

**CHAPTER 4 - TYPES OF CONTRACTS AND ANALYSIS OF OFFERS**

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## CHAPTER 4 - TYPES OF CONTRACTS & ANALYSIS OF OFFERS

### CONTRACT TYPES

#### Part 4.1. Selecting Contract Type

##### 4.1.1. General

- a. The choice of contract type and price are closely related and must be considered together with the issues of requirement complexity, schedule, technical, and cost risks involved.
- b. The type of contract used should reflect the risks and responsibility assumed by the judiciary and the contractor. Full cost and performance responsibility is assumed by the contractor under a firm-fixed-price contract; while the contractor undertakes less cost and performance responsibility under cost-reimbursement, labor-hour and time-and-material contracts. Where the contractor does not take on the cost and performance risk, it must be assumed by the judiciary. The profit or fee calculations will also reflect the cost and performance cost responsibilities resulting from the contract type selected. Generally, a contractor will be able to collect more profit or fee as it assumes increased cost risks and performance risks.
- c. When a contract type other than firm-fixed-price is used, the contract file must include adequate documentation to explain the choice (i.e. memo to the file signed by the CO).
- d. This chapter describes various different contract types which are authorized for use in the judiciary. Contract types which require the prior approval of the PE are listed at [4.1.3.a](#). Any contract type not described in this chapter is not authorized for use in the judiciary. The most commonly used contract types include:
  - (1) firm-fixed-price (see [4.1.4.](#));
  - (2) indefinite-delivery (see [4.1.5.](#))
    - (a) indefinite-quantity and
    - (b) requirements;
  - (3) ordering agreement - a commonly used type of instrument even though it is not a contract (see [4.1.6.](#));
  - (4) labor-hour (see [4.1.7.](#)); and
  - (5) time-and-materials (see [4.1.8.](#)).

##### 4.1.2. Selecting Contract Type

- a. The CO is responsible for selecting the contract type appropriate to the circumstances of the procurement.
- b. Although contract type is a matter for negotiation, competitive purchasing procedures require that the solicitation specify an intended type of contract in order to provide a basis for comparing competing offers. Solicitation [Provision 4-1](#), "Type of Contract" must be included in all solicitations which exceed the judiciary's small purchase threshold (see [3.4.1.c](#). and [Guide Volume 1, Chapter 8, Part B](#)), and which are not for information or planning purposes. The CO will appropriately fill in the provision's blank spaces.
- c. A firm-fixed-price contract is generally preferred because it makes the contractor fully responsible for cost control, performance, and minimizes the need for judiciary

monitoring of cost performance. However, when there is no reasonable basis for firm fixed pricing, a solicitation requiring a firm-fixed-price contract may reduce competition. It may lead to higher prices because compensation for contingencies will be added by the offerors for protection from real or perceived risks. Whenever the probable cost of performance cannot be reasonably estimated, a firm-fixed-price contract should not be used.

- d. When a firm-fixed-price contract is not appropriate, costs may be controlled by using incentives. Efficient performance is promoted by relating the amount of profit or fee available under the contract to the contractor's ability to manage performance costs effectively.
- e. Factors to be considered include:
  - (1) realism of cost estimate;
  - (2) extent of competition;
  - (3) nature of the required product or service (e.g., commercial or developmental);
  - (4) performance risks and uncertainties;
  - (5) complexity of the requirement;
  - (6) adequacy and firmness of specifications;
  - (7) likelihood of changes;
  - (8) prior experience (pricing and production);
  - (9) extent of subcontracting;
  - (10) adequacy of contractor's cost estimating and accounting system; and
  - (11) urgency of the requirement.

#### 4.1.3. Limitations

- a. COs must obtain the prior written approval of the PE before using any of the following contract types:
  - (1) Indefinite-Delivery ([4.1.5.](#));
  - (2) Labor-Hour ([4.1.7.](#));
  - (3) Time and Materials ([4.1.8.](#));
  - (4) Letter Contract ([4.1.9.](#));
  - (5) Fixed-Price Award Fee ([4.1.10.](#));
  - (6) Fixed-Price Incentive Contract ([4.1.11.](#));
  - (7) Fixed-Price Contract with Economic Price Adjustment ([4.1.12.](#));
  - (8) Cost Reimbursement Contract ([4.1.13.](#)).
- b. If a situation develops where the CO determines that one of the contract types listed above would be of benefit for a particular procurement, a justification for the use of the specific contract type, along with a statement of work for the proposed procurement must be forwarded to the PE for review and written approval. A cost-plus-a-percentage-of-cost contract must not be used.

#### 4.1.4. Firm-Fixed-Price Contracts

- a. **Description** A firm-fixed-price (FFP) contract requires a price that is not subject to change or adjustment based on the contractor's cost of performance, provided the specified requirements are not changed during performance, and both parties fulfill their obligation under the contract. The contractor assumes full responsibility for all costs and

resulting profits/losses, maximizing the motive to control costs and perform effectively, economically, and efficiently. It is the least burdensome type of contract for the judiciary to administer when requirements are stable. However, if frequent changes are likely, administration will be difficult. The amount to be recorded is the full contract/delivery order/task order price using funds available in the period awarded, regardless of whether or not performance will continue into future fiscal years. For a firm fixed price contract, delivery order or task order in which the government has an option to purchase additional products and/or services, the contract price for the basic products and/or services is an obligation at the time the contract is awarded, and the options become an obligation only when they are exercised.

**b. Application** A firm-fixed-price contract is suitable for:

- (1) commercial products or services;
- (2) modified commercial products or services; or
- (3) products or services having reasonably definitive specifications or statements of work; and
- (4) whenever fair and reasonable prices can be reasonably estimated at the procurement outset, such as when:
  - (a) adequate price competition is anticipated;
  - (b) there are reasonable price comparisons with prior purchases of the same or similar products or services made on a competitive basis;
  - (c) in noncompetitive procurement situations, it is anticipated that cost or pricing data is expected to be adequate to permit realistic and reasonable estimates of the costs of performance; or
  - (d) the cost impact of performance uncertainties can be estimated closely enough to reach agreement on a reasonable price representing appropriate assumption of the risks involved.

#### 4.1.5. Indefinite-Delivery Contracts: Indefinite Quantity and Requirements

**a. General** An indefinite delivery contract may be used when it is known or anticipated that there will be requirements for products or services over a period of time, but specific quantities, times, and/or places of delivery are not known at the time of contract award. The contract authorizes orders to be placed directly by using activities or by specified purchasing offices with contract deliveries made directly to using activities. Only the amount of the minimum guarantee must be obligated with funds at the time of award. The later placement of delivery and task orders against the contract will require additional fund obligations when placed. The amount to be obligated against individual orders will depend upon the prescribed order type. Fixed price orders must be obligated to the full amount of the order; labor hour or time and materials orders may be incrementally funded.

**b. Reserved**

**c. Reserved**

**d. Indefinite-Quantity Contracts** An indefinite delivery/indefinite-quantity (IDIQ) contract provides for an indefinite quantity of specific products or services, within

contract specified minimum and maximum limits, to be delivered during the contract period to designated locations when ordered. The stated minimum quantity is guaranteed to be ordered. However, the total estimated quantity is not guaranteed. The price for the guaranteed minimum is obligated at contract award. Additional quantities up to the stated contract maximum are obligated on individual delivery orders or task orders. Maximum limits may be stated on an individual order basis or for the contract as a whole or both. Minimums and maximums may be stated in terms of quantities or in terms of dollars. This type is for use when precise quantities for products or services during the contract period, above known minimum requirements, cannot be determined before contract award.

- (1) The contract must require the judiciary to order, and the contractor to deliver, at least a stated minimum quantity of products or services during the contract period and requires the contractor to deliver any additional quantities ordered, not to exceed a stated maximum quantity. If the judiciary does not order the guaranteed minimum quantity over the stated term of the contract, the contractor is entitled to payment of the guaranteed amount regardless of the circumstances.
- (2) The established minimum quantity must not exceed known requirements and the maximum quantity must be realistic. The contract may specify minimum or maximum quantities for individual delivery orders and a maximum that may be ordered during a specified time. The contractor is not obligated to deliver or perform beyond the stated maximum amounts.

**e. Requirements Contracts** A requirements contract provides for filling all requirements of designated activities for specific products and services to be delivered as ordered during the contract period. It is for use when recurring requirements are anticipated during the contract period, but precise quantities cannot be determined before contract award. However, this contract type must be used cautiously, as it obligates the designated judiciary activities to place all of their orders for the specific products and services during the life of the contract with the contractor.

- (1) The solicitation and contract must state an estimated total quantity, and, if feasible, the maximum limit of the contractor's obligation to deliver. The total quantity estimate must be as realistic as possible, based on records of previous requirements and current information. The contract may specify minimum or maximum quantities for individual delivery orders and a maximum that may be ordered during a specified ordering period. The estimates of a requirements contract are not a commitment that the estimated quantity will be ordered and there is no minimum order requirement.
- (2) When a requirements contract is for repair, modification, or overhaul of items of judiciary property, the solicitation must state that failure of the judiciary to furnish such items in the amounts described as "estimated" or "maximum" will not entitle the contractor to any price adjustment under the "Property" clause of the contract.

**f. Contract Terms**

Both IDIQ contracts and requirements contracts must identify the period for placing orders and the activities authorized to place orders. The contract must also state estimated quantities, describe the scope of the products or services to be provided, contain appropriate terms and conditions, and provide for the placement of delivery orders or task orders by the CO. These two types of contracts are suitable when

purchasing an estimated kind and amount of products or services anticipated to be needed, but the requirement is not definite at the time of contract award. In addition, IDIQ solicitations must state whether a single award or multiple awards are anticipated, and, in the case of multiple awards, must state the basis for competing delivery or task orders under the contract. See [3.5.1.c.\(26\)](#) instructions for use of [Provision 3-135](#), “Single or Multiple Awards.”

**g. Delivery Orders or Task Orders**

- (1) Delivery orders (for products) and task orders (for services, or services with some products) are two types of orders that can be placed under indefinite contracts. Once it is clear what is needed, the CO places orders against the contract. These orders clearly quantify and specify the requirement to deliver products or task the contractor to perform services in accordance with the terms and conditions of the contract.
- (2) Each order describes the products to be delivered or task to be performed and specifies the price, either as the price established by the contract or the price agreed to after competition and negotiation.
- (3) Each order must be within the scope, period, and maximum value of the contract.
- (4) Ordinarily, orders must be placed in writing or by written communication; when necessary, oral orders may be made if they are promptly confirmed in writing. Orders must contain:
  - (a) date of order, contract number, and order number;
  - (b) item number and description, unit price, and total price;
  - (c) place and date of delivery or performance;
  - (d) packaging, packing, and shipping instructions (if these are not already defined in the contract);
  - (e) accounting and fiscal data; and
  - (f) any other pertinent information.
  - (g) If the price cannot be negotiated before issuance of the order, the order must have a ceiling price limiting the judiciary’s obligation and the definitive price must be negotiated as soon as practicable.

**h. Reserved**

**i. Clauses**

- (1) The following clauses are included when a requirements contract, or an IDIQ contract is contemplated:
  - (a) [Clause 4-5](#), “Ordering,” and
  - (b) [Clause 4-10](#), “Order Limitations.” The CO will appropriately fill in the clause’s blank spaces;
- (2) Reserved
- (3) [Clause 4-20](#), “Requirements” when an indefinite delivery, requirements contract is contemplated;
- (4) [Clause 4-25](#), “Indefinite Quantity” when an indefinite delivery, indefinite-quantity contract is contemplated.

