COST AND PRICE ANALYSIS

One of the most important functions reviewers or analysts perform is the evaluation of offerors' submitted cost and price proposals. This is so because:

- The agency must spend public funds economically and wisely.
- The supply of government-provided and other funds is quite limited, particularly when this supply is measured against the need or demand.
- There is a varying degree of price competition in nearly all procurements for services. In most instances, the agency is bound to award to the offerors that present the best services at the most favorable prices.

There are other reasons for conducting cost and price analysis. Offerors' cost and pricing information demonstrates their understanding of the work to be done and their commitment of the needed resources to do that work. Sometimes a smooth and glib technical proposal is accompanied by a budget that is confused, with costs that are not necessary, reasonable or are clearly not allocable to the project to be funded. This weakness is identified through a cost and price analysis.

In many instances, procurements do not yield effective price competition. This is clearly the case when there is non-competitive or sole source procurements. Here cost and price analyses are especially important tools because they can compensate for the absence of the positive pressures of full price competition. The agency must ensure that what its buying is fairly and reasonably priced.

But even in procurements that result in several offerors responding to the solicitation, true price competition may not exist. This happens when open or rolling RFPs are used, or when the specifications leave open to the offeror to propose the specifics of the services. Comparing the price of an offer to conduct a ten-week course in auto repair with that of one to conduct an eighteen-week clerical skills course is extremely difficult. The contracting agency will have to perform detailed cost analysis in addition to price analysis in these types of procurements to ensure that proposed costs and prices are allowable and fair.

This part of the text covers cost and price analysis. First some basic theoretical and conceptual material is presented. Then techniques for analyzing typical cost proposals are covered.

PRICING THEORY

PRICES IN GENERAL

There are a number of ways to look at the price of something. In ordinary life, the price of a product or service is the amount of money that must be paid by the buyer to obtain the product or service. This money could be exchanged for the goods or services when the purchase is made: this is buying with cash. In other instances, the buyer can exchange an obligation to pay for the goods or services at the time of purchase: this is buying on credit. In rare instances, goods or service can be exchanged for other goods or services: this is a barter transaction. But even a barter situation can be ultimately expressed in money value.

In procurement terms, price is the money the agency pays a contractor for the delivery of a product or the performance of a service.

Many factors and forces affect prices. Competition is clearly a significant factor. The greater or more nearly perfect the competition in the sale of goods and services the more likely that the resulting price will be the "best" price, or the market price reflecting supply and demand.

In addition to the degree of competition, the availability, or supply, of the product or service affects prices. While supply is technically a factor relating to degree of competition, it is useful to isolate this for separate consideration. One need only remember the oil embargo to realize how shortage affects prices.

DIFFERENT VIEWS OF PRICES

There are at least three views of what constitutes a good, fair, reasonable or appropriate price. One is that the market price is the reasonable price. A second is the seller's idea that a reasonable price is the full cost to produce plus a reasonable profit. A third view is the buyer's idea that a reasonable price is the lowest price that must be paid to obtain the needed product or service.

The market price concept rests on the idea of perfect competition. Such a state is rare, however. Many factors reduce the degree of competition so that the market price may be distorted and not the most reasonable.

The "cost-plus" approach is similarly imperfect. One maker's cost may be unreasonably high because of production inefficiencies or managerial incompetency. Also, costs for a given producer may be unduly high (or low) because of temporary, local factors in the market or economy.

The third concept - paying the lowest price to get the needed product or service - has conceptual problems, too. The urgency of the need can significantly affect how much the buyer is willing to pay. The breakdown of a furnace on a winter weekend can lead someone to pay a greater amount for heating system repairs than the buyer would willingly pay during the week. One need only remember that Shakespeare has King Richard cry, in a moment of great distress, "A horse, a horse! My kingdom for a horse!"

In sealed bid procurements, it is usually presumed that the lowest bid is fair and reasonable (unless only one bid is received). In such cases, every bidder is offering to provide the same product or service at the same time to the same degree of quality. Effective and adequate price competition operates in this environment to provide assurance of price reasonableness.

In negotiated procurements, the lowest offer is not necessarily fair and reasonable. Other factors that must be considered are quality in relation to use, ability to deliver on time, and ultimate cost to the taxpayer.

The conclusion that a price is fair and reasonable must be based on some form of analysis, either price analysis or a combination of cost and price analysis.

PRICE ANALYSIS

Price analysis is the process of examining and evaluating a price without looking at the estimated cost elements and proposed profit of the offeror whose price is being evaluated. This examination of cost and profit is cost analysis, discussed later. Price analysis includes a number of techniques:

- Comparison of competitive price quotations.

- Comparison of prior quotations and contracts with current quotations for the same or similar end items.

- Use of yardsticks or parametric relationships to point apparent gross differences. Examples are: square foot cost of a building, dollars per pound or per horsepower, daily cost of a hospital room, cost of washing a single window, etc. In training terms, the best examples are dollars per placement, price per instruction hour, price per participant/training hour, etc.

- Comparison of prices on published price lists with published market prices of commodities, together with discount or rebate schedules.

- Comparison of proposed prices with independent estimates of cost developed within the contracting agency.

In sealed bidding, price analysis is used to determine whether the price is reasonable. The basic method is a comparison of prices offered. But a complete analysis may include a look at what the companies have done on earlier contracts, a comparison of prices paid for the same or similar products in the past, or a comparison with independent Government estimates. However, because of the rules of sealed bidding, this analysis tends to be rather routine.

In negotiated procurements, especially where technical factors are most important, price competition may be weak. In such instances, comparing the prices of offers is not usually sufficient to make a decision and a more detailed analysis is needed using past prices, quantities, production and delivery rates, and similar non-cost information. Usually the Government will have to conduct discussions with offerors in negotiated procurements to be sure about price. Frequently, cost analysis is necessary.

In the right circumstances, a sound decision about price can be made without cost analysis techniques at all, but a decision cannot be made on the basis of cost analysis alone. In other words, price analysis is to be performed on every procurement. Cost analysis is frequently used in analyzing offers for training services. But, price analysis must also be employed before a decision to award is made.

Concentrating on cost alone can lead a reviewer down a "primrose path."

Example: Suppose an entity receives an offer from an organization to conduct a training project on a cost plus fixed fee basis. The offeror proposes to perform the services at a total price of $185,000. The agency conducts a careful review of the cost and price proposal. It finds that the vendor's direct labor costs are consistent with the services described in the technical proposal; the agency verifies that the labor costs reflect the vendor's current wage scale and compensation policy. All other direct costs are analyzed and verified. The indirect costs proposed by the vendor are supported by audited rates. The proposed profit of the vendor is a little high, but not exorbitant or inconsistent with agency policies. All these analyses show that $165,000 represents the reasonable costs of the company, operating at high levels of efficiency. A profit objective is developed and added to the analyzed costs to come up with a desirable contract price. In this example, the agency may decide it is willing to pay something more than $165,000 but less than the $185,000 originally offered by the vendor. If the company making the original offer was the only offeror, a negotiated price of $178,000 would be a good price, based on the entity's careful analysis of costs and price.

But what if a second company were to make an offer to deliver the same training program, with essentially all the same services, for $165,000? An analysis of the second company's costs is made and shows that their costs are reasonable, too. The entity is satisfied that the second company can do the job on time and at the required level of quality.

Now the agency can no longer say that the training program is worth $178,000, no matter how realistic and reasonable the first company's costs were shown to be by the entity's careful analysis. This example is presented to show that price analysis is used to focus attention on value, and it must always be done. Cost analysis **must always be accompanied by price analysis.**

Cost analysis and price analysis are different techniques, but they are not used on an either/or basis. Price analysis always plays a role in analyzing offers, because it helps the buying agency decide on what is a good buy or value for the program.

COST ANALYSIS BASICS

Proposal cost analysis is used to establish the basis for negotiation of contract prices where price competition is not adequate or is lacking altogether, and where price analysis, by itself, does not ensure the reasonableness of prices. Cost analysis is the review and evaluation, element by element, of the cost estimate supporting a company's proposal for the purpose of pricing a contract. This review includes analysis and evaluation of (1) the supporting data submitted by the offeror, (2) the cost elements, and (3) the factors the offeror considered from that data to develop the estimate of cost to perform the specified work.

Frequently, governmental agencies carry out cost-plus pricing. The cost-plus theory is: price is a direct function of the cost to perform. A fair price is the combination of an accurate representation of the cost and a fair profit. When such pricing is used, it is essential that the agencies conduct analyses and evaluations to ensure that the costs presented are accurate and reasonable and that the agreed upon profit is fair. Therefore, cost analysis is used to determine whether the offerors' total cost estimates approximate the dollars it should cost to perform the contract if operating with reasonable economy and efficiency.

After costs are identified, they are evaluated to determine allowability of individual items. Necessity, reasonableness, allocability, application of generally accepted accounting principles and practices appropriate to the particular circumstances, and any regulatory or contract limitations on types or amounts of cost items are factors affecting allowability.

ELEMENTS OF COSTS ANALYSIS

Offerors are usually required to submit basic cost or pricing data for most procurements. Even when the contract type contemplated is a fixed unit price performance-based one, the offeror will submit a detailed, or "line item," budget. This budget shows the detailed cost elements and sub-elements that the offeror estimates it will incur in carrying out the work in its technical proposal. Frequently, the offeror is requested to submit backup data to support its cost estimates, either with the cost and price proposal or at a later point in the procurement process.

Contract cost analysis is the element-by-element examination of the costs and related information presented in the cost and pricing data offerors submit. It involves analyzing cost data furnished, estimating assumptions stated, and the rationale employed by offerors in reaching the amounts proposed. All these are cost factors that contribute to the total cost of a procurement estimated by offerors.

In performing cost analysis, the assigned staff must perform discrete functions. First, they must verify the cost and pricing data submitted and evaluate the cost elements. This includes judging the necessity for and reasonableness of proposed costs, including allowances for specific contingencies. It also includes evaluating the offeror's cost trends on the basis of current and historical cost or pricing data. This function also includes conducting a technical appraisal of the estimated labor, material, and other requirements proposed. This first analysis step may also require evaluators to apply negotiated, audited, or proposed indirect cost rates to determine the contract price, where such rates are proposed.

A second element of cost analysis is comparison of costs proposed by offerors with other data. This data includes actual costs incurred by the same offeror in the past. Cost analysts can also compare the current proposed costs with previous cost estimates from the same offeror or from other offerors for the same or similar items. It is quite appropriate and helpful to compare an offeror's costs with those proposed by other offerors in the same procurement. Another important comparison that can be made is with the agency's independent cost estimate, if they have developed one.

An additional cost analysis function that must be performed is the verification that the offeror's cost submissions are in accordance with applicable contract cost principles. These cost principles define and describe the meanings and limits of a variety of costs. Costs that do not conform to these meanings and limits are not allowable. State or local laws and regulations may make certain costs unallowable or place limits on costs in addition to those cited in a specific programs provisions and regulations.

ALLOWABILITY OF COSTS

One of the goals of cost analysis is to determine the allowability of proposed costs. Allowability is measured by the following standards:

- necessity;
- reasonableness;
- allocability;
- terms of the contract;
- cost principles; and
- regulations/policies.

The reviewer analyzing cost proposals must apply each of these standards to the proposed costs to determine whether they are allowable.

<u>Necessity</u>

A cost is necessary if it is the type of cost that is recognized as ordinary and necessary for the conduct of the contract or the contractor's business. It must also be necessary for "proper and efficient administration of the program.

<u>Reasonableness</u>

Costs are allowable only if they are reasonable both in type and amount. The three points to consider are:

1. The restraints or requirements imposed by such factors as accepted sound business practices, arms-length bargaining, Federal and State laws and regulations, and contract terms and specifications.

2. The action that a prudent business person, considering responsibilities to the owners of the business, employees, customers, the Government, and the public at large, would take under the circumstances.

3. Any significant deviations from the established practices of the contractor that may unjustifiably increase contract costs.

