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COST ANALYSIS  
GUIDE

# 23710636

PROCUREMENT AND CONTRACTS MANAGEMENT DIVISION  
U. S. ENVIRONMENTAL PROTECTION AGENCY  
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Washington, D.C. 20460  
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(Revised 8/90)

## I. GLOSSARY

ACTUAL COST: A cost sustained in fact, on the basis of costs incurred, as distinguished from forecasted or estimated costs.

ALLOCABLE COST: A cost is allocable if it is assignable or chargeable to one or more cost objectives in accordance with the relative benefits received or other equitable relationships defined or agreed to between contractual parties.

BILLING RATES: Indirect cost rates used for interim reimbursement on contracts.

CONTRACT PRICING: A series of actions used to obtain, evaluate, assess, verify, and judge cost or pricing information, and to record the steps taken to ascertain that prices agreed to have been determined (found) fair and reasonable.

CONTRACT PRICING PROPOSAL: The instrument required of an offeror for the submission or identification of cost or pricing data. The basic SF 1411 (Contract Pricing Proposal) is the general purpose form, providing a standard format by which an offeror submits to the Government a summary of estimated (or in some instances incurred) costs suitable for detailed review and analysis.

COST ACCOUNTING: A system of accounting analysis and reporting on costs of production of goods or services, or of operation of programs, activities, functions or organizational units. The system may also embrace cost estimating, determination of cost standards based on engineering data, and comparison of actual and standard costs for the purpose of aiding cost control.

COST ANALYSIS: The review and evaluation of a contractor's cost or pricing data and of the judgmental factors applied in projecting from the data to the estimated costs in order to form an opinion leading to a position on the degree to which the contractor's proposed costs represent what contract performance should cost, assuming reasonable economy and efficiency. It includes appropriate verification of cost data, evaluation of specific elements of costs and projection of these data to determine the effect on price factors like cost necessity, allowances for contingencies, and the basis used for allocation of overhead costs.

COST ESTIMATING: The process of forecasting a future result in terms of cost, based upon information available at the time.

COST INCURRED: A cost identified through the use of the accrued method of accounting and reporting or otherwise actually paid. Cost of direct labor, direct materials, and direct services identified with and necessary for the performance of a contract, and all properly allocated and allowable indirect costs as shown by the books of the contractor.

COST OBJECTIVE: A function, organizational subdivision, contract, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capitalized projects, and so forth.

COST OR PRICING DATA: Data consisting of all facts existing up to the time of agreement on price, which prudent buyers and sellers would reasonably expect to have a significant effect on price negotiations. Being factual, these data are types of information that can be verified. They do not reflect on the accuracy of the contractor's judgment about estimated future costs or projections; they do, however, reflect on the data upon which the contractor based his judgment.

COST OVERRUN (or UNDERRUN): A net change in contractual amount over (under) that contemplated by a contract target price (FPI contract), estimated cost plus fee (any cost-reimbursement type contract), or redeterminable price (FPR contract), due to the contractor's actual costs being over (under) target or anticipated contract costs, but not attributable to any other cause of cost growth (e.g., quantity changes, engineering changes, economic changes, or changes in estimates of program/project costs).

COST REIMBURSEMENT: Refers to a family of pricing arrangements that provide for payment of allowable, allocable and reasonable costs incurred in the performance of a contract, to the extent that such costs are prescribed or permitted by the contract. In the case of a cost-plus-fixed-fee arrangement, costs may vary under or over the initially agreed-to estimate, but the fee remains fixed as an expressed dollar amount and is not subject to adjustment by reason of contractor cost experience during the life of the contract.

COST RISK: An assumption of possible monetary loss or gain in light of the job or work to be done. One of the elements to be considered in the negotiation of a fair and reasonable price, as well as in determining the type of contract under which performance will occur.

DEFECTIVE COST OR PRICING DATA: Certified cost or pricing data subsequently found to have been inaccurate, incomplete or noncurrent as of the effective date of the certificate. In this case, the Government is entitled to an adjustment of the negotiated price, including profit or fee, to exclude any significant sum by which price was increased because of the defective data, provided the data were relied upon by the Government.

DIRECT COST: Any cost that is specifically identified with a particular final cost objective, but not necessarily limited to items that are incorporated in the end product as material or labor.

ECONOMIC PRICE ADJUSTMENT: An alteration permitted and specified by contract provisions for the upward and/or downward revision of a stated contract price upon the occurrence of certain contingencies that are specifically defined in the contract.

ESCALATION: A term traditionally used to indicate an upward or downward movement of price. "Economic price adjustment" is the contemporary term used to express the sense of "escalation."

ESTABLISHED CATALOG PRICE: A price included in a catalog, price list, schedule or other form that (1) is regularly maintained by a manufacturer or vendor, (2) is published or made available for inspection by customers, and (3) states prices at which sales are currently or were last made to a significant number of buyers constituting the general public.

ESTABLISHED MARKET PRICE: A current price, established in the usual and ordinary course of trade between buyers and sellers free to bargain, which can be substantiated from sources independent of the manufacturer or vendor, although the data may be prepared by the seller.

FEE: In specified cost-reimbursement pricing arrangements, fee represents an agreed-to amount beyond the initial estimate of costs. In most instances, fee reflects a variety of factors, including risk, and is subject to statutory limitations. Fee may be fixed at the outset of performance, as in a cost-plus-fixed-fee arrangement, or may vary (within a contractually specified minimum-maximum range) during performance, as in a cost-plus-incentive-fee arrangement.

**FIELD PRICING SUPPORT:** Involves the analysis of contractor pricing proposals by any or all field technical and other specialists, including plant representatives, administrative contracting officers, contract auditors, price analysts, quality assurance personnel, engineers, and legal and small business specialists.

**FINAL COST OBJECTIVE:** A cost objective that has allocated to it both direct and indirect costs and, in the contractor's accounting system, is one of the final accumulation points.

**FINAL RATES:** Used for determination of final indirect costs allowable to contracts. Rates are determined on a contractor fiscal year basis.

**FIXED PRICE:** Refers to a family of pricing arrangements whose common discipline is a ceiling beyond which the Government bears no responsibility for payment. In the case of a firm fixed-price arrangement, the agreed-to price is not subject to any adjustment by reason of the contractor's cost experience in the performance of the contract.

**FORWARD PRICING:** A pricing decision made in advance of performance, based on analysis of comparative prices, cost estimates, past costs or combinations of such considerations.

**GENERAL AND ADMINISTRATIVE:** Indirect expenses, including a company's general and executive offices, executive compensation, the cost of staff services such as legal, accounting, public relations, financial and similar expenses and other miscellaneous expenses related to the overall business.

**INDIRECT COST:** Any cost not directly identified with a single final cost objective but identified with two or more final cost objectives or with at least one intermediate cost objective. Also referred to as overhead or burden.

**INDIRECT COST POOL:** A grouping of projected or incurred costs identified with two or more cost objectives but not specifically identified with any final cost objective.

**LEARNING CURVE:** A tool of calculation used primarily to project resource requirements, in terms of direct manufacturing labor hours or the quantity of material (for this purpose, usually referred to as an improvement curve) required for a production run. Used interchangeably with the term "improvement curve," the concept of a learner's curve was adopted from the observation that individuals who perform repetitive tasks exhibit a rate of improvement due to increased manual dexterity.

LEVEL OF EFFORT: The devotion of talent or capability to a predetermined level of activity, over a stated period of time, on the basis of a fixed-price or cost-reimbursement pricing arrangement. Payment is usually based on effort expended rather than on results achieved.

MARKETPLACE: The commercial world; the realm of business, trade and economics; the environment in which buyers and sellers bargain to achieve their separate and mutual ends.

OVERHEAD: (See Indirect Cost.)

PRICE: A monetary amount given, received or asked in exchange for property or services, expressed in terms of a single item or unit of measure for such property or services.

PRICE ANALYSIS: The process of examining and evaluating a prospective price without evaluation of the separate cost elements and proposed profit of the individual offeror whose price is being evaluated. It may be accomplished by a comparison of submitted quotations, a comparison of price quotations and contract prices with current quotations for the same or similar items, the use of rough yardsticks (dollars per pound, for instance), or a comparison of proposed prices with independently developed Government estimates.

PRICING: The process of establishing the amount or amounts to be received or paid in return for providing goods and/or performing services.

PRICING ARRANGEMENT: An agreed-to basis between contractual parties for the payment of amounts for specified performance. Usually expressed in terms of a specific cost-reimbursement or fixed-price type arrangement.

PROFIT: Generally characterized as the basic motive of business enterprise; on occasion referred to as "the wages of risk." In contract pricing, profit represents a projected or known monetary excess realized by a producer or performer after the deduction of cost (both direct and indirect) incurred or to be incurred in the performance of a job, task or series of the same.

PROFIT CENTER: A discrete, organizationally independent segment of a company, which has been charged by management with profit and loss responsibilities.

PROFIT OBJECTIVE: That part of the estimated contract price objective or values that the contracting officer concludes is appropriate for the procurement at hand. Where cost analysis is undertaken, a profit objective should be developed. Developed, that is to say, after a thorough review of proposed contract work and all available knowledge regarding an offeror as well as an analysis of the offeror's cost estimate, and a comparison of it with the Government's estimate or projection of cost.

REASONABLE COST: A cost is reasonable if, in its nature or amount, it does not exceed what would be incurred by an ordinarily prudent person in the conduct of competitive business.

REQUEST FOR PROPOSALS: A solicitation document used in negotiated procurements. When an RFP so states, the Government reserves the right to award a contract based on initial offers received without any written or oral discussion with offerors.

REQUEST FOR QUOTATIONS: A solicitation document used in negotiated procurements. An RFQ is a request for information. Quotes submitted in response to it are not offers that the Government may accept without some confirmation or discussion with offerors.

RETROACTIVE PRICING: A pricing decision made after some or all of the work specified under contract has been completed, based on a review of contractor performance and recorded cost data.

SAMPLING: Method of obtaining statistics from a large body of data without resorting to a complete census of the data. Two broad methods of selecting samples are probability sampling (in which sample units are selected according to the law of chance) and nonprobability sampling (in which personal choice, expert judgment or some other nonprobabilistic rationale is used to select sample units).

SHOULD COST: A concept of contract pricing that employs an integrated team of Government procurement, contract administration, audit, and engineering representatives to conduct a coordinated, in-depth cost analysis at the contractor's plant. Its purpose: to identify uneconomical or inefficient practices in the contractor's management and operations, to quantify the findings in terms of their impact on cost, and to develop a realistic price objective for negotiation that reflects the outcome of the should-cost effort.

VALUE ANALYSIS: A systematic and objective evaluation of the function of a product and its related cost. Its purpose is to ensure optimum value. As a pricing tool, it provides insight into the inherent worth of a product.

VARIABLE COST: A cost that changes with the rate of production of goods or the performance of services. As distinguished from "fixed" costs (which do not change with the rate of production or performance), there may be "semivariable" costs (neither entirely fixed nor variable) and "variable" costs as defined here.