**4.1.6. Ordering Agreements**

- a. General** Ordering agreements (i.e., blanket purchasing agreement (BPA), basic ordering agreement (BOA), and basic agreement (BA)) do not constitute legally binding contracts at the time of award, and thus, no obligation must be recorded. An ordering agreement is not a contract. It is a written agreement negotiated between a purchasing office and a contractor that contains terms and conditions applying to future transactions between the parties. Ordering agreements are useful to expedite contracting for uncertain requirements for products or services when specific quantities and prices are not known at the time the agreement is signed, but substantial quantities of the products or services covered by the agreement are expected to be purchased from the contractor. Ordering agreements reduce administrative lead time and inventory investment. They are agreements that establish the terms and conditions, and sometimes the price.
- b. Types of Ordering Agreement**
- (1) A **BPA** is a simplified way of buying products and services. The BPA contains pre-negotiated terms and conditions that will apply if and when an order (or “call”) is placed against the BPA for products or services. Funds are not required at the time a BPA is established; funds are obligated at the time a call is placed against the BPA. BPA calls can be made informally by telephone, fax, letter, email, etc. BPAs are very useful for a repetitive requirement over a period of time. There are two sources for BPAs - open market and GSA; and two types - single and multiple. See [3.4.8.b.](#) for further information on awarding BPAs and placing orders.
  - (2) A **BOA** is a written instrument of understanding, negotiated between the judiciary purchasing office, and a contractor. The use of a BOA can result in economies in ordering parts for equipment by reducing administrative lead-time, inventory investment, and inventory obsolescence due to design changes. A BOA may be used to expedite contracting for uncertain requirements for products or services when specific items, quantities, and prices are not known at the time the agreement is executed, but a substantial number of requirements for the type of products or services covered by the agreement are anticipated to be purchased from the contractor. Orders issued under a BOA require competition above the open market noncompetitive threshold or advertising for any individual call above the small purchase threshold unless a valid exemption is justified. For open market BOAs which were competed, there is no requirement to compete each individual call regardless of the dollar amount. A BOA contains:
    - (a) terms and clauses applying to future contracts (orders) between the parties during its terms;
    - (b) a description, as specific as practicable, of products or services to be provided; and
    - (c) methods for pricing, issuing and delivering future orders under the BOA.
  - (3) A **BA** will be used when a substantial number of separate contracts may be awarded to a contractor during a particular period and significant recurring negotiating problems have been experienced with the contractor. A BA is a written instrument of understanding, negotiated between the judiciary purchasing office and a contractor that:
    - (a) contains contract clauses applying to future contracts between the parties during its term, and



- (b) contemplates separate future contracts that will incorporate by reference or attachment the required and applicable clauses agreed upon in the basic agreement.
- c. **Obligation** The obligation of funds for agreements occurs when an order (or “call”) is placed. The amount to be obligated on such orders depends on the order type (i.e., fixed-price, labor hour, time and material, etc). Note: All BPA calls must be firm fixed price or fixed unit price.
- d. **Limitations**
  - (1) An ordering agreement may not state or imply any obligation or agreement by the judiciary to place future contracts or orders with the contractor.
  - (2) An ordering agreement may be changed only by modifying the agreement itself and not by individual orders issued under it. Modifying an ordering agreement does not retroactively affect orders previously issued under it.
  - (3) An ordering agreement extending for more than one year must be reviewed annually to determine whether there is a continuing need for the products or services covered by the agreement and whether any revisions to the agreement are necessary.
- e. **Content of Agreement** An ordering agreement must:
  - (1) describe the products and services to be provided;
  - (2) describe the method for determining prices to be paid to the contractor for the products or services;
  - (3) include delivery terms and conditions or specify how they will be determined;
  - (4) list the authorized ordering officers of the requesting office authorized to issue orders under the agreement;
  - (5) specify the point at which each order becomes a binding contract (for example, issuance of the order, acceptance of the order in a specified manner, or failure to reject the order within a specified number of days);
  - (6) provide that failure to reach agreement on price on any one order issued before its price is established is a dispute under [Clause 7-235](#), “Disputes” included in the ordering agreement; and
  - (7) contain the clauses prescribed for the type of contract represented by the orders to be placed. Note: BPAs are always firm-fixed price. For clauses which are prescribed according to the contract dollar amount, the aggregate value of orders expected to be placed under the agreement over its full life must be estimated.
- f. **Ordering** A CO or an authorized ordering officer representing any requesting office listed in an ordering agreement may issue orders for products or services covered by that agreement. Competition must be obtained before placing an order, unless permitted by other than full and open competition circumstances. (See [3.4.8.b](#). concerning awarding BPAs and ordering from them. Also see [3.6](#).) If an order is placed without obtaining competition, the file must be documented to show the reason. If the orders are competed open market, then the ordering agreement must state that it is open, allowing any other qualified firms to get agreements at any time (does not apply to BPAs).
- g. The CO will state in the solicitation how the BPA, BOA or BA will be competed. Competition for ordering agreements may be by oral or written solicitation:
  - (1) limited to firms holding ordering agreements for the same products or services;
  - (2) competed on the open market subject to the estimated dollar value of the requirement and the terms and conditions of the ordering agreement; or

(3) both (1) and (2).

- h. Pricing** Ordinarily, the CO may not authorize the contractor to begin work on an order under an ordering agreement until prices have been established. However, with prior written approval of the PE, if urgency precludes advance pricing and the order establishes a ceiling price limiting the judiciary's obligation, then the CO may place an unpriced order. Pricing must be accomplished as soon as possible after issuance of an unpriced order.

#### 4.1.7. Labor-Hour Contracts

- a.** A labor-hour contract provides for direct labor hours at specified, fixed hourly rates (which include wages, overhead, general and administrative expense, and profit). It requires labor hours only; materials are not supplied by the contractor. Labor hour contracts containing a not to exceed amount may be fully funded at the time of award or may be incrementally funded provided that the funding balance is always in excess of the cumulative value of the services ordered, and provided that a clause reserving this right is contained in the contract.
- b. Application** A labor-hour contract is for use only when it is not possible to estimate in advance the extent or duration of the work required or to anticipate costs with any reasonable degree of confidence. It does not encourage effective contractor management or control of costs. Therefore, this contract form may be used only when provision is made for adequate monitoring by judiciary personnel during performance, to give reasonable assurance that inefficient or wasteful methods are not being used. Examples of situations in which this type of contract might be appropriate are:
- (1) repair, maintenance, and overhaul work; and
  - (2) work to be done in emergency situations.
- c. Limitation** This type of contract may be used only if no other type of contract will meet the judiciary's needs and when approved in writing by the PE. The CO must establish a ceiling price that the contractor exceeds only at its own risk. The CO must document the contract file to show the basis for any change in the ceiling.
- d. Clause** [Clause 4-30](#), "Payment (Time-and-Materials and Labor-Hour Contracts)" is included when a time-and-materials or labor-hour contract is contemplated.

#### 4.1.8. Time-and-Materials Contracts

- a. Description** Time-and-materials contracts reimburse the contractor for labor at fixed labor rates and for materials at cost. The contract must contain a not-to-exceed amount and may be fully funded at the time of award or incrementally funded provided that the funding balance is always in excess of the cumulative value of the services ordered and the materials provided, and provided that a clause reserving this right is contained in the contract. A time-and-materials contract is similar to a labor-hour contract except that it includes reimbursement at cost for materials. It provides for the purchase of:
- (1) direct labor hours at specified, fixed hourly rates (which include wages, overhead, general and administrative expense, and profit); and
  - (2) materials reimbursed at cost. No profit is allowed on the material component of a time and materials contract. When appropriate, material-handling costs are reimbursed as a part of material costs. Material-handling costs may include all

indirect costs, including general and administrative expense, allocated to direct materials in accordance with the contractor's usual accounting practices. Such material-handling costs may include only costs clearly excluded from the fully burdened labor-hour rate.

- b. Application** A time-and-materials contract is for use only when it is not possible to estimate in advance the extent or duration of the work required or to anticipate costs with any reasonable degree of confidence. Because it does not encourage effective contractor management control of costs by the contractor, this contract form may be used only when provision is made for adequate monitoring by judiciary personnel during performance, to give reasonable assurance that inefficient or wasteful methods are not being used. Examples of situations in which this type of contract might be appropriate are:

  - (1) repair, maintenance, and overhaul work; and
  - (2) work to be done in emergency situations.
- c. Limitation** This type of contract may be used only if no other type of contract will meet the judiciary's needs and when approved in writing by the PE. The CO must establish a ceiling price that the contractor exceeds at its own risk. The CO must document the contract file to show the basis for any change in the ceiling.
- d. Optional Method of Pricing Material** When the work to be performed requires the contractor to furnish material that is regularly sold to the general public in the normal course of business by the contractor, the CO may provide for charging and reimbursement of material on a basis other than at cost if:

  - (1) the total estimated contract price does not exceed \$25,000 or the estimated price of material so charged does not exceed 20 percent of the estimated contract price;
  - (2) the material to be so charged is identified in the contract;
  - (3) no element of profit on material so charged is included in the profit in the fixed hourly labor rates; and
  - (4) the contract provides that the price to be paid for such material must be on the basis of an established catalog or list price, in effect when material is furnished, less all applicable discounts, and not exceeding the contractor's sales price to its most favored customer for the same item in like quantity, or the current market price, whichever is lower.

#### 4.1.9. Letter Contract

- a. Description** A letter contract is a written preliminary contractual instrument that authorizes the contractor to begin work immediately, before negotiation of a definitive contract.
- b. Application** A letter contract is for use when:

  - (1) the requirement demands that the contractor be given a binding commitment so that work can commence immediately; and
  - (2) it is not possible to negotiate a definitive contract in sufficient time to meet the requirement.
- c.** Each letter contract must be as complete and definitive as possible under the circumstances. When award is based on price competition, an overall price ceiling must be included in the letter contract.
- d.** Each letter contract must contain a negotiated definitization schedule including a:

  - (1) date for submission of the contractor's priced offer;

- (2) date for the start of negotiation; and
- (3) target date for definitization, which must be the earliest practicable date.
- e. Each letter contract must state the maximum liability of the judiciary. This is the amount estimated to be needed to cover performance prior to contract definitization; it may not exceed 50 percent of the total estimated cost of the contract.
- f. The definitization schedule must provide for definitization of the contract within 180 days after the date of the letter contract or before completion of 40 percent of the work to be performed, whichever occurs first. However, the PE may, in extreme cases, authorize an additional period if, after exhausting all reasonable efforts, the CO and the contractor cannot negotiate a definitive contract agreement because of failure to reach agreement on price or fee. [Clause 4-45](#), “Contract Definitization” requires the contractor to proceed with the work and provides that the CO may determine a reasonable price or fee subject to appeal as provided in [Clause 7-235](#), “Disputes.”
- g. **Limitations** A letter contract:
  - (1) may be used only if no other type of contract is suitable and if prior written approval is given by the PE;
  - (2) may not commit the judiciary to a definitive contract in excess of the funds available at the time the letter contract is executed; and
  - (3) may not be modified to add new work unless the work added is inseparable from the work being performed under the letter contract.
- h. **Clauses**  
A letter contract must include clauses required for the type of definitive contract contemplated, and any additional clauses known to be appropriate. In addition, all letter contracts must include the following clauses:
  - (1) [Clause 4-35](#), “Execution and Commencement of Work (Letter Contract)”. The CO will appropriately fill in the clause’s blank spaces;
  - (2) [Clause 4-40](#), “Limitation of Judiciary Liability (Letter Contract)”. The maximum liability in the clause is the amount necessary to cover the contractor’s performance before definitization. The CO will appropriately fill in the clause’s blank spaces.
  - (3) [Clause 4-45](#), “Contract Definitization”. Also included is the definitization schedule established in accordance with subparagraphs (a) and (b) above. If the contract is not awarded on the basis of price competition, paragraph (d) of the clause is omitted. The CO will appropriately fill in the clause’s blank spaces.
  - (4) [Clause 4-50](#), “Payment of Allowable Costs Before Definitization,” is included when definitization of the letter contract is expected to result in a definitive cost-reimbursement contract.

