

# UNIT 64: DEFECTIVE PRICING

*October 2003*

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<b>Duty</b>	Determine if cost or pricing data were defective (i.e., not current, accurate, and complete) and appropriate remedies.
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<b>Conditions</b>	Given a contract, a copy of the price negotiation memorandum, and results of a defective pricing audit.
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<b>Overall Standard</b>	Correctly determine if cost or pricing data were defective and the extent to which it was relied upon. Accurately calculate the downward adjustment in price. Correctly determine the amount of penalty and interest due the Government.
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## Policies

<i>FAR</i>	<i>Agency Suppl.</i>	<i>Subject</i>
15.407-1		Defective cost or pricing data.
52.214-26		Audit and records – sealed bidding.
52.214-27		Price reduction for defective cost or pricing data – modifications – sealed bidding.
52.215-2		Audit and records – negotiation.
52.215-10		Price reduction for defective cost or pricing data.
52.215-11		Price reduction for defective cost or pricing data – modifications.

## Other KSAs

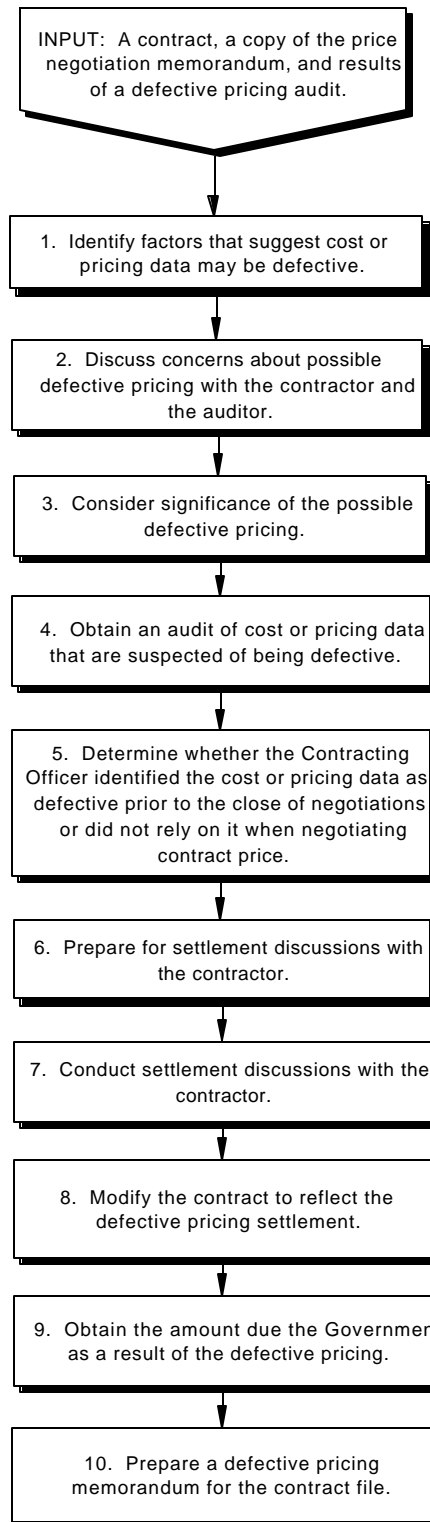
1. Knowledge of how the courts and Boards of Contract Appeals have interpreted the Truth in Negotiations Act.
2. Ability to understand and interpret audit reports.
3. Ability to communicate orally and in writing concerning the issues raised in defective pricing.
4. Ability to relate to people with different backgrounds and points of view regarding defective pricing.
5. Ability to select and use appropriate mathematical techniques for resolution of defective pricing issues.
6. Ability to conscientiously attend to the details associated with defective pricing.
7. Ability to maintain the honesty and integrity of the acquisition process.