VISUAL ANALYSIS: The visual inspection of an item or its drawings, from which a general estimate may be made about probable value. In most instances, visual analysis deals with obvious, external features.

WEIGHTED GUIDELINES METHOD: A technique of negotiated procurement the Government uses to insure consideration of the relative value of appropriate profit factors in establishing a profit objective and conducting negotiations. Also used as a basis for documenting and explaining the final pricing agreement reached between buyer and seller. Appropriate profit factors include contractor's input to total performance, contractor's assumption of contract cost risk, record of contractor's performance, selected factors (such as source of resources) and any special profit consideration.



## II. ACQUISITION PROCESS

1. Definitions
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3. Definition of Cost Analysis, Cost or Pricing Data and Price Analysis
4. Certified Cost or Pricing Data
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  - b. Certificate of Cost or Pricing Data
  - c. Exemptions
5. Responsibilities of the Contracting Officer in the Pricing Decision
  - a. Price Analysis
  - b. Cost Analysis
  - c. Technical Analysis
6. Audit Requirements
7. Who Performs Cost and Price Analysis at EPA



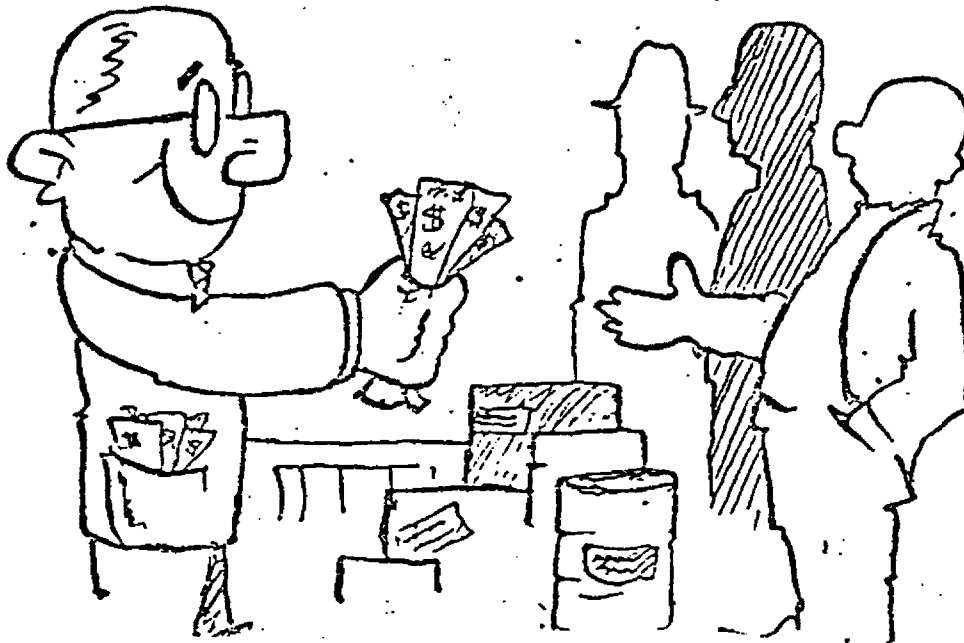
## II. THE ACQUISITION PROCESS

ACQUISITION means the acquiring by contract with appropriated funds of supplies or services (including construction) by and for the use of the Federal Government through purchase or lease, whether the supplies or services are already in existence or must be created, developed, demonstrated, and evaluated. Acquisition begins at the point when agency needs are established and includes the description of requirements to satisfy agency needs, solicitation and selection of sources, award of contracts, contract financing, contract performance, contract administration, and those technical and management functions directly related to the process of fulfilling agency needs by contract.

Contracting officers are the Government's agents in the acquisition process. They are responsible for assuring compliance with the Federal Acquisition Regulation (FAR) in fulfilling the Government's needs.

As part of this responsibility, contracting officers should fulfill these needs at a reasonable cost.

It is this responsibility that the Cost Analysis Guide is intended. With cost or price as a consideration, this section will examine the FAR 15.8\* section governing the negotiation of price.



\*Federal Acquisition Circular 84-5, effective April 1, 1985 has been incorporated in this section.

## Regulatory Requirements for Cost Analysis [FAR 15.805-1(h)]

When cost or pricing data are required, the contracting officer shall make a cost analysis to evaluate the reasonableness of individual cost elements.

In addition, the contracting officer should make a price analysis to ensure that the overall price offered is fair and reasonable.

When cost or pricing data are not required, the contracting officer shall make a price analysis to ensure that the overall price offered is fair and reasonable.

## Definitions of Cost Analysis, Cost of Pricing Data and Price Analysis [FAR 15.801]

"Cost Analysis" means the review and evaluation of the separate cost elements and proposed profit of

- (a) offeror's or contractor's cost or pricing data, and
- (b) the judgmental factors applied in projecting from the data to the estimated costs, in order to form an opinion on the degree to which the proposed costs represent what the contract should cost, assuming reasonable economy and efficiency.

"Price analysis" means the process of examining and evaluating a proposed price without evaluating its separate cost elements and proposed profit.

"Cost or pricing data" means all facts as of the time of price agreement that prudent buyers and sellers would reasonably expect to affect price negotiations significantly. Cost or pricing data are factual, not judgmental, and are therefore verifiable. While they do not indicate the accuracy of the prospective contractor's judgment about estimated future costs or projections, they do include the data forming the basis for that judgment. Cost or pricing data are more than historical accounting data; they are all the facts that can be reasonably expected to contribute to the soundness of estimates of future costs and to the validity of determinations of costs already incurred. They also include such factors as (a) vendor quotations; (b) nonrecurring costs; (c) information on changes in production methods and in production or purchasing volume; (d) data supporting projections of business

prospects and objectives and related operations costs; (e) unit-cost trends such as those associated with labor efficiency; (f) make-or-buy decisions (g) estimated resources to attain business goals; and (h) information on management decisions that could have a significant bearing on costs.

"Field pricing support" means a review and evaluation of the contractor's or subcontractor's proposal by any or all field pricing support personnel [(See 15.805-5(a)(2))].

When is Certified Cost or Pricing Data Required? [FAR 15.804-2]

- (a)(1) Except as provided in 15.804-3, certified cost or pricing data are required before accomplishing any of the following actions:
- (i) The award of any negotiated contract (except for unpriced actions such as letter contracts) expected to exceed \$100,000.
  - (ii) The modification of any sealed bid or negotiated contract (whether or not cost or pricing data were initially required) when the modification involves a price adjustment expected to exceed \$100,000. (For example, a \$30,000 modification resulting from a reduction of \$70,000 and an increase of \$40,000 is a pricing adjustment exceeding \$100,000.) This requirement does not apply when unrelated and separately priced changes for which costs or pricing data would not otherwise be required are included for administrative convenience in the same modification.
  - (iii) The award of a subcontract at any tier, if the contractor and each higher tier subcontractor have been required to furnish certified cost or pricing data, when the subcontract is expected to exceed \$100,000.
  - (iv) The modification of any subcontract covered by subdivision (iii) above, when the price adjustment (see subdivision (ii) above) is expected to exceed \$100,000.

Is certified cost or pricing data required for actions over \$25,000 and not in excess of \$100,000? [FAR 15.804-2]

- (2) If cost or pricing data are needed for pricing action over \$25,000 and not in excess of \$100,000, certified cost or pricing data may be obtained. There should be relatively few instances where certified cost or pricing data and inclusion of defective pricing clauses would be justified in awards between \$25,000 and \$100,000. The amount of data required to be submitted should be limited to that data necessary to allow the contracting officer to determine the reasonableness of the price. Whenever certified costs or pricing data are required for pricing actions of \$100,000 or less, the contracting officer shall document the file to justify the requirement. When awarding a contract of \$25,000 or less, the contracting officer shall not require certified cost or pricing data.
- (b) When certified cost or pricing data are required, the contracting officer shall require the contractor or prospective contractor to submit to the contracting officer (and to have any subcontractor or prospective subcontractor submit to the prime contractor or appropriate subcontractor tier) the following in support of any proposal:
  - (1) The cost or pricing data.
  - (2) A certificate of current cost or pricing data, in the format specified in 15.804-4, certifying that to the best of its knowledge and belief, the cost or pricing data were accurate, complete, and current as of the date of final agreement on price.

Certificate of Current Cost or Pricing Data [FAR 15.804-4]

(a) When certified cost or pricing data are required under 15.804-2, the contracting officer shall require the contractor to execute a Certificate of Current Cost or Pricing Data, shown below, and shall include the executed certificate in the contract file. The certificate states that the cost or pricing data are accurate, complete, and current as of the date the contractor and the Government agreed on a price. Only one certificate shall be required; the contractor shall submit it as soon as practical after price agreement is reached.

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 (as defined in section 15.801 of the Federal Acquisition Regulation (FAR) and required under FAR subsection 15.804-2 to the contracting officer or to the contracting officer's representative in support of .....\* are accurate, complete, and current as of .....\*\* This certification includes the cost of pricing data supporting any advance agreements and forward pricing rate agreements between the offeror and the Government that are part of the proposal.

Firm.....

Name.....

Title.....

Date of execution\*\*\*.....

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

\*\* Insert the day, month, and year when price negotiations were concluded and price agreement was reached.

\*\*\* Insert the day, month, and year of signing, which should be as close as practicable to the date when the price negotiations were concluded and the contract price was agreed to.

(End of Certificate)

Why is the certificate of current cost and pricing required?

The certificate is required so that if the cost and pricing data is subsequently found to be inaccurate, incomplete, or noncurrent as of the effective date of the certificate, the Government is entitled to an adjustment of the negotiated price.

Is a certificate of current cost and pricing data an acceptable substitute for current cost and pricing data?

No. A certificate of cost or pricing data is not a substitute for examining and analyzing the contractor's proposal.

Are there exemptions from or waiver of submission of certified cost or pricing data? [FAR 15.804-3]

- (a) General. Except as provided in paragraphs (b) and (c) below, the contracting officer shall not require submission or certification of cost or pricing data when the contracting officer determines that prices are:
  - (1) Based on adequate price competition (see paragraph (b) below);
  - (2) Based on established catalog or market prices of commercial items sold in substantial quantities to the general public (see paragraph (c) below); or
  - (3) Set by law or regulation (see paragraph (d) below).

What is adequate price competition? [FAR 15.804-3(b)]

Adequate price competition.

- (1) Price competition exists if
  - (i) Offers are solicited;
  - (ii) Two or more responsible offerors that can satisfy the Government's requirements submit priced offers responsive to the solicitation's expressed requirement; and
  - (iii) These offerors compete independently for a contract to be awarded to the responsible offeror submitting the lowest evaluated price.
- (2) If price competition exists, the contracting officer shall presume that it is adequate unless
  - (i) The solicitation is made under conditions that unreasonably deny to one or more known and qualified offerors an opportunity to compete;
  - (ii) The low offeror has such a decided advantage that it is practically immune from competition; or
  - (iii) There is a finding, supported by a statement of the facts and approved at a level above the contracting officer, that the lowest price is unreasonable.
- (3) A price is "based on" adequate price competition if it results directly from price competition or if price analysis alone clearly demonstrates that the proposed price is reasonable in comparison with current or recent prices for the same or substantially the same items purchased in comparable quantities, terms, and conditions under contracts that resulted from adequate price competition.