In making judgements about reasonableness, the reviewer needs to have a clear understanding of the technical requirements of the contract. He or she must determine whether the quality and quantity of labor and materials proposed are necessary and sufficient to do the job. Cost analysis rarely can be separated from technical analysis.

Allocability

Costs may be allocable to a contract either as direct or indirect costs. A direct cost is any cost that can be identified specifically with a particular final cost objective. An indirect cost is any cost not directly identified with a single, final cost objective, but is identified with two or more final cost objectives or an intermediate cost objective.

A further distinction between types of indirect costs can be made. There are two types of indirect expenses:

1) Those that benefit both the contract and other work that can be distributed to them in reasonable proportion to the benefits received; and

2) Those that are necessary to the overall operation of the business although a direct relationship to any particular cost objective cannot be shown.

Indirect costs of the first type are often considered part of "overhead." Indirect costs of the second type are often part of "G&A." This distinction is by no means absolute. Contractors are permitted flexibility in their accounting systems. But, however the books are kept, costs must reflect an equitable allocation to each cost objective.

The Terms of the Contract

A contract may contain specific limitations or exclusions of cost. Some limitations are set by the federal statute and regulations. In addition, further elaboration of allowable costs is made by each State and this will affect the terms of the contract vis-a-vis allowability of costs.

The terms of the contract may also reflect other State or local allowability limitations. For example, an entity might set limits on staff salaries that a service provider can charge to the contract. There might be prohibitions or limitations on acquisition of property; leases of facilities; travel; and more. Offerors must adhere to these to have their proposed costs (and ultimately their contract costs) deemed allowable.

Reviewers must be familiar with Federal, State, and agency rules affecting allowability. They must also review the RFP to see what limitations it sets. When they evaluate the cost proposal, they must be sure that the offerors are proposing costs that conform with these rules. If there is doubt, reviewers should seek clarification through further data from offerors.

Cost Principles

This is very close to the previous standard of allowability. A State may be governed by certain OMB cost principles. It may also have its own. Sub-grantees of the State, in turn, would be bound by these cost principles in its own operations and in its procurements or other sub-agreements. Similarly, local governments may have adopted or enacted principles that further define State cost principles and which prohibit or set limits on certain cost categories. Such cost principles would affect the allowability of proposed costs. Reviewers must be fully aware of these principles and apply them in their review of offerors' cost and price proposals.

RELATION OF COST ANALYSIS AND PRICE ANALYSIS

While there are similarities between the two types of analyses and they often are performed together, there are distinct differences. Cost analysis focuses on what the work "should" cost a particular offeror, assuming reasonable economy and efficiency. The method necessarily involves a review of costs as they impact the one offeror's proposal. "Should" cost in this environment is primarily descriptive. It is used in the sense of what is the most likely amount to be spent for performance if this offeror is awarded the contract.

Price analysis per se is not concerned with any single offeror's methods or situations. It focuses on a comparison between the amount proposed and a benchmark amount that is considered fair and reasonable for successfully accomplishing the work. Price analysis also deals with a question of what the work "should" cost - but it is in a more normative or prescriptive context. Here, it is used in the sense of, "What amount reflects a going rate for the goods or services in the market, in general?" Price analysis focuses on what the buyer should pay to ensure that reasonable value is received as opposed to the cost analysis focus on how much a firm needs to receive to ensure that it recovers its costs, and makes a fair profit (where that is appropriate).

In business jargon, price analysis can be said to be concerned with the "bottom line."

Very often the analysis of an offeror's submitted cost elements must be a combination of the two approaches. If an entity, for example, were reviewing the offeror's proposed direct labor costs, the agency would want to determine if the right amount (number of hours) and the right mix (types of staff positions) have been proposed. This would be cost analysis. But the entity needs to judge also if the total salary and wages proposed are reasonable or too high. This determination would require price analysis - some kind of comparison, perhaps to other offerors' proposed labor costs; past contracts for the same or similar work; the agency's own internal estimate; and other standards.

This last example shows that price analysis is applied to individual cost elements or line items of the offeror's cost proposal. In addition, the total price (the bottom line) is subject to this analysis. On balance, in price analysis, the total price (or the total unit price) is the most important concern when the contract will be a fixed price agreement. However, examination of major constituent costs or prices is valuable because if may identify problems the offeror may face because of undesirable allocations of the total price among the elements. If price analysis, for example, shows that offeror is proposing to pay relatively low wages but high materials and other costs, even though the total price may be good, there might be a concern that the offeror, if it is awarded the contract, might have staff turnover problems or attract staff that is not fully qualified.

INDEPENDENT AGENCY ESTIMATES

One of the most valuable tools available for cost and price analysis is an independent agency estimate. This is an in-house estimate of what the likely costs and price of the procurement will be. While it takes some staff time to put together this estimate, it is time well spent.

If such an independently developed estimate is available, reviewers have another yardstick with which they can measure each offeror's costs and prices. A well-crafted estimate yields line item costs and prices; it presents an estimate of amounts and types of direct labor that should be needed to perform the work; it estimates the quantity and kinds of materials that will be necessary to perform the contract; it projects travel that will be needed; and it presents all other costs that should be necessary to fill the requirement.

An independent agency estimate is a cost proposal prepared by the agency in advance of issuing the solicitation. If done early enough in the procurement process, it enables the agency to plan for internal allocation of funds. This is a valuable use in addition to providing a standard for comparing offers that come in after the RFP is issued.

To develop this estimate, an agency can use a number of sources. One valuable source is past and current contracts for the same or similar services. Another very useful source is contractor financial reports. Using these, the agency can develop estimates of labor, materials, and other direct costs for each segment of the requirement. For example, the agency can develop an estimate of the type of staff, the quantity of hours, and the likely salary scale to carry out recruitment and enrollment; training; supervision of training; counseling; and all other staff functions required by the solicitation. Then the agency can estimate the kinds and quantity of training materials that will be necessary for contract performance, including text books, participant workbooks, courseware, and similar needs. Estimates can be made for staff travel; facilities costs; and any other necessary costs for contract performance. Participant support service costs should be relatively easy to project, once the number of participants to be served is estimated and the services to be provided are identified.

Once all these estimates are complete, they should be checked for accuracy and currency. Historical cost data should be adjusted for inflation and any upward or downward price trends.

After the estimate is completed, the agency has, in effect, prepared what is an offeror's cost and price proposal. If the estimate has been thoughtfully and carefully developed, it will be an excellent tool for reviewing cost and price proposals that come in subsequently.

Even where an entity's specifications are relatively loose or open, an independent agency estimate can be prepared on a unit cost basis for key costs. For example, while the total number of staff devoted to the contract in such an RFP may be unknown, the types needed and the appropriate compensation rate can be estimated. Similarly, the types of materials needed and unit costs for these can be estimated. Such an estimate can be adjusted for each offeror's mix and quantity of direct costs and provide benchmark unit costs for evaluating the offerors' proposed costs and price.

The independent agency estimate can also come up with valuable parametric estimates, such as price per instruction hour, price per participant/training hour, and price per placement. These are particularly important for performing price analysis where different types of training are being proposed. By reducing the disparate offers to common units, such as dollars per hours or dollars per placement, the entity will be able to make judgments about the value of the offerors' services.

Where such multiple awards will be made, it is imperative that the agency have these prices estimated before it goes into cost and price analysis. This will make the analysis easier to perform, as well as helping the agency determine if the offerors' proposed prices are way out of line and unreasonable.

CLASSIFICATION OF COSTS

Most programs place limitations on certain categories of cost. Exhibit A is included as a reminder of how costs can be classified. These may be subject to further elaboration and definition by each set of program requirements.

The second analysis objective is to determine whether the costs are appropriately categorized. This may be difficult to determine unless the offeror is required to submit detailed back-up to explain and justify proposed costs or to otherwise justify these costs. Usually the costs allocated to training and participant support services will be clear and well-documented. Costs classified as administration costs may not be so clear or well explained.

Agencies can reduce this problem by calling for narrative and other justifications for administration costs in the RFP. If they do not do this, they should require the offerors to provide justifications during negotiations, especially when the costs are unclear or dubious.

Another complexity may arise when an offeror submits its cost and pricing proposal with an indirect cost line item. Nearly all the costs included in an indirect pool are administration costs of some sort. Therefore, the agency must assure itself that some costs are not being proposed in both direct administrative and indirect administrative categories. For example, the offeror's overhead or general and administrative pool may include costs for accounting services. At the same time they may propose a cost for accounting and auditing as a direct administration charge to the contract. This is a problem. Unless there is something unique about the charges it is proposing as direct, they should not be allowed, or they might have to be reduced if they are overlapping and duplicative costs. Another example might be in the labor or personnel costs category. Certain management costs might be subsumed in the offeror's indirect pool; yet they might be charging these again as direct administrative costs.

Where no indirect rates have been approved by cognizant Federal agencies, the entity should require a cost allocation plan, which will form the basis for the rate. The entity must be careful before accepting the proposed costs and their allocation. An organization must have the financial management capacity to collect, allocate, and report costs before it can properly allocate them to categories. While this is really not a difficult accounting task, some organizations may not have the capacity to do it. In those cases, it would be wise to require that all allocated costs be direct, and that proposed indirect costs be reallocated as direct costs.

When an indirect cost line item is proposed, reviewers should check to see if it complies with program, state and entity rules and policies and require the offeror to submit documentation that shows what cost elements are included in its indirect pools. Where an offeror has rates submitted to and negotiated with cognizant Federal agencies, there should be no problem identifying the constituent costs and also in verifying proposed rates. In some cases, where the reviewer does not have sufficient expertise or the issue is complex, the staff analyzing the cost should seek expert accounting and auditing help.

Other than the foregoing special concerns, all costs, no matter what category they fall into, are subject to the same test of necessity, reasonableness, allocability to the contract being considered, compliance with contract terms, and conformance to governing cost principles. The reviewer must apply these standards to these costs, as they would to any others.

ANALYZING PROPOSED COSTS

So far this has presented some fundamental concepts relating to price and cost analysis. It will now shift to techniques for analyzing specific costs that are typically proposed in procurements for training services. The emphasis is on cost analysis because this will be used widely in program procurements, where price competition is relatively weak and where most programs require offerors to identify and justify cost elements for the work they propose to perform. Applied price analysis will be covered, too.

GENERAL APPROACH TO ANALYSIS

Each cost element must be reviewed individually. While each element has unique aspects, there are certain universally appropriate steps that should be taken. These general steps are:

- Check Computations

  During the preliminary steps (before approaching analysis of specific cost elements), the reviewer should have checked the math in the backup provided to be sure that subtotals and grant totals are correct. The purpose is to look at the figures within each cost element to ensure that the total cost is consistent with the sum of sub-costs included in that element. For example, where there is a "materials" or "operating supplies" line item, the total of component costs for that item should agree with the summary shown in the budget for materials or operating supplies.

  While checking computations may seem like an unsophisticated activity, the analyst should remember that proposals are put together by human beings under pressure. Mistakes in a proposal do not necessarily mean that the offeror is not a worthy contractor. Last minute changes can be made by a proposal manager that are not conveyed to everyone involved in production of the final copy. Totals may get inserted while the underlying factors are left unaltered. In some cases, rounding differences lead to inconsistent display of amounts. These types of problems usually have only a minor impact - but they do indicate a need to check calculations more thoroughly. In some cases, however, significant changes in dollar amounts can result from small clerical mistakes - the classic case being misplaced decimals so that $12.95 become $1,295 or vice versa.

- Review for Completeness of Information

  The reviewer should be alert to various cost elements and sub-elements that might have been omitted by the offeror. For example, there ought to be some figure for participant training materials under material expenses. If there are no costs listed and no satisfactory explanation for the omission, this should be clearly noted. It is possible that they are covered under another category, but if that is not explicitly noted, there is a cause for concern.

  Missing cost elements and sub-elements can be a form of "low-balling," carelessness, or lack of understanding of the program. Once a problem is suspected in one area, the reviewer should be increasingly alert in others.