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## Other Policies and References (Annotate As Necessary):

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## Tasks

## Related Standards

Tasks	Related Standards
<p>1. Identify factors that suggest cost or pricing data may be defective.</p>	<p>Examples include:</p> <ul style="list-style-type: none"><li>• Incurred costs seem to be significantly less than projected.</li><li>• Operations included in the contractor's proposal are not actually performed.</li><li>• Direct cost items included in the proposal appear overpriced based on information available to the contractor during negotiations.</li><li>• Data presented during later negotiations provide information that is significantly different from earlier negotiations.</li><li>• Data collected during later market research are inconsistent with the certified data.</li><li>• Defective pricing is identified on related contracts.</li><li>• Operating budget plans contain data that are different from contract proposal data.</li><li>• Labor-mix estimates do not include data on the actual labor mix on similar contracts.</li><li>• Review of other proposals indicates that the value of the contractor's inventory was not correct in the contractor's proposal.</li><li>• Estimating system review reveals deficiencies.</li><li>• Contractor pricing personnel or negotiators informally state that they failed to follow contractor estimating or purchasing policy.</li><li>• Review of contract performance indicates that quantity estimates were erroneous because the contractor did not use current information.</li><li>• Purchasing reviews indicate that the contractor did not submit current pricing information.</li><li>• Purchasing reviews indicate that order cancellations were not disclosed.</li><li>• Later technical evaluations indicate that the contractor did not disclose projected changes that would affect indirect cost rates.</li><li>• Contract performance reviews indicate that the contractor duplicated cost estimates.</li><li>• The submitted make-or-buy plan is significantly different than the working plan.</li><li>• New or revised production processes which will be used were not disclosed.</li></ul>

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## Tasks

## Related Standards

<p>2. Discuss concerns about possible defective pricing with the contractor and the auditor.</p>	<p>Discuss possible defective pricing with the contractor to assure understanding of the situation. Normally, such discussions should take place before contacting the cognizant auditor. During your discussions:</p> <ul style="list-style-type: none"><li>• Describe the suspected defective data;</li><li>• Unless it would jeopardize the Government's position, describe the reasons for suspecting that the data are defective;</li><li>• Obtain the contractor's position on whether the cost or pricing data were accurate, complete, and current;</li><li>• Determine if contractor's position provides a satisfactory resolution of concerns about the validity of the cost or pricing data; and</li><li>• Document any suspicions and the results of discussions and a copy of the documentation in the affected contract file(s).</li></ul> <p>If not satisfied with the contractor's position, it may be useful to informally contact the cognizant auditor before requesting a defective pricing audit. A situation that appears suspicious may, in fact, result from using acceptable accounting and estimating practices.</p>
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## Tasks

## Related Standards

<p>3. Consider significance of the possible defective pricing.</p>	<p>The FAR defective pricing clauses provide that the Government is entitled to remedies if a contract price was increased by any "significant amount," because the contractor provided and the Government relied on cost or pricing data that were not complete, accurate, and current. However, they do not define what amount is significant.</p> <p>One Board of Contract Appeals found that the Government was entitled to a reduction of \$5,000 even though that amount was only two-tenths of one percent of the contract price. The decision pointed out that the language of the Truth in Negotiations Act does not vest in a contractor the right to keep amounts obtained through supplying defective pricing data on the grounds that the amount so obtained was insignificant in relation to the overall contract price.</p> <p>However, substantial resources are required to identify, pursue, and settle defective pricing allegations. Accordingly, you should consider the materiality of alleged defective pricing before you decide to pursue the allegation.</p> <p>Use applicable agency guidance and good business judgment in determining the significance of the alleged defective pricing.</p>
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## Tasks

## Related Standards

<p>4. Obtain an audit of cost or pricing data that are suspected of being defective.</p>	<p>If it appears that the contract price may have been significantly increased because of defective cost or pricing data, request an audit to evaluate the accuracy, completeness, and currency of the cost or pricing data submitted by the contractor through the close of negotiations. As part of the request:</p> <ul style="list-style-type: none"><li>• Identify the suspect cost or pricing data.</li><li>• Describe, in detail, the reasons for suspecting that the data are defective.</li><li>• Provide the auditor a copy of:<ul style="list-style-type: none"><li>– The price negotiation memorandum (PNM) if one was not previously provided.</li><li>– The final proposal index of cost or pricing data provided by the contractor.</li><li>– Any cost or pricing data provided to the contracting officer to support the contractor's pricing proposal, but not previously provided to the auditor.</li></ul></li></ul> <p>If the auditor needs any additional information or support to complete the audit, you should provide it in a timely manner.</p> <p>Note: Public Law requires audit resolution within six months of the date that the audit is issued. Resolution occurs when the Government prenegotiation objective is documented and approved.</p>
<p>5. Determine whether the Contracting Officer identified the cost or pricing data as defective prior to the close of negotiations or did not rely on it when negotiating contract price.</p>	<p>Base the determination on available information. In particular consider information presented in the PNM.</p> <p>The Government cannot pursue a case of defective pricing against a contractor if the Contracting Officer knew that the data were not accurate, complete, and current prior to agreement on price and conclusion of negotiations.</p> <p>Similarly, if the Contracting Officer did not rely on the cost or pricing data provided, the Government was not harmed by the defective data.</p>

