50 share are points of departure	•Fixed-price. •Award amount •Award fee evaluation criteria and procedures for measuring performance against the criteria	•Fixed-price for the first period. •Proposed subsequent periods (at least 12 months apart). •Timetable for pricing the next period(s).	•Target cost •A minimum, maximum, and target fee •A formula for adjusting fee based on actual costs and/or performance •Performance targets (optional)	•Estimated cost •Base amount, if applicable, and an award amount •Award fee evaluation criteria and procedures for measuring performance against the criteria	•Estimated cost •Fixed fee	•Total estimated cost •No fee •If CS, an agreement on the Government's share of the cost.	•Ceiling price •A per-hour labor rate that also covers overhead and profit •Provisions for reimbursing direct material costs
Contractor is Obliged to:	Provide an acceptable deliverable at the time, place and price specified in the contract.	Provide an acceptable deliverable at the time and place specified in the contract at the adjusted price.	Provide an acceptable deliverable at the time and place specified in the contract at or below the ceiling price.	Perform at the time, place, and the price fixed in the contract.	Provide acceptable deliverables at the time and place specified in the contract at the price established for each period.	Make a good faith effort to meet the Government's needs within the estimated cost in the Contract, Part I the Schedule, Section B Supplies or services and prices/costs.				Make a good faith effort to meet the Government's needs within the ceiling price.
Contractor Incentive *(other than maximizing goodwill)* [1]	Generally realizes an additional dollar of profit for every dollar that costs are reduced.	Generally realizes an additional dollar of profit for every dollar that costs are reduced.	Realizes profit on cost by completing work below the ceiling price. May earn higher profit by incurring costs below the target cost or by meeting objective performance targets.	Generally realizes an additional dollar of profit for every dollar that costs are reduced; earns an additional fee for satisfying the performance standards.	For the period of performance, realizes an additional dollar of profit for every dollar that costs are reduced.	Realizes a higher fee by completing the work at a lower cost and/or by meeting other objective performance targets.	Realizes a higher fee by meeting judgmental performance standards.	Realizes a higher rate of return (i.e., fee divided by total cost) as total cost decreases.	If CS, shares in the cost of providing a deliverable of mutual benefit.	
Typical Application	Commercial supplies and services.	Long-term contracts for commercial supplies during a period of high inflation.	Production of a major system based on a prototype.	Performance-based contracts.	Long-term production of spare parts for a major system.	Research and development of the prototype for a major system.	Large scale research study.	Research study.	Joint research with educational institutions.	Emergency repairs to heating plants and aircraft engines.
Principal Limitations in FAR/DFARS Parts 16, 32, 35, and 52[2]	Generally NOT appropriate for R&D.	Must be justified.	Must be justified. Must be negotiated. Contractor must have an adequate accounting system. Cost data must support targets.	Must be negotiated.	MUST be negotiated. Contractor must have an adequate accounting system that supports the pricing periods. Prompt redeterminations.	The contractor must have an adequate accounting system. The Government must exercise surveillance during performance to ensure use of efficient methods and cost controls. Must be negotiated. Must be justified. Statutory and regulatory limits on the fees that may be negotiated. Must include the applicable Limitation of Cost clause at FAR 52.232-20 through 23.				D&F required (w/ HCA if over 3 years). Government MUST exercise appropriate surveillance to ensure efficient performance. Document any ceiling increases.
Variants	Firm-Fixed-Price Level-of-Effort.		Successive Targets (FPIS), with ceiling and floor on firm target profit.		Retroactive Redetermination			Completion or Term.		Labor Hour (LH)

[1] Goodwill is the value of the name, reputation, location, and intangible assets of the firm.

[2] Comply with any USD(A&S) (formerly AT&L), DPC (formerly DPAP), or other memoranda not yet incorporated into the DFARS, DoD Directives, or DoD Instructions.

The contract price arrangement depends on what the Government buys and the Contracting Officer's discretion to consider various factors in selecting a price arrangement (discretion is limited by FAR)

Services = Firm-Fixed-Price or Time and Materials or Cost-Reimbursement
(depends on complexity, urgency, and government's ability to define the work)

Supplies = Firm-Fixed-Price (*always*)

Construction = Firm-Fixed-Price or Cost-Reimbursement or Time and Materials
(depends on complexity, urgency, and government's ability to define the work)

Commercial Items = Firm-Fixed-Price (*always*)

Architect-Engineer Services = Firm-Fixed-Price or Cost-Reimbursement

Research and Development = Cost-Reimbursement *(usually always)*

Government Evaluation of a Price Proposal

Price Analysis ***(Firm-Fixed-Price contracts)***
Evaluating a price proposal to determine if the price is fair and reasonable without its separate cost elements and profit; Based on a comparison of the proposed with-

- Other offerors' prices
- Commercial prices
- Independent government estimate
- Previous identical or similar contracts

Cost Analysis ***(Firm-Fixed-Price and Time-and-Materials contracts)***
Evaluation of separate cost elements (Direct Costs and Indirect Costs) and proposed profit.

