

COMMERCE ACQUISITION MANUAL

Part 15 - Contracting by Negotiation

Subpart 15.8 - Price Negotiation

Chapter 1 - Audits

April 1988

AUDITS

1. Policy:

It is the policy of the Department of Commerce that all required contractual audit services will be obtained in accordance with this Chapter. It is also the policy of the Department that program officials will plan their acquisitions so that they are received in the servicing procurement office well in advance of the required need so as to allow sufficient time for the processing of the acquisition in accordance with applicable statutes and regulations, including audits when required.

2. Reference:

This chapter is issued under the authority of Department Administrative Order (DAO) 208-0 "Commerce Acquisition Manual" dated January 29, 1987.

3. Background:

Acquisition statutes and regulations have developed the Government policy that all required property or services will be acquired in the required quantity, within the time needed, *at the lowest reasonable cost*, and permitting all responsible sources to compete. Traditionally, the economic and competitive forces of the market place have been used to establish the lowest reasonable price. This is the fundamental principle of the sealed bid acquisition method. In negotiated acquisitions, these market forces are not always present and some form of cost/price analysis is needed to determine that the price is fair and reasonable. The contracting officer (CO) is given the sole responsibility for determining that the negotiated prices of contracts or modifications are fair and reasonable.

4. Audits:

The decision that a price is fair and reasonable must be based upon some form of analysis, either price analysis or a combination of price and cost analysis. The Federal Acquisition Regulation (FAR) requires that the analysis of more complex acquisitions include an audit. FAR 15.805-5 requires the CO to request a field pricing report (including an audit review). The term "field pricing report" refers to the Department of Defense system of obtaining pricing support from DOD field support personnel. Since the Department has no such field staff, the requirements of this

subpart will be met by obtaining an audit, when necessary. Audits are used to help establish the initial price of contracts and modifications; establish the final costs of cost reimbursement type contracts; and interim and final redetermination, economic price adjustments, target prices, and settlement of incentive type contracts. There are two basic types of contract audit: preaward and postaward.

A. Preaward Audits

Preaward audits are used to provide the CO a detailed analysis of the cost data before negotiating contracts and modifications, including changes. Modifications are included, even though this contract action occurs after award, since the purpose is to reach agreement on projections of what the supply or service will cost. In a preaward audit, the auditor will review and analyze the cost data, verify the proposed costs, as well as evaluate the contractor's cost accounting system, estimating methods and procedures, and financial condition.

Audit Requirements

The FAR, Subpart 15.805-5, requires preaward audits before negotiating any contract or modification resulting from a proposal which is over \$500,000, for which cost or pricing data have been required. FAR 15.804-3 provides for exemptions from the submission of cost or pricing data *only* when the CO has determined that the prices are:

- Based on adequate competition
- Based on established catalog or market prices of commercial items sold in substantial quantities to the general public, or
- Set by law or regulation.

B. Postaward Audits

Postaward audits are concerned with establishing what the work actually cost or should have cost. Postaward audit support is used for the following.

1. Monitoring of indirect costs for cost reimbursement contracts and for compliance with the Cost Accounting Standards.
2. Issuing interim pricing decisions. These decisions relate to the establishment of overhead and forward pricing rates; the exercise of soft options; and adjustment of flexible or economic fixed price contracts.
3. Issuing final pricing decisions. Final audits involve final pricing of fixed price arrangements in redeterminable or incentive contracts, final costs for cost reimbursement type contracts and pricing of termination settlements.

Audit Requirement

1. FAR Requirement - the FAR requires audits for termination proposals over \$25,000 (FAR 49.107(a)).
2. Department Requirement - In addition to the FAR requirement, the Department requires audits for the following actions.
 - Interim pricing decisions over \$100,000.
 - Final audits for fixed price redeterminable or incentive contracts over \$100,000.

- Final audits for cost reimbursement type contracts over \$250,000.