How can you determine if a price is based on an established catalog or market price? FAR 15.804-3(c)]

Established catalog or market prices. A proposal is exempt from the requirement for submission of certified cost or pricing data if the prices are, or are based on, established catalog or established market prices of commercial items sold in substantial quantities to the general public. In order to qualify for this exemption, the terms of the proposed purchase, such as quantity and delivery requirements, should be sufficiently similar to those of the commercial sales that the catalog or market price will be fair and reasonable.

- (1) "Established catalog prices" must be recorded in a form regularly maintained by the manufacturer or vendor. This form may be a catalog, price list, schedule, or other verifiable and established record. The record must (i) be published or otherwise available for customer inspection and (ii) state current or last sales price to a significant number of buyers constituting the general public (see subparagraph (5) below).
- (2) "Established market prices" are current prices that (i) are in the course of ordinary and usual trade between buyers and sellers free to bargain and (ii) can be substantiated by data from sources independent of the manufacturer or vendor.
- (3) "Commercial items" are supplies or services regularly used for other than Government purposes and sold or traded to the general public in the course or normal business operations.
- (4) An item is "sold in substantial quantities" only when the quantities regularly sold are sufficient to constitute a real commercial market. Nominal quantities, such as models, samples, prototypes, or experimental units, do not meet this requirement. For services to be sold in substantial quantities, they must be customarily provided by the offeror, using personnel regularly employed and equipment (if any is necessary) regularly maintained solely or principally to provide the services.

- (5) The "general public" is a significant number of buyers other than the Government or affiliates of the offeror; the item involved must not be for Government end use. For the purpose of this subsection 15.804-3, items acquired for "Government end use" include items acquired for foreign military sales.
- (6) A price is "based on" a catalog or market price only if the item being purchased is sufficiently similar to the catalog or market priced commercial item to ensure that any difference in prices can be identified and justified without resorting to cost analysis.
- (7) If an item is substantially similar to a commercial item for which there is an established catalog or market price at which substantial quantities are sold to the general public, but the price proposed is not based on this catalog or market price (see subparagraph (6) above), the contracting officer may, if doing so will result in a fair and reasonable price, limit any requirement for costs or pricing data to those data that pertain to the differences between the items. When the difference between the catalog or market price of an item or items and the proposed total contract price is \$100,000 or more, the contracting officer shall require submission of certified cost or pricing data to identify and justify that difference unless an exemption or waiver is granted.
- (8) Even though there is an established catalog or market price of commercial items sold in substantial quantities to the general public, the contracting officer may require costs or pricing data if (i) the contracting officer makes a written finding that the price is not reasonable, including the facts upon which the finding is based, and (ii) the finding is approved at a level above the contracting officer.

How do you receive an exemption? FAR 15.804-3(e)]

Claiming and granting exemption. To receive an exemption under paragraph (c) or (d) above, the offeror must ordinarily claim it on standard Form 1412, Claim for Exemption from Submission of Certified Cost or Pricing Data, when the total proposed amount exceeds \$100,000 and more than one catalog item for which an exemption is claimed exceeds \$25,000. When an exemption is claimed for more than one item in a proposal, a separate SF 1412 is required for each such item exceeding \$25,000 except as otherwise provided in the solicitation. The contracting officer may grant an exemption and need not require the submission of SF 1412 when

- (1) The Government has acted favorably on an exemption claim for the same item or similar items within the past year. In that case, except as otherwise directed by the contracting officer, the offeror may furnish a copy of the prior claim and related Government action. The offeror must also submit a statement to the effect that to its knowledge since the prior submission, except as expressly set forth in the statement, there have been no changes in the catalog price or discounts, volume of actual sales, or the ratio of sales for Government end use to sales in other categories which would cause a cumulative change in price exceeding \$25,000;
- (2) Special arrangements for the submission of exemption claims have been made in anticipation of repetitive acquisitions of catalog items;
- (3) There is evidence, before solicitation, that the item has an acceptable established catalog or market price or a price set by law or regulation. Evidence may include (i) recent submissions by offerors or (ii) the contract officer's knowledge or market conditions, prevailing prices, or sources.

CLAIM FOR EXEMPTION FROM SUBMISSION OF CERTIFIED COST OR PRICING DATA		FORM 15-804-3	
1. OFFEROR (Name, address, ZIP Code)		3. SOLICITATION NO. 3090-0118	
		4. ITEM OF SUPPLIES AND/OR SERVICES TO BE FURNISHED	
2. DIVISION(S) AND LOCATION(S) WHERE WORK IS TO BE PERFORMED		5. QUANTITY	
		6. TOTAL AMOUNT PROPOSED FOR ITEM	
<p>By submission of this form the offeror claims exemption from requirements for submitting certified cost or pricing data on the basis that the price offered is based on an established catalog or market price of a commercial item sold in substantial quantities to the general public or is a price set by law or regulation (see FAR 15.804-3). Complete Section I, II, or III below as applicable.</p>			
<b>SECTION I - CATALOG PRICE (See Instructions for items 7 thru 11 on reverse.)</b>			
7. CATALOG IDENTIFICATION AND DATE		8. SALES PERIOD COVERED	
		FROM TO	
9. CATEGORIES OF SALES	TOTAL UNITS SOLD*	10. REMARKS	
a. U.S. Government sales			
b. Sales at catalog price to general public			
c. Other sales to general public			
<p>*If your accounting system does not provide precise information, insert your best estimate and explain the basis for it in item 10, REMARKS. Continue on a separate sheet, if necessary.</p>			
<b>11. LIST THREE SALES OF THE ITEM OFFERED</b>			
SALES CATEGORY	DATE	NO. OF UNITS SOLD	PRICE/UNIT
a. <input type="checkbox"/> B <input type="checkbox"/> C			\$
b. <input type="checkbox"/> B <input type="checkbox"/> C			\$
c. <input type="checkbox"/> B <input type="checkbox"/> C			\$
<b>SECTION II - MARKET PRICE (See Instructions for item 12 on reverse.)</b>			
12. SET FORTH THE SOURCE AND DATE OR PERIOD OF THE MARKET QUOTATION OR OTHER BASE FOR MARKET PRICE, THE BASE AMOUNT, AND APPLICABLE DISCOUNTS.			
<b>SECTION III - LAW OR REGULATION (See Instructions for item 13 on reverse.)</b>			
13. IDENTIFY THE LAW OR REGULATION ESTABLISHING THE PRICE OFFERED			
<b>REPRESENTATION (See Instructions for item 14 on reverse.)</b>			
<p>The offeror represents that all statements made above and on attachments submitted are accurate and are submitted for the purpose of claiming exemption from requirements for submitting certified cost or pricing data. The offeror also represents that, except as stated in an attachment, a like claim for exemption involving the same or a substantially similar item has not been denied by a Government Contracting Officer within the last 2 years. Pending consideration of the proposal supported by the submission and, if this proposal or a modification of it is accepted by the Government, until the expiration of 3 years from the date of final payment under a contract resulting from this proposal, the Contracting Officer or any other authorized employee of the United States Government is granted access to books, records, documents, and other supporting data that will permit verification of the claim.</p>			
14. TYPED NAME, TITLE, AND FIRM	15. SIGNATURE	16. DATE OF SUBMISSION	

INSTRUCTIONS TO OFFERORS SUBMITTING  
CLAIM FOR EXEMPTION FROM SUBMISSION  
OF CERTIFIED COST OR PRICING DATA

Item 7. Attach a copy of the catalog, or the appropriate pages covering price and published discounts, or a statement that the catalog is on file in the buying office to which this proposal is being made. Catalog price, is a price that is included in a catalog, price list, schedule, or other form that is regularly maintained by the manufacturer or vendor, is either published or otherwise available for inspection by customers, and states prices at which sales are currently, or were last, made to a significant number of buyers constituting the general public. To justify a catalog price exemption for the Government item, the catalog item must be identical or must be so similar in material and design that any price difference or its absence can be evaluated solely by price analysis (see FAR 15.805-2). In the latter case, a statement must be attached identifying the specific differences and explaining, by price analysis of the differences, how the proposed price is derived from the catalog price.

Item 8. This period should include the most recent regular monthly, quarterly, or other period for which sales data are reasonably available and should extend back only far enough to provide a total period representative of average sales. You may also attach sales data for a prior representative period if for any reason recent sales are abnormal and the prior period is sufficiently recent (not more than 2 years preceding) to support the proposed price for the Government item. In the latter case, you must explain, by price analysis only, how the proposed price is derived from the catalog sales for the prior period.

Item 9. (a) Include in Category A all sales of the catalog item (a) directly to the U.S. Government and its instrumentalities and (b) for U.S. Government use (sales directly to U.S. Government prime contractors, or their subcontractors or suppliers at any tier, for use as an end item, or as part of an end item, by the U.S. Government).

(b) Include in Category B all sales of the catalog item made strictly at the catalog price, less only published discounts, to the general public (i.e., catalog price sales other than those (i) to affiliates of the offeror or (ii) included in Category A (Instruction 9(a)).

(c) Include in Category C all sales to the general public that were not made strictly at the catalog price or that were made at special discounts or discount rates not published in the catalog.

Item 11. On line a, insert information on the lowest price at which Category B or C sales of the offered item was made during the period, regardless of quantity.

On lines b, and c, insert sales information in the following manner.

a. Give the lowest price Category C sales of comparable quantities. If there were no sales of comparable quantities, then give

b. The lowest price Category C sales of quantities most nearly the quantity being offered. If there were no sales of Category C, then give

c. The lowest price Category B sales of comparable quantities. If there were no sales of comparable quantities, then give

d. The lowest price Category B sales of quantities most nearly the quantity being offered.

Attach a complete explanation (i) if you, during the period covered, offered special discounts not included in the catalog, or (ii) if the price proposed is not the lowest price at which a sale was made to any customer during that period for like items and comparable quantities.

Item 12. Market price is a current price, established in the usual and ordinary course of trade between buyers and sellers free to bargain, that can be substantiated from sources independent of the manufacturer or vendor. There must be a sufficient number of commercial buyers so that their purchases establish an ascertainable current market price for the item or service. The nature of this market should be described. To justify a market-price exemption, the item or service being purchased must be identical to the commercial item or service or must be so similar in material and design (for supplies) or in work and facilities (for services) that any price difference or its absence can be evaluated solely by price analysis (see FAR 15.805-2). In the latter case, a statement must be attached identifying the specific differences and explaining, by price analysis of the differences, how the proposed price is derived from the market price.

Item 13. Identify the law or regulation establishing the price offered. If the price is controlled under law by periodic rulings, reviews or similar actions of a governmental body, attach a copy of the controlling document, unless it was previously submitted to the contracting office.