#### 4.1.10. Fixed-Price Award Fee Contract

- a. **Description** A fixed-price award fee contract is used in fixed-price contracts when the judiciary wishes to motivate a contractor and another incentive cannot be used because contractor performance cannot be measured objectively.
- b. **Application** Such contracts must:
  - (1) establish a fixed price (including normal profit) for the effort. This price will be paid for satisfactory contract performance. Award fee earned (if any) will be paid in addition to the fixed price; and

- (2) provide for periodic evaluation of the contractor's performance against an award-fee plan.
- c. Limitations** A solicitation contemplating award of a fixed-price contract with award fee must not be issued unless the following conditions exist:
- (1) the administrative costs of conducting award-fee evaluations are not expected to exceed the expected benefits;
  - (2) procedures have been established for conducting the award-fee evaluation;
  - (3) the award-fee board has been established; and
  - (4) may be used only if no other type of contract is suitable and if prior written approval is given by the PE.

#### 4.1.11. Fixed-Price Incentive Contract

- a. Description** A fixed-price incentive (FPI) contract specifies fixed prices, but provides for a profit adjustment formula to be applied either at a pre-determined mid-point of performance or upon completion of performance in order to establish the final contract price. The formula is based on the relationship of the total actual cost to an established target cost. For each item subject to incentive price revision, the contract must specify a target cost, a target profit, a target price, a price ceiling, and a profit adjustment formula. The price ceiling is the maximum that may be paid to the contractor, except for adjustments specially provided for under contract clauses.
- b. Application** A fixed-price incentive contract is appropriate when the parties can negotiate at the outset an initial target cost, target profit, and profit adjustment formula that will provide a fair and reasonable incentive and a ceiling that provides for the contractor to assume an appropriate share of the risk. When the contractor assumes a considerable or major share of the cost responsibility under the adjustment formula, the target profit must reflect this responsibility.
- c. Limitations** This contract type may be used only when:
- (1) a firm-fixed-price contract is not suitable;
  - (2) the nature of the products or services being procured and other circumstances of the procurement are such that the contractor's assumption of a degree of cost responsibility will provide a positive profit incentive for effective cost control and performance; and:
    - (a) if the contract also includes incentives on technical performance or delivery, the performance requirements provide a reasonable opportunity for the incentives to have a meaningful impact on the contractor's management of the work;
    - (b) the contractor's accounting system is adequate for providing data for negotiating firm targets and a realistic profit adjustment formula, as well as later negotiation of final costs; and
    - (c) adequate cost or pricing information for establishing a reasonable firm target is reasonably expected to be available for contract negotiations.
  - (3) A fixed-price incentive contract must be used only when the CO determines that this type of contract would be less costly than another type or that it is impractical to obtain products or services of the kind or quality required without the use of this contract type.

- (4) A fixed-price incentive contract with a firm target must at the outset of the contract negotiate and specify these elements:
  - (a) a target cost;
  - (b) a target profit;
  - (c) a price ceiling (but not a profit ceiling or floor);and
  - (d) a profit adjustment formula.
- (5) The profit adjustment formula must have the following:
  - (a) when the final cost is less than the target cost, application of the formula will result in a final profit greater than the target profit;
  - (b) when the final cost is more than the target cost, application of the formula will result in a final profit less than the target profit or net loss; and
  - (c) if the final negotiated cost exceeds the price ceiling, the contractor will absorb the difference as a loss.
- (6) In a fixed-price incentive contract with a firm target, the price ceiling must be the maximum that may be paid to the contractor, except for any adjustment under other contract clauses.
- (7) When the contractor completes contract performance, the CO and the contractor must negotiate the contractor's final cost and establish the final price by applying the formula.

#### 4.1.12. Fixed-Price Contract with Economic Price Adjustment

- a. **Description** A fixed-price contract with economic price adjustment provides for the upward and downward revision of the contract price based upon the occurrence of contingencies that are defined in the contract.
- b. **Application** This type of contract is appropriate when there is serious doubt as to the stability of market and labor conditions that will exist during an extended period of contract performance and contingencies that would otherwise be included in a firm-fixed-price contract are identifiable and can be covered separately. Its usefulness is limited by the difficulties of its administration.
- c. **Limitation** The CO must not use a fixed-price contract with economic price adjustment unless the CO first determines that it is necessary to protect the contractor and the judiciary against significant fluctuations in labor or material costs or to provide for contract price adjustment in the event of changes in the contractor's established prices.
- d. An economic price adjustment may be one of the following general types:
  - (1) adjustment in price based on increases or decreases from an agreed-upon level in published or otherwise established prices of specific items or the contract end items (e.g., Consumer Price Index);
  - (2) adjustment based on increases or decreases in specified costs of labor or material that the contractor actually experiences during contract performance; or
  - (3) adjustment based on increases or decreases in labor or material cost standards or indices that are specifically identified in the contract.
- e. Price adjustments based on established catalog prices must be restricted to industry-wide contingencies. Industry-wide contingencies must be those affecting a particular industry as a whole and not be dependent on circumstances within the contractor's control.
- f. Price adjustments based on labor and material costs must be limited to contingencies beyond the contractor's control.

- g.** When establishing the base level from which adjustment may be made, the CO must ensure that contingency allowances are not duplicated by inclusion in both the base price and the adjustment requested by the contractor.
- h.** In contracts that do not require submission of cost or pricing data, the CO must obtain adequate information to establish the base level from which adjustments will be made and may require verification of data submitted.
- i.** Fixed-price contracts provide for economic price adjustment when:

  - (1) there is no major element of design engineering or development work involved,
  - (2) there are identifiable labor or material cost factors subject to change, and
  - (3) the CO determines it is necessary to protect the contractor and the judiciary against significant fluctuations in labor or material costs or to provide for contract price adjustment in the event of changes in the contractor's established prices.
- j. Clauses** When contemplating standard products that have an established catalog or market price [Clause 4-55](#), "Economic Price Adjustment-Standard Products" must be included. The offeror will appropriately fill in the clause's blank spaces.

#### 4.1.13. Cost-Reimbursement Contract

- a. General** Cost reimbursement contracts may be incrementally funded, as long as the amount obligated is always in excess of the cumulative costs that it is anticipated that the contractor will incur during the following voucher period. These contracts establish an estimate of the total performance cost for the purpose of committing and obligating funds. They also establish a total estimated reimbursement cost. The contractor may not exceed the total estimated reimbursement cost, except at its own risk, without the prior written approval of the CO. Cost-reimbursement contracts are suitable for use only when uncertainties involved in contract performance do not permit the establishment of reasonably accurate fixed prices.
- b. Limitations** A cost-reimbursement contract may be used only when:

  - (1) the contractor's accounting system is adequate for recording and segregating costs applicable to the contract;
  - (2) appropriate judiciary monitoring during performance will provide reasonable assurance that efficient methods and effective cost controls are used; and
  - (3) the CO determines in writing, that:

    - (a) the use of a cost-reimbursement type contract is likely to be less costly than any other type; or
    - (b) it is impractical to obtain products or services of the kind or quality required without the use of this contract type.
- c. Cost Contract** A cost contract is a cost-reimbursement contract under which the contractor receives no fee (profit). A cost contract may be appropriate for research and development work, particularly with nonprofit educational institutions or other nonprofit organizations.
- d. Cost-Sharing Contract** A cost-sharing contract is a cost-reimbursement type contract under which the contractor does not receive a fee and is reimbursed only for an agreed upon portion of its allowable costs. It is suitable for use where there is a high probability that the contractor will receive substantial commercial benefits as a result of contract performance.
- e. Cost-Plus-Incentive-Fee Contract**

- (1) A cost-plus-incentive-fee contract is a cost-reimbursement contract that provides for the initially negotiated fee to be adjusted later by application of a formula based on the relationship of total allowable performance costs to target costs. This contract type specifies a target cost, a target fee, minimum and maximum fees, and a fee adjustment formula.
- (2) **Application** A cost-plus-incentive-fee contract is suitable when a cost-reimbursement contract is appropriate and a target cost and fee adjustment formula likely to motivate the contractor to manage the contract effectively can be negotiated. The fee adjustment formula must provide an incentive effective over the full range of reasonably foreseeable variations from target cost. If a high maximum fee is negotiated, the contract must provide for a low minimum fee, or even a zero or negative fee.

**f. Cost-Plus-Fixed-Fee Contract**

- (1) **Description** A cost-plus-fixed-fee contract is a cost-reimbursement contract that provides for payment to the contractor of a negotiated fee in a fixed amount. The fixed fee amount does not vary with actual performance costs incurred, but may be adjusted as a result of changes made in contract requirements. This contract type gives the contractor only a minimum incentive to control costs.
- (2) **Application** The CO may use a cost-plus-fixed-fee contract when contracting for efforts that might otherwise present too great a risk to the contractor, such as when the contract is for a study and the level of effort cannot be reasonably estimated.
- (3) **Completion or Term Form** A cost-plus-fixed-fee contract must be in one of two basic forms: the **completion** form or the **level-of-effort** form.
  - (a) **Completion Form** The completion contract form describes the scope of work by stating a definite goal or target and specifying an end product deliverable. This form of contract normally requires the contractor to complete and deliver the specified end product within the estimated cost, if possible, as a condition for payment of the entire fixed fee. If the work cannot be completed within the estimated cost, the judiciary may require more effort without an increase in fee, but the estimated cost and funding must be increased.
  - (b) **Term Form** The term form describes the scope of work in general terms and obligates the contractor to devote a specified level of effort for a stated time period. Under this form, if performance is satisfactory, the fixed fee is payable at the expiration of the agreed upon period, upon contractor certification that the level of effort specified in the contract has been expended in performing the contract work. It does not require a deliverable end product. Renewal for further periods of performance requires new cost and fee arrangements and is treated as a new purchase.
- (4) **Preference** Because of the greater risks and obligation assumed by the contractor, the completion form is preferred over the term form whenever the work can be defined well enough to permit a reasonable cost estimate within which the contractor can be expected to complete the work.

**g. Cost-Plus-Award-Fee Contract**

- (1) **Description** A cost-plus-award-fee contract is a cost-reimbursement contract that provides for a fee consisting of



- (a) a base amount (which may be zero) fixed at inception of the contract; and
- (b) an award amount, based upon a judgmental evaluation by the judiciary, sufficient to provide motivation for excellence in contract performance in such areas as quality, timeliness, technical ingenuity, and cost-effective management. The amount of the award fee to be paid is determined by the judiciary's judgmental evaluation of the contractor's performance in terms of the criteria stated in the contract. This determination and the methodology for determining the award fee are unilateral decisions made solely at the discretion of the judiciary.