- Review for Proper Categorization

  Costs are categorized in response to various requirements. The RFP usually contains a budget that identifies and categorizes costs. There may also be instructions in the RFP on how costs should be displayed. The requirements are intended to force a consistency in offerors' presentations that will aid in the analysis of costs. Later it will aid in contract monitoring of costs compared to initial line item estimates, where cost reimbursement contracts are awarded.

  Offers must also classify costs according to specific program rules, if required. Reviewers should ensure that costs are correctly allocated under these rules. If there is doubt, offerors should be asked for explanations and justifications.

- Determine the Estimating Basis

  Reviewers should know how the cost or price proposed by offerors was estimated. Did they use historical costs for operating the same or similar programs? Did they obtain competitive quotes for materials, equipment, space and other direct costs? Do they use price lists or catalogues that present truly competitive prices? Are any of the prices or costs based on sole source quotes?

  Entities will strengthen their capabilities to analyze costs and prices by requiring offerors to identify the bases they used for estimating various costs. This can be done by inserting instructions in the RFP that require this information.

  The reviewer must remember that cost estimating combines both factual data and judgments applied to project future costs. Determining the estimating basis is nothing more than the process of separating the facts from the judgments.

- Determine the Allowability of the Estimate

  This is the hart of cost analysis. All of the prior steps are in support of this one.

  Remember that the primary function of cost analysis is to form an opinion of what the job should cost the offeror, given reasonable economy and efficiency.

  The reviewer must verify the cost data. If the estimate is purportedly based on historical data, can both the amounts and the period in which the costs were incurred be verified? If the estimate is purportedly based on current quotations, are those identified?

  The reviewer must make use of technical analysis. That is, are the quantities of resources (including labor hours) sufficient, but not excessive to accomplish the work described in the technical proposal? Does the staffing pattern comply with sound ratios and program needs? Has the offeror either shortchanged or gold-plated some aspect of the proposal?

  The analyst must check unit prices or rates. Are salaries in line with the going rate? Are subcontract estimates realistic for the efforts required? Is the indirect rate supported by a negotiated agreement or a detailed proposal showing how it was developed?

  The analyst must check for regulatory compliance. Are specifically unallowable items included in the proposal? Do any of the listed costs violate a restriction in the RFP or applicable cost principles?

  The reviewer must double check totals reached by comparing the offeror's assumptions to independent indicators. Even though the resource requirements and unit costs seem appropriate, how does the total compare to indicators of overall reasonableness such as the independent agency estimate?

Aspects that are likely to indicate unreasonableness in any cost element are covered under "Reviewer Focus" in each of the sections which follow. The analyst, however, should not feel limited by anything presented in this text. Thorough and effective analysis requires both imagination and initiative to identify flaws in the offerors' presentations. New ways to make mistakes are invented every day. The analysis should endeavor to stay one step ahead of this "technology" of error.

When reviewing costs for necessity and reasonableness, the reviewer should usually think in terms of ranges. There is rarely one number that is "correct" while all others are unacceptable. Training services RFPs are written on a basis that lead to significant uncertainties about the costs. Each proposal will have within it a single figure for each cost element or sub-element which reflects judgments about how those uncertainties will affect future costs. Variances between the analyst's best guess and those of the offerors are to be expected. The cost proposal should be judged primarily by whether the offeror's guesses are rationally supported - not by whether they happen to correspond with the analyst's. For example, the reviewer's best projection for a supportive service cost might be $3.25. An estimate of $3.50 by one offeror is probably just as good as $3.10 fro another, even though the variance ($.25 versus $.15) is greater. Both are within a reasonable range of the most likely costs as projected by the agency. On the other hand, an estimate of $4.00 is probably outside the range of reasonableness and would have to be supported by strong rationale not to be considered unrealistic.

DOCUMENT CONCLUSIONS AND CONCERNS

The job is not done until the paperwork is finished. There are several aspects of cost analysis which must be documented.

First, the entity may give some kind of rating to offerors for cost-related aspects of offers. For example, the agency may rate an offer on cost reasonableness, cost realism, or cost justification. Reviewers need notes, comments and other narrative documentation to support their ratings and to note concerns with the offerors' cost proposals.

Second, aspects of the cost proposal are likely to be matters for discussion and negotiation with offerors, especially those that make the first "cut" and remain in consideration for award. What needs to be discussed will be drawn from what the reviewer documents are errors, weakness, deficiencies, or other problems.

Third, even if no formal discussions will be held, there will likely be a need to conduct direct cost and price negotiations with offerors selected for award. The documentation will guide these negotiations.

Fourth, if an offeror files a protest against the award, documentation of concerns with cost will be necessary to support the award decision, where price was a factor.

Fifth, cost analysis documentation can be used during the contract monitoring and administration phase, particularly where the budget is made a part of the contract. If the cost analysis indicates doubt about some aspect of the proposal, that should make that cost a candidate for careful monitoring and scrutiny later.

ANALYZING SPECIFIC COSTS

There are certain types of cost that are typically found in proposals for training services. While different agencies may give differing names to these, they have common objectives and serve common functions. Each of these major typical costs is discussed in this section of the text. At the end of each discussion is a set of questions called "Reviewer Focus." These questions will help guide the cost analysis of each of the costs. Staff involved in reviewing cost and price proposals should feel free to supplement these questions with ones they have developed through experience and practice.

Staff Costs

Staff costs, because they make up by far the largest group of costs in providing training services are especially important in the offerors' cost proposals. It is, therefore, of equal importance that the analysis of these costs be complete and thoughtful. Staff costs are the costs of all direct labor used on the contract. This includes the costs for all staff salaries, wages, and fringe benefits paid to those employees whose work for that remuneration will benefit the proposed program, and only that program.

The cost of direct labor is a product of two variables. One is the number of hours or other time units necessary to perform the functions in question. The other variable is the rate of remuneration for each time unit. Put another way, total estimated staff costs are the product of the level of effort for each staff position and the rate per hour or year for that position.

Therefore, the cost proposal reviewer must verify and analyze the two variables. He or she must examine the offeror's estimate of hours and numbers of staff determine whether these are necessary and adequate for the requirement. Is the number of staff proposed in the cost proposal high enough or excessive to carry out the function being analyzed? Another question for the reviewer is the appropriateness of the staff positions and levels being proposed. The reviewer needs to be sure that the staff category and level are consistent with the functions to be carried out. This analysis will help prevent "low-balling" through offering staff that is less qualified than needed or "gold-plating" by offering positions excessive to the needs.

The reviewer must also look at the proposed wage rates and determine whether they are appropriate for the positions proposed. In addition, the reviewer must determine that those rates are consistent with its compensation policies.

Labor rates are influenced by several factors. First the level of the position, the skills experience, and responsibility significantly affect the wage grade or rate set by the offeror. Second, company policy will also influence wage rates, particularly those policies covering seniority, promotion, and fringe benefits. Finally, geography is an especially important factor. Supply and demand in labor markets and the cost of living differ markedly across the country and cause differing pay levels for the very same occupations in different sectors of the U.S.

Fringe benefits make up yet another part of staff costs. Employee benefits increase staff cost by approximately one-fourth to one-third and are a significant offeror expense. In analyzing these, reviewers must be sure that they are consistent with offeror policies; that they are correctly computed; and that they do not violate any governing cost principles. The reviewer should examine the components of the offeror's fringe benefit package and look at the various rates and bases to which the rates are applies. If the fringe component is a Government mandated one, is the rate consistent with known or planned tax rates and is the basis consistent with ceilings on these? FICA and FUTA, as well as state unemployment benefit taxes are examples of this. For non-tax generated benefits, is the rate consistent with what the offeror has proposed on other contracts or with what it is experiencing (if it is an operator of one or more programs or with past rates for old programs)? One method for judging the reasonableness of the non-tax fringes is to have the offeror submit its personnel manual.

Where an offeror proposes to use one or more subcontractors to perform come of the essential training services or closely related services, the reviewer must be sure that there is no duplication of staff costs. If it does not already have the information, agencies should require detailed cost proposals to be submitted for significant subcontractors. Looking for duplication will ensure that the total staff costs are reasonable and in line with the RFP requirements.

<u>Reviewer Focus</u>

1. Are the number of staff and staff hours proposed consistent with operational requirements? If not, are they too high or low?

2. Has the offeror supplied a satisfactory rationale for determining the number of positions for each operational area?

3. Does the number of staff proposed track with the staffing estimate in the independent agency estimate?

4. If subcontracted staff is proposed, is it excluded from offeror's direct staffing? Has offeror submitted subcontractor's proposal or other data enabling the analysis of subcontractor staff levels and costs?

5. Are position levels proposed commensurate with skill levels needed to carry out functions? Are they too low or high? Is the mix of supervision and management with operational staff appropriate for size of the programs and necessary spans of control? Is the mix of entry-level and senior staff reasonable and consistent with offerors' discussions of staffing?

6. Are wage and salary rates consistent with offeror's personnel and compensation policies, especially job classification and rating policies?

7. How do offeror's rates track with those in the independent agency estimate?

8. Are the offeror's proposed rates consistent with prevailing area rates? If not, can the reasons for the differences be identified and justified?

9. Has the offeror applied adjustment factors to wage and salary rates for a second year (if this is requested in the RFP)? Are these factors explained and justified by economic trends and company pay increase and promotion policies in the narrative justification?

10. Has the offeror broken out the components of its fringe benefit package, showing salary base and rates applied? Are these bases and rates in conformance with Federal and state statutes and with the offeror's compensation policies?

11. Does the fringe benefit package conform to the offeror's policy and is it made up of usual and reasonable components? Has the offeror explained any unusual components satisfactorily? Have these been checked for allowability with governing State or local cost principles?

12. Have the fringe benefit rates been checked against those in the independent agency estimate?

13. Is the offeror providing staff with usual and reasonable number and kind of paid holidays?

14. If the offeror is proposing an indirect cost line item, has the reviewer ensured that this does not contain holiday or leave pay that has also been charged a part of direct salary costs?

15. Have staff labor and fringe costs been allocated to training and administration? Are these reasonable allocations? Should the offeror provide more explanation and justification for its allocation?

Materials

Materials can include two categories - training or program materials and office supplies. These categories should be "costed" separately even if they are included under the broad heading of materials. The issues for these costs are the same as those for the other types of costs. Are the type and quantity estimated necessary and reasonable, given the requirements of the program? Are the unit prices fair ones, representing competitive rates?

The offeror should identify the training materials it estimates it needs and the unit price. For office supplies, unless the amount proposed is relatively small, the cost proposal should contain some estimating basis. This might be historical cost per employee or per office, for example.

Reviewer Focus

1. Are the types and quantities of educational or training materials proposed reasonable for the training offered? Are these quantities consistent with the number of participants who likely will be served?

2. Where necessary, are the training materials specified, either in the cost proposal or the technical proposal or both? If they are not, does the reviewer need to obtain this information from the offeror to justify these costs?

3. Are occupational and academic materials included? Are they cost separately?

4. Are the unit prices specified for the educational materials? If not, does the reviewer need to obtain this information from the offeror?

5. Does the offeror describe the basis for its proposed unit cost? Is it historical or based on current price quotes? If not, is the cost sufficient to require the offeror to submit its estimating basis?

6. Is there any evidence that some of the proposed materials and costs are already owned by or in the possession of the offeror? (This might include instructor guides or test administration manuals that the offeror has used in the past. It could also include inventories acquired under past contracts.)

7. If computer-based software is proposed, are the costs justified and base on the most reasonable prices, particularly where they are available commercially?

8. For office supplies (or consumable supplies), does the offeror provide an explanation of how it made the estimate? (This might be a historically-based estimate, using recent past experience or it might be a detailed estimate based on predications of items to be acquired and used.)

9. Is there a unit price stated for office supplies? (This might be a certain amount per employee or per work unit, or it could be more detailed.)

10. Are the estimated quantity and/or the unit price reasonable, based on the agency's current and past experience with similar programs?

11. Are office or consumable supplies costs allocated to training or/and administration? Is the allocation reasonable? Is it explained and justified in the cost proposal?