Item 14. Insert the name, title, and firm of the person authorized by the offeror to sign this form.

What process is involved when an exemption is claimed?  
[FAR 15.804-3(f)]

Verification.

- (1) When a prospective contractor requests exemption from submission of certified cost or pricing data, the contracting officer shall ensure that applicable criteria in either paragraph (c) or (d) above, as appropriate, are satisfied before issuing the exemptions.
- (2) SF 1412 lists three categories of sales related to the established catalog price of a commercial item sold in substantial quantities to the general public:
  - A: Sales to the U.S. Government or to contractors for U.S. Government use;
  - B: Sales at catalog price to the general public; and
  - C: Sales to the general public at other than catalog price.

Although "substantial quantities" cannot be precisely defined (see subparagraph (c)(4) above), the following guidelines are provided for determining whether exemption claims submitted under the catalog price provision of SF 1412 meet the "substantial quantities" criterion:

- (i) Sales to the general public are normally regarded as substantial if (a) Category B and C sales are not negligible in themselves and comprise at least 55 percent of total sales of the item and (b) Category B sales comprise at least 75 percent of the total of Category B and C sales.
- (ii) Sales to the general public are rarely considered substantial enough to grant an exemption if (a) Category B and C sales comprise less than 35 percent of total sales of the item or (b) Category B sales comprise less than 55 percent of the total of Category B and C sales.

- (iii) When percentages fall between those above, the contracting officer should analyze the individual situation in order to determine whether or not an exemption is justified.
- (3) The contracting officer may verify or obtain verification (including audit or contract administration assistance) of the submitted data pertaining to catalog or market prices or prices set by law or regulation. Access to the prospective contractor's records is limited to access to the facts bearing directly on the exemption claimed. It does not extend to cost, profit, or other data relevant solely to the reasonableness of the catalog or proposed price.

If an exemption is received, is price analysis required?  
[FAR 15.804-3(h)]

Price analysis

Even though an item qualifies for exemption from the requirement for submission of certified cost or pricing data, the contracting officer shall make a price analysis to determine the reasonableness of the price and any need for further negotiation. Unless information is available from Government sources, it may be necessary to obtain from the prospective contractor information such as that regarding -

- (1) The supplier's marketing system (i.e., use of jobbers, brokers, sales agencies, or distributors);
- (2) The services normally provided commercial purchasers (e.g., engineering, financing, or advertising or promotion.
- (3) Normal quantity per order; and
- (4) Annual volume of sales to largest customers.

What circumstances can the agency head waive the requirement for submission of certified cost or pricing data?  
[FAR 15.804-3(i)]

The agency head (or, if the contract is with a foreign government or agency, the head of the contracting activity) may, in exceptional cases, waive the requirement of submission of certified cost or pricing data. The authorization for the waiver and the reasons for granting it shall be in writing. The agency head may delegate this authority.

Who is responsible for assuring that adequate cost and pricing data is furnished? (FAR 15.804-6)

#### Procedural Requirements

(a) The contracting officer shall specify (1) whether or not cost or pricing data are required, (2) whether or not certification will be required, (3) the extent of cost or pricing data required if complete data are not necessary, and (4) the form (see paragraph (b) below) in which the costs or pricing data shall be submitted. Even if the solicitation does not so specify, however, the contracting officer is not precluded from requesting such data if they are later found necessary.

(b)(1) Cost or pricing data shall be submitted on Standard Form 1411 (SF 1411), Contract Pricing Proposal Cover Sheet, unless required to be submitted on one of the termination forms specified in Subpart 49.6 Data supporting forward pricing rate agreements or final indirect cost proposals shall be submitted in a format acceptable to the contracting officer.

(2) Contract pricing proposals submitted on SF 1411 with supporting attachments shall be prepared to satisfy the instructions and appropriate format provided in the Federal Acquisition Regulations.

SF-1411 Contract Pricing Cover Sheet is discussed in Part IV of this guide.

When is the defective pricing clause required? [FAR 15.804-8]

Contract clauses.

(a) Price Reduction for Defective Cost or Pricing Data. The contracting officer shall, when contracting by negotiation, insert the clause at 52.215-22, Price Reduction for Defective Cost or Pricing Data, in solicitations and contracts when it is contemplated that cost or pricing data will be required (see 15.804-2).

(b) Price Reduction for Defective Cost or Pricing Data-Modifications. The contracting officer shall, when contracting by negotiation, insert the clause at 52.215-23, Price Reduction for Defective Cost or Pricing Data-Modifications, in solicitations and contracts when (1) it is contemplated that cost or pricing data will be required (see 15.804-2) for the pricing of contract modifications, and (2) the clause prescribed in paragraph (a) above has not been included.

(c) Subcontractor Cost or Pricing Data. The contracting officer shall insert the clause at 52.215-24, Subcontractor Cost or Pricing Data, in solicitations and contracts when the clause prescribed in paragraph (a) above is included.

(d) Subcontractor Cost or Pricing Data-Modifications. The contracting officer shall insert the clause at 52.215-25, Subcontractor Cost or Pricing Data-Modifications, in solicitations and contracts when the clause prescribed in paragraph (b) above is included.

What are the responsibilities of the contracting officer in the pricing decision? [FAR 15.805]

Proposal Analysis

(a) The contracting officer, exercising sole responsibility for the final pricing decision, shall, as appropriate, coordinate a team of experts and request and evaluate the advice of specialists in such fields as contracting, finance, law, contract audit, packaging, quality control, engineering traffic management, and contract pricing. The contracting officer should have appropriate specialists attend the negotiations when complex problems involving significant matters will be addressed. The contracting officer may assign responsibility to a negotiator or price analyst for (1) determining the extent of specialists' advice needed and evaluating that advice, (2) coordinating a team of experts, (3) consolidating pricing data and developing a prenegotiation objective (see 15.807), and (4) conducting negotiations.

(b) The contracting officer shall require prospective contractors to perform (1) price analysis for all significant proposed subcontracts and purchase orders and (2) cost analysis when the prospective subcontractor is required to submit cost or pricing data or the contractor is unable to perform an adequate price analysis (see 15.806(a)).

#### Price Analysis

The contracting officer is responsible for selecting and using whatever price analysis techniques will ensure a fair and reasonable price. One or more of the following techniques may be used to perform price analysis:

- (a) Comparison of price quotations received in response to the solicitation.
- (b) Comparison of prior quotations and contract prices with current quotations for the same or similar end items.
- (c) Application of rough yardsticks (such as dollars per pound or per horsepower, other units) to highlight significant inconsistencies that warrant additional pricing inquiry.
- (d) Comparison with competitive published price list, published market prices of commodities, similar indexes, and discount or rebate arrangements.
- (e) Comparison of proposed prices with independent Government cost estimates (see 15.803(b)).

#### Cost Analysis

The contracting officer shall, as appropriate, use the techniques and procedures outlined in paragraphs (a) through (f) below to perform cost analysis:

- (a) Verification of cost or pricing data and evaluation of cost elements, including:
  - (1) The necessity for and reasonableness of proposed costs, including allowances for contingencies;
  - (2) Projection of the offeror's costs trends, on the basis of current and historical cost or pricing data;

- (3) A technical appraisal of the estimated labor, material tooling, and facilities requirements and of the reasonableness of scrap and spoilage factors; and
  - (4) The application of audited or negotiated indirect cost rates (see Subpart 42.7), labor rates, and cost of money or other factors.
- (b) Evaluating the effect of the offeror's current practices on future costs. In conducting this evaluation, the contracting officer shall 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 contracting officer should make a trend analysis of basic labor and materials even in periods of relative stability.
- (c) Comparison of costs proposed by the offeror for individual cost elements with:
- (1) Actual costs previously incurred by the same offeror;
  - (2) Previous costs estimates from the offeror or from other offerors for the same or similar items;
  - (3) Other cost estimates received in response to the Government's request;
  - (4) Independent Government cost estimates by technical personnel; and
  - (5) Forecasts of planned expenditures.
- (d) Verification that the offeror's costs submissions are in accordance with the contract cost principles and procedures in Part 31 and, when applicable, the requirements and procedures in Part 30, Cost Accounting Standards.
- (e) Review to determine whether any costs or pricing data necessary to make the contractor's proposal accurate, complete, and current have not been

either submitted or identified in writing by the contractor. If there are such data, the contracting officer shall attempt to obtain them and negotiate, using them or making satisfactory allowance for the incomplete data.

- (f) Analysis of the results of any make-or-buy program reviews, in evaluating subcontract costs.

#### Technical Analysis.

When cost or pricing data are required, the contracting officer should generally request a technical analysis of proposals, asking that requirements, logistics, or other appropriate qualified personnel review and assess, as a minimum:

- (a) The quantities and kinds of material proposed;
- (b) The need for the number and kinds of labor hours and the labor mix;
- (c) The special tooling and facilities proposed;
- (d) The reasonableness of proposed scrap and spoilage factors; and
- (e) Any other data that may be pertinent to the cost or price analysis.

When is audit required? [FAR 15.805-5]

#### Field pricing support.

- (a) (1) When cost or pricing data are required, contracting officers shall request a field pricing report (which may include an audit review by the cognizant contract audit activity) before negotiating any contract or modification resulting from a proposal in excess of \$500,000 except as otherwise authorized under agency procedures, unless information available to the contracting officer is considered adequate to determine the reasonableness of the proposed cost or price. When available data are considered adequate for a reasonableness determination, the contracting officer shall document the contract file to reflect the basis of the determination.

- (2) Field pricing reports are intended to give the contracting officer a detailed analysis of the proposal, for use in contract negotiations. Field pricing support personnel include, but are not limited to, administrative contracting officers, contract auditors, price analysts, quality assurance personnel, engineers, and small business and legal specialists.
- (b) Contracting officers should not request field pricing support for proposed contracts or modifications of an amount less than that specified in subparagraph (a)(1) above. An exception may be made when a reasonable pricing result cannot be established, because of (1) lack of knowledge of the particular contractor, (2) sensitive conditions, or (3) an inability to evaluate the price reasonableness through price analysis or cost analysis of existing data.

When is the audit clause required in the contract?  
[FAR 15.106-2]

The following audit clause shall be included in all negotiated contracts, except small purchases.

Audit-Negotiation clause

- (a) This subsection implements 10 U.S.C. 2313 (a), 41 U.S.C. 254(b), and 10 U.S.C. 2306(f).
- (b) The contracting officer shall, when contracting by negotiation, insert the clause at 52.215-2, Audit-Negotiation, in solicitations and contracts, unless the acquisition is a small purchase under Part 13. In facilities contracts, the contract officer shall use the clause with its Alternate 1.

## Audit-Negotiation clause

As prescribed in 15.106-2(b), when contracting by negotiation, insert the following clause in solicitations and contracts, unless the acquisition is a small purchase under Part 13.