(2) **Application**

- (a) The cost-plus-award-fee contract is suitable for use when:
  - 1) the work to be performed is such that it is neither feasible nor effective to devise predetermined objective incentive targets applicable to cost, technical performance, or schedule;
  - 2) the likelihood of meeting procurement objectives will be enhanced by using a contract that effectively motivates the contractor toward exceptional performance and provides the judiciary with the flexibility to evaluate both actual performance and the conditions under which it was achieved; and
  - 3) any additional administrative effort and cost required to monitor and evaluate performance are justified by the expected benefits.
- (b) The number of evaluation criteria and the requirements they represent will differ widely among contracts. The criteria and rating plan must motivate the contractor to improve performance in the areas rated, but not at the expense of at least minimum acceptable performance in all other areas.
- (c) Cost-plus-award-fee contracts must provide for evaluation at stated intervals during performance, so that the contractor will periodically be informed of the quality of its performance and the areas in which improvement is expected. Partial payment of fee must generally correspond to the evaluation periods. This makes effective the incentive which the award fee can create by inducing the contractor to improve poor performance or to continue good performance.

(3) **Limitations** A cost-plus-award-fee contract will not be awarded unless:

- (a) all of the limitations in [4.1.13.b](#) are complied with; and
- (b) the contract amount, performance period, and expected benefits are sufficient to warrant the additional administrative effort and cost involved.

**h. Clauses** Cost-reimbursement contracts must include the following clauses, as applicable:

- (1) [Clause 4-60](#), "Allowable Cost and Payment" is included when a cost reimbursable contract is contemplated;
- (2) Cost plus-fixed-fee contracts must include [Clause 4-65](#) "Fixed Fee";
- (3) Cost-plus-incentive-fee contracts must include [Clause 4-70](#), "Incentive Fee". The CO will appropriately fill in the clause's blank spaces.
- (4) Cost no fee contracts must include [Clause 4-75](#), "Cost Contract - No Fee";
- (5) Cost-sharing contracts must include [Clause 4-80](#), "Cost-Sharing Contract - No Fee;"

- (6) Include [Clause 4-85](#), “Limitation of Cost” when a fully funded cost reimbursable contract is contemplated, whether or not the contract provides for payment of a fee;
- (7) Include [Clause 4-90](#), “Limitation of Funds” when an incrementally funded cost reimbursable contract is contemplated.

#### 4.1.14. Multi-Year Contracts

##### a. General

This part prescribes guidance for the acquisition of products and services through multi-year contracting;

- (1) Definitions as used in this subpart—
  - (a) “Cancellation” means the cancellation (within a contractually specified time) of the total requirements of all remaining contract years. Cancellation results when the contracting officer notifies the contractor that funds will not be made available for contract performance for any subsequent contract year
  - (b) “Cancellation ceiling” means the maximum cancellation charge that the contractor can receive in the event of cancellation.
  - (c) “Cancellation charge” means the amount of unrecovered costs which would have been recouped through amortization over the full term of the contract, including the term canceled.
  - (d) “Multi-year contract” means a contract for the purchase of products or services for more than 1, but not more than 5, contract years. A multi-year contract may provide that performance under the contract during the second and subsequent years of the contract is contingent upon the appropriation of funds, and (if it does so provide) may provide for a cancellation payment to be made to the contractor if appropriations are not made. The key distinguishing difference between multi-year contracts and multiple year contracts is that multi-year contracts represent more than one year’s commitment to a vendor without establishing and having to exercise an option for each contract year after the first.
  - (e) “Fixed costs” means those costs which are generally incurred on a one-time basis and include such costs as plant or equipment relocation, plant rearrangement, special tooling and special test equipment, preproduction engineering, initial spoilage and rework, and specialized work force training.
  - (f) “Variable costs” means costs that vary with the quantity being produced, such as labor and materials.

##### b. Multi-year contracting.

Multi-year contracting is a special contracting method which allows the judiciary to order products or services to meet known requirements over a period of up to a maximum of five years, unless otherwise authorized by statute. Multi-year contracts are not indefinite ordering vehicles and the solicitation and contract are limited to definite known requirements for the proposed multi-year period. Multi-year contracts may either be fully funded for the entire multi-year period at the time of award or may be funded by

contract year. See Paragraph [4.1.14.e\(1\)](#) below regarding requirements to fund cancellation charges when annually funding multi-year contracts.

- (1) Multi-year contracting is a flexible contracting method applicable to a wide range of acquisitions. The extent to which cancellation terms are used in multi-year contracts will depend on the unique circumstances of each contract.
- (2) The funds obligated for multi-year contracts must be sufficient to cover any potential cancellation and/or termination costs; and multi-year contracts for the acquisition of products should be fully funded or funded in stages that are economically or programmatically viable. If funded in stages, the funding must always include the potential cancellation costs.
- (3) The termination for convenience procedure may apply to any Government contract, including multiyear contracts. As contrasted with cancellation, termination can be effected at any time during the life of the contract (cancellation is effected between contract years) and can be for the total quantity or partial quantity (where as cancellation must be for all subsequent contract years' quantities).

**c. Use of Multi-Year Contracting:**

- (1) Prior to issuance of a multi-year solicitation or contract, the contracting officer must prepare and obtain PE approval of a determination addressing the following factors:
  - (a) The need for the products or services is reasonably firm and continuing over the period of the contract; and
  - (b) A multi-year contract will serve the best interests of the Judiciary by encouraging full and open competition or promoting economy in administration, performance, and operation of the agency's programs. Factors which should be addressed within the required determination and finding to the extent that they are applicable include:
    - 1) Lower costs;
    - 2) Enhancement of standardization;
    - 3) Reduction of administrative burden in the placement and administration of contracts;
    - 4) Substantial continuity of production or performance, thus avoiding annual startup costs, preproduction testing costs, make-ready expenses, and phaseout costs;
    - 5) Stabilization of contractor work forces;
    - 6) Avoidance of the need for establishing quality control techniques and procedures for a new contractor each year;
    - 7) Broadening the competitive base with opportunity for participation by firms not otherwise willing or able to compete for lesser quantities, particularly in cases involving high startup costs;
    - 8) Providing incentives to contractors to improve productivity through investment in capital facilities, equipment, and advanced technology.

**d. Type of contract.** If a fixed price multi-year contract is planned, the Contracting Officer should consider inclusion of economic price adjustment terms and profit objectives commensurate with contractor risk and financing arrangements.

**e. Cancellation procedures.**

- (1) All contract years except the first are subject to cancellation. For each contract year subject to cancellation, the contracting officer shall establish a cancellation ceiling. Ceilings must exclude amounts for requirements included in prior contract years. The contracting officer shall reduce the cancellation ceiling for each contract year in direct proportion to the remaining requirements subject to cancellation. If a multi-year contract is not fully funded upon award, but is funded at the beginning of each contract year, the modification obligating each year's funds must also establish and obligate the cancellation ceiling or cancellation charge applicable in the event the contract is cancelled at the end of that contract year.
  - (2) The contracting officer shall incorporate in the contract cancellation dates for each contract year's requirements and the date by which funding for these requirements can reasonably be established.
- f. Payment of cancellation charges.** If cancellation occurs, the Government's liability will be determined by the terms of the applicable contract.
- g. Payment limit.** The contracting officer shall limit the Government's obligation to an amount available for contract performance. If funding at the beginning of each contract year, the contracting officer shall insert the amount for the first contract year in the contract upon award and modify it for successive contract years upon availability of funds.
- h. Termination payment.** If the contract is terminated for the convenience of the Government in whole, including requirements subject to cancellation, the Government's obligation shall not exceed the amount specified in the contract as available for contract performance, plus the cancellation ceiling.
- i. Solicitations.** Solicitations for multi-year contracts may be awarded on either a best value or a lowest price/technically acceptable basis. In either case, the solicitation must identify all the factors related to multi-year contracting that will be considered in offer evaluation and shall including the following specific information:
- (1) The requirements, by item of supply or service, for the—
    - (a) First contract year; and
    - (b) Multi-year contract including the requirements for each contract year.
  - (2) Criteria for comparing the lowest evaluated submission on the first contract year requirements to the lowest evaluated submission on the multi-year requirements.
  - (3) A provision that, if the Government determines before award that only the first contract year requirements are needed, the Government may evaluate offers and make award solely on the basis of prices offered on that year's requirements.
  - (4) A provision for the vendor to propose a separate cancellation ceiling (on a percentage or dollar basis) and dates applicable to each contract year subject to a cancellation. The solicitation shall also include a requirement that the vendor provide its rationale and supporting data for its proposed cancellation ceiling(s).
  - (5) A statement that award will not be made on less than the first contract year requirements.
  - (6) The Government's administrative costs of annual contracting (only permissible if they can be reasonably established).
  - (7) A statement that the cancellation ceiling shall not be an evaluation factor.
  - (8) All other technical evaluation factors.
- j. Evaluation**

- (1) Evaluation of offers shall involve (a) determination of the lowest overall evaluated cost to the Government for both the multiyear and the first contract year acquisitions, and (b) comparison of the cost of buying the total requirement under a multiyear acquisition with the cost of buying the total requirement in successive independent acquisitions.
  - (2) To determine the lowest evaluated unit price, the Contracting Officer shall compare the lowest evaluated offer on the first program year alternative against the lowest evaluated offer on the multiyear alternative as follows:
    - (a) Multiply the evaluated unit price for each item of the lowest evaluated offer on the first program year alternative by the total number of units of that item required by the multiyear alternative.
    - (b) Add the total amount for all the items to the dollar amount of any administrative costs identified in the solicitation.
    - (c) Compare this result against the total evaluated price of the lowest offer on the multiyear alternative.
    - (d) Where the multiyear acquisition is being computed on a basis other than price alone, the Contracting Officer shall conduct the evaluation based on the evaluation factors contained in the solicitation.
    - (e) The evaluation procedures contained in this paragraph may be modified if necessary to meet the unique circumstances of a particular acquisition.
- k. Options.** Benefits may accrue by including options in a multi-year contract. In that event, contracting officers must follow the requirements of [2.2.7](#). Options should not include charges for plant and equipment already amortized, or other fixed charges which were included in the basic contract. The total duration of a multi-year contract shall not exceed five years.
- l. Contract clauses**  
The CO will include the following clauses in solicitations and contracts for multi-year contracts unless the prescription indicates otherwise:
- (1) [Clause 4-150](#), "Cancellation Under Multi-year Contracts";
  - (2) [Clause 4-55](#), "Economic Price Adjustment - Standard Products" (applicable to fixed price multi-year contracts);
  - (3) [Clause 3-175](#), "Fair Labor Standards Act and Service Contract Act—Price Adjustment (Multi-Year and Option Contracts)" (applicable when contracting for services on a fixed price, labor-hour or time-and-materials basis and the contract includes [Clause 3-160](#), "Service Contract Act of 1965, as amended");
  - (4) [Provision 4-155](#), "Evaluation of Price Proposal – Multi-year Contract";
  - (5) [Clause 4-160](#), "Cancellation Period and Ceiling";
  - (6) [Provision 4-165](#), "Price Proposal Instruction – Multi-year Contract."

## OFFER ANALYSIS

### Part 4.2. Technical Analysis

- 4.2.1. Technical Analysis** Technical analysis must be performed as necessary to assist in price and/or cost analysis. The CO will rely on the technical expertise of the requesting activity's designated expert(s) or other appropriate advisors. Technical analysis of offers may range from evaluating technical offers in accordance with evaluation factors

specified in the solicitation (competitive offers) to extensive analysis of materials, labor hours and labor mix, special tooling and facilities, and other factors.

### **Part 4.3. Price Evaluation**

**4.3.1. General** This section describes procedures for evaluating initial prices, subcontract prices, and pricing modifications. COs are responsible for ensuring that prices are fair and reasonable. To carry out this responsibility, COs must:

- (1) evaluate proposed prices using the methods of price or cost analysis described in this chapter; and
- (2) price each contract separately and independently without considering:
  - (a) proposed price reductions under other contracts; or
  - (b) losses or profits on other contracts.

