



# 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



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## 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.)

- Undefined 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 from 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?