### Audit-Negotiation (APR 1984)

- (a) Examination of costs. If this is a cost-reimbursement, incentive, time-and-materials, labor-hour, or price-redeterminable contract, or any combination of these, the Contractor shall maintain and the contracting officer or representatives of the contracting officer shall have the right to examine and audit books, records, documents, and other evidence and accounting procedures and practices, sufficient to reflect properly all costs claimed to have been incurred or anticipated to be incurred in performing this contract. This right of examination shall include inspection at all reasonable times of the contractor's plants, or parts of them, engaged in performing the contract.
- (b) Cost or pricing data. If, pursuant to law, the contractor has been required to submit cost or pricing data in connection with pricing this contract or any modification of this contract, the contracting officer or representatives of the contracting officer who are employees of the Government shall have the right to examine and audit all books, records, documents, and other data of the contractor (including computations and projections) related to negotiating, pricing, or performing the contract or modification, in order to evaluate the accuracy, completeness, and currency of the costs or pricing data. The right of examination shall extend to all documents necessary to permit adequate evaluation of the cost or pricing data submitted, along with the computations and projections used.
- (c) Reports. If the contractor is required to furnish cost, funding, or performance reports, the contracting officer or representatives of the contracting officer who are employees of the Government shall have the right to examine and audit books, records, other documents, and supporting materials, for the purpose of evaluating (1) the effectiveness of the contractor's policies and procedures to produce data compatible with the objectives of these reports and (2) the data reported.

(d) Availability. The contractor shall make available at its office at all reasonable times the materials described in paragraphs (a) and (b) above, for examination, audit, or reproduction, until 3 years after final payment under this contract, or for any shorter period specified in Subpart 4.7, Contractor Records Retention, of the Federal Acquisition Regulation, or for any longer period required by statute or by other clauses of this contract. In addition:

- (1) If this contract is completely or partially terminated, the records relating to the work terminated shall be made available for 3 years after any resulting final termination settlement; and
- (2) Records relating to appeals under the Disputes clause or to litigation or the settlement of claims arising under or relating to this contract shall be made available until such appeals, litigation, or claims are disposed of.

(e) The Contractor shall insert a clause containing all the terms of this clause, including this paragraph (e), in all subcontracts over \$10,000 under this contract, altering the clause only as necessary to identify properly the contracting parties and the contracting officer under the Government prime contract.

(End of Clause)

What is EPA's policy with respect to cost and price analysis?

It is the intent of the Environmental Protection Agency to utilize cost or price analysis to the maximum extent practicable prior to the negotiation of contracts and, when necessary supplement the analysis with audits of contractor's records and procedures.

Who performs cost and price analysis at EPA?

The FAR [15.608] states that the contracting officer shall use cost or price analysis and shall document the cost and price evaluation. FAR 15.804-3 (a)-(d) sets forth the exemption from cost or pricing data.

- (1) adequate price competition
- (2) established catalog or market price of commercial items
- (3) prices set by law or regulation

The EPA Acquisition Handbook states:

On procurements of \$500,000 or less, the Contracting Officer may perform his/her own cost or price analysis. If the action is over \$500,000, the contracting officer will forward the proposals to the local cost advisory operations. The cost advisory operations will either request audits on the proposals, perform an appropriate audit, or recommend to the contracting officer that he/she waive audit because adequate data is available through other means to perform a detailed analysis in-house.

In EPA, contracting officers and contract specialists can obtain cost advisory services from the Cost Advisory Section. For a detailed explanation of the cost advisory function, refer to Section III of this guide.

Who provides field audit services for EPA?

Field audit services are provided primarily by the Defense Contract Audit Agency, and the Department of Health and Human Services. EPA has an Interagency Agreement whereby the reimbursable costs of these services are charged against the budget of the EPA Office of the Inspector General.

To control and coordinate these services, all requests for field audit services must be coordinated through one of the EPA Cost Advisory Offices. Contracting officers and contract specialists are not authorized to request audits. A telephone verification of labor rates and indirect cost rates is not considered a field audit in this context. The EPA Cost Advisory Offices are located at the principal contracting offices in Washington, D.C., Research Triangle Park, NC and Cincinnati, OH.

Emphasize the requirement that a copy of the postnegotiation summary be provided to the cost advisory group by the contract specialist.

As required by FAR 15.808(b), P&CMD Acquisition Handbook Units 3 (FAR. 6) and 4 (FAR. 4), please furnish the Cost Advisory Section with a copy of the Summary of Negotiations after contract award. Please advise us if no award is made.

Prenegotiation Plan/Summary.

The summary shall address the planned disposition of all questioned and set-aside costs resulting from an audit. The Chief of the Contracting Office may issue procedures that do not require a formal prenegotiation plan. The procedures shall require at a minimum that the Contract Specialists discuss all significant objectives with the Contracting Officer or applicable Branch Chief or Section Head prior to initiating negotiations.

Postnegotiation Summary.

At the conclusion of each negotiation, the Contract Specialist shall promptly prepare a summary of the principle elements of the negotiation, using the Postnegotiation summary format (Attachment). The summary shall address the disposition of all questioned and set-aside costs resulting from an audit. The memorandum shall be included in the contract file.

Distribution.

The Contract Specialist shall provide the Cost Advisory Group with a copy of the postnegotiation summary for each offeror who was audited. After completion of the negotiations, the Cost Advisory Group shall distribute a copy of the postnegotiation summary to both the EPA Audit Division and the office performing the audit. The Cost Advisory Group shall provide the Contracting Officer with a record of the transmittal for insertion into the official contract file. (See Exhibit B)

POSTNEGOTIATION SUMMARY

1. Name of Offeror: \_\_\_\_\_
2. RFP Number: \_\_\_\_\_
3. Date of Negotiation: Opened: \_\_\_\_\_ Closed: \_\_\_\_\_
4. Purpose of Negotiation: \_\_\_\_\_
5. Name, position and organization of government employees involved in negotiation: \_\_\_\_\_
6. Name, position and organization of contractor employees involved in negotiation: \_\_\_\_\_
7. Status of contractor's purchasing system (if applicable):  
\_\_\_\_\_
8. Was certified cost or pricing data required? \_\_\_\_\_  
If yes, date certified as accurate, complete, and current;  
if no, refer to attached waiver: \_\_\_\_\_
9. Was this data relied on in negotiating cost/price? \_\_\_\_\_  
If not, why not? \_\_\_\_\_
10. Did members of Congress, other agencies or higher level officials, not normally involved in the award and review process have significant effect on this action? \_\_\_\_\_  
If yes, explain. \_\_\_\_\_
11. Basis for determining the profit or fee if different from the prenegotiation objective: \_\_\_\_\_
12. Are subcontractors /consultants to be approved in the contract document? \_\_\_\_\_ If yes, list subcontractors/consultants:  
\_\_\_\_\_
13. Was subcontractor's certified cost or pricing data received (cite waiver if applicable): \_\_\_\_\_
14. Best and Final Offer received? \_\_\_\_\_ Date: \_\_\_\_\_  
Explain any variance from negotiated agreements: \_\_\_\_\_
15. Have all required representations and certifications been completed? \_\_\_\_\_

16. Narrative: (Include a discussion for each cost element where the final agreed to cost element differs from the Government's prenegotiation objective. The discussion shall provide a thorough rationale for arriving at the negotiated amount.)
17. Technical negotiations: (Include a discussion of any technical negotiations held.)
18. Name of selected offeror: \_\_\_\_\_

SELECTED OFFEROR ONLY

19. Is offeror debarred, ineligible or suspended? \_\_\_\_\_
20. Has the Equal Employment Opportunity program been approved? \_\_\_\_\_
21. Does the offeror meet the responsibility standards of FAR subpart 9.1? \_\_\_\_\_
22. Other information: \_\_\_\_\_  
\_\_\_\_\_

Prepared by:

Signature: \_\_\_\_\_ Date: \_\_\_\_\_

Approval:

Signature: \_\_\_\_\_ Date: \_\_\_\_\_

POSTNEGOTIATION ABSTRACT

Offeror \_\_\_\_\_

A. Base Period

	Cost Element	Proposed	Objective	Negotiated	Narrative (may be set forth in footnotes)
1.	_____	_____	_____	_____	_____
2.	_____	_____	_____	_____	_____
3.	_____	_____	_____	_____	_____
4.	_____	_____	_____	_____	_____
5.	_____	_____	_____	_____	_____
6.	_____	_____	_____	_____	_____
7.	Subtotal	_____	_____	_____	_____
8.	Fee/Profit	_____	_____	_____	_____
9.	Total	_____	_____	_____	_____

B. Option Period 1

	Cost Element	Proposed	Objective	Negotiated	Narrative
1.	_____	_____	_____	_____	_____
2.	_____	_____	_____	_____	_____
3.	_____	_____	_____	_____	_____
4.	_____	_____	_____	_____	_____
5.	_____	_____	_____	_____	_____
6.	_____	_____	_____	_____	_____
7.	Subtotal	_____	_____	_____	_____
8.	Fee/Profit	_____	_____	_____	_____
9.	Total	_____	_____	_____	_____

C. Option Period 2

	Cost Element	Proposed	Objective	Negotiated	Narrative
1.	_____	_____	_____	_____	_____
2.	_____	_____	_____	_____	_____
3.	_____	_____	_____	_____	_____
4.	_____	_____	_____	_____	_____
5.	_____	_____	_____	_____	_____
6.	_____	_____	_____	_____	_____
7.	Subtotal	_____	_____	_____	_____
8.	Fee/Profit	_____	_____	_____	_____
9.	Total	_____	_____	_____	_____

D. Total (maximum contract - all options)

1.	Total Est. Cost	_____	_____	_____	_____
2.	Fee/Profit	_____	_____	_____	_____
3.	Total Including Fee/Profit	_____	_____	_____	_____

(NOTE: a separate sheet is required for each offeror in the competitive range)



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C. 20460

Exhibit B

OFFICE OF  
ADMINISTRATION  
AND RESOURCES  
MANAGEMENT

MEMORANDUM

DATE: \_\_\_\_\_

SUBJECT: Transmittal of the Postnegotiation Summary  
Contractor: \_\_\_\_\_  
RFP #: \_\_\_\_\_

FROM: Stephen O. Leahy, Chief  
Washington Cost Advisory Operations

TO: \_\_\_\_\_  
\_\_\_\_\_

In accordance with the Acquisition Handbook, (unit three-revised 10/24/88) we have sent the OIG a copy of the subject postnegotiation summary on \_\_\_\_\_. This memorandum should be included in the Official Contract File as a record of transmittal of the postnegotiation memorandum.