**4.3.2. Offer Analysis** The CO exercises sole responsibility for the final pricing decision with advice and assistance appropriately obtained in accordance with the complexity and dollar value of the offer to be analyzed. As circumstances warrant, the CO must obtain and evaluate the advice of specialists, including, but not limited to, specialists in contracting, finance, law, audit, quality assurance, engineering, and pricing. The team effort involved in the analysis must be coordinated by the CO. When complex problems involving significant matters will be addressed, the CO must have appropriate specialists in attendance for advice during the negotiations. The CO may assign responsibility to a negotiator or price analyst for:

- (1) determining the necessary extent of specialists' advice;
- (2) evaluating the specialists' advice;
- (3) coordinating a team of experts;
- (4) consolidating pricing data;
- (5) developing a prenegotiation objective; and
- (6) conducting negotiations.

### **4.3.3. Adequate Price Competition**

**a.** Price competition is adequate when:

- (1) at least three offers are solicited;
- (2) two or more independent and responsible offerors submit priced offers meeting the solicitation's requirements; and
- (3) the solicitation identifies price as an evaluation factor for award.

**b.** If price competition exists, it is presumed as adequate unless:

- (1) the solicitation is made under conditions that unreasonably deny one or more known and qualified offerors an opportunity to compete;
- (2) the low offeror has such a decided advantage that it is practically immune from competition; or
- (3) the CO determines that the lowest price is not fair and reasonable.

## **4.4. Price Analysis**

### **4.4.1. Price Analysis**

- a. Price analysis (defined in [3.8.4.](#)), rather than cost analysis (defined in [3.8.5.](#)), is the preferred method of evaluating and negotiating the competitive pricing for firm fixed price contracts, the unit prices of many indefinite delivery contracts, the burdened hourly rates contained in labor hour and time and material contracts, and other contract instruments where prices can be compared to prices for the same or similar products or services sold in substantial quantities in the same time frame elsewhere in the market place. It is a method of determining that the overall price is fair and reasonable without a detailed analysis of its cost and profit components.
- b. The CO is responsible for selecting and using appropriate price analysis techniques to ensure a fair and reasonable price. One or more of the following techniques may be used to perform price analysis:
  - (1) comparison of proposed prices received from two or more offerors in response to the solicitation;
  - (2) comparison of prior proposed prices with current proposed prices for the same or similar end items in comparable quantities;
  - (3) compare with similar products or services purchased previously;
  - (4) compare with similar products or services purchased at other federal agencies;
  - (5) application of estimating metrics (such as dollars per pound or per horsepower, or other units) to highlight significant inconsistencies which may warrant additional pricing inquiry;
  - (6) comparison with competitive published catalogs or price lists, published market prices or commodities, similar indices, and discount or rebate arrangements;
  - (7) comparison of proposed prices with independent judiciary estimates; or
  - (8) ascertaining that the price is set by law or regulation.
- c. At a minimum, whenever adequate price competition has been obtained, the CO will compare the proposed prices with the independently developed government estimate (see [2.1.3.\(3\)\(d\)](#)). Comparison of competed prices will ordinarily suffice to meet price analysis requirements.

## **4.5. Cost Analysis**

### **4.5.1. Cost Analysis**

- a. Cost analysis must be performed when it is necessary to examine individual cost elements, such as labor or material prices, to determine the reasonableness of price. Cost analysis and requests for supporting data must be limited only to those cost elements that the CO decides need analysis.
- b. Cost analysis involves the following techniques and procedures as appropriate:
  - (1) Verification and evaluation of individual cost elements, including --
    - (a) the necessity for, and reasonableness of, proposed costs, including allowances for contingencies;
    - (b) projection of the offeror's cost trends, on the basis of current and historical cost or pricing data;
    - (c) a technical appraisal of the estimated labor, material, tooling, and facilities requirements and of the reasonableness of scrap and spoilage factors; and
    - (d) the application of audited or negotiated indirect cost rates and labor rates.

- (2) Evaluating the effect of the offeror's current practices on future costs. In conducting this evaluation, the CO must ensure that the effects of inefficient or uneconomical past practices are not projected into the future. In pricing production of recently developed, complex equipment, the CO must make a trend analysis of basic labor and materials even in periods of relative price stability.
- (3) Comparison of costs proposed by the offeror for individual cost elements with:
  - (a) actual costs previously incurred by the same offeror;
  - (b) previous cost estimates from the offeror or from other offerors for the same or similar items;
  - (c) independent judiciary cost estimates; and
  - (d) forecasts of planned expenditures;
- (4) Analysis of contractor make-or-buy decisions in evaluating subcontract costs;
- (5) Verification that the offeror's cost submissions are in accordance with the cost principles in [4.5](#);
- (6) Review to determine whether any cost or pricing data necessary to make the contractor's offer accurate, complete, and current have not been either submitted or identified in writing by the contractor. If there is such data, the CO must attempt to obtain it. If it cannot be obtained, satisfactory allowance for the incomplete data must be made in negotiations; and
- (7) Analysis of any applicable Defense Contract Audit Agency (DCAA) audits for the contractor.

#### 4.5.2. Cost or Pricing Data

- a. *Exceptions* The CO may determine that cost or pricing data is not required if:
  - (1) the price reasonableness can be determined by adequate competitive offers;
  - (2) prices are set by law or regulation;
  - (3) the prices are based on commercial catalogs or price lists; or
  - (4) a waiver is granted by the CO.
- b. Cost or pricing data may be obtained before the award of any competitive contract or contract modification when the CO requires it for the analysis and determination of price reasonableness. Only the data needed to make that determination will be obtained. If the price reasonableness can be determined due to adequate price competition, the fact that prices are set by law or regulation or when a commercial item is being acquired, then it is not necessary to request cost or pricing data. When the CO requires the contractor to provide cost or pricing data, then the CO will send the contractor [Exhibit 4-1](#), Certificate of Current Cost or Pricing Data and [Table 4-2](#), Instructions for Submitting Cost/Price Offers When Cost or Pricing Data is Required (see [Exhibit 4-2](#)). When warranted, and before an agreement on price can be reached, the CO must require the contractor to update the data as of the latest dates for which information is reasonably available.
- c. The CO must require offerors or contractors to obtain cost or pricing data for proposed subcontracts or subcontract modifications only when necessary to determine the reasonableness of the proposed subcontract price, including negotiated final pricing actions (such as termination settlements and total final price agreements for fixed-price incentive contracts).
- d. The offeror or contractor is responsible to submit to the CO, as part of its cost or pricing data, its price analysis or cost analysis on subcontract offers, including the results of its



subcontract price reviews and analysis. In unusual circumstances, to ensure that adequate analysis is performed, the CO may require the offeror or contractor to submit, along with its own cost or pricing data, the subcontract cost or pricing data obtained. This in no way diminishes the offeror's or contractor's responsibility to perform subcontract cost or price analysis and negotiate fair and reasonable subcontract prices.

- e. If cost or pricing data is required by the CO to determine fair and reasonable pricing and the offeror or contractor refuses to provide necessary data in spite of repeated requests, the CO must withhold the award or contract modification and refer the matter to the PE. The ultimate disposition of the matter must be documented.

#### **4.5.3 . Profit**

- a. Except for architect-engineer contracts (see [5.3.](#)), it is judiciary policy that predetermined percentages or limitations on profit or fee must not be used. However, for cost-plus-fixed-fee contracts, the fee must not exceed 10 percent of the contract's estimated cost, excluding fee.
- b. When adequate price competition is obtained or price analysis techniques are sufficient to ensure a fair and reasonable price, then analysis of profit is not appropriate.
- c. When cost analysis is required for price negotiations, profit must be analyzed as well. Profit must be analyzed with the objective of rewarding contractors for:
  - (1) financial and other risks they assume;
  - (2) resources they use; and
  - (3) organization, performance, and management capabilities they employ.
- d. Due consideration must be given to:
  - (1) the complexity of materials requirements;
  - (2) the extent of subcontracting;
  - (3) the ratio of indirect costs to direct costs;
  - (4) the contribution of capital investments to contract performance; and
  - (5) weighted guidelines profit analysis.
- e. If the pricing action involves a contract change or modification that requires essentially the same type and mix of work as the basic contract, and is of relatively small dollar value compared to the total contract amount, then the profit or fee may be established on the basis of the basic contract's profit or fee rate.

#### **4.5.4. Defective Cost or Pricing Data**

- a. If, before a price agreement is reached, the CO learns that any of the cost or pricing data required to be submitted are inaccurate, incomplete, or noncurrent, the CO must immediately bring the matter to the attention of the offeror or contractor, regardless of whether the defective data increases or decreases the price. The CO must then negotiate using any new data submitted or make allowance for the incorrect data and document the file accordingly.
- b. If, after award, the CO learns or suspects that the data furnished was not accurate, complete, and current, the CO must obtain an audit to evaluate the data. The CO may not reprice the contract solely because the profit was greater than forecast or because some contingency specified in the submission failed to materialize.

- c. For each advisory audit received based on a postaward review which indicates defective pricing, the CO must determine if the data submitted was defective and relied upon. Before making such a determination, the CO must give the contractor an opportunity to support the accuracy, completeness, and currency of data in question. If the CO relied on the data, and the results of any contract action taken, the CO must prepare a memorandum indicating the CO's determination, as to whether the submitted data was accurate, complete, and current as of the date of final agreement on price. The CO must send one copy of this memorandum to the contractor.
- d. If, after award, the requested and submitted cost or pricing data is found to be inaccurate, incomplete, or noncurrent as of the date of final agreement on price, the judiciary may be entitled to a price adjustment, including profit or fee, of any significant amount by which the price was increased because of the defective data. This entitlement is ensured by including in the contract the appropriate clause prescribed in [4.5.5](#) below. The appropriate clause gives the judiciary the right to a price adjustment for defects in cost or pricing data submitted by the contractor, a prospective contractor, or an actual subcontractor. In arriving at a price adjustment under the clause, the CO must consider:
  - (1) the time by which the cost or pricing data became reasonably available to the contractor;
  - (2) the extent to which the judiciary relied upon the defective data; and
  - (3) any understated cost or pricing data submitted in support of price negotiations, up to the amount of the judiciary claim for overstated pricing data arising out of the same pricing action. This includes the initial pricing of the same contract or the pricing of the same modification order. Such offsets need not be in the same cost groupings (such as materials, direct labor, or indirect costs).
- e. If both contractor and subcontractor submitted cost or pricing data, the judiciary has the right, under the clauses prescribed in [4.5.5](#) below, to reduce the prime contract price if it was significantly increased because a subcontractor submitted defective data. This right applies whether the data supported subcontract cost estimates or supported firm agreements between subcontractor and contractor.
- f. If the audit discloses defective subcontractor cost or pricing data, the information necessary to support a reduction in prime contract and subcontract prices may be available only from within the judiciary. To the extent necessary to secure a prime contract price reduction, the CO must make this information available to the prime contractor or appropriate subcontractor upon request. If release of the information would compromise judiciary security or disclose trade secrets or confidential business information, the CO may release it only under the conditions that will protect it from improper disclosure. Information made available under this subparagraph must be limited to that used as the basis for the prime contract price reduction. In order to afford an opportunity for corrective action, the CO must give the prime contractor reasonable advance notice before determining to reduce the prime contract price.
- g. When a prime contractor includes defective subcontract data in arriving at the price, but later awards the subcontract to a lower priced subcontractor (or does not subcontract for the work), any adjustment in the prime contract price due to defective subcontract data is limited to the difference (plus applicable indirect cost and profit markups) between (1) the subcontract price used for pricing the prime contract, and (2) either the actual subcontract price or the actual cost to the contractor, if not subcontracted, provided the data on which the actual subcontract price is based are not themselves defective.

