

DHG

DIXON HUGHES GOODMAN LLP

Price Analysis and Reasonable Pricing





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The Cost and Price Analysis Series

- May 18 - Part I: Price Analysis and Fair and Reasonable Pricing
- June 15 - Part II: Commercial Item Pricing and Challenges in the Current Environment
- September 21 - Part III: Direct and Indirect Costs and a Little Thing Called G&A!
- October 19 - Part IV: Profit – Yes, contractors are allowed to have some!?
- November 16 – Part V - Cost Analysis and Cost Realism and Their Expanding Roles in Contract Pricing
- December 21 - Part VI: Defective Pricing – Hazards & Defenses

Agenda

- Price Analysis Overview
 - What, where, why, when and how?
 - Risks and Rewards
- Performing Price Analysis
 - Market Research and Price-Related Factors
 - Planning
 - Price Analysis Techniques
 - Resolving Pricing Challenges
 - Documenting Price Analysis

What Is Price Analysis?

- Price –
 - General Business - The amount a willing buyer pays a seller for the delivery of a product or service
 - ASPM - A fair and reasonable price is one that is fair to both parties to the contract, considering the quality and timeliness of contract performance
 - FAR 15.401 – cost plus any fee or profit applicable to the contract type
- Contract pricing is the function that gathers, assimilates, evaluates and, in establishing objectives, brings to bear all the skills and techniques needed to shape the eventual pricing arrangement.
- Pricing services include price analysis, cost analysis and the use of accounting and technical evaluations and systems analysis techniques to facilitate negotiation of realistic pricing arrangements.

When Is Price Analysis Used?

- Price analysis is used for every procurement
- When certified cost and pricing data are not required – price analysis alone should suffice
 - i.e. - when the Truth In Negotiations Act (“TINA”) does not apply (or TCPD – Truthful Cost or Pricing Data)
 - Without TINA, KISS - Obtain the type and quantity of data necessary to establish a fair and reasonable price, **but not more data than is necessary**
- TINA exceptions
 - Competition
 - Commercial Items
 - Value below \$750K
 - Price set by law or regulation
 - Waiver

Why Does Price Analysis Matter?

- Impact of contract type and timing of analysis
- Cost-type contracts
 - At award the estimated cost is used to determine fixed fee/award fee pools
 - During performance the government may disallow (not reimburse) costs that are unreasonable
- Fixed-price contracts
 - At award a contractor's failure to estimate accurate price may result in losses on contract
 - During performance every dollar saved increases profit

What Is a Fair and Reasonable Price?

- “Fair” is not defined in the FAR
- What is “fair and reasonable” depends on which side of the transaction a party finds itself
 - FAR does recognize the importance of profit to incentivize contractors to perform
 - Reasonableness of profit depends upon risks taken by seller
- Goal is to avoid paying a price that is too high or too low; too low presents risks to buyer/buying-in
- Reasonable is the price a prudent person would pay

Special Circumstances/Challenges

- Changes
 - Modifications to goods or services or extensions of performance other than priced options
 - Realistically there is no competition
 - Must ascertain price reasonableness of deleted and added work
 - Profit margins on changed work
- Terminations for convenience
 - Services performed /goods provided paid for at agreed upon prices
 - Work in progress is essentially converted into cost-type contract



Price Analysis Techniques



Price-Related Factors and Award Combinations

- Contract award criteria should address all price-related factors that will have a significant and quantifiable effect on the total cost of the acquisition
- Price-related factors include
 - Foreseeable costs or delays to the government resulting from differences in inspection, locations of supplies and transportation
 - Changes made or requested by the bidder to provisions of the invitation for bids
 - Advantages/disadvantages resulting from making more than one award
 - Origin of supplies, and if foreign, application of Buy American Act

Acquisition Planning

- Market research - definition
- Market research must be conducted
 - Before developing new requirements document
 - Before soliciting offers for acquisitions in excess of \$150K
 - Before soliciting offers for acquisitions with an estimated value below \$150K when adequate information is not available and the circumstances justify its cost
 - Before soliciting offers for acquisitions that could lead to a bundled contract

Acquisition Planning: Techniques

- Contact knowledgeable individuals in government and industry regarding market capabilities
- Review similar recent market research reports
- Publish formal requests for information in appropriate scientific or business publications
- Review trade journals
- Attend trade shows
- Review catalogs published by manufacturers, distributors and dealers

Price Analysis Techniques: Overview

- FAR identifies seven examples of price analysis techniques
 - Comparison of proposed prices received in response to solicitation
 - Comparison of proposed prices to historical prices paid for the same or similar items
 - Parametric estimating methods
 - Comparison with catalogs and published price lists
 - Comparison with independent government cost estimates
 - Prices obtained during market research
 - Other than cost or pricing data

Preferred Price Analysis Techniques

- Comparison of proposed prices received in response to solicitation
- Comparison to previous/historical prices
- Additional techniques can be used if CO determines that the preferred techniques are insufficient to determine that price is fair and reasonable

Comparison – Response to Current RFP

- Primary price analysis technique
- Preferred and most commonly used price analysis technique
- Adequate price competition normally establishes a fair and reasonable price, but not always
- Prices must still be reasonable, even if apparent competition exists
 - Must determine that offeror's price is reasonable
 - Price must be a substantial factor in award determination