CC: OIG  
\_\_\_\_\_ Audit Division



### III. EPA COST REVIEW & POLICY BRANCH

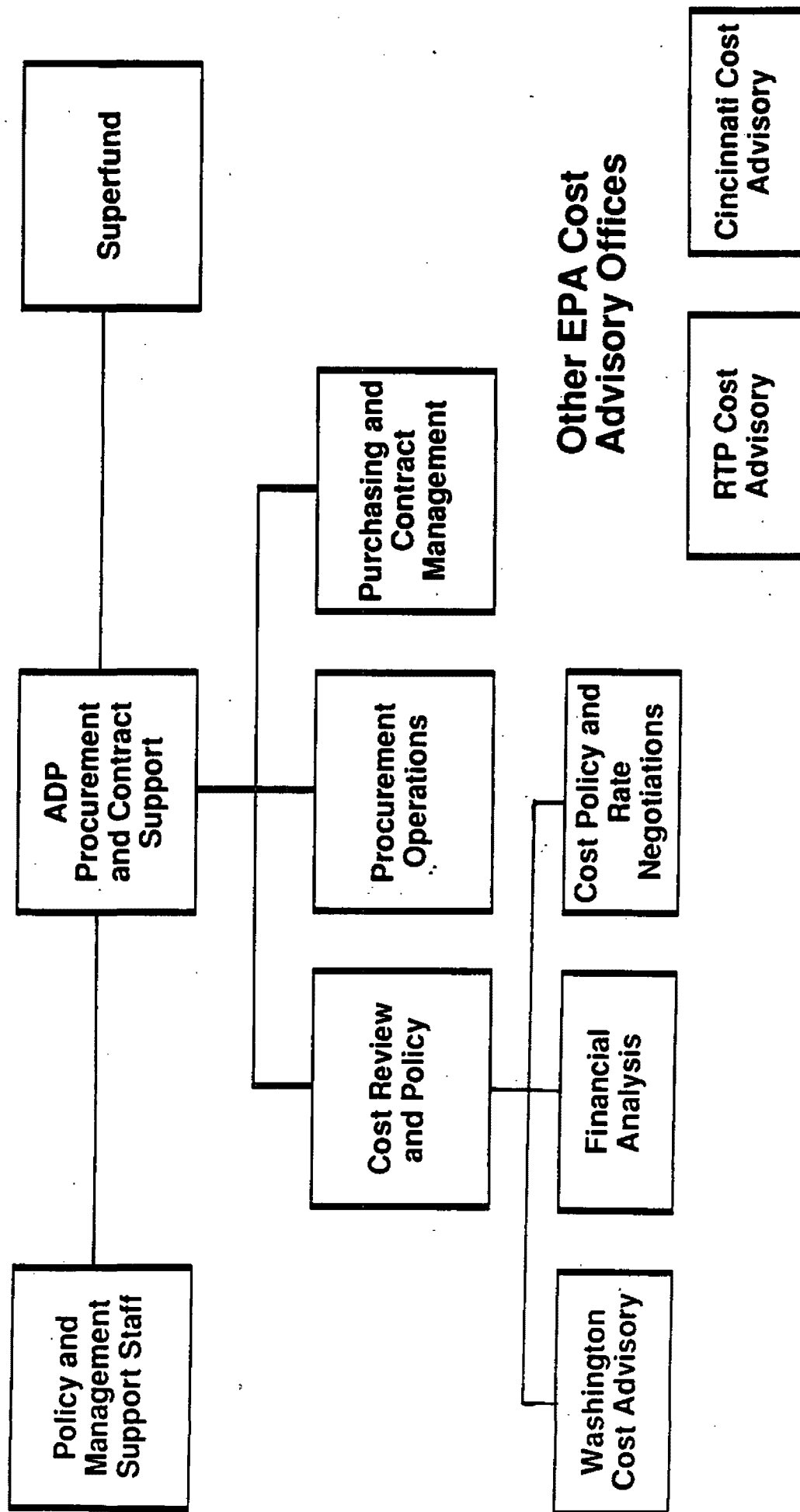
1. The Function of EPA's Cost Review and Policy Branch
2. EPA's Policy on Cost and Price Analysis
3. How to Request Cost Analysis
4. Function of the Cost Advisory Offices
5. Sample Reports from the Cost Advisory Offices
  - a. Cost Advisory Report (CAR)
  - b. Preliminary Analytical Cost Evaluation Report (PACER)
  - c. Comments on RFP
6. Cost Advisory Operations Review Program and Index
7. Function of the Cost Policy and Rate Negotiation Section (CPRNS)

The organization chart of the EPA Procurement and Contracts Management Division is illustrated as follows:

It is the Cost Review and Policy Branch which provides cost and price analysis services to the Contracting Officer and Specialists; specifically, the Cost Advisory Section (formerly WCAO) and the Cost Policy and Rate Negotiation Section (CPRNS) in Washington, DC. There are also Cost Advisory Offices in Cincinnati, OH and Research Triangle Park, NC..



# Procurement and Contracts Management Division



What is EPA's policy with respect to cost and price analysis?

It is the intent of the Environmental Protection Agency to utilize cost or price analysis to the maximum extent practicable prior to the negotiation of contracts and, when necessary to supplement the analysis with audits of contractor's records and procedures.

The FAR [15.608] states that the contracting officer shall use cost or price analysis and shall document the cost and price evaluation. FAR 15.804-3 (a-d) sets forth the exemptions from cost or pricing data.

- (1) adequate price competition
- (2) established catalog or market price of commercial items
- (3) prices set by law or regulation

The EPA Acquisition Handbook states:

On procurements of \$500,000 or less, the Contracting Officer may perform his/her own cost or price analysis. If the action is over \$500,000, the Contracting Officer will forward the proposals to the local cost advisory operations. The costs advisory operations will either request audits on the proposals, perform an appropriate audit, or recommend to the Contracting Officer that he/she waive audit because adequate data is available through other means to perform a detailed analysis in-house.

How do I request a cost analysis?

Complete a " Request for Cost Analysis" form and forward it to the appropriate Cost Advisory Office along with the business proposal(s).

- A separate request should be completed for each offeror under the RFP.

The Contracting Officer should submit to the Cost Advisory Office along with the necessary business proposals (including subcontractor information sent directly to EPA under separate cover) the following information:

- A copy of the Request for Proposal (RFP)
- Technical Evaluation(s) (if available)
- Representations and Certifications
- General financial and organizational information  
(Prime contractor and subcontractor(s))

Each cost analysis request should include a listing of the associated subcontractors proposed and their respective dollar amounts.

It is important that the requestor identify the type of report desired. (i.e. PACER, Cost Analysis, etc.)

Any specific areas of concern or any special information or analysis desired by the requestor must be clearly stated in the request.

On page III-4 is an example of the request form used by the Cost Advisory Section in Washinton, D.C. The Cost Advisory Offices in Cincinnati, OH and Research Triangle Park, N.C. use a similar form.





UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, DC 20460

REQUEST FOR COST ANALYSIS

TO:  US Environmental Protection Agency Procurement & Contracts Management Division (PM-214) Planning & Cost Advisory Branch Washington, DC 20460	Contractor/Grantee	Contract/RFP/Grant No.
	Subcontractor (Fill in if appropriate)	Desired Date for Completed Report
	Date of Proposal	Proposed Amount \$
	Project Title	

Information Required To Be Submitted (Fill in the appropriate blocks)

CONTRACTS/RFPs	GRANTS
Type of Contract	Project Officer's Name
Period of Performance	Phone
Check One <input type="checkbox"/> Solicited <input type="checkbox"/> Unsolicited	Location
Check One <input type="checkbox"/> Sole Source <input type="checkbox"/> Competitive	Has Funding Package Been Received? If "Yes," For How Much? <input type="checkbox"/> Yes <input type="checkbox"/> No    Amount: \$

The following documents are enclosed:

- ☐ Cost proposal For EPAAR 1552.215-74)
- ☐ General financial and organizational information
- ☐ RFP (if L.O.E. type contract)
- ☐ Representations and certifications
- ☐ Technical evaluation

Comments (Including specific areas of interest, if any.)

Requestor	Telephone (Include extension)	Date
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The Desired Date For Completed Report Is Satisfactory Unless Explained Below.

Cost Analyst	Date
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Page 1



Effective immediately, all assist audits received by the Cost Advisory Office from DCAA should be included as an attachment to the Cost Advisory Report. The OIG tracks all DCAA audit reports via the Prime Audit Tracking System (PATS). The Cost Advisory Offices are responsible for furnishing the OIG with a response which summarizes cost question agreed to and not agreed to. Normally, the summary of negotiation is sufficient for this purpose. In addition to responding to the OIG, the Cost Advisory offices now must respond to EPA Management with a report which summarizes what was reported to the OIG. The attachments include both the instructions on reporting Audit Resolutions and the form for summarizing data to be reported to EPA Management. A copy of the instructions and a form for summarizing data (one for each assist audit report from DCAA) should be included in all the cost advisory reports which transmit a DCAA audit. Refer to page III-6, Attachment I.

Instructions for Reporting the Resolution of Preaward Audits  
to the IG and EPA Management

The attached audit report is being tracked in the OIG's audit tracking system for resolution of the recommendations in the report.

Any audit resolved or reported on after October 1, 1989 will require:  
1) a response to the IG which details the resolution of each audit recommendation, and 2) a report to EPA management that summarizes what was reported to the IG. Both pieces of information will flow through the Washington Cost Advisory Section to the OIG and to EPA management.

If the audit is of an unsuccessful offeror, simply inform the Chief, Washington Cost Advisory Section, who will take the steps necessary to inform the IG to remove the audit from the tracking system.

For successful offerors the Contracting Officer must prepare an audit response which summarizes questioned costs agreed with, and details questioned costs not agreed with. A SON will be sufficient as a response only if it details questioned costs not agreed with and provides the reasons for the disagreement. If the SON does not provide detail of the questioned costs not agreed with, that additional information must be added for your response to the IG.

There may be instances where you may not be able to make a dollar-for-dollar determination of an audit recommendation, whether or not you agree. For example, the proposal audited may be different than the proposal from which you negotiate. In these instances you should report that you cannot compute a dollar amount agreed or disagreed with, but you must provide a narrative explanation why you cannot compute the amount.

Also attached is a form to use for reporting the EPA management portion of the information. This form merely summarizes the information that is given in detail to the OIG. Return this form along with your OIG response to Steve Leahy, Chief, Washington Cost Advisory Operations.

Attachment's

FORM FOR SUMMARIZING DATA FOR MANAGEMENT AUDIT  
TRACKING SYSTEM DATA INPUT OPERATOR

Successful Offeror: \_\_\_\_\_  
Contractor: \_\_\_\_\_

RFP: \_\_\_\_\_

Audit report No. \_\_\_\_\_

Questioned costs agreed with. \_\_\_\_\_

Questioned costs not agreed with. \_\_\_\_\_

Questioned costs which a dollar  
for dollar determination of  
agreement or disagreement  
cannot be made. \* \_\_\_\_\_

TOTAL (This amount should  
reconcile to the total  
amount questioned in the  
Audit Report.) \_\_\_\_\_

\* Provide a narrative explanation of why a dollar for dollar determination  
cannot be made.

Submit to Chief, Washington Cost Advisory Operations.



What are some of the functions of the cost advisory offices?