Cost Realism Analysis ***(mandatory for Cost-Reimbursement contracts)***
>Evaluation of Direct and Indirect costs and proposed profit to determine if the proposed costs are-

- Realistic for the work described in the solicitation; and
- Reflect a clear understanding of the contract requirements; and
- Consistent with the offeror's technical proposal.

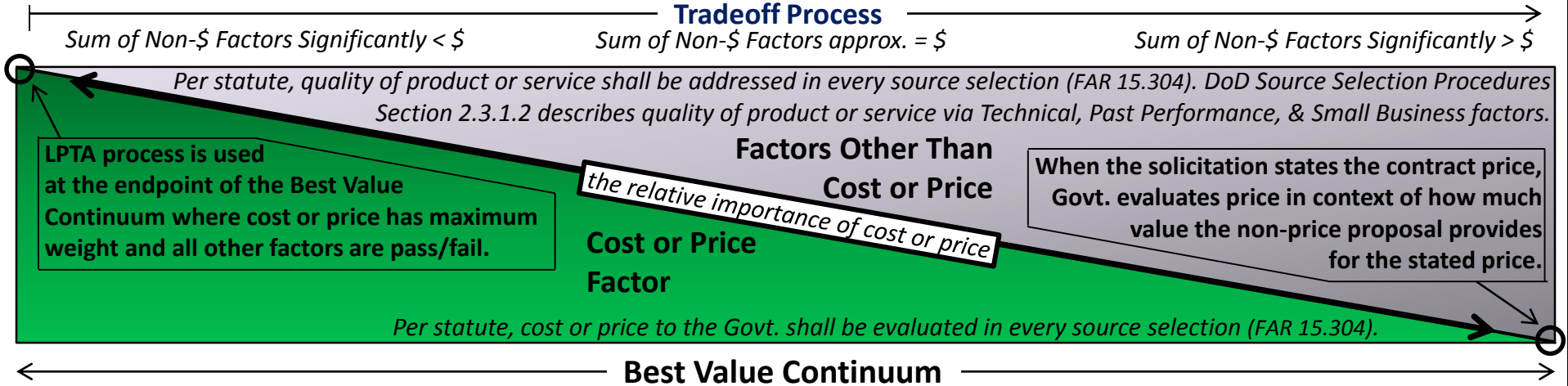
>Government can adjust an offeror's estimated cost up or down to determine the Probable Cost of Performance for each offeror.

The Best Value Continuum and Source Selection

June 30, 2015
Comments/suggestions may be sent to: salvatore.cianci@dau.mil

"**Best Value** means the expected outcome of an acquisition that, in the Government's estimation, provides the greatest overall benefit in response to the requirement." FAR 2.101

Across the **Best value Continuum**, *the relative importance of cost or price may vary*. FAR 15.101



"The objective of source selection is to select the proposal that represents the best value." FAR 15.302

Lowest Price Technically Acceptable (LPTA) process: An offer is acceptable if meets or exceeds standards. No additional evaluation credit given for exceeding standards. The acceptable proposal with lowest evaluated price is selected for award. FAR 15.101-2

Tradeoff process: Allows the Government to accept a proposal from other than the lowest priced or highest rated offeror. FAR 15.101-1

Stated Importance of Evaluation Factors: Per statute, the solicitation shall: (i) clearly state the *relative importance of all factors & significant subfactors*; and (ii) *identify the relationship of all factors other than cost or price, when combined,* as "significantly more important than", "approximately equal to", or "significantly less important than" *the cost or price factor*. FAR 15.304

Source Selection Authority (SSA): Per statute, the SSA shall ensure proposals are evaluated solely on factors & subfactors contained in the solicitation and select the source whose proposal is the best value to the Government. The decision shall be based on a comparative assessment of proposals, represent the SSA's independent judgment, and be documented, to include any rationale for any business judgments and tradeoffs made or relied on by the SSA. Though the rationale need not quantify any tradeoffs, the perceived benefits of selecting the higher priced proposal shall merit the additional costs. FAR 15.101 FAR 15.308

Though the FAR describes it in the context of the competitive procedure called "Source Selection", the Best Value Continuum can be applied to competitive procedures using simplified acquisitions, Federal Supply Schedules (e.g., GSA orders), fair opportunity, & broad agency announcements.