Adequate Price Competition

- Two or more responsible bidders, competing independently, submit offers and price is substantial factor; or
- There was a reasonable expectation that there would be two or more offerors and CO can conclude offer was submitted with expectation of competition; or
- Price is reasonable in comparison with recent prices for same or similar items purchased in comparable quantities, under contracts resulting from adequate price competition

Comparison - Strategies

- Competitive solicitation best practices
 - Plan ahead!
 - Adequately developed scope of work
 - Include required terms and conditions
 - Either require acceptance of terms as a condition of responsiveness or require offeror to identify exceptions in proposal
 - Be strategic about pricing
 - Per unit/volume discounts
 - Option years
 - How will price be evaluated
 - Best value tradeoff

Comparison with Historical Prices

- Primary price analysis technique
- Comparison of proposed prices to historical prices paid for the same or similar items
- May be used for commercial items including those “of a type” or requiring minor modifications; similar items sold in past but slightly modified good is offered

Use of Historical Prices

- Prior price must be valid basis for comparison
 - Time lapse
 - Terms and conditions
 - Reasonableness of prior price must not be uncertain

Adjusting Historical Prices for Comparison

- Prior price may need to be adjusted
 - Materially differing terms and conditions
 - Quantities
 - Market and economic factors
 - Similar items – adjust for material differences
- Expert technical advice on magnitude of changes and pricing assistance
 - Similar items, commercial items or items “of a type”
 - Requiring minor modifications

Parametric Estimating Methods

- Secondary price analysis technique
- Cost estimating relationships (“CERs”) used to develop parametric estimating methods or rough yardstick estimates
 - \$ per pound
 - \$ per foot
 - \$ per horsepower
- Metric may be physical, performance, operations, programmatic, or cost

Catalogs and Published Price Lists

- Secondary price analysis technique
- Comparison with:
 - Competitive published price lists
 - Published market prices of commodities
 - Similar indexes and
 - Discount or rebate arrangements
- Government considers a price list an MSRP – wants to know “what the commercial consumer pays”

Independent Cost/Price Estimates

- Secondary price analysis technique
- Government/prime contractor determines internal estimate of what it would cost to perform service/build product
 - Estimate could include labor costs, materials costs, required effort, learning curves
 - Could be a comparison of prices

Data Other Than Certified Pricing Data

- Secondary price analysis technique
- If other techniques don't work - CO may rely upon "other than cost and pricing data"
 - Data could look, feel and smell like certified cost and pricing data - but the data is not certified
 - No requirement to disclose all data, parties may disclose only data necessary to demonstrate price reasonableness
- Data other than certified cost or pricing data may include:
 - Sales data
 - Any information reasonably required to explain the offeror's estimating process, including
 - Judgmental factors applied and mathematical or other methods used in estimate
 - Nature and amount of any contingencies included in proposed price

Best Practices for Data Other than . . .

- Offerors may be reluctant to provide other than certified cost or pricing data, especially commercial item offerors
- May focus on specific elements of price that are difficult for the price evaluator to grasp
 - Offeror may be willing to provide workload requirements but not specific labor rates
 - Reasonable labor rates, may be estimated in order to determine reasonable price
 - Overhead and G&A rates may be combined with profit margin into a total markup to protect proprietary data
- Must be able to make a meaningful assessment of each element of cost

Value Analysis

- Used in conjunction with price analysis
- Provides insight into the relative worth of the product or service

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Resolving Pricing Challenges



Resolving Pricing Challenges

- Economic price adjustment
 - Useful tool for resolving contingencies in prices
 - Provides tool for price adjustment based upon changes to market prices
 - Specify commodity indexes
 - Not used for general inflation
- Reopener clauses
 - Parties can renegotiate pricing on one or more elements in the future
 - Should maintain retainage until reopener is resolved

Resolving Pricing Challenges (cont.)

- **Undefinitized contracts**
 - Letter contracts
 - Parties agree to work and receive limited payments until pricing agreement (definitization)
 - Allows additional time to complete price analysis
 - Customer maintains retainage pending price agreement
- **Prime/Subcontractor**
 - Challenge regarding competition sensitive data
 - Request support form CO
 - Third-party audit/assessment

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Documenting Price Analysis



Why Is Documentation Important?

- Documenting price analysis/negotiations is critical
 - For cost type contract, FAR 52.215-2 requires records to substantiate costs
 - Contractor must be able to substantiate reasonableness of its costs
- CPSR – fundamental element of “adequate purchasing system” determination
- “Best practice” to manage costs and maximize profit under fixed priced contracts

What Should Be Documented?

- Using a PNM (“price negotiation memorandum”)
 - Why price is fair and reasonable
 - Explanation of price analysis technique used and why that technique was appropriate
 - Comparisons used
 - Discussion of negotiations and arms-length bargaining
- Should be analytically rigorous
- Should not be considered a formality or a “check the box” exercise
- Justify any best-value determinations
 - Why was other than lowest priced offeror selected?
 - What additional benefits warrant higher price?

Anything else?

- Documentation should include
 - What TINA and or CAS exception was applied?
 - If competition was not used, why not?
 - Is the acquired good or service a commercial item?
 - Sole source of commercial items in the DoD may require extra attention
- Maintain supporting materials that were relied upon or were not relied upon
 - Request for proposals/proposals
 - Market research
 - Catalog prices
 - Data other than certified cost or pricing data

Questions?