Equipment

Equipment, like materials, can be divided into categories. Certain equipment will be devoted to program goals - for the direct provision of training or other central services being sought. Other equipment will have a more general use, particularly office equipment and business machines. Some equipment, computers, for example, may have multiple uses.

Equipment may be acquired through purchase, lease, or rental. How the offeror proposes to acquire its equipment and what the contracting agency will allow are subject to various rules. These include: cost principles; state and local agency property and property management rules and policies; and RFP provisions.

At a minimum the cost proposal should clearly describe what method of property acquisition it will use - rent, lease, or purchase. It should justify the method; or the reviewer should be able to justify the choice him - or herself.

In general, outright purchase is the least expensive method of property that will be used for its useful life or a duration near to that. However, the immediate outlay for purchase is the greatest. Leasing is more expensive than purchase but less so than rental when the property will be used for the full term of its life. Rental is the most expensive, but it usually requires the lowest outlay and is valuable when the equipment or property is needed for the shortest period of time.

The leasing and purchase of equipment raises questions about the necessity and reasonableness of costs and about rights and title to the property that can be quite complex. Usually, when the purchase is made with funds supplied by a governmental organization, the government gains title to what is purchased with its funds. Leases are more complex, depending on whether there is a purchase clause or option in the lease.

On the issues of how the equipment is to be acquired, the reviewer must be guided by federal and state requirements, and by local rules, where they exist. If such rules are not in place, reviewers should seek expert opinion from accountants and attorneys.

Reviewer Focus

1. For training equipment, is the equipment needed for delivering the services, given the anticipated character and length of the training? Is this need explained and justified in either the technical or cost proposal or both?

2. Are the quantities of training equipment appropriate to the number of classes or participants?

3. Is the method of acquisition (purchase, lease, or rental) justified by the offeror? Is it consistent with State and entity policies and RFP or contract terms? Does it yield the most reasonable cost?

4. For needed training equipment, does the agency have access to surplus property that it can make available for the use of the contractor for the project in question?

5. For office equipment, is there any information available that the offeror already has some or sufficient quantities that could satisfy its needs on this contract without the need for additional costs? (If this is a question, agencies might ask the offerors for current inventories of general and training equipment.)

6. Are unit prices stated for all the equipment to be acquired? Does the offeror describe the basis for estimating these unit prices?

7. Can the reviewer justify unit prices, based on offeror documentation, experience of past or current contractors or by obtaining its own quotes or reviewing available catalogs and price lists?

8. Are the proposed costs allocated to training or/and administration? Is the allocation reasonable? Explained and justified by the offeror?

Facilities

This cost element would include the estimated costs for office and training site rental. Some Entities include the costs for renovations and repairs of facilities here, too.

In general the cost for space rental is determined by the number of square feet used multiplied by a rate, usually in a lease, per square foot.

The main concern in cost analysis for this cost element is whether the space is sufficient for the needs of the program and whether the rate is a reasonable price.

Reviewer Focus

1. Is the amount of space commensurate with the needs of the program? Is there sufficient space for all classroom work and other training and training-related work? Is the amount of space devoted to office use sufficient, insufficient, or excessive, given the number of staff who will be using the space?

2. If the space is being used for other purposes, is there an adequate explanation of how space will be apportioned to this contract?

3. Is the rate per square foot (or other unit cost) a reasonable price, given the location of the facility and the use to which it is being put?

4. Are the costs of utilities and maintenance of the space broken out separately? If so, are they already included in the lease payment the offeror makes and which it is already charging to you for your apportioned share of the space?

5. If the space is in an offeror-owned building, what costs are being allocated to this contract? (Generally, the offeror should charge only for depreciation, utilities, mortgage costs, taxes, and other costs of owning and operating the facility **apportioned to the amount of space that will be devoted to this project.**)

6. Are any proposed renovation costs necessary to the effective operation of the project? Are they reasonable and supported by quotes from the landlord or a building contractor?

7. Where required, is this cost allocated to training and administration?

Communications

Customarily the communications category includes the sub-elements of telephone and postage. In some organizations the cost of faxing materials is included, too.

Telephone costs are generally limited to the monthly costs for the local telephone company's charges for the "wire-in" service it provides. Telephone costs will also include long-distance and other toll charges, including "message units."

Postage is customarily limited to the costs to mail letters and package via the U.S. Postal Service. Other costs might be included here, such as, those for overnight mail (Federal Express, UPS, etc.). Typically, however, these other costs are usually categorized elsewhere - in miscellaneous, or other direct costs, for instance. Just so long as the reviewer knows where these costs are contained and that they are not duplicated in the cost proposal, where they are included is not an important issue.

Fax costs are also included in this category, where they are treated separately from telephone expenses. Sometimes the cost of an answering service is treated as a telephone expense, too.

Reviewer Focus

1. Are the costs for telephone expense reasonable on a monthly and total basis? If the offeror is a large organization, is there an explanation of how many lines will be devoted to this contract or how the organization's total telephone costs will be allocated to this contract?

2. If the offeror is proposing to obtain new or additional phone service for this project, is this explained and justified? Does the offeror show how it arrived at a price for this?

3. Are toll charges and long distance charges presented and explained in the cost proposal? Are the quantity and amount of such calls consistent with the requirements of the project?

4. Are postage costs reasonable when compared to the contracting agency's experience with similar contracts and with its own independent cost estimate?

Insurance

Since contractors are often required to have certain insurance in effect and to obtain fidelity bonds, these costs will be specifically identified in their cost proposal. The analysis of these costs is straightforward.

Reviewer Focus

1. Are the appropriate types of insurance identified and represented by costs in the proposal?

   (Usually, the contractor will be required to obtain a fidelity bond, general liability and auto insurance. In some instances, the contractor must obtain certain insurance coverage for participants, if this is a condition of the RFP. Workers' compensation can be an insurance requirement, but such coverage for staff is usually included in fringe benefits.)

2. Are the coverage limits in accordance with RFP and agency requirements?

3. Is the fidelity bond amount appropriate for the amount of funds that could be in jeopardy at any time? Is it insufficient? Excessive?

4. Are the insurance costs or premiums reasonable, when compared to similar projects or contracts?

5. Are costs realistically allocated to Training, Administration, and/or Participant Support (in the case of certain expenses for participant coverage)?

Staff Travel

Staff travel is proposed for staff to conduct contract services and to administer the project. It should be almost all local travel, although there might be some instances where out-of-area travel might be necessary. This could occur when the contract is part of a large organization, with headquarters or other offices away from the location of the training site. This does not seem to be the case very often.

Generally, however, out-of-area travel occurs when contractor staff goes to training or to meetings at State or U.S. Department of Labor designated sites. In these cases, the offeror would propose the costs for transportation and for lodging and subsistence, where required.

In analyzing travel costs, the focus of the reviewer is on the need for the trip, that is, whether it serves a necessary contract purpose. The reviewer must also examine whether the proposed costs are reasonable and in line with travel policies set by the RFP, the State and entity, and governing cost principles.

While local project travel is fairly routine, it should be examined to see if the number of trips is reasonable and whether the total costs are in line with the agency's experience.

Problems in local travel can arise when the offeror is proposing to charge the contract for leased vehicles that will serve contract purposes. When this occurs, the reviewer must obtain from the offeror a justification that delineates how much of the lease will be apportioned to the contract and how the offeror plans to make that apportionment. Before final costs are accepted, the reviewer must be sure that leased vehicle costs are equal to or less than the reimbursed costs of the use of individual staff-owned automobiles or the use of public transportation, where this is available and sufficient.

<u>Reviewer Focus</u>

1. Is the local travel cost explained in the offeror's cost or technical proposal? Are destinations, frequency, and distances identified? Are they necessary and reasonable?

2. Is the mileage rate for local travel consistent with the offerors' and the contract agency's travel policies and/or with other governing rules and cost principles? Are parking costs necessary and reasonable?

3. Are out of town trips fully identified and justified by the offeror? Are they necessary to project performance and administration? Are some of these trips scheduled meetings known by the contracting agency and that will be required of other contractors?

4. Are airfare and hotel and lodging costs consistent with offerors and contracting agency travel policies and with any other binding cost principles affecting trave?

   (NOTE: Since airfares are extremely difficult to estimate because they fluctuate rather widely, it might be desirable to make out-of-area travel a cost reimbursement item, rather than a fixed prince one.)

1. If the proposed travel is for training, is the reviewer sure that its costs have not been repeated in any other line item in the cost proposal, specifically training?

2. If the offeror proposes to use leased vehicles or vehicles that the organization owns, does it show how the costs have been apportioned to this contract? Does it show the basis for developing the cost estimate for these kinds of vehicles? Are the costs of using these vehicles either equal to or less than the costs of reimbursing staff for the use of privately owned vehicles? Does the offeror adequately justify the use of the leased or company-owned vehicles?

Other Direct or Miscellaneous Direct Costs

There are many other possible costs that an offeror may propose. The most commonly proposed ones include:

- consultants;
- professional services (legal and account);
- printing and photocopying; and
- staff training.

These costs are subject to the same general analysis as any others. The reviewer must determine if they are necessary, reasonable, and allocable under Federal, State, and entity policies and rules. This entails examining the proposed quantity or level of the service or supply covered by the cost and making a judgment about the reasonableness of the unit price and the total.

Reviewer Focus

For consultants:

1. Does the contracting agency have a policy limiting the use of consultants and/or prescribing how their services will be acquired? Does the offeror adhere in its technical and cost proposal to those policies?

2. Is a description of the services and a justification of their use contained? Is it adequate?

3. Is the offeror proposing to use a consultant for work it could do itself? Could it obtain these services free or charge or at a lesser cost from the entity? The State?

4. Are the specific consultants or consulting organizations specified? If not, is the type of consultant specified?

5. Is the proposed consultant fee consistent with the expertise of the consultant and with the going rate for that kind of consultant service?

For professional services:

1. For attorney costs, is this for services that will benefit the contract directly? Is it for the kind of legal service allowed by the program regulations and local or State rules?

2. For accounting fees, do the costs include work that is being or should be done by the offeror's in-house accounting and bookkeeping staff?

3. Do accounting costs cover services to ensure that the offeror complies with contract and other guidelines affecting financial management?

4. If the cost of an audit is proposed, is the price consistent with and comparable to those of similarly situated contractors?

5. If indirect costs are proposed, are nay of these costs included in the indirect pool.

Photocopying and Printing

1. Where the printing or copying of training materials is proposed, does the offeror present any explanation and justification of the nature and quantity of materials to be printed or photocopied?

2. Does the level of general office copying seem appropriate and comparable with other contractors performing the same or similar work? Has the offeror identified the general types of copying or printing that it will do?

3. Is the method of estimating copying or printing costs explained in the offeror's cost proposal? Do they use a cost per copy? Is this cost consistent with commercial rates? If they use another method of costing, is this justified? Does it yield a price that is comparable to the commercial rate?

Staff Training

1. Is the training proposed necessary to prepare staff to perform contract work or to improve their effectiveness and efficiency?

2. Is the provider of training identified (either organization of individual consultant(s))?

3. Are the costs proposed for the training reasonable? Are they consistent with the expertise of the providers? Can comparable training be provided at a better price elsewhere?

4. If the provider usually provides a tuition-price package to the public, if the contractor is proposing in-house training, is there evidence that it obtained a discount of any sort?

5. If the training will be provided through a subcontract, is the proposed subcontractor identified? Is their cost or price proposal included with the offeror's? Is there evidence that the offeror used competition for this subcontract quote? Does the offeror provide evidence that it conducted cost or price analysis on the subcontractor's offer? Does the entity need to conduct cost or price analysis on the subcontract?

Subcontracts

Where the offeror proposes to use subcontractors, this poses slightly different cost analysis issues. First, where the subcontract is significant, either in dollar size or because of the nature of the work covered by the subcontract, it should be clearly identified, described, and justified in the offeror's cost proposal. Solicitations should require that all offerors submit cost or pricing data from subcontractors for these proposed significant subcontracts. This will enable the contracting agency to do cost and price analysis of the subcontracts.