Price Proposal Credibility

Credibility depends on how well you communicate the price information in your proposal to the government

Compliance with the solicitation instructions

- Format > usually specified in the solicitation
- Content > level of detail

Price/cost rationale and narrative

- Many solicitations (even FFP) require an offeror to explain its pricing rationale, including breakdown of direct costs and indirect costs;
- Solicitations for Cost-Reimbursement contracts <u>always</u> require a detailed cost breakdown and pricing rationale;
- If a solicitation requires a price rationale, then do not let the government guess or interpret what you mean;
- How do you explain your pricing? Who writes the narrative?

QUESTIONS
(10 minutes)

Every question in federal contracting can be answered with one of the following 3 answers-

1. It depends on the situation; or

2. Yes and No, depending on the situation; or

3. Because it's in the Federal Acquisition Regulation (or DFARS or some other regulation)

PART 3 – POST-AWARD PRICING
Adjustments in the Contract Price or Total Estimated Cost

>What is a contractor entitlement to request an adjustment (increase) in the contract price or total estimated cost?

A contract clause which states that a contractor may request the Contracting Officer to make an equitable adjustment in the contract price or total estimated cost when a government action or other event occurs that is described in the clause.
**An increase in profit is not allowed unless the relevant contract clause allows such increase.*

Examples

FAR 52.243-1 – Changes – Fixed-Price (FFP services or supplies)
FAR 52.243-3 – Changes – Time-and-Materials
FAR 52.241-14 – Suspension of Work (FFP construction)
FAR 52.242-17 – Government Delay of Work (FFP supplies)
FAR 52.245-1 – Government Property (all price arrangements)
FAR 52.236-2 – Differing Site Conditions (FFP construction)
FAR 52.232-20 – Limitation of Cost (all Cost-Reimbursement contracts)
FAR 52.249-2 – Termination for Convenience of the Government (FFP services or supplies)

>When is a contractor entitled to request an adjustment (increase) in the contract price under a Firm-Fixed-Price contract?

(a) When a contractor incurs an additional cost that is not included in the contract price **and**

(b) The additional incurred cost is directly attributable to a government action or omission, an unforeseeable event not under the contractor's control, and not due to the contractor's fault or negligence; **and**

(c) There is a relevant contract clause under which a contractor has an entitlement to request an adjustment in the contract price; **and**

(d) The contractor can provide evidence for (a) + (b) + (c) in a request for equitable adjustment or a claim submitted to a Contracting Officer.

>When is a contractor entitled to request an adjustment (increase) in the total estimated cost under a Cost-Reimbursement contract?

- When a contractor's total incurred cost (real or forecasted) for performing a contract will be substantially greater than the Total Estimated Cost currently funded in the contract ***>> Indicates a cost overrun***

  Applicable contract clauses-
  FAR 52.232-20 – Limitation of Funds (for fully-funded contracts)
  FAR 52.232-22 – Limitation of Funds (for incrementally-funded contracts)

Important Factors

- These are the only contract clauses which allow a contractor to request additional funds under a Cost-Reimbursement contract;
- Contractor is not obligated to complete the work if funds are depleted and the CO does not obligate more funds to the contract;
- The clauses require a contractor to submit advance notice of cost overrun and a revised cost estimate;
- Contractor must have a government-approved accounting system;
- No profit unless additional cost results from additional work that was not part of the original contract requirement.

Government Actions that Cause a Contractor to Incur Additional Cost under a Firm-Fixed-Price Contract

Examples-

- Change in scope of work (addition or deletion)
- Delay in the work
- Suspension of work (construction)
- Differing site conditions (construction)
- No access to work site
- Government interference in contractor's performance
- Change in government-furnished property or services
- Termination for convenience

A successful Request for Equitable Adjustment in price depends on your-

- Recognition of the government action or event; and
- Knowledge of the relevant contract clause for each action or event; and
- Process for applying the relevant clause, with written notice to a CO; and
- Ability to prove that the additional cost (incurred or forecasted) is ***directly attributable*** to a government action or omission or other relevant event; and
- The additional cost is not already included in the contract price.

QUESTIONS
(10 minutes)

Every question in federal contracting can be answered with one of the following 3 answers-

1. It depends on the situation; or

2. Yes and No, depending on the situation; or

3. Because it's in the Federal Acquisition Regulation (or DFARS or some other regulation)

PART 4 - CONCLUSION

How Will Your Company Acquire the Necessary Knowledge to Improve Your Capability in Federal Contract Pricing

1. Learn It Yourself

- Read the regulations (FAR and DFARS)
- Read the textbooks on federal contract pricing
- Training courses and webinars

2. Hire a Contracts Manager (full-time or part-time)

- Must have experience in federal contract pricing *(solicitation analysis; pre-award; post-award)*
- Must know the regulations and how to apply them
- Should hold certification from the *National Contracts Management Association (CPCM; CFCM)*

3. Engage an Outside Consultant

- To help with specific proposals, contracts, or projects
- To assess your capability and needs
- To train your in-house staff
- To help you hire qualified contracting staff