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## Tasks

## Related Standards

Tasks	Related Standards
6. Prepare for settlement discussions with the contractor.	<p>Prepare for discussions with the contractor considering the following sequence of events:</p> <ul style="list-style-type: none"><li>• Review the audit report in detail.</li><li>• Review any contractor comments included in the audit report.</li><li>• If the contractor does not accept the audit findings, provide a copy of the audit or a summary of key points to the contractor for a final review and response.</li><li>• Review related information available in the contracting office.</li><li>• Examine the contractor's review of and response to audit findings.</li><li>• If the contractor does not accept the audit findings and available information indicates that the data were defective and the resulting price difference significant, prepare a Government position for negotiations. In preparing that position:<ul style="list-style-type: none"><li>– Consider the requirements of FAR 15.407-1.</li><li>– Establish a price-adjustment baseline – the price supported by cost or pricing data submitted before the close of negotiations.</li><li>– Calculate a dollar-for-dollar reduction to estimate what the price would have been if the contractor had submitted accurate, compete and current cost or pricing data.</li><li>– Consider special rules for unused subcontractor quotes with defective data.</li><li>– Consider any offset for costs overstated because the contractor relied on defective cost or pricing data.</li><li>– Calculate the amount of any interest due the Government because the contractor was overpaid as a result of using item prices that were based on defective data.</li><li>– Calculate the amount of any penalty on any overpayment that resulted because cost or pricing data were defective.</li><li>– Obtain any required reviews or approvals. This action will normally meet the requirement for audit resolution.</li></ul></li></ul>



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## Tasks

## Related Standards

Tasks	Related Standards
7. Conduct settlement discussions with the contractor.	<p>When it would benefit discussions, invite the cognizant auditor to participate in discussions.</p> <p>In attempting to reach a settlement, do not:</p> <ul style="list-style-type: none"><li>• Allow any of the circumstances identified at FAR 15.407-1(b)(3) to affect the Government's right to a price adjustment.</li><li>• Make an agreement that precludes further defective pricing audit reviews on the same or other contracts.</li><li>• Make an agreement that is contingent upon settling defective pricing found in other contracts.</li><li>• Accept contractual goods or services on the same or other contracts as compensation for, or disposition of, a defective pricing case.</li><li>• Credit the amount of defective pricing in negotiating a concurrent or subsequent contract, including a follow-on contract.</li><li>• Adjust only one contract for defective pricing when the same defective pricing was cited on multiple contracts with the same contractor.</li><li>• Settle, compromise, pay, or otherwise adjust any claim involving fraud, or any claim or dispute for penalties or forfeitures prescribed by statute or regulation that another Federal agency is specifically authorized to administer, settle, or determine.</li></ul> <p>If a settlement cannot be reached, issue a Contracting Officer's final decision under the contract Disputes clause.</p>
8. Modify the contract to reflect the defective pricing settlement.	<p>If the contract price is reduced as a result of the alleged defective pricing, document the price reduction in a bilateral contract modification. Assure that the contract modification includes the following information:</p> <ul style="list-style-type: none"><li>• The repayment amount;</li><li>• The penalty amount (if any);</li><li>• The interest amount through a specified date; and</li><li>• A statement that interest will continue to accrue until the date repayment is made.</li></ul>

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## Related Standards

9. Obtain the amount due the Government as a result of the defective pricing.	If the amount due the Government exceeds the amount remaining on the contract, issue a demand letter to obtain the difference. Assure that the demand letter includes the following information: <ul style="list-style-type: none"><li>• The repayment amount;</li><li>• The penalty amount (if any);</li><li>• The interest amount through a specified date; and</li><li>• A statement that interest will continue to accrue until the date repayment is made.</li></ul>
10. Prepare a defective pricing memorandum for the contract file.	Prepare and distribute the memorandum as provided in FAR 15.406 and 15.407-1.