- h.** Under cost-reimbursement contracts and fixed-price incentive contracts, payments to subcontractors that are higher than they would be had there been no defective subcontractor cost or pricing data will be the basis for disallowance or nonrecognition of costs under the clauses prescribed in 4.5.5. below.

**4.5.5. Clauses** Include the following provisions and clauses in solicitations and contracts as applicable:

- (1) [Clause 4-95](#), “Price Reduction for Defective Cost or Pricing Data” is included when cost or pricing data will be required from the contractor or subcontractor for the negotiation of a contract award.
- (2) [Clause 4-100](#), “Price Reduction for Defective Cost or Pricing Data - Modification” is included when cost or pricing data is not required for the contract award, but may be required for the negotiation of a modification of a contract and [Clause 4-125](#) “Cost Accounting Standards” has not been included.
- (3) [Clause 4-105](#), “Integrity of Unit Prices” is included in solicitations and contracts estimated to exceed the judiciary’s small purchase threshold, except when:
  - (a) the contract is for architect-engineer services;
  - (b) the contract is for utility services;
  - (c) the contract is for services and no products are to be provided;
  - (d) the contract is for a commercial product; or
  - (e) the contract is for petroleum products.
- (4) [Provision 4-110](#), “Requirements for Cost or Pricing Data or Information Other Than Cost or Pricing Data” is included in all solicitations when it is reasonably certain that cost or pricing data or information other than cost or pricing data will be required. The provision with Alternate I will be used if cost or pricing data are not expected to be required, but it is reasonably certain that information other than cost or pricing data will be required.
- (5) [Clause 4-115](#), “Requirements for Cost or Pricing Data or Information Other Than Cost or Pricing Data - Modification” is included in all solicitations and contracts when it is reasonably certain that cost or pricing data or information other than cost or pricing data will be required for negotiation of modifications to a contract. The clause with Alternate I will be used if cost or pricing data are not expected to be required, but it is reasonably certain that information other than cost or pricing data will be required for the negotiation of modifications.

## **Part 4.6. Cost Principles**

**4.6.1. General** This part contains the principles for determining or negotiating the allowability of costs. When the CO determines that price analysis is not sufficient, then the CO will make a written determination of the allowable costs under new contract offers. These principles apply to the:

- (1) determination of allowable costs under cost-reimbursement contracts and subcontracts;
- (2) determination or negotiation of cost or price when required by a contract clause;
- (3) pricing or estimation of costs in change orders or contract modifications; and
- (4) settlement of contract costs for contracts which have been terminated.

#### 4.6.2. Contract Costs

- a. **Composition of Total Cost** The total cost of a contract is the sum of the allowable direct and indirect costs allocable to the contract, incurred or to be incurred, less any allowable credits.
- b. A contractor may use any consistently applied, generally accepted method of determining or estimating costs which is equitable under the circumstances.
- c. Whenever a contractor is required by the judiciary to submit a cost or price offer, the contractor must:
  - (1) estimate costs in a manner consistent with generally accepted cost accounting principles;
  - (2) consistently apply the cost accounting principles to its pricing;
  - (3) be in accordance with its DCAA audited rates; and
  - (4) be consistent with the provisions of this chapter.
- d. **Direct Cost** is any cost that can be specifically identified directly with delivery or performance of a specific contract. Direct costs are segregated from other costs, recorded into separate accounts, and are identified as costs for a particular contract. They are not mingled with costs associated with other contracts, nor with indirect, administrative or management costs of the business.
- e. **Indirect Costs**
  - (1) Indirect costs are those costs that, because of their incurrence for common or joint contractor objectives, are neither readily segregable nor subject to treatment as direct costs. Indirect costs may be allocated to contracts on the basis of necessity to the overall operation of the contractor's business.
  - (2) An indirect cost must not be allocated to a judiciary contract if:
    - (a) other costs incurred for the same purpose, in like circumstances, have been included as a direct cost of that contract ; or
    - (b) the costs have been included as any final cost objective not related to the judiciary contract.
  - (3) Indirect costs must be accumulated into logical groupings known as “indirect cost pools.”
  - (4) The contractor’s method of allocating indirect costs must be in accordance with generally accepted accounting principles which are consistently applied in accordance with the provisions of this chapter.
  - (5) The CO must examine the contractor’s method of allocating indirect costs when any of the following apply:
    - (a) a substantial difference exists between the cost patterns of work performed under the contract and the contractor’s other work;
    - (b) a significant change occurs in:
      - 1) the nature of the contractor’s business;
      - 2) extent of subcontracting;
      - 3) fixed asset improvement programs;
      - 4) inventories;
      - 5) volume of sales and production;
      - 6) manufacturing processes;
      - 7) products;
      - 8) other relevant circumstances; or

- (c) indirect cost groups developed for a contractor's primary location are applied to off-site locations. Then separate cost groups for costs allocable to off-site locations may be necessary to distribute the contractor's costs on the basis of the benefits accruing to the appropriate cost objective.
- (6) The CO must consider the base period for indirect cost allocation as the one in which the costs are incurred and accumulated for distribution to work performed in that period.
- f. Credits** A credit is the applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor.
- g. Provisions and Clauses** Include the following provisions and clauses as indicated. These clauses are not applicable to awards to small businesses.
  - (1) [Provision 4-120](#), "Cost Accounting Standards Notices and Certification" is included in solicitations for negotiated contracts when the CO anticipates requiring certified cost and pricing data. The offeror will appropriately fill in the provision's blank spaces.
  - (2) [Clause 4-125](#), "Cost Accounting Standards" is included in negotiated contracts when the CO requires certified cost and pricing data.
  - (3) [Clause 4-130](#), "Disclosure and Consistency of Cost Accounting Practices" is included in negotiated contracts when the CO requires certified cost and pricing data.
  - (4) [Clause 4-135](#), "Cost Accounting Standards - Educational Institution" is included in all negotiated solicitations and contracts when an award to an educational institution is contemplated and when the CO requires certified cost and pricing data.
  - (5) The CO must insert [Clause 4-140](#), "Predetermined Indirect Cost Rates" in solicitations and contracts when a cost-reimbursement contract with an educational institution is contemplated, predetermined indirect cost rates are to be used, and when the CO requires certified cost and pricing data.
  - (6) [Clause 4-145](#), "Administration of Cost Accounting Standards" is included in all negotiated solicitations and contracts when *JP3* Clauses [4-125](#), [4-130](#), and/or [4-135](#) are used.

## **4.7. Cost Allowability**

### **4.7.1. Determining Cost Allowability**

- a.** When determining whether an incurred cost is allowable, the CO must consider the following factors:
  - (1) reasonableness;
  - (2) allocability;
  - (3) consistency with generally accepted accounting principles and practices appropriate to the particular circumstances;
  - (4) consistency with the requirements and terms of the contract; and
  - (5) consistency with the limitations set forth in this chapter.
- b.** If a contractor's accounting practices are inconsistent with this chapter, the CO must not allow costs resulting from those practices in excess of the amount that would have resulted from using practices consistent with this chapter.

### 4.7.2. Determining Reasonableness

- a. A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business.
- b. In determining the reasonableness of a specific cost, matters to consider include:
  - (1) whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or contract performance;
  - (2) the restraints or requirements imposed by such factors as:
    - (a) generally accepted sound business practices;
    - (b) arm's-length bargaining; and
    - (c) federal and state laws and regulations;
  - (3) the action that a prudent business person would take under the circumstances considering responsibilities to:
    - (a) the owners of the business;
    - (b) employees;
    - (c) customers;
    - (d) the judiciary; and
    - (e) the public at large;
  - (4) any deviations from the established practices of the contractor that may unjustifiably increase the contract costs; and
  - (5) any other relevant factors.

### 4.7.3. Determining Allocability

- a. An incurred cost is allocable to a contract if it:
  - (1) is incurred specifically for performance of the contract;
  - (2) benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
  - (3) is necessary to the overall operation of the business, even though a direct relationship to the contract cannot be shown.
- b. **Advance Agreements**
  - (1) Because the reasonableness or allocability of costs may be difficult to determine in some cases, the contracting parties must reach advance agreement on the treatment of special or unusual costs to avoid later disputes and disallowances.
  - (2) Advance agreements may be negotiated either before or during a contract but must be negotiated before contractor incurrence of the costs involved. The agreements must be in writing, signed by both parties, and incorporated into applicable current and future contracts. An advance agreement must contain a statement of its applicability and duration.
  - (3) Advance agreements may be negotiated with a particular contractor for a single contract, a group of contracts, or all the contracts of one or more purchasing activities.
  - (4) Advance agreements may not provide for treatment of costs inconsistent with this chapter.
  - (5) The absence of an advance agreement on any cost will not, in itself, affect the reasonableness or allocability of that cost.

- (6) Examples of costs for which advance agreements may be particularly important are:
- (a) compensation for personal service, including but not limited to, allowances for off-site pay, incentive pay, relocation allowances, hardship pay, and cost-of-living differentials;
  - (b) use charges for fully depreciated assets;
  - (c) deferred maintenance costs;
  - (d) pre-contract costs;
  - (e) independent research and development and bid and proposal costs;
  - (f) royalties and other costs for use of patents;
  - (g) selling and distribution costs;
  - (h) travel and relocation costs;
  - (i) costs of idle facilities and idle capacity;
  - (j) costs of information technology;
  - (k) severance pay to employees on support services contracts;
  - (l) professional services (for example, legal, accounting, and engineering);
  - (m) general administrative costs (such as corporate, division, or branch allocations attributable to the general management, supervision, and conduct of the contractor's business as a whole, particularly in construction, job-site, architect-engineer, and facilities contracts);
  - (n) costs of construction plant and equipment; and
  - (o) costs of public relations and advertising.

#### 4.7.4. Selected Costs

This section discusses certain specific types of costs in terms of allowability. It does not cover every element of cost, nor does the omission of a specific type of cost from this section imply that it is either allowable or unallowable. A determination of allowability must be based upon the principles and standards of this Chapter and treatment of similar or related items.

- a. Public Relations and Advertising Costs** Incurred public relations and advertising costs are unallowable except for costs of:
  - (1) responding to inquiries concerning company policies and activities;
  - (2) essential communication with the public, press, stockholders, creditors, and customers, including communication on matters of public concern;
  - (3) participation in community service activities, such as blood bank drives, charity drives, and disaster assistance (but not contribution to civil defense funds and projects);
  - (4) recruitment of personnel needed for contract performance;
  - (5) acquiring scarce items for contract performance; and
  - (6) disposing of scrap or surplus materials acquired for contract performance.
- b. Bad Debts** Bad debts costs, including actual or estimated losses arising from uncollectible accounts receivable due from customers and other claims, and any directly associated costs such as collection costs and legal costs are not allowable.
- c. Contributions or Donations** Contractor contributions or donations, including cash, property, and services, except as provided in [4.7.4.a.\(3\)](#) above are not allowable.