In analyzing proposed subcontracts, the reviewer will use the same techniques as he or she would on the prime's cost proposal. However, there are some differences. The reviewer must be sure that the subcontract does not duplicate the contract in any way. Staff, materials, equipment and any other direct costs in the subcontract must be unique to that subcontract and not repeated in the offeror's cost proposal.

This means that the work proposed for the subcontractor that is specified in its statement of work must be quite discrete and separable from the work proposed for the prime contract. The offeror should submit as part of its cost proposal either a draft, unsigned subcontract or a very detailed description of the proposed subcontract. A subcontractor cost and price proposal should also be submitted.

The review should then apply either cost or price analysis techniques or both to the subcontractor. If the offeror can demonstrate that it used vigorous competition to identify the subcontractor and the proposed subcontract procurement is in a price competitive area, then price analysis along might be sufficient. Examples would be for supplies and for services commonly available commercially, such as building repairs and maintenance, security services, and similar work.

All things being equal, when a subcontract is used, this is likely to cause additional costs in the prime contract. These costs will be for the administration of the subcontracts. Someone in the prime contractor's organization has to monitor subcontractor work; review reports; inspect and accept services and other deliverables; and perform other contract management services. This need will elevate the administration costs of the prime contract. The degree of that elevation will depend on the number of subcontracts and their complexity.

Reviewer Focus

1. For training and other central services, is the aggregate of proposed staffing of prime and subcontractor equal to the projected level of staffing effort for the whole job, if the services were not subcontracted out?

2. Are subcontractor's cost elements consistent with those of the prime and other contractors? Are the quantities and unit prices adequate and reasonable?

Participant Support Services

Participant support services are those which are necessary to enable an individual eligible for training, but who cannot afford to pay for such services, to participate in a funded training program. Such services may include:

- transportation;
- health care;
- special services and materials for the handicapped;
- child care;
- temporary shelter; and
- other reasonable expenses required for participation in the training program.

In some cases participant support services are treated as cost reimbursement cost elements, regardless of the type of contract to be executed. In other cases, these costs are aggregated into the single unit cost of training when fixed unit price performance-based contracts are used. Whatever type of contract agreement is used, participant support services cost should be subject to the same analytical treatment.

The reviewer must ensure that two conditions are met: that the proposed participant support services costs are needed and that they are reasonably and fairly priced. In addition to federal legislation and regulations, the RFP will often define what participant support services are allowable under the contract that will result from the solicitation.

Sometimes the entity pays for participant support services directly or through the use of vouchers or other means. For example, where public transportation is available, the entity may provide the contractor with tokens for the fares of participants. In these instances, the reviewers must ensure that the offeror takes these direct payments into account and doesn't propose to be reimbursed from contract funds for what it will be furnished by the entity.

Reviewer Focus

1. Are the proposed participant support services consistent with those specified in the solicitation and allowable under all requirements?

2. Are other kinds of participant support services payments identified by the offeror? Are they necessary? Justified by the offeror?

3. Is total of participant support services units consistent with the number of participants to be served? The length of time participants will be in the program and eligible for participant support services payments?

4. Is the price or cost of participant support services fair and reasonable? Is it consistent with known current rates for these same services used in other contracts?
5. Where participant support services can be covered by in-kind services is this taken into account in offeror's cost or price proposal?

Indirect Costs

Many times federal programs do not require indirect cost rates. However, under the rules and policies of individual States, such rates may be allowed in contracts. The costs that are allowed and their allocation must conform to these State rules. This subsection of the text treats indirect costs for those agencies operating in jurisdictions where indirect cost rates are allowed and can be used in contracts.

Some offerors who do a large quantity of business with the Federal Government and agencies that received Federal assistance have indirect cost rates that they apply to their contracts with these agencies. Usually, these rates are audited ones that are agreed to by cognizant Federal agencies.

Such a contractor is nearly always required by contract terms to submit an indirect cost proposed to the cognizant Federal agency. The proposals show actual and/or projected indirect costs, identify the bases to which they apply, and propose a rate. These proposals are examined by the cognizant agency and a rate is negotiated with by that agency and the contractor.

Indirect costs consist of a percentage rate that is applied to a base. Often the base is total direct labor and fringe benefit costs, although other bases can be used. The components of the indirect costs make up a "pool." These components are costs that cannot be readily allocated to any one contract and benefit all contracts of the offeror. Examples of these costs include: the labor necessary to perform accounting and bookkeeping; the labor to direct overall operations of the organization; the labor to purchase supplies and equipment; a variety of materials and equipment that benefit the organization and enable it to operate; and many other labor and material costs.

When an offeror proposes to apply an indirect cost rate to the contract under consideration, the reviewer has a slightly more complex task. He or she must ensure that the costs that make up the indirect pool are not duplicated by proposed direct charges that are categorized as administration costs; this will avoid duplicate charging.

To make this judgment, the reviewer must see the offeror's latest approved indirect cost agreement and the proposal that was submitted to the cognizant agency that approved these rates. Then it must compare the pool costs to those proposed as direct administration costs to ensure that they are not duplicated.

Where there is no approved rate, the offeror must submit a cost allocation plan. This must show the costs that will be designated as indirect and how they will be allocated to the contract.

<u>Reviewer Focus</u>

1. Where indirect costs are proposed, has the offer attached to its proposal an agreement with a cognizant Federal agency verifying the rates? Is the latest indirect cost proposal attached? If not, does the offeror submit a cost allocation plan that identifies costs that make up the indirect pool?

2. Is the reviewer sure that costs included in the indirect rate are not also being charged directly elsewhere? If there is doubt, has the offeror been asked to demonstrate how it allocated these costs and how it segregated direct from indirect costs?

PROFIT OR FEE BACKGROUND

Most simply put: **COST + PROFIT = PRICE**

This means that the total amount paid by the buyer of goods or services (the price) equals the amount expended by the seller (cost) plus some differential (profit). In the commercial marketplace and in some government fixed price contracts, costs can exceed price; then profit becomes negative and the contractor takes a loss on the work.

In cost reimbursement contracts, however, things work a little differently. The price is not fixed-it changes with the amount of costs reimbursed. However, in a cost-plus-fixed-fee (CPFF) contract, the profit (and only the profit) is fixed. Costs may vary from the final estimate but the profit will not vary, unless it is changed by modification to the contract. Such a change should only be made when the original work is so altered and expanded that the contractor might be entitled to additional profit on the new work besides the profit that was fixed for the original work.

Why is profit desirable? It motivates the contractor to perform. It stimulates organizations to bid and offer on solicitations. It helps stimulate contractors to perform efficiently.

In the procurement system, profit can only be earned by for-profit organizations. Non-profit public and private organizations cannot earn profits from fixed price performance-based contracts. Such excess of receipts over expenses is deemed to be program income and must be reprogrammed in accordance with federal and state agency rules.

How should profit levels and rates be determined? This is a difficult question. Profits should be set at levels that provide the desired motivation for participation and efficient performance, but they should not be excessive. Arriving at this "golden mean" is not easy; there are not hard and fast rules or directions to get there.

In cost reimbursement contracts, usually the profit is a fixed fee that is negotiated at the time all contract costs are negotiated. This should not vary. Therefore, if the fixed fee that is negotiated is reasonable and fair, then the issue is resolved.

In fixed price contracts, the fee will vary with the efficiency of contractor performance. If the contractor and the agency negotiated a reasonable price that included a fair profit, it is up to the contractor to perform in such a way that it will earn its full profit. If the contractor, performs inefficiently, incurring more and larger costs than it originally contemplated, it will lose money. However, if the contractor performs with extra efficiency, it will earn a greater profit than originally contemplated.

It is that last case that poses concerns for program operators and those who support and monitor them. When does that greater profit become excessive and how can that be prevented?

In the best of all possible worlds, where there is maximum price competition, the amount of profit would not be a concern of the buyer. It is assumed that the best will be the lowest and that may or may not include a profit for the seller. It probably does, for no business will be able to continue operating without sustained profits. But it might not. Maybe the market is down, supply exceeds demand, the offeror is trying to penetrate a new market, or some other condition exists that leads the offeror to take a risk and be willing to break even or take a loss. It makes no difference to the buyer. Buying a car or an appliance are examples. Most buyers don't stop to determine what profit the dealers will be making. They shop for the best price.

However, this ideal of maximum price competition rarely exists, so price will almost never be the sole determinant for award. That's why cost analysis, even for fixed price contracts, is almost always necessary. And when you analyze costs, you have to analyze proposed profits or fees.

ANALYZING PROFIT OR FEE

How should the level of profit be determined? There are some general ways that contracting organizations use. One is to set a fee level for awards that will not vary or only vary slightly. An agency might decide that eight, nine, or ten percent is a good rate and use this in its negotiations. Should the offeror come in with a lower effective rate of profit, that is fine for these agencies. If the proposed profit exceeds this, they will negotiate it down. The attractiveness of this approach is that it is easy to administer; its drawbacks are that it fails to distinguish among types of contracts and types of contractors.

A second approach is one where the contracting agency gives no profit or sets very low limits. While this may be desirable for non-profit contractors, it surely is a bad way to attract high quality service providers or to motivate them to perform up to their highest potential.

Another approach, related to the first, is to set rates or limits that differ for differing types of contracts. An agency might feel (rightly) that fixed price contracts are riskier than cost reimbursement contracts. Therefore a contractor proposing to perform on a fixed price contract should be entitled to more profit than one proposing on a cost plus fixed price job. This is a better approach than the first, but it does not reward factors affecting profit other than risk.
To find a more desirable approach, one can turn to the Federal contracting system. The Federal Government (in the FAR) recommends that profit levels reflect several factors. Among these factors, the following have relevance for the type of contracting that Entities carry out:

- **Contractor Effort.** This measures the complexity of work and the resources required. The higher the level of complexity (as measured by the skills necessary to perform the work), the higher the fees should be specific consideration should be given to relative proportions of different type of resources that an offeror proposes to "invest" in the effort. Does it take a great deal of highly skilled instructors, managers, course or curriculum developers? Will there be a need to acquire a great deal of materials? Will there be a great deal of subcontracting? Will the level and amount of general management required be high?

  Here the FAR is saying that a contract with a great deal of resources will reflect and require greater contractor effort than one with lesser inputs. A contract to perform a wide range of services - from enrollment to classroom training to OJT to placement likely reflects greater effort than a contract that is for recruitment and enrollment only.

- **Contract Cost Risk.** The more risk that a contractor must assume, the higher the profit potential should be. CPFF have the least risk. While the risk is not zero, it is minimal. The contractor only has to perform up to the level of total estimated costs in the contract. If these run out, the contractor will (or should) stopo work until new funds are added or the buyer chooses not to fund any further work. In fixed price contracts, the risks are greatest. The contractor has to perform what the contract requires, regardless of what it costs. It could lose its organizational shirt.

  Performance-based fixed price contracts pose even greater cost risks. Here the contractor won't be paid unless it can affect the performance of the participants it will be serving. This can be a complex undertaking, made even more so by the terms of performance specified.

- **Federal Socioeconomic Programs.** In the Federal system, the degree to which a contractor provides support to programs such as small and minority business programs, affirmative action for the handicapped, and energy conservation can be recognized and reflected in the profit negotiated. At the State or local level, there are often similar social and economic goals; contracting agencies at these levels might give weight to an offeror's commitment to these programs. For example, the offeror might commit itself to obtaining supplies or subcontracting with small and small minority businesses only, wherever possible. This could be a consideration in developing a profit objective.

- **Past Performance: Cost Control and Other Accomplishments.** A contractor with a proven record should be able to earn more profit than one who has not been so successful in the past. Credit should be given to past technical performance excellence and to a demonstrated ability to control costs and to perform economically. In addition, where the offeror is proposing methods for the contract being considered to improve productivity or to control costs, this, too, should have weight in determining the fee or profit.