Some of the functions are to provide:

- o cost and/or price analysis as requested by the contracting officers, negotiators and grant specialists;
- o final audits on EPA contracts and grants;
- o financial systems reviews of EPA contractors;
- o conduct purchasing system reviews on EPA contractors;
- o provide accounting and financial assistance as requested;
- o review and provide written comments on RFP's;
- o assist in the quality assurance review performed by CPRNS;
- o at the request of the contracting officer, assist in negotiations;
- o assist the contracting officer in contract monitoring for contracts meeting the threshold;
- o advise the Grant Administration Division on cost and price issues.

What other services can I request from the cost advisory offices?

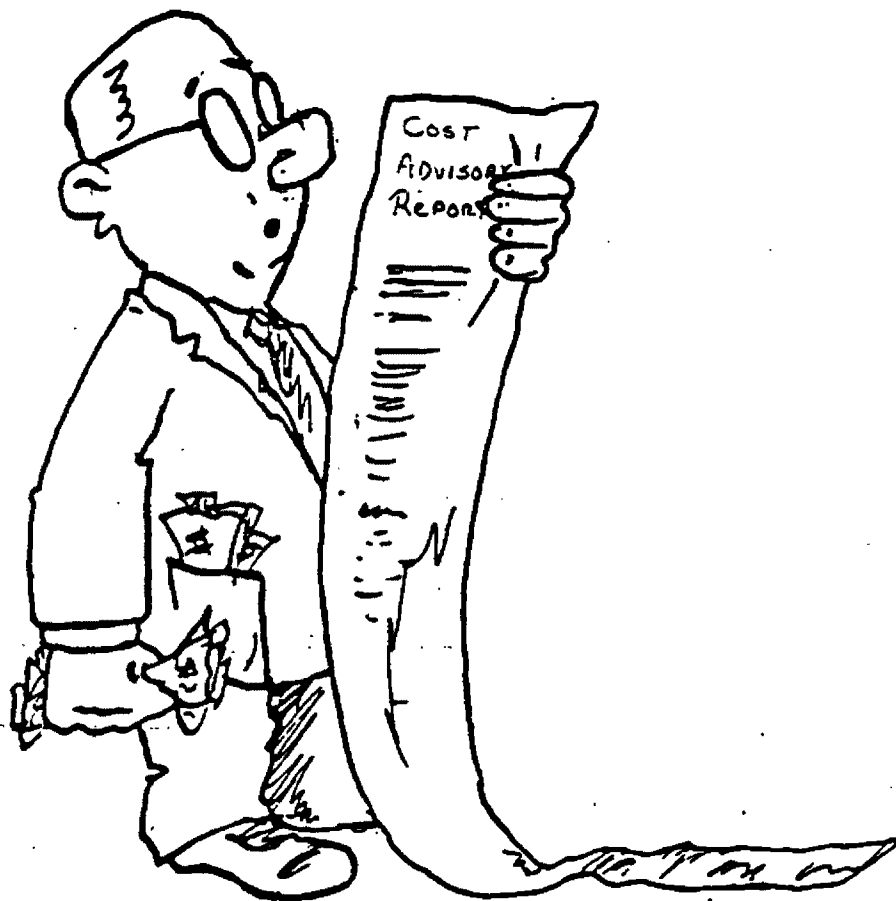
Besides providing cost analysis, they also perform preliminary analytical cost evaluation reports (PACER's) and reviews of RFP's.

Of course the contracting officer may request any special analysis from the cost advisory office.

A brief explanation and example of the types of reports discussed above follow:

Cost Advisory Report - The cost advisory report (see example) is a detailed cost analysis of a specific contractor's proposal.

Each significant line item of the contractor's proposal will be analyzed either by an EPA cost analyst or a contract auditor in the field. These reports are frequently used by contract specialists to formulate their prenegotiation plans.



Janaury 4, 1982

Cost Advisory Report - XYZ Corporation

John J. Smith  
Chief, Cost Advisory Operations

Procurement Branch B  
Attention: Snow White

The results of our review of the subject contractor's proposal dated June 30, 1981 are discussed below and summarized as follows:

	<u>Contractor's Proposal</u>	<u>WCAO Recommendations*</u> <u>For</u> <u>Acceptance</u>	<u>For Non-</u> <u>Acceptance</u>
Estimated Costs	\$ 3,885,930	\$ 3,885,930	\$ -0-
Fixed Fee	163,200	=====	=====
Total CPFF	\$ 4,049,130		
	=====		

\*We were not provided a copy of the technical evaluation. Therefore, our recommendations are qualified to the extent that costs may be questioned as a result of the quality and quantity of proposed direct costs.

Direct Costs

Direct labor hours, other travel and ODC's have been proposed in accordance with instructions in the RFP. However, XYZ Corporation has not proposed any travel costs for trips to Washington, DC. The RFP stated that the contractor should propose one (1), one person two-day, round trip to Washington per each 2,000 man-hours of effort.

We have reviewed direct costs in detail and consider them acceptable for pricing purposes.

Indirect Costs

The contractor's proposed and our recommended indirect expense rates are summarized as follows:

<u>Period</u>	<u>Cost Center</u>	<u>Type</u>	<u>Rate</u>	<u>Base</u>
Date of Award	Overhead	Billing	100.7%	(a)
Until Amended	G&A Expense	Billing	23.3%	(b)

Basis for Allocation

(a) Direct labor dollars

(b) Total costs excluding general and administrative expense

Other Comments.

The contractor's cost accounting system is considered adequate for the accumulation and reporting of cost under Government contracts and its billing procedures are reliable to permit provisional approval for payment of its claims for reimbursement. The contractor has the necessary financial capability to perform this contract.

The amounts shown above reflect our best estimate of what contract performance should cost assuming reasonable economy and efficiency.

Upon completion of Negotiation of the subject proposal please complete the following form, copy provided on page III-11, and return it to the Cost Advisory Operations.

As required by FAR Part 15.808(b), P&CMD Acquisition Handbook Units 3 (FAR. 6) and 4 (FAR. 4), please furnish us a copy of the Summary of Negotiations after contract award. Please advise us if no award is made. Also, we invite your comments and suggestions on this report. You may use the attached contracting officer response sheet for these comments.

If you have any questions or if we can be of further assistance please contact, Joe Smith on extension 382-2061

Negotiation Memorandum

RFP Number: \_\_\_\_\_ Contractor: \_\_\_\_\_

Contract Specialist: \_\_\_\_\_

Procurement Branch: \_\_\_\_\_

John J. Smith  
Chief, Cost Advisory Operations

Negotiations on the subject RFP are complete and a contract has been awarded. [The subject offeror was not the successful bidder and the contract was awarded to:

\_\_\_\_\_ ]  
The subject offeror was the successful offeror and I have attached a copy of the negotiation memorandum in accordance with FAR 15.808(b).]

PACER (Preliminary Analytical Cost Evaluation Report)-The PACER provides a comparison of the competing cost proposals received on a competitive RFP. It does not provide a detailed cost analysis of each item of cost proposed.

This type of report can be of particular assistance on Level of Effort (LOE) contracts since it will determine whether offerors have proposed upon the requested basis (i.e. labor mix, number of hours, travel, ODC's).

This type of report can be of assistance on all procurements of a competitive nature since its detailed comparisons of the contractor's price by line item can be a source for interrogatories and may assist in the determination of the competitive range.

An example of a PACER on a level of effort contracting arrangement follows:

Preliminary Analytical Cost Evaluation Report (PACER) on Proposals Submitted  
in Response to RFP WA82-2000

John J. Smith  
Chief, Cost Advisory Operations

Procurement Section 2  
Attention: John Doe

In response to your request, we have performed a preliminary evaluation of (9) nine offers received in response to the subject RFP. The contractors' cost proposals, including the amounts contained in this report have not been subjected to technical evaluation or cost analysis. Specifically, we express no opinion on the labor rates, indirect rates, travel or other direct costs at this time. We have reviewed the proposals for arithmetical accuracy and compliance with the terms of the RFP and will provide cost advisory reports on each proposal when requested. The prices proposed and the result of our review are discussed in detail in Exhibits A and B and are summarized as follows:

<u>Contractor</u>	<u>Amount Proposed*</u>	<u>Amount per Review *</u>	<u>Difference</u>
Blue, Inc.	\$396,501	\$396,501	\$ 0
White, Inc.	\$390,694	\$418,087	(\$27,393)
Red Company	\$501,398	\$501,398	\$ 0
Green Associates	\$345,300	\$352,400	(\$ 7,100)
Yellow, Inc.	\$409,235	\$409,235	\$ 0
Lilac, Inc.	\$400,825	\$402,588	(\$ 1,762)
Orange Systems, Inc.	\$391,977	\$391,977	\$ 0
Aqua Associates	\$465,038	\$454,226	(\$10,812)
Peach, Inc.	\$521,831	\$521,831	\$ 0

( ) Indicates Increase

\* Cost is inclusive of subcontractors' fees, but exclusive of prime contractors' fees.

### Other Comments

We recommend that you incorporate the following comments in your interrogatories.

#### Blue, Inc.

Your proposal contained no escalation for consultants. Do you have agreements with the consultants to work at the current hourly rate for the entire period of performance?

#### White Corporation

Although you stated in your cost proposal that you used \$5,000 per 500 hours of LOE for other direct charges as directed by the RFP, your summary of 60 showed only \$67,426. The RFP specified amount of \$5,000 per 500 hours LOE is exclusive of any indirect burdens. Please include the RFP specified amounts in future proposals.

You have proposed Brown Company as a subcontractor. Your proposal package does not include any SF 1411's for Brown Company. Please have them submit cost proposals for their allocated share of the base 6,000 hours, the 5000 hour increment for the optional hours and a summary of their share of the total 9,000 hours LOE.

Your proposal contained no escalation for proposed consultants. Do you have agreements signed by consultants to work at current rates for the entire period of performance?

#### Red Company

The RFP requires a summary proposal for the maximum 9,000 LOE hours. Please have your proposed subcontractors submit summary SF 1411's for their allocated shares of the maximum LOE hours.

#### Green Associates

Your proposal appears to be short fifty-four (54) hours for professional level 4. Please correct this error or explain the omission. Please include sufficient computations to show how you computed your proposed hourly rates.

Your proposal shows Cambridge, MA as the place of performance. Explain why travel was priced from Vienna, Virginia.

Your proposal contained no escalation for proposed consultants. Do you have agreements signed by the consultants to work at current rates for the entire period of performance?

You have proposed Whiteen & Soward as subcontractor. We request a more detailed explanation of their proposed costs. Specifically, what is the overhead rate and what are they proposing for profit. They should also identify their proposed personnel with the RFP labor categories.

Yellow, Inc.

Your proposed subcontractor, G. C. Johns has proposed Water Resources, Inc. as a subcontractor. We request a complete breakdown by cost element for Water Resources for their allocated share of the 6,000 hours LOE, 500 hours increment and total 9,000 hours LOE.

Lilac, Inc.

Your proposed subcontractor, Associates, Inc., should identify their proposed employees with the RFP specified labor categories.

Since it is your company policy to direct charge indirect telephone costs, this cost should be proposed in addition to the ODC specified in the RFP.

Orange Systems, Inc.

Your proposal contained no escalation for proposed consultants. Do you have agreements signed by the consultants to work at the current rates for the entire period of performance?