Table 1 Summary of Audits Thresholds

Preaward Audits - \$500,000
Interim Audits - \$100,000
Final Audits - \$250,000 (cost reimbursement contracts)
Final Audits - \$100,000 (fixed price redeterminable or incentive contracts)
Termination Settlement Audits - \$25,000

Regardless of these thresholds, the CO shall request an audit whenever an audit is needed. An audit will be requested when any or all of the following conditions are applicable: available cost data is inadequate, the contractor's estimating system, accounting system or purchasing methods are not reliable or are unknown, the CO is unable to evaluate the reasonableness of the existing data, inability to obtain current data, or the existence of sensitive conditions. Before an audit is requested for small dollar acquisitions, the CO shall give due consideration to the costs of the audit, the type of audit needed and the value of the costs to be audited.

No final audit will be required for contracts with Universities *regardless of dollar amount*, for whom HHS has audit responsibility, unless there are indications of fraud or mismanagement. The Department's Model Procedures for Closeout of Completed Contracts remains in effect and will be used for the closeout of contracts when a final audit is not required.

5. Audits Requests:

When an audit is required, the CO should be specific about the type and extent of audit services required and the date the audit report is required. Whenever possible, the audit request should be limited to the specific areas of review in which audit assistance is needed. In requesting a due date for the audit report, the CO shall allow as much time as possible for the audit, but not less than four to six weeks. Exceptions to this minimum period may be made only when unusually urgent program considerations necessitate a shorter time and the contract file is fully documented to justify this request. Fourth quarter spending shall not be used as a justification for a shorter audit time.

The CO must also recognize that as the end of the fiscal year approaches, the auditors' work load will increase and audit times may lengthen. In truly unusual instances, the CO may request that the OIG obtain verbal audit results with the written results to follow, or that the OIG obtain audit assistance from another Agency under the Government cross serving arrangement (see OMB Circular A-73).

All requests for audit should be sent to the Office of Inspector General (OIG) at the following address.

Audit Manager, Systems Acquisition Division
Office of Automated Information Systems
Office of Inspector General
Room 7099c (HCHB)
14th and Constitution Avenue, N.W.
Washington, D.C. 20230

The request for audit should indicate the desired due date for the audit report, the type of audit services required, and include two copies of the following documentation, as appropriate:

A. Preaward Audits

All information required by FAR Subpart 15.804-6, to include:

1. Cost Proposal

2. Request for Proposal

3. Technical Analysis Report on the cost proposal. This must be provided to the Office of the Inspector General (OIG), Systems Acquisition Division, within 10 days before projected audit completion date, if not available at the time of audit request.

B. Postaward Audits

1. Final Audits

- Contract and all modifications
- Contractor's cumulative claim
- Contractor's final invoice

2. Other Than Final Audits

- Contract and all modifications
- Specific instructions on the required postaward audit review
- Any other documents which will assist the auditors during the review

All audit reports will be sent by the audit agency directly to the OIG. In the event the audit report is sent directly to the contracting agency, it should be transmitted to the OIG. The OIG will review and distribute the reports.

6. Audit Waiver:

The FAR permits the CO to waive the audit when the reasonableness of the negotiated price can be determined from information already available. In making the determination that adequate information is available, the CO will perform a desk review which will include:

In-house engineering estimates of the level of effort, audited cost information from contracts in process or recently negotiated contracts, adequately reviewed data on proposed subcontract items which constitute the major portion of the prime contractor's cost proposal, prices of standard commercial items which constitute the major portion of the prime contractor's cost proposal; special forward pricing or overhead rates contained in advance agreements; current labor rates, overhead rates, loading factors, and per diem rates; recent audit reports or price negotiation memoranda.

COs are encouraged to work with the OIG auditors to verify information. The information so obtained shall be recorded in the contract file. No category of information is necessarily sufficient by itself to waive the audit. Care must be taken to fully document the reasons for the audit waiver in the contract file. At least one Board of Contract Appeal has found a negotiated contract not to be binding because the CO improperly waived a preaward audit. The Government estimate of the cost or price shall not be used as the sole justification for the audit waiver. Time restraints, urgency, or end of year funding considerations shall not be used to justify waiver of the audit.

The CO shall provide a copy of the audit waiver memorandum to the OIG within five working days after signature.

7. Pre-negotiation Analysis:

Before entering into negotiations, the CO must analyze the costs or prices. In making this analysis, the CO is generally expected to seek the advice and assistance of informed experts before reaching a final pricing decision. The CO shall document the pre-negotiation objectives in a memorandum which reflects FAR 15-807 and 15.905.