In the Federal system, there is a method for weighting these guidelines, using percentage ranges for each factor, and coming up with an overall profit target for the contractor. This method is too complex and time-consuming to use for the typical procurement. In fact, this so-called "weighted guidelines" method is not used widely outside of Department of Defense, even by the Federal Government.

However, knowing the guidelines and applying them subjectively might help Entities develop differentiated profit or fee targets. To aid in this, Exhibit B, Profit Guidelines, is an adaptation of these guidelines to many situations. This form can be adapted to local program objectives. While use of this will not give someone a mechanical method to develop profit objectives, it will help reviewers come up with differentiated profit target values that will reward the most accomplished and responsive offerors, rather than treating all proposed profit requests equally.

Whether these guidelines are used or not to develop a profit objective, the cost/price analyst is obligated to analyze the profit proposed by the offeror. There is a strong concern that profits earned by for-profit organizations be reasonable, and not excessive. (Non-profit private or public agency offerors may not retain any profits they might earn. If they do, they must reprogram this excess to benefit the program they run.)

There is no easy way to judge the reasonableness of profit levels. The agency may wish to develop a data base on what profit percentages typical offerors earn over an extended period and use this to help make decision on what profit levels are appropriate, given the risk, investment, competence, and other factors inherent in the contracts in the data base.

As previously stated, cost type contracts should bring lower profit levels than fixed price agreements because of the lesser risk. Contractors who exhibit efficient and cost-effective performance should earn more profit than those who are less efficient or who are less cost-conscious. The other factors in the profit guidelines should be applied to develop ranges of profit levels, too. The point here is that profit objectives should not be uniformly applied to all contractors and contracts. There should be differentiation that rewards and motivates the better contractor or potential contractor.

SECOND YEAR COSTS

Where solicitations seek second-year operations or option year cost proposals from offerors, these proposals must be subject to the same detailed cost and price analysis as the first year. The reviewer must examine how the second year costs will change from the first year ones. Unless there is something in the RFP calling for a reduced scope of work in the second year, usually the work will be the same.

However, in nearly all instances, costs must change. That is, generally, they go up. Since inflation is almost institutional, the prices the offeror will pay for the same labor, materials and other cost will escalate. In addition, agency personnel policies usually require annual increments and some promotions will occur.

Thus, labor and materials costs almost certainly rise. However, they will not rise equally. Applying a one-factor inflator or escalation percentage is not the way increased costs should be estimated. Some costs will vary at certain percentage rates; others will rise at greater or lesser rates; and some costs might even lower or disappear (if lease payments on equipment will be completed in the first year, for instance). In addition, certain first-year "star-up" costs will not recur and this will result in reducing certain costs in the second year.

<u>Reviewer Focus</u>

1. Are the bases for increasing costs stated in the second year cost proposal? That is, are percentages of increase shown?

2. Do these inflators differentiate between likely differences in increases?

3. Are labor costs increased to reflect annual increments, cost of living allowances, and promotions? If the rates are not changed, can the offeror justify this? Will new staff be inserted? Is there a freeze on increases and promotions?

4. If facilities rent is a cost element, is there any provision in the proposal reflecting lease adjustments for increases or decreases in utilities or real estate taxes?

5. If materials costs have been increased, has the offeror justified this?

6. Will any equipment leases be completed in the first year and is this reflected in the second year budget?

7. Have first-year, nonrecurring costs been removed from second-year estimates? Have other reductions in costs due to completion of strata up been made?

SUMMARY OF STEPS FOR REVIEWING COST PROPOSALS

Following is a recapitulation of the steps that should be carried out in performing cost analysis. The reviewer should:

1. Check offeror computations.

2. Make sure that all necessary costs have been included in the cost proposal, including typical and customary costs and costs attributable to activities proposed in the technical proposal.

3. Review any justifications for the costs proposed by the offeror.

4. Ensure that required allocation of costs among training, administration, and participant support services is correct and reasonable, and within limits set by statute and by RFP.

5. Review each proposed cost element for necessity, reasonableness, and consistency with technical proposal.

6. Make a determination that proposed price of the cost element is fair and reasonable. Compare with independent agency cost estimate, other offers for the same solicitation, past offers for the same or similar work, market prices (known or supported by quotes), and/or any other yardstick available.

7. Identify cost elements that need more explanation or justification and that are too high (or too low).

8. Where significant subcontracts are proposed, review these using the same steps.

9. Where a second-year or option year cost proposal is obtained, review this using same steps, and evaluate increases in terms of offeror justification and known prices trends.

10. Review proposed profit or fee, using guidelines or other benchmarks to develop a fee target or objective.

11. Make a "bottom line" judgment about the total estimated price or cost, comparing it to other offers in the same procurement, past offers, your independent agency estimate, or any other measure of competitive price.

12. Document all findings, including additional information needed from offerors, questioned costs, and cost and price comparisons. Write out all information needed by agency decision-makers to make award.

A tool to help in this process is included as Exhibit C, Cost/Price Analysis Tool. This presents a convenient and relatively easy-to-use instrument for moving the reviewer through cost analysis in a logical fashion and for documenting findings.

Part I of the tool covers the general steps to be taken - checking computation, cost categorization, etc.

Part II covers specified costs that are typically found in cost proposals. Reviewers should refresh their understanding of what to look for on each cost element by reading the previous sections discussing each cost element, especially "Reviewer Focus." For each cost element, the reviewer can make a "yes-no" decision about the necessity and reasonableness of the cost, and support the decision on "reasonableness" by showing what benchmark was used to measure that cost against.

Part III offers a place for the reviewer to document findings; to identify additional information needed from the offeror; and any other comments he or she would like to make. At every point in this tool, there is a place for brief narrative comments. They are just as important here as they are for documenting the evaluation of the technical proposal.

Some entity staff members or others might feel that using this tool will place an extra burden on them or their colleagues. Cost analysis, however, is serious and consequential business. It is something that is likely to grow in importance, as the program continues to face oversight from many sources. Using this tool, like using new process, has a "learning curve." After some amount of repetition, it should be relatively easy and convenient to apply.

However, if staff limitations are severe and if workloads are tremendous, perhaps some kind of triage should be employed to determine what costs to pay most attention to. One group of costs might be small in value and have little likelihood of significant overstatement or variance from a benchmark. These could be given scant attention. Another set of costs might be quite significant because of their magnitude and the negative consequences or incorrect estimation. These should receive the reviewer's greatest allocation of time and attention. Still another group might fall in the middle, being of medium value among all costs and posing some risk if incorrectly estimated.

Entities surely have their own experience with costs, both in proposal and in contract performance. Agency staff will know which ones deserve the greatest attention and time and which ones can be treated with less than perfect diligence.

PRICE ANALYSIS TECHNIQUES

This text has preached the message that price analysis must always occur, even when cost analysis is used. If the example of the two offers cited earlier in this text is reviewed, the importance of price analysis will be reinforced. Even when both offerors have evaluated costs that are necessary, reasonable, properly allocated and classified, in accordance with federal, state, and entity cost principles, well documented, and verified, one of the offerors presents a more favorable price and thus offers more value to the hypothetical entity.

If one thinks of his or her experience in buying an automobile, the value of price analysis becomes quite clear. Before someone shops for a care, he or she must know what they want: the make and model, the accessories, etc. Then, they go from dealer to dealer looking for that particular car at the best (lowest) price. It wouldn't (or shouldn't) make a difference to the buyer if they knew what it cost the auto manufacturer to produce the car (labor, material, overhead, profit); or what it cost the dealer to sell the car (sales expenses, advertising, storage, interest on loans, etc.). The buyer will make a decision based on the lowest price for the car of his or her choice.

Some sophisticated car shoppers will go shopping armed with price information. They may check Consumer's Report or similar sources. They will look at the going prices published in "blue books" that are available. They may check with their banks or credit unions to determine a fair price for the car. This is comparable to having an independent agency estimate before the buy is made.

In the environment, similar "shopping" techniques are available. These techniques make up the approaches that can be used in price analysis.

The most basic form of price analysis is called **primary comparisons.** Here the prices of competing offers are compared and the best price is selected. However, before this direct approach can be used, it must be clearly demonstrated that there is strong price competition. The offers must be for the same or quit similar items or services. In the car example, the buyer couldn't compare the prices of a Toyota Corolla with a Lincoln Town Car or with a Ford Escort. There must also be vigorous price competition. In many places, there are several dealers selling the same make of cars, competing with each other on a daily basis.

In procurements, there are situations when the offers will be for the same or similar work. There may even be price competition, although it is not likely to be as robust as that found in the commercial marketplace. In some cases, "pure" price be possible. If, for example, a large number of offerors compete to perform the same fixed price contract and the prices they offer are tightly grouped, then the entity may be able to conclude that it has adequate competition and the best buy is the lowest price.

But in many situations, the RFP will not be soliciting a particular kind of occupational training, but rather will ask the offeror to propose the training and occupational areas. Often, too, one RFP may lead to multiple contract awards. So pure price comparison of total fixed price or fixed unit prices of the offers will not enable someone to make a best buy decision.

Nevertheless, price analysis can and must be done. It can be done through **secondary comparisons.** Secondary comparisons include:

- comparison of offers to prior contracts and price quotes for same or similar work;
- comparison of offers to an independent agency estimate;
- comparison of offers to a parametric estimates or benchmarks; and
- comparison of offers with market prices.

Examining these in order, comparison of offers to prior contracts, offers, or price quotations can be useful **provided that the prices of these of prior offers were competitive themselves.** Knowing that a current price is close or somewhat lower than an uncompetitive, unnegotiated, or poorly analyzed past price is of little value. If the entity uses past prices, it must use ones that were developed in a highly competitive procurement, that were analyzed by the entity when originally offered, and were negotiated so that the entity can demonstrate that these "old" prices were best buys in their time.

An independent agency estimate is like the price information the car buyer gets before shopping for the car. Comparing current offers to an independent agency estimate, developed in-house and without input of offerors is an excellent technique, **providing that the independent agency estimate has been carefully developed and reflects the probable costs an efficient and well-run vendor will incur.** However, because of the openness of some solicitations for training services, it may not be possible to predict what each offer will propose and thus prepare a detailed cost and price estimate in advance. In those cases, the entity should develop a parametric estimate, or yardstick, that can be compared with offerors' proposed prices.

A parametric estimate is procurement jargon for a cost or price yardstick or benchmark, such as dollars per pound; dollars per square yard; cost per hour; and so forth. There are a number of yardsticks that can be developed and used for price analysis: cost per instructional hour; cost of instructional/participant hour; cost per placement.

As part of its price analysis, Entities should derive a unit price for each offeror, using the offerors proposed costs and price. Then, they can compare this figure price against the estimated price and see if the price is reasonable and represents a good value.

Even if the entity does not develop an independent agency estimate prior to receipt and evaluation of proposals, they should still compute these yardsticks for each offeror. Cost or price per training hour is a useful yardstick. In addition to placement, an entity is buying time in training and each unit of time (usually hours) has a price that the agency can easily compute. Once this price is developed, the reviewers can compare it to the prices of other offerors in the procurement and to current and past contracts.

Some of these analyzed prices may be exorbitant, compared to what others are offering **and compared to what the public would pay for the same or similar training in a commercial environment.** When the price per training (or other similar yardstick) seems out of line, then the reviewer can re-examine the cost data and see what costs are driving the price up. Then, the entity decision-makers will be in a position to negotiate with the offeror, with the objective of bringing the price down to a reasonable level.

Because procurements are not done in the same price competitive environment as commercial purchases, it is **incumbent on cost and price reviewers to be as hard nosed as possible.** Unlike the ubiquitous car buyer, the entity cannot run from vendor to vendor. The vendors themselves, unlike auto dealers, are not directly or immediately subject to the discipline of the marketplace and the pressures of supply and demand. Therefore, in all instances the entity "buyer" will be well served to approach each offer with a skeptical, if not jaundiced, eye. They should:

- Develop an independent agency estimate on what the procurement should cost, or what the likely unit prices will be.
- Conduct cost analysis using the techniques or approaches described earlier.
- Conduct price analysis by:

  comparing the prices of offers submitted for the same or similar work;

  comparing the prices of offers with existing contracts, past contracts, or past offers or quotes for the same of similar work; and developing yardsticks for each offered price, particularly price or cost of instructional/participant hour and comparing these with similar yardsticks for each offeror; with the independent agency estimate yardsticks; and with the market price per hour for the same or similar training offered to the public commercially.