- d. **Dividends** Dividend provisions or payments and distribution of profits are not allowable when part of an employee's compensation if that compensation is based on changes in stock prices or corporate ownership.
- e. **Entertainment Costs** Contractor costs of amusement, diversion, social activities, and directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are not allowable. Costs of membership in social, dining, or country clubs or other organizations having the same purposes are not allowable, regardless of whether or not the cost is reported as taxable income to the employees.
- f. **Fines and Penalties** Contractor costs of fines and penalties resulting from violations of, or failure of, the contractor to comply with, federal, state, local, or foreign laws and regulations are not allowable, except when incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the CO.
- g. **Life Insurance** Contractor costs for insurance on the lives of officers, partners, or proprietors are not allowable, unless the insurance represents additional compensation.
- h. **Interest and Other Financial Costs** Contractor interest costs on borrowings (however represented), bond discounts, costs of financing and refinancing capital, and the costs of preparing and issuing prospectuses and stock rights, are not allowable.
- i. **Lobbying Costs**
  - (1) Contractor costs associated with attempts to influence the outcome of any federal, state, or local election, referendum, initiative, or similar procedure through contributions, endorsements, publicity, or similar activities are not allowable.
  - (2) Costs associated with establishing, administering, contributing to, or paying the expenses of a political party, campaign, political action committee, or other organization established for the purpose of influencing the outcomes of elections are not allowable.
  - (3) Costs associated with any attempt to influence (i) the introduction of federal or state legislation, or (ii) the enactment or modification of any pending federal or state legislation through communication with any member or employee of the Congress or state legislature (including efforts to influence state or local officials to engage in similar lobbying activity), or with any judiciary official or employee in connection with a decision to sign or veto enrolled legislation are not allowable.
  - (4) Costs associated with any attempt to influence the introduction of federal or state legislation, or the enactment or modification of pending federal or state legislation by preparing, distributing, or using publicity or propaganda, or by urging members of the general public to contribute to or participate in any mass demonstration, march, rally, fund-raising drive, lobbying campaign, or letter-writing or telephone campaign are not allowable.
  - (5) Costs associated with legislation liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effect of legislation, when such activities are carried on in support of, or knowledge of preparation, for an effort to engage in activities for which the unallowable costs are not allowable.
  - (6) The cost of providing a technical and factual presentation of information on a topic directly related to the performance of a contract through hearing testimony, statements, or letters to the Congress or state legislature, or subdivision, member, or cognizant staff member thereof, in response to a documented request



- (including a Congressional Record notice requesting testimony or statements for the record at a regularly scheduled hearing) made by the recipient member, legislative body or subdivision, or a cognizant staff member thereof are allowable.
- (7) The costs for transportation, lodging or meals in connection with the activities authorized under 4.7.4.i. must not be allowable unless incurred for the purpose of offering testimony at a regularly scheduled congressional hearing in response to a written request for such presentation made by the chair or ranking minority member of the committee or subcommittee conducting such hearing.
  - (8) Any lobbying to influence state legislation in order to directly reduce contract cost, or to avoid material impairment of the contractor's authority to perform the contract are allowable.
  - (9) Any activity specifically authorized by statute to be undertaken with funds from the contract are allowable.
- j. Losses on Other Contracts** An excess of costs over income under any other contract (including the contractor's contributed portion under cost-sharing contracts) are not allowable.
- k. Taxes** The following costs are not allowable:
- (1) federal income and excess profits taxes;
  - (2) taxes in connection with financing, refinancing, refunding operations, or reorganizations;
  - (3) taxes from which exemptions are available to the contractor directly, or available to the contractor based on an exemption afforded the judiciary, except when the CO determines that the administrative burden incident to obtaining the exemption outweighs the corresponding benefits accruing to the judiciary. The term "exemption" means freedom from taxation in whole or in part and includes a tax abatement or reduction resulting from mode of assessment, method of calculation, or otherwise;
  - (4) special assessments on land that represent capital improvements;
  - (5) taxes (including excises) on real or personal property, or on the value, use, possession or sale thereof, which is used solely in connection with work other than on judiciary contracts;
  - (6) taxes on accumulated funding deficiencies of, or prohibited transactions involving, employee deferred compensation plans; and
  - (7) income tax accruals designed to account for the tax effect of differences between taxable income and pretax income as reflected by the books of account and financial statements.
- l. Defense of Fraud Proceedings** Contractor costs incurred in connection with defense of any of the following are not allowable:
- (1) criminal or civil investigation, grand jury proceeding, or prosecution;
  - (2) civil litigation; or
  - (3) administrative proceedings such as suspension or debarment, or any combination of the foregoing, brought by the judiciary against a contractor, its agents or employees, are unallowable when the charges that are the subject of the investigation, proceedings, or prosecution involve fraud or similar criminal offenses (including filing of a false certification) on the part of the contractor, its agents or employees, and result in conviction (including conviction entered on a plea of *nolo contendere*), judgment against the contractor, its agents or employees, or decision to debar or suspend, or are resolved by consent or

compromise. When the charges of fraud are resolved by consent or compromise, the parties may agree on the extent of allowability of such costs as a part of such resolution.

- m. Accounting for Unallowable Costs** The CO must identify and exclude from each billing, claim, and offer those costs that are expressly unallowable under this chapter or as mutually agreed to be unallowable under an advance cost agreement (see [4.7.3.b.](#)).
- (1) When costs are identified as unallowable or mutually agreed to be unallowable, all directly associated costs are also unallowable.
  - (2) Costs and directly associated costs specifically designated as unallowable as a result of a written decision by a CO must be identified when included in or used in computing any billing, claim, or offer applicable to a judiciary contract.
  - (3) For those costs which have been identified as unallowable, the CO must require records as support for claims, billings, and offers. These must be adequate to establish and maintain visibility of those costs and directly associated costs.
  - (4) The CO must identify unallowable costs involved in determining rates used for standard costs, indirect cost offers, or billings at the time rates are proposed, established, revised, or adjusted.

#### 4.7.5. Termination Costs

- a. General** Contract terminations generally give rise to the occurrence of costs or the need for special treatment of costs that would not have arisen, if the contract had not been terminated. This part describes the cost principles peculiar to termination situations to be used in conjunction with the other cost principles.
- b. Common Items** The costs of items reasonably usable on the contractor's other work are not allowable unless the contractor submits evidence that the items could not be retained at cost without sustaining a loss. The CO must consider the contractor's plans and orders for current and planned production when determining if items can reasonably be used on other work of the contractor.
- c. Costs Continuing After Termination** Costs that cannot be discontinued immediately after the effective date of termination are generally allowable. However, any costs continuing after the effective date of the termination because of the negligent or willful failure of the contractor to discontinue them are unallowable.
- d. Start-Up Costs** Reasonable start-up and preparatory costs are generally allowable. When included in the settlement offer as a direct charge, they must not also be included in overhead. Start-up costs for one contract must not be allocated to others.
- e. Loss of Useful Value** Loss of useful value of special tooling and special machinery and equipment is generally allowable provided the:
  - (1) special tooling or special machinery and equipment is not reasonably capable of use in the other work of the contractor;
  - (2) judiciary's interest is protected by transfer of title or by other means deemed appropriate by the CO; and
  - (3) loss of useful value for any one terminated contract is limited to that portion of the equipment cost which bears the same ratio to the total cost as the terminated portion of the contract bears to the entire terminated contract and to other judiciary contracts for which the special tooling or special machinery and equipment were acquired.

- f. Rental Under Unexpired Leases** Rental costs under unexpired leases, less the residual value of such leases, are generally allowable when shown to have been reasonably necessary for the performance of the terminated contract when the:
- (1) amount of rental claimed does not exceed the reasonable use value of the property leased for the period of the contract and such further period as may be reasonable; and
  - (2) the contractor makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease.
- g. Alterations of Leased Property** The cost of alterations and reasonable restorations required by the lease may be allowed when the alterations are necessary for performing the contract.
- h. Settlement Expenses** Settlement expenses, including the following are generally allowable:
- (1) accounting, legal, clerical, and similar costs reasonably necessary for the:
    - (a) preparation and presentation, including supporting data, of settlement claims to the CO; and
    - (b) termination and settlement of subcontracts.
  - (2) reasonable costs for storage, transportation, protection and disposition of property acquired or produced for the contract;
  - (3) indirect costs related to salary and wages incurred as settlement expenses under (1) and (2) above. Normally, such indirect costs must be limited to payroll taxes, fringe benefits, occupancy costs, and immediate supervision costs.
- Note:** If settlement expenses are significant, a cost account or work order must be established to separately identify and accumulate them.
- i. Subcontractor Claims** Subcontractor claims, including the allocable portion of the claims common to the contract and to other work of the contractor are generally allowable. An appropriate share of the contractor's indirect expenses may be allocated to the amount of settlements with subcontractors, provided that the amount allocated is reasonably proportionate to the relative benefits received and is otherwise consistent with the principles of this chapter. The indirect expense so allocated must exclude the same and similar costs claimed directly or indirectly as settlement expenses.

**Exhibit 4-1**  
**Certificate of Current Cost or Pricing Data.**

When cost or pricing data are required, the contracting officer must require the contractor to execute a Certificate of Current Cost or Pricing Data, using the format in this paragraph, and must include the executed certificate in the contract file.

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 being submitted, either actually or by specific identification in writing, to the contracting officer or to the contracting officer's representative in support of the offer (as identified below) are accurate, complete, and current as of the date of execution completed below. This certification includes the cost or pricing data supporting any advance agreements and forward pricing rate agreements between the offeror and the government that are part of the offer.

Document Number \_\_\_\_\_

(Identify the offer, request for price adjustment, or other submission involved, giving the appropriate identifying number (e.g., RFP No.).)

Firm Name \_\_\_\_\_

Signature \_\_\_\_\_

Printed Name of Signer \_\_\_\_\_

Title of Signer \_\_\_\_\_

Date of execution \_\_\_\_\_

(Insert the day, month, and year when price negotiations were concluded, price agreement was reached, and signing was effected or, if applicable, an earlier date agreed upon between the parties that is as close as practicable to the date of agreement on price.)

(end of certificate)

**Exhibit 4-2**  
**Table 4-2 - Instructions for Submitting Cost/Price Offers**  
**When Cost or Pricing Data Is Required**

This document provides instructions for preparing a contract pricing offer when cost or pricing data are required.

**Note 1** There is a clear distinction between submitting cost or pricing data and merely making available books, records, and other documents without identification. The requirement for submission of cost or pricing data is met when all accurate cost or pricing data reasonably available to the offeror have been submitted, either actually or by specific identification, to the contracting officer or an authorized representative. As later information comes into your possession, it should be submitted promptly to the contracting officer in a manner that clearly shows how the information relates to the offeror's price offer. The requirement for submission of cost or pricing data continues up to the time of agreement on price, or an earlier date agreed upon between the parties if applicable.

**Note 2** By submitting your offer, you grant the contracting officer or an authorized representative the right to examine records that formed the basis for the pricing offer. That examination can take place at any time before award. It may include those books, records, documents, and other types of factual information (regardless of form or whether the information is specifically referenced or included in the offer as the basis for pricing) that will permit an adequate evaluation of the proposed price.