This memorandum will become part of the official file. Each operating unit will establish procedures for pre-negotiation clearances. The Government auditors are the principal advisors to the CO for cost accounting and pricing matters. Auditors can verify the factual data contained in the cost proposal but in many cases cannot verify the judgmental data. The program office is needed to examine the estimates and projections which comprise the judgmental data. The CO assembles the data provided from as many sources as possible (audit, technical, price analyst) and develops the pre-negotiation position. The CO cannot pass on the responsibility for making the pricing decisions even while relying upon advisors for information and advice.

A. Adequate Price Competition

The CO cannot rely upon the presence of competition to assure that the prices offered are fair and reasonable. There must be adequate price competition. Adequate price competition is defined as:

- (1) at least two offerors
- (2) that can satisfy the Government's requirement
- (3) independently contested for a contract to be awarded to the offeror that submits the lowest evaluated price
- (4) by submitting priced offers responsive to the stated requirements of the solicitation.

In many acquisitions there is technical competition rather than price competition. Technical competition results when companies offer unlike products to accomplish the requirements of the solicitation. Negotiations must take place before deciding that the prices are reasonable. In this instance, selection will be based upon technical qualifications rather than the low price. In the absence of adequate price competition, the CO must perform a cost analysis on the offers before deciding that the price is fair and reasonable.

B. Price Analysis:

This technique compares the proposed price with other prices or independent price estimates. Care must be taken in making comparisons of similar items to ensure that allowances are made for differing economic conditions, differences in specifications, quantities, time for delivery and improvements in efficiency. Price analysis includes comparison with proposed prices for the same or similar items, parametric comparisons, comparisons with prices on published lists, and comparison of offered prices with the Government estimate. The CO shall not rely solely upon the Government estimate unless the reliability of the estimate can be shown. In those instances, the CO must document the file to demonstrate that the estimate is based upon a realistic engineering analysis.

C. Cost Analysis:

Cost analysis is the element by element examination of the estimated or actual cost of performance. It involves analyzing cost accounting data, design features, materials, manufacturing processes, organization structure and estimating assumptions and includes verification of cost data, evaluation of specific elements of cost, and projection of these data. In performing a cost analysis, the CO will utilize cost and pricing data supplied by the contractor, historical data, vendor quotes, nonrecurring costs, information on changes in production methods and production volume, data supporting projections of business prospects, objectives and related operation costs, current trend costs, make or buy decisions, estimates of resources needed to obtain business goals, and information on management decisions which may have a bearing on costs. The CO evaluates the elements of cost to identify the costs necessary for contract performance, establish the costs that are reasonable, and to isolate any contingent amounts. Cost analysis is used to prove the reasonableness of the offered price by evaluating each specific element of the proposal.

8. Negotiation Team:

In preparing the pre-negotiation objectives, the CO should examine the complexities of the issues and decide if it

would be beneficial for the auditors, who evaluated the proposal, to attend the negotiations as part of the negotiation team. The OIG has auditors who are available to participate in selected negotiations. Once the CO has decided upon the team, a meeting must be held in advance of negotiations to discuss the negotiation issues and the role of each team member. This meeting is important because there can be no public disagreement or airing of differences among the team members during negotiations. It must be clearly understood that there can be only one Government spokesperson and that is the CO or the authorized contract negotiator.

9. Documentation:

After completion of negotiations the CO will carefully document the results of the negotiations and show why the agreed upon price is fair and reasonable. To document the reasonableness of the price, the file must show the offered price, the data used to evaluate the offer, the conclusions reached, and that the conclusions were sound. When an audit report has been obtained, the CO will explain why any significant audit recommendations were not followed in reaching a final pricing decision. The CO shall also include the impact of any directions given by Congress, other agencies, and higher officials if this direction had a significant effect on the negotiated price. The CO will send the OIG, Systems Acquisition Division, two copies of the price negotiation memorandum within thirty (30) days after award date or notify the OIG, in writing, that the acquisition was cancelled or an award was not made to the audited firm. Correspondence with the auditor should be through the OIG.

10. Supersession:

This Chapter will supercede Acquisition Letters 5 and 5-1.