Once these steps are taken, the entity will be in a strong position to enter into price negotiations with offerors who stand a good chance of being awarded contracts. The agency representatives will be able to develop negotiation price objectives and guide offerors to the development of fair and satisfactory prices.

As in all aspects of proposal review, documentation of analyses is important for those cases where price analysis alone is the principle or sole tool, there needs to be some documentation of the analysis. Exhibit D, Price Analysis Tool, presents a format for documenting the price analysis. It presents a method for the price analyst to show what kind of price comparison he or she used.

TRAINING PACKAGES AND MARKET-PRICE TUITION

Section 141 (d)(3) allows the purchase of commercially available training packages to be made for "off-the-shelf" prices and without a breakdown of the cost components of the package if it is "purchased competitively and include(s) performance criteria." For such procurements there obviously need not be any cost analysis.

Programs often send participants to training and educational institutions that offer tuition-based prices. These, too, should not have to be subject to cost analysis, if they meet the criteria listed subsequently.

However, in both cases there should be price analysis. The principle issue here will be the competitiveness of the price. The best principle to apply is the Federal rule states that no cost or price data need be submitted when "prices are established catalog or established market prices for a commercial item sold in substantial quantities to the general public." To meet these criteria:

- There must be a catalog and/or a price list describing the course and showing prices that any non-government buyer (student) would pay.

- The sales should be in substantial quantities. For training and education this implies that the course has been available for some time and the developmental costs have been amortized over many sales.

- The course or package must be commercially available. That is, it is not one that is not just an in-house course or one with limited availability.

If the package price or tuition does not meet the above criteria, then more extensive price analysis must be performed. This will include comparing the prices to the independent agency estimate; comparing prices to current contracts for the same or similar services; comparing prices to past contracts and offers or quotes; doing a price/training hour analysis; and other similar activities. Where the offeror is able to develop the data, the entity should require the submission of a line item budget with narrative justification. This may not be possible in some instances, such as in the case of community colleges and other educational institutions that don't develop their prices based on cost elements. In these cases, there will be a strong need to perform the price analysis techniques described in this section and in the previous section.

Many educational, vocational and consulting organizations with commercially priced courses offer discounts for presenting to specially assembled groups and for conducting "in-house" courses and programs or for conducting organization-specific programs. The agency should bargain for discounts wherever possible.

DEFECTIVE COST OR PRICING

A major concern in cost and price analysis and the resulting contract award is the issue of defective cost or pricing and its effects on the price of the contract and subsequent payments to the contractor. "Defective cost or pricing" is pricing of a contract based on erroneous or false data submitted by the contractor, accepted in negotiations, and used as the basis for determining a contract price. The defects in the cost or pricing data submitted by proposers or contractors may be due to errors or deliberate misstatement of facts.

The effects of such erroneous cost or pricing data can be significant. As an example, an offeror gives a cost or price estimate in its proposal for leased space and the estimate is accepted by the entity because it is necessary, reasonable, allocable to the program, and similarly acceptable. After negotiations are completed and the offer is accepted, it is learned that the contractor will receive the space free of charge from its parent organization (of from a sister governmental organization). Is the entity "stuck" with contract price that included this erroneous cost? Can anything be done?

Something can indeed be done if the contract contains a clause for price reduction for defective cost or pricing data. Such a clause enables the contracting agency to the price or cost of the contract can be reduced accordingly and a modification to the contract can be prepared that reflects that reduction.

The "defectiveness" of the price or cost may be due to one or more factors. First, it could be the result of an outright misstatement or misrepresentation of cost or price elements in the offeror's proposal. While it is hoped that this is rare, it certainly occurs. The existence of the price or cost reduction clause can help the entity remedy the problem, without availing itself of complex and costly legal remedies against fraud. The solution becomes administrative, rather than legal.

More often the inaccuracy of the price is due to an error in the offeror's estimates. The offeror may price its proposal with the expectation that it will acquire a certain number of pieces of equipment at a given price. However, after the contract is let, the contractor acquires far fewer units of equipment or obtains the equipment at a substantially lower price per unit than estimated.

The error may be due to offeror's use of out-of-date cost or price information. For example, if the cost proposal includes an indirect cost rate, the offeror may be using the rate derived from a non-current period that is higher than the rate it was experiencing at the time it submitted its offer. The true rate may be determined as a result of an audit after the contract is awarded. Unless the contract had a provision for reduction of the price, the entity could have to live with the erroneous rate.

It is most important to have a price or cost reduction provision in a fixed price contract. Theoretically, in a cost reimbursement contract, the agency will be paying only for those costs actually incurred. Thus, the original estimate or contract price can be reduced based on the costs experienced by the contractor. However, in a fixed price contract, the price agreed upon is generally immutable. Thus, the ingredients making up the contract price should be as accurately determined as possible, or the contracting agency should have a mechanism for reducing the price, if there is an error in pricing by the contractor.

Exhibit E, Model Clause, Price Reduction for defective Cost or Pricing Data, contains a prototype contract provision that empowers Entities to reduce the price of the contract when defective cost or pricing data are submitted and used to price the contract. Also included as Exhibit F is a model Certificate of Current Cost or Pricing Data. This certification is typically a companion to the clause. It requires the offeror to certify that the cost or pricing data are "accurate, complete, and current" as of a given date. While submission of the certificate is not absolutely required to enable the reduction for defective pricing, it is good procurement practice to have the successful offeror complete one as close to the date of completion of negotiations and execution of the contract as possible.

Readers of this text should be aware that a price reduction action can lead to disputes and claims. The clause should be used judiciously. Whenever the clause is included in a contract or it is used to administer the contract, the contracting agency should seek advice from the procurement experts it usually relies upon.

Exhibit A
Classification of Costs

TRAINING

Costs associated with:

- On-the-job Training Services
- Salaries, Fringe Benefits, Equipment and Supplies of Personnel Directly Engaged in Providing Training (Including Remedial Education)
- Job Related Counseling for Participants
- Employability Assessment and Job Development
- Job Search Assistance (Including Preparation for Work and Labor Market Orientation)
- Books and Other Teaching Aids
- Equipment and Materials Used in Providing Training to Participants
- Classroom Space and Utility Costs
- Tuition and Entrance Fees that Represent Instructional Costs Which Have a Direct and Immediate Impact on Participants

Exhibit A (Continued)

ADMINISTRATION

Training costs shall not include the direct or indirect costs associated with the supervision and management of the program.

The salaries and fringe benefits of project directors, program analysts, supervisors, and other administrative positions shall not be charged to training. The compensation of individuals who both instruct and supervisor other instructors shall be prorated among the training and administration cost categories based on time records or other verifiable means.

SUPPORTIVE SERVICES

The term "supportive services" means services which are necessary to enable an individual eligible for training under this program, but who cannot afford to pay for such services, to participate in a training program funded under this program. Such supportive services may include:

- Transportation
- Health Care
- Special Services and Materials for the Handicapped
- Child Care
- Temporary Shelter
- Other Reasonable Expenses Required for Participation in the Training Program

Exhibit B
Profit Guidelines

Contractor Effort

High

- Contractor proposes instructional staff that exceeds qualifications, educations, and experience requirements.
- Managerial staff covers all aspects of management and program administration, including financial, procurement, records; sound supervision and management of all functions proposed.
- Contractor proposes to use ample and high quality educational and training materials that exceed minimum solicitation requirements. Supplementary and enrichment materials proposed.

- Contractor proposes instruction staff meeting minimum requirements of project.
- Bare-bones administrative and management staffing proposed.
- Contractor proposes to use educational and training materials that meet but do not exceed minimum solicitation requirements.

Low

Exhibit B (Continued)

<u>Contract Cost Risk</u>

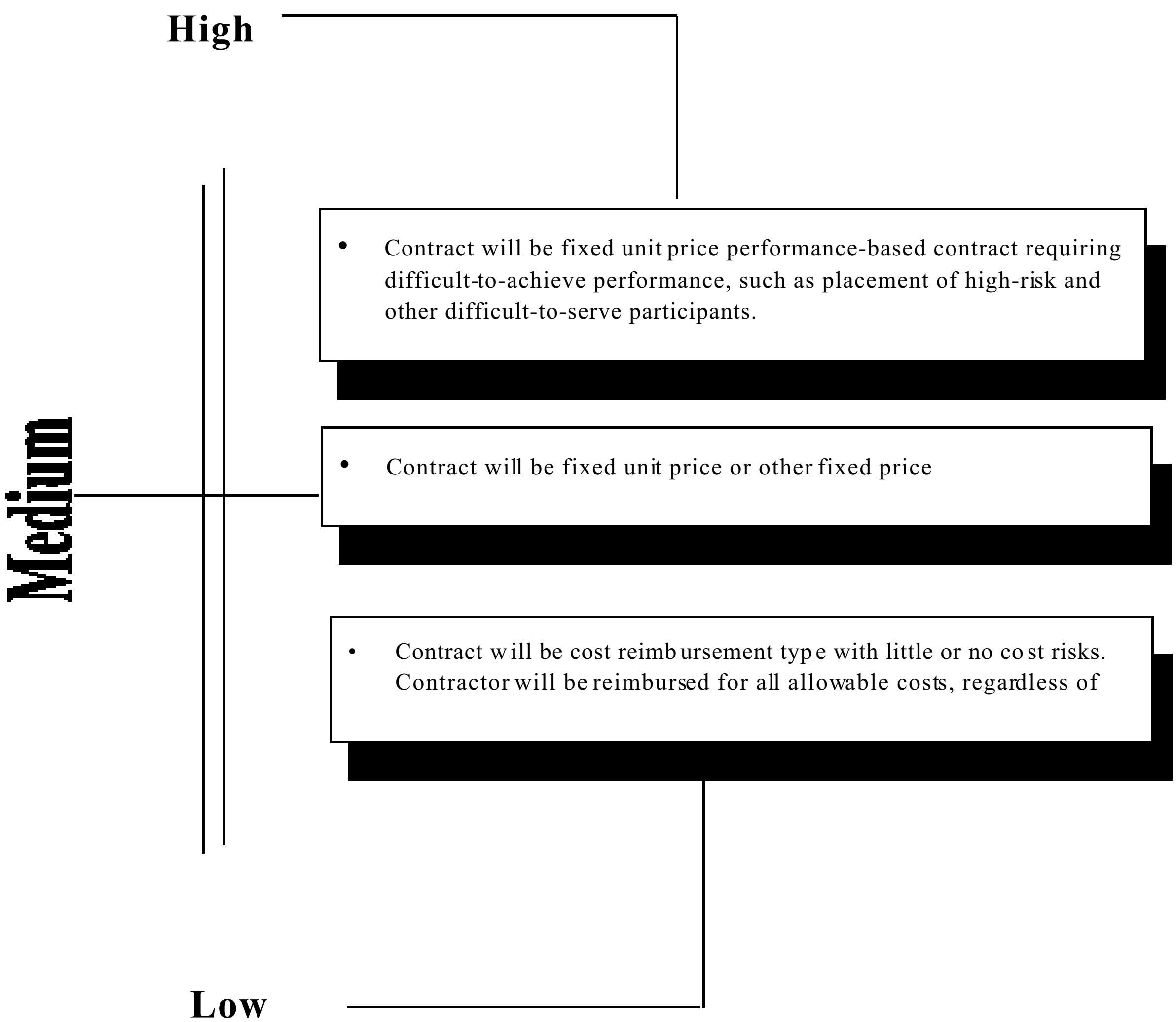

Exhibit B (Continued)

Socio-economic Programs

The specifics must be filled in to reflect State or local
procurement programs to meet State or local social and economic goals

High

- Offeror proposes to subcontract with or to obtain supplies with identified local small and small minority businesses in the preponderance of purchases it will make.