**I. General Instructions**

- A. You must provide the following information on the first page of your pricing offer:
- (1) solicitation, contract, and/or modification number;
  - (2) name and address of offeror;
  - (3) name and telephone number of point of contact;
  - (4) name of cognizant contract administration office (if available);
  - (5) type of contract action (that is, new contract, change order, price revision/redetermination, letter contract, unpriced order, or other);
  - (6) proposed cost; profit or fee; and total;
  - (7) whether you will require the use of judiciary property in the performance of the contract, and, if so, what property;
  - (8) whether your organization is subject to cost accounting standards; whether your organization has submitted a CASB Disclosure Statement, and if it has been determined adequate; whether you have been notified that you are or may be in noncompliance with your Disclosure Statement or CAS (other than a noncompliance that the cognizant federal agency official has determined to have an immaterial cost impact), and, if yes, an explanation; whether any aspect of this offer is inconsistent with your disclosed practices or applicable CAS, and, if so, an explanation; and whether the offer is consistent with your established estimating and accounting principles and procedures and, if not, an explanation;
  - (9) the following statement:  
"This offer reflects our estimates and/or actual costs as of this date and conforms with the instructions provided by the contracting officer and in Table 4-2. By submitting this offer, we grant the contracting officer and authorized representative(s) the right to examine, at any time before award, those records, which include books, documents, accounting procedures and practices, and other data, regardless of type and form or whether such supporting information is specifically referenced or included in the offer as the basis for pricing, that will permit an adequate evaluation of the proposed price."
  - (10) date of submission; and
  - (11) name, title, and signature of authorized representative.
- B. In submitting your offer, you must include an index, appropriately referenced, of all the cost or pricing data and information accompanying or identified in the offer. In addition, you must annotate any future additions and/or revisions, up to the date of agreement on price, or an earlier date agreed upon by the parties, on a supplemental index.
- C. As part of the specific information required, you must submit, with your offer, cost or pricing data (that is, data that are verifiable and factual). You must clearly identify on your cover sheet that cost or pricing data are included as part of the offer. In addition, you must submit with your offer any information reasonably required to explain your estimating process, including:

- (1) The judgmental factors applied and the mathematical or other methods used in the estimate, including those used in projecting from known data; and
- (2) The nature and amount of any contingencies included in the proposed price.
- D. You must show the relationship between contract line item prices and the total contract price. You must attach cost-element breakdowns for each proposed line item, using the appropriate format prescribed in the "Formats for Submission of Line Item Summaries" section of this table. You must furnish supporting breakdowns for each cost element, consistent with your cost accounting system.
- E. When more than one contract line item is proposed, you must also provide summary total amounts covering all line items for each element of cost.
- F. Whenever you have incurred costs for work performed before submission of a offer, you must identify those costs in your cost/price offer.
- G. If you have reached an agreement with government representatives on use of forward pricing rates/factors, identify the agreement, include a copy, and describe its nature.
- H. As soon as practicable after final agreement on price or an earlier date agreed to by the parties, but before the award resulting from the offer, you must, when requested by the contracting officer., submit *JP3 Exhibit 4-1* Certificate of Current Cost or Pricing Data.

## II. Cost Elements

Depending on your system, you must provide breakdowns for the following basic cost elements, as applicable:

- A. *Materials and services* Provide a consolidated priced summary of individual material quantities included in the various tasks, orders, or contract line items being proposed and the basis for pricing (vendor quotes, invoice prices, etc.). Include raw materials, parts, components, assemblies, and services to be produced or performed by others. For all items proposed, identify the item and show the source, quantity, and price. Conduct price analyses of all subcontractor offers. Conduct cost analyses for all subcontracts when cost or pricing data are submitted by the subcontractor. Include these analyses as part of your own cost or pricing data submissions for subcontracts expected to exceed the appropriate threshold. Submit the subcontractor cost or pricing data as part of your own cost or pricing data as required in paragraph II.A.(2) of this table. These requirements also apply to all subcontractors if required to submit cost or pricing data.
  - (1) *Adequate Price Competition* Provide data showing the degree of competition and the basis for establishing the source and reasonableness of price for those contracts (such as subcontracts, purchase orders, material order, etc.) priced on the basis of adequate price competition. For interorganizational transfers priced at other than the cost of comparable competitive commercial work of the division, subsidiary, or affiliate of the contractor, explain the pricing method.
  - (2) *All Other* Obtain cost or pricing data from prospective sources for those procurements (such as subcontracts, purchase orders, material order, etc.) and not otherwise exempt (i.e., adequate price competition, prices set by law or regulation, the prices are based on commercial catalogs or price lists, or waiver by the contracting officer). Also provide data showing the basis for establishing source and reasonableness of price. In addition, provide a summary of your cost analysis and a copy of cost or pricing data submitted by the prospective source in support of each subcontract, or purchase order that is \$10,000,000 or more, or more than 10 percent of the prime contractor's proposed price. The contracting officer may require you to submit cost or pricing data in support of offers in lower amounts. Subcontractor cost or pricing data must be accurate, complete and current as of the date of final price agreement, or an earlier date agreed upon by the parties, given on the prime contractor's Certificate of Current Cost or Pricing Data. The prime contractor is responsible for updating a prospective subcontractor's data. For standard commercial items fabricated by the offeror that are generally stocked in inventory, provide a separate cost breakdown, if priced based on cost. For interorganizational transfers priced at cost, provide a separate breakdown of cost elements. Analyze the cost or pricing data and submit the results of your analysis of the prospective source's offer. When submission of a prospective source's cost or pricing data is required as described in this paragraph, it must be included along with your own cost or pricing data submission. You must also submit any other cost or pricing data obtained from a subcontractor, either actually or by specific identification, along with the results of any analysis performed on that data.
- B. *Direct Labor* Provide a time-phased (e.g., monthly, quarterly, etc.) breakdown of labor hours, rates, and cost by appropriate category, and furnish bases for estimates.
- C. *Indirect Costs* Indicate how you have computed and applied your indirect costs, including cost

- breakdowns. Show trends and budgetary data to provide a basis for evaluating the reasonableness of proposed rates. Indicate the rates used and provide an appropriate explanation.
- D. *Other Costs* List all other costs not otherwise included in the categories described above (e.g., special tooling, travel, computer and consultant services, preservation, packaging and packing, spoilage and rework, and federal excise tax on finished articles) and provide bases for pricing.
- E. *Royalties* If royalties exceed \$1,500, you must provide the following information on a separate page for each separate royalty or license fee:
- (1) name and address of licensor;
  - (2) date of license agreement;
  - (3) patent numbers;
  - (4) patent application serial numbers, or other basis on which the royalty is payable;
  - (5) brief description (including any part or model numbers of each contract item or component on which the royalty is payable);
  - (6) percentage or dollar rate of royalty per unit;
  - (7) unit price of contract item;
  - (8) number of units;
  - (9) total dollar amount of royalties.
  - (10) If specifically requested by the contracting officer, a copy of the current license agreement and identification of applicable claims of specific patents.
- F. *Facilities Capital Cost of Money* When you elect to claim facilities capital cost of money as an allowable cost, you must submit Form CASB-CMF and show the calculation of the proposed amount.

**III. Formats for Submission of Line Item Summaries**

A. <i>New Contracts (including letter contracts)</i>			
Cost Elements	Proposed Contract Estimate-Total Cost	Proposed Contract Estimate-Unit Cost	Reference
(1)	(2)	(3)	(4)
<u>Column</u>	<u>Instruction</u>		
(1)	Enter appropriate cost elements.		
(2)	Enter those necessary and reasonable costs that, in your judgment, will properly be incurred in efficient contract performance. When any of the costs in this column have already been incurred (e.g., under a letter contract), describe them on an attached supporting page. When pre-production or startup costs are significant, or when specifically requested to do so by the contracting officer, provide a full identification and explanation of them.		
(3)	Optional, unless required by the contracting officer.		
(4)	Identify the attachment in which the information supporting the specific cost element may be found.		
	(Attach separate pages as necessary.)		

B. Change Orders, Modifications, and Claims.						
Cost Elements	estimated cost of all work deleted	Cost of deleted work already performed	net cost to be deleted	cost of work added	net cost of change	reference
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Column		Instruction				
(1)		Enter appropriate cost elements.				
(2)		Include the current estimates of what the cost would have been to complete the deleted work not yet performed (not the original offer estimates), and the cost of deleted work already performed.				
(3)		Include the incurred cost of deleted work already performed, using actuals incurred if possible, or, if actuals are not available, estimates from your accounting records. Attach a detailed inventory of work, materials, parts, components, and hardware already purchased, manufactured, or performed and deleted by the change, indicating the cost and proposed disposition of each line item. Also, if you desire to retain these items or any portion of them, indicate the amount offered for them.				
(4)		Enter the net cost to be deleted, which is the estimated cost of all deleted work less the cost of deleted work already performed. Column (2) minus Column (3) equals Column (4).				
(5)		Enter your estimate for cost of work added by the change. When nonrecurring costs are significant, or when specifically requested to do so by the contracting officer, provide a full identification and explanation of them. When any of the costs in this column have already been incurred, describe them on an attached supporting schedule.				
(6)		Enter the net cost of change, which is the cost of work added, less the net cost to be deleted. Column (5) minus Column (4) equals Column (6). When this result is negative, place the amount in parentheses.				
(7)		Identify the attachment in which the information supporting the specific cost element may be found.				
		(Attach separate pages as necessary.)				
C. Price Revision/Redetermination						



Cutoff Date	Number of Units completed		Number of units to be completed	Contract Amount	Redetermination offer amount	difference	
(1)	(2)		(3)	(4)	(5)	(6)	
Cost Elements	incurred cost-pre-production	incurred cost-completed units	incurred cost-work in progress	total incurred cost	estimated cost to complete	estimated total cost	reference
(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
(Use as applicable)							
<u>Column</u>	<u>Instruction</u>						
(1)	Enter the cutoff date required by the contract, if applicable						
(2)	Enter the number of units completed during the period for which experienced costs of production are being submitted.						
(3)	Enter the number of units remaining to be completed under the contract.						
(4)	Enter the cumulative contract amount.						
(5)	Enter your redetermination offer amount.						
(6)	Enter the difference between the contract amount and the redetermination offer amount. When this result is negative, place the amount in parentheses. Column (4) minus Column (5) equals Column (6).						
(7)	Enter appropriate cost elements. When residual inventory exists, the final costs established under fixed-price-incentive and fixed-price-redeterminable arrangements should be net of the fair market value of such inventory. In support of subcontract costs, submit a listing of all subcontracts subject to repricing action, annotated as to their status.						
(8)	Enter all costs incurred under the contract before starting production and other nonrecurring costs (usually referred to as startup costs) from your books and records as of the cutoff date. These include such costs as pre-production engineering, special plant rearrangement, training program, and any identifiable nonrecurring costs such as initial rework, spoilage, pilot runs, etc. In the event the amounts are not segregated in or otherwise available from your records, enter in this column your best estimates. Explain the basis for each estimate and how the costs are charged on your accounting records (e.g., included in production costs as direct engineering labor, charged to manufacturing overhead). Also show how the costs would be allocated to the units at their various stages of contract completion.						
(9)	Enter in Column (9) the production costs from your books and records (exclusive of pre-production costs reported in Column (8)) of the units completed as of the cutoff date.						

(10)		Enter in Column (10) the costs of work in process as determined from your records or inventories at the cutoff date. When the amounts for work in process are not available in your records but reliable estimates for them can be made, enter the estimated amounts in Column (10) and enter in column (9) the differences between the total incurred costs (exclusive of pre-production costs) as of the cutoff date and these estimates. Explain the basis for the estimates, including identification of any provision for experienced or anticipated allowances, such as shrinkage, rework, design changes, etc. Furnish experienced unit or lot costs (or labor hours) from inception of contract to the cutoff date, improvement curves, and any other available production cost history pertaining to the item(s) to which your offer relates.
(11)		Enter total incurred costs (Total of Columns (8), (9), and (10)).
(12)		Enter those necessary and reasonable costs that in your judgment will properly be incurred in completing the remaining work to be performed under the contract with respect to the item(s) to which your offer relates.
(13)		Enter total estimated cost (Total of Columns (11) and (12)).
(14)		Identify the attachment in which the information supporting the specific cost element may be found.
		(Attach separate pages as necessary.)