Medium

- Offeror will subcontract with or obtain supplies from some identified local small and small minority supplies and businesses.

- Offeror makes little or no reference to obtaining supplies from or subcontracting with local small and small minority business sources.

Low

Exhibit B (Continued)

Past Performance: Cost Control & Other Accomplishments

High

- Offeror performed all or most past contracts for same or similar work on time and at high level of quality. It met or exceeded all contract performance standards. Training provided was highly effective and placements were high quality.
- On cost reimbursement contracts and on fixed price with cost reimbursement elements, contractor stayed within contract budget limits in all or nearly all cases.

Medium

- Contractor performed well but not outstandingly on most of the past contracts of the same or similar nature. Its training was satisfactory, and the placements met contract standards most of the time.
- Where cost reimbursement contracts or other contracts with cost reimbursement elements were used, contractor stayed within contract budget limits on most occasions, but sometimes requested additional funds because of underestimates.

- Contractor's past work on similar or same type of contracts was satisfactory the majority of times; however, some corrective action was necessary to correct inadequate performance. There were problems with the quality of the training provided. Many of the placement goals were not met.
- Contractor has several instances of past performance problems of exceeding contract budgets where cost reimbursement agreements or contracts with cost reimbursement elements were used. These averages were due in most instances to inadequate estimating by the contractor.

Low

Exhibit C
Cost/Price Analysis

Part I – General	Yes	No
1. Offeror computations checked and verified? Problems/Comments:		
2. All necessary cost elements included? Problems/Comments:		
3. Offeror supporting documentation and justification complete? Problems/Comments:		
4. Categorization (Training, Administration, Supportive Services) Correctly categorized? Need more information? Problems/Comments:		

Exhibit C (Continued)

Part II – Specific Costs		
Cost Element	**Necessary/ Reasonable**	**Basis for Judgement** (Check One or More)
1. **Staff Costs**	Yes No	Independent Agency Estimate _____ Compared/Other Current Offers _____ Compared/Past Offers _____ Verified Market Price or Quote _____ Other (Specify) _______________ _____
Comments/Concerns/Problems:		
2. **Fringe Benefits** (For tax-based elements, be sure that rates and bases are current.)	Yes No	Independent Agency Estimate _____ Compared/Other Current Offers _____ Compared/Past Offers _____ Verified Market Price or Quote _____ Other (Specify) _______________ _____
Comments/Concerns/Problems:		
3. **Materials Training/Program**	Yes No	Independent Agency Estimate _____ Compared/Other Current Offers _____ Compared/Past Offers _____ Verified Market Price or Quote _____ Other (Specify) _______________ _____
Comments/Concerns/Problems:		

Exhibit C (Continued)

Part II – Specific Costs		
Cost Element	**Necessary/ Reasonable**	**Basis for Judgement** (Check One or More)
1. **Materials – Office Supplies/General**	Yes No	Independent Agency Estimate _____ Compared/Other Current Offers _____ Compared/Past Offers _____ Verified Market Price or Quote _____ Other (Specify) ________________ _____
Comments/Concerns/Problems:		
2. **Equipment**	Yes No	Independent Agency Estimate _____ Compared/Other Current Offers _____ Compared/Past Offers _____ Verified Market Price or Quote _____ Other (Specify) ________________ _____
Comments/Concerns/Problems:		
3. **Facilities**	Yes No	Independent Agency Estimate _____ Compared/Other Current Offers _____ Compared/Past Offers _____ Verified Market Price or Quote _____ Other (Specify) ________________ _____
Comments/Concerns/Problems:		

Exhibit C (Continued)

Part II – Specific Costs		
Cost Element	**Necessary/ Reasonable**	**Basis for Judgement** (Check One or More)
1. **Communications**	Yes No	Independent Agency Estimate ______ Compared/Other Current Offers ______ Compared/Past Offers ______ Verified Market Price or Quote ______ Other (Specify) ________________ ______
Comments/Concerns/Problems:		
2. **Insurance/Bonding**	Yes No	Independent Agency Estimate ______ Compared/Other Current Offers ______ Compared/Past Offers ______ Verified Market Price or Quote ______ Other (Specify) ________________ ______
Comments/Concerns/Problems:		
3. **Staff Travel**	Yes No	Independent Agency Estimate ______ Compared/Other Current Offers ______ Compared/Past Offers ______ Verified Market Price or Quote ______ Other (Specify) ________________ ______
Comments/Concerns/Problems:		

Exhibit C (Continued)

Part II – Specific Costs		
Cost Element	**Necessary/ Reasonable**	**Basis for Judgement** (Check One or More)
1. **Consultants**	Yes No	Independent Agency Estimate ______ Compared/Other Current Offers ______ Compared/Past Offers ______ Verified Market Price or Quote ______ Other (Specify) ________________ ______
Comments/Concerns/Problems:		
2. **Accounting/Audits**	Yes No	Independent Agency Estimate ______ Compared/Other Current Offers ______ Compared/Past Offers ______ Verified Market Price or Quote ______ Other (Specify) ________________ ______
Comments/Concerns/Problems:		
3. **Legal Services**	Yes No	Independent Agency Estimate ______ Compared/Other Current Offers ______ Compared/Past Offers ______ Verified Market Price or Quote ______ Other (Specify) ________________ ______
Comments/Concerns/Problems:		

Exhibit C (Continued)

Part II – Specific Costs		
Cost Element	**Necessary/ Reasonable**	**Basis for Judgement** (Check One or More)
1. **Photocopying Printing**	Yes No	Independent Agency Estimate ______ Compared/Other Current Offers ______ Compared/Past Offers ______ Verified Market Price or Quote ______ Other (Specify) ________________ ______
Comments/Concerns/Problems:		
2. **Supportive Services**	Yes No	Independent Agency Estimate ______ Compared/Other Current Offers ______ Compared/Past Offers ______ Verified Market Price or Quote ______ Other (Specify) ________________ ______
Comments/Concerns/Problems:		
3. **Indirect Costs** (When proposed, be sure that audit agreement and proposal are attached; ensure that costs not duplicated in direct costs.)	Yes No	Independent Agency Estimate ______ Compared/Other Current Offers ______ Compared/Past Offers ______ Verified Market Price or Quote ______ Other (Specify) ________________ ______
Comments/Concerns/Problems:		

Exhibit C (Continued)

Part II – Specific Costs		
Cost Element	**Necessary/ Reasonable**	**Basis for Judgement** (Check One or More)
1. **Subcontracts** (Review subcontractor cost/price proposal.)	Yes No	Independent Agency Estimate _____ Compared/Other Current Offers _____ Compared/Past Offers _____ Verified Market Price or Quote _____ Other (Specify) ________________ _____
Comments/Concerns/Problems:		
2. **Other** (Specify)	Yes No	Independent Agency Estimate _____ Compared/Other Current Offers _____ Compared/Past Offers _____ Verified Market Price or Quote _____ Other (Specify) ________________ _____
Comments/Concerns/Problems:		

Part III – Profit/Fee		
1. Offeror is (check one)	___________ For-Profit	___________ Non-Profit
2. If non-profit, no profit allowable.		
3. If for-profit, amount of profit proposed Profit as percent of total other costs	$____________ ____________%	
4. Profit is (check one)	____________ Reasonable	___________ Not Reasonable/ Excessive

Exhibit C (Continued)

5. If profit is deemed reasonable, describe basis for judgement (e.g., agency profit guidelines; application of profit guidelines; other)	
6. If profit is deemed excessive, list profit objective (% or dollar amount) to be negotiated	
Part III – Conclusions	
Prepare a brief narrative citing: 1) Specific additional cost justifications needed; 2) Recommended adjustments to specific cost elements; and 3) Any other comments about cost/price proposal. (Use another sheet of paper, if additional writing space is needed.)	
Part IV – Signature(s)	

Exhibit D
Price Analysis Tool

Procurement (RFP No.)		
Offeror		
Part I – General		
	Yes	No
1. Proposed price is for off-the-shelf package or tuition-based training?		
2. If yes to 1 above, was verification of price reasonableness made by checking offeror catalog or price list?		
3. If yes to 2 above, give date of catalog or price list.		
4. Verification		
5. Was discount offered?		
6. Will discount be sought?		

Part II – Primary Comparison (with other offerors to this RFP)				
	This Offeror	**Offeror 2 Name**	**Offeror 3 Name**	**Offeror 4 Name**
1. Price per placement:	$			
2. Total fixed price:	$			
3. Price per instruction house:	$			
4. Price per participant/instruction hour:	$			

Exhibit D (Continued)

Part III -- Secondary Comparison					
	This Offeror	**Past Contractor Name**	**Past Contractor Name**	**Past Contractor Name**	**Past Contractor Name**
1. Price per placement:	$				
Date:					
Price:		$	$	$	$
2. Total fixed price**:**	$	$	$	$	$
Note: In using past offers on contracts, be sure that past prices were competitive and evaluations reasonable.					

Part IV – Narrative		
1. Give a brief narrative judgment about reasonableness of offeror's proposed prices. Justify your judgment. If you developed an independent agency cost estimate, describe how offeror's proposed prices compare to your estimate.		
2. If price is too high, develop new price objectives for negotiations and justify.		
A. Proposed new prices:	$	$
B. Rationale:		
Part V – Signatures		

Exhibit E
Pricing Reduction for Defective Cost or Pricing Data

(a) If any price, including profit or fee, negotiated in connection with this contract, or any cost reimbursable under this contract was increased by any significant amount because (1) the Contractor or a subcontractor furnished cost or pricing data that were not complete, accurate, and current as certified in its Certificate of Current Cost or Pricing Data, (2) a subcontractor or prospective subcontractor furnished the Contractor cost or pricing data that were not complete, accurate, and current as certified in the Contractor's Certificate of Current Cost or Pricing Data, or (3) any of these parties furnished data of any description that were not accurate, the price or cost shall be reduced accordingly and the contract shall be modified to reflect the reduction.

(b) Any reduction in the contract price under paragraph (a) above due to defective data from a prospective subcontractor that was not subsequently awarded the subcontract shall be limited to the amount, plus applicable overhead and profit markup, by which (1) the actual subcontract or (2) the actual cost to the Contractor, if there was no subcontract, was less than the cost estimate submitted by the Contractor; provided that the actual subcontract price was not itself affected by the defective cost or pricing data.

(c)(1) if the (*specify* entity) determines under paragraph (a) of this clause that a price or cost reduction should be made, the Contractors agrees not to raise the following matters as a defense:

(i) The Contractor or subcontractor was a sole source supplier or otherwise was in a superior bargaining position and thus the price of the contract would not have been modified even if accurate, complete, and current cost or pricing data had been submitted.

(ii) The (*specify* entity) should have known that the cost or pricing data in issue were defective even though the Contractor or subcontractor took no affirmative action to bring the character of the data to the attention of the (*specify* entity).

(iii) The Contract was based on an agreement about the total cost of the contract and there was no agreement about the cost of each item procured under the contract.

(iv) The Contractor or subcontractor did not submit a Certificate of Current Cost or Pricing Data.

Exhibit F
Certificate of Current Cost or Pricing Data

This is to certify that, to the best of my knowledge and belief, the cost or pricing data, submitted, either actually or by specific identification in writing to the ______________ (*specify agency*) in support of _____________ are accurate, complete, and current as of ___________ . This certification includes the cost or pricing data supporting any advance agreements and forward pricing agreements between the offeror and the (entity) that are part of the proposal.

Organization ____

Name ____

Title ____

Date of Execution ____

Identify the proposal, quotation, modification proposal or other submission involved, giving the appropriate identifying number (RFP No., etc.).

Insert the day, month, and year when price negotiations were concluded and price agreement was reached.

Insert the day, month, and year of signing, which should be as close as practicable to the date when the price negotiations were concluded and the contract was agreed to.