Aqua Associates

You list four consultants for professional level 4 in your technical proposal. Explain why these consultants are not included in your cost proposal.

We request that your proposed subcontractor, submit a summary SF 1411 of their allocated share of the 9,000 hours LOE.

Peach, Inc.

Your proposal contained no escalation for proposed consultants. Do you have agreements signed by the consultants to work at current rates for the entire period of performance?

Your proposed subcontractor, Malcolm Lord, Inc., has incorrectly proposed his allocated hours for professional level 4 and technician level 3. You allocated him 148 hours for professional level 4 and 302 hours for technician level 3. He proposed 160 hours for professional level 4 and 290 for technician level 3.

SCHEDULE OF UNLOADED HOURLY COST  
OF OPERATIONS  
RFP WA 82-Z000

Contractor	Blue Inc.	White Corp.	Red Inc.	Green Assoc.	Yellow Inc.	Lilac Inc.	Orange Systems Inc.	Aqua Assoc.	Peach Inc.
Cost Proposal	\$227,003	\$265,409	\$276,384	\$133,255	\$203,861	\$203,562	\$189,128	\$224,984	\$290,775
Normalization Adjustments	\$ 0	\$ 0	\$ 0	(\$ 981)	\$ 0	\$ 1,259	\$ 0	\$ 10,812	\$ 0
Normalized Costs	\$227,003	\$265,409	\$287,384	\$134,236	\$203,861	\$202,303	\$189,128	\$214,172	\$290,775
LOF Hours	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000
Unadjusted Unloaded Hourly Cost	\$25.22	\$29.49	\$30.71	\$14.81	\$22.65	\$22.62	\$21.02	\$25.00	\$32.31
Normalized Unloaded Hourly Cost	\$25.22	\$29.49	\$30.71	\$14.92	\$22.65	\$22.48	\$21.02	\$23.80	\$32.31

( ) Indicates Increase

\* The unloaded hourly cost includes direct labor (including any additional clerical and support labor proposed), consultant costs and subcontract costs.

Explanatory Notes of Adjustments

Blue, Inc.

The total direct labor hours are as per RFP specifications. Professional level 1 is three (3) short of RFP specifications. Technician level 3 is three (3) hours over RFP specifications. The prime contractor and the subcontractors proposed a total of 900 hours for direct secretarial labor. The prime contractor proposed direct labor escalation factors of approximately 3.2% for the base 6,000 hours and 7.6% for the 3,000 option hours applied to current rates. The proposed subcontractor, Associates, Inc., proposed 3% escalation for the base 6,000 hours and 7.6% escalation for the option 3,000 hours applied to current rates. The proposed subcontractor, (ABC) proposed direct labor escalation factors as follows:

Base 6,000 hours

Professional Levels 3 & 4 - 12% applied to current rates  
Professional Levels 2 & 1 - 7.3% applied to current rates

Option 3,000 hours

Professional Levels 3 & 4 - 16.7% applied to current rates  
Professional Levels 1 & 2 - 10.2% applied to current rates

APC did not include any names in their cost proposal for proposed employees. Therefore, we could not compare employees in the cost proposal with employees in the technical proposal. The prime contractor and Associates utilized the same employees for cost and technical proposals.

The prime contractor did not propose any escalation for the proposed consultants. Since he proposed most of the consulting hours for the base LOE, we made no adjustment for consultants.

White Corporation

The total direct labor hours are as per RFP specifications. Professional level 1 is three (3) hours short of RFP specifications. Technician level 3 is three (3) hours over RFP specifications. Direct labor escalation is based on 9.5% applied to a base rate as of the date that rate is effective through the midpoint period of performance. An additional 720 hours for technical assistant has been proposed.

The proposed subcontractor is Brown Company. There are no SF 1411's for the subcontractor. It appears that fully loaded hourly rates have been used for pricing the proposed cost for the subcontractor. We cannot determine if any adjustment is required for the subcontractor. There is no escalation proposed for the proposed consultants. The same proposed employees appeared in the cost and technical proposals.

Red Company

The total direct labor hours are as per RFP specifications. Professional level 1 is three (3) over RFP specifications. Technician level 3 is three (3) hours short of RFP specifications. The prime contractor has proposed 1,190 hours of direct secretarial labor.

The direct labor escalation factors for the prime contractor are 16.05% for the base 6,000 hours and 32.09% for the option 3,000 hours. This is based on the company's historical salary escalation of 10% per year.

The direct labor escalation factor for the proposed subcontractor, Research Systems, Inc., is based on a 10% increase effective January 1 of each year.

\* The direct labor escalation factor for the proposed subcontractor, Associates is based on increases of 7% each calendar year.

The proposed employees are the same in both the cost and technical proposals.

There are no summary SF 1411's for the subcontractors.

Green Associates

The contractor is short 54 hours for professional level 4. We added the cost for these hours to the direct labor for the prime contractor. The cost proposal states that a 7% escalation factor is used. Since the same hourly rates were used throughout the proposal, we could not determine if escalation is included. Labor category rates were used to calculate the proposed costs. Individuals were named in the technical proposal.

There was no escalation proposed for the proposed consultants.

The proposed subcontractor, Mutt and Jeff have proposed fully loaded hourly rates. We cannot determine the specific makeup of these rates and therefore cannot determine if any adjustments are required. They included a copy of their "Usual Day Rates". We could not determine how their labor categories correlated with the RFP labor categories. There is a potential for understatement for costs due to the range in cost per 8 hour day.

There is no escalation proposed for the subcontractor.

Yellow, Inc.

The total hours proposed are as per RFP specifications. Professional levels 2 and 1 and technician level 3 are proposed in accordance with RFP. Because the subcontractor proposed hours for consultants without identifying which RFP labor category they belonged to, we could not determine the hours proposed for professional levels 3 and 4.

The direct labor escalation factor for both the prime and the subcontractor (and the subcontractor's consultants) is 5% for the optional 3,000 hours.

There were no names for proposed employees included in the cost proposal. Therefore, no comparison could be made with the technical proposal.

Lilac, Inc.

The proposed direct labor hours are in accordance with RFP specifications. The prime contractor proposed an additional 1,020 hours for direct secretarial and administrative labor.

Direct labor escalation for the prime contractor is a composite amount covering the three year period. There was not sufficient information to allow us to determine the percentage of increase for each year. They state in the proposal that it is 5% per annum.

Proposed subcontractor, Mee, Inc., escalated professional level 4 7.2% and professional level 3 1.8% for the optional 3,000 hours. There was no escalation for professional level 2.

Proposed subcontractor, Associates, Inc., proposed no escalation.

The prime contractor proposed category averages. Mee, Inc., did not include any names in the cost proposal for proposed employees. Associates, Inc. proposed the same employees in both the cost and technical proposals. Associates should identify the proposed employees with the RFP labor categories.

The \$1,259 adjustment is for Mee, Inc. They proposed a 10% fee of estimated cost. We limited the fee to 8.5% of estimated cost.

Orange Systems, Inc.

The proposed direct labor hours are in accordance with RFP specifications. Proposed subcontractors, E. C., proposed 115 hours of direct secretarial labor. The direct labor escalation for the prime contractor is based on a 6% increase for 1983 and a 5% increase for 1984. Subcontractor proposed no escalation.

Subcontractor, E. C. proposed an escalation of 5% for 1982 and 5.25% for 1983.

There is no escalation for the proposed consultants.

The proposed employees are the same in both the cost and technical proposal.

Aqua Associates

The direct labor hours are in accordance with RFP specifications. There are 900 hours of direct clerical labor proposed.

There are no employees named in the cost proposals (for prime contractor and subcontractor). Therefore, we could not make any comparison with the technical proposal. We did note that Aqua listed four consultants in their technical proposal and no consultants were proposed in the cost proposal.

The direct labor escalation for the prime contractor is 7.6% for the base 6,000 hours and 9.2% for the optional 3,000 hours. The direct labor escalation for the subcontractor is based on approximately 10% increase on July 1, 1983, and 10% increase on July 1, 1984.

The subcontractor increased his overhead rate for each of his fiscal years covered by the proposed contract. For comparison purposes we computed costs using the base year rate for the entire proposed period. The subcontractor proposed a fee of approximately 19.9% of estimated cost. We limited fee to 8.5% of estimated cost. The \$10,812 adjustment consists of \$708 for indirect costs and \$10,104 for fee.

Peach, Inc.

The total direct labor hours are in accordance with RFP specifications. The proposed subcontractor, Malcolm Lord, Inc., did not propose his hours as allocated by the prime contractor. (See Other Comments.) The difference in cost would be insignificant, so we made no adjustment.

There are 666 hours of direct secretarial labor proposed. The direct labor escalation factors are as follows:

Peach Inc.	6.5% for the base 6,000 hours 16.6% for the option 3,000 hours
Malcolm Lord	6.5% for the base 6,000 hours 16.6% for the option 3,000hours
Act Incorporated	6.8% for the option 3,000 hours
Teal Associates, Inc.	8% for the base 6,000 hours 8% for the option 3,000 hours

There was no escalation proposed for the consultants. There were no names for proposed employees in the cost proposal.

## SCHEDULE OF LOADED HOURLY COST OF OPERATIONS

RFP WA 82-7000

Contractor	Blue Inc.	White Corp.	Red Inc.	Green Assoc.	Yellow Inc.	Lilac Inc.	Orange Systems Inc.	Aqua Assoc.	Peach Inc.
Cost Proposal	\$396,501	\$390,694	\$501,398	\$345,300	\$409,235	\$400,825	\$391,977	\$465,038	\$521,831
Normalization Adjustments	\$ 0	(\$ 27,393)	\$ 0	(\$ 7,100)	\$ 0	(\$ 1,763)	\$ 0	(\$ 10,812)	\$ 0
Normalized Costs	\$396,501	\$418,087	\$501,398	\$352,400	\$409,235	\$402,180	\$391,977	\$454,226	\$521,831
LOE Hours	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000	9,000
Unadjusted Unloaded Hourly Cost	\$44.06	\$43.41	\$55.71	\$38.37	\$45.47	\$44.54	\$43.56	\$51.67	\$57.98
Normalized Unloaded Hourly Cost	\$44.06	\$46.46	\$55.71	\$39.16	\$45.47	\$44.73	\$43.56	\$50.47	\$57.98

( ) Indicates Increase

\*The hourly cost of operations includes direct labor, indirect expenses, travel, ODC, consultants and subcontractor. It does not include the prime contractors' fees.

Explanatory Notes

Blue, Inc.

The travel and ODC are as per RFP specifications.

White Corporation

The \$27,393 increase is for the ODC and its applicable FICON and G&A. The prime contractor proposed \$67,426 for ODC on the OF 60. We could not determine if the remainder of the \$90,000 specified in the RFP was included anywhere else in the proposal. Therefore, we added the additional ODC and its applicable indirect burden.

The travel is per RFP specifications.

Red Company

The travel and ODC are as per RFP specifications.

Green Associates

The \$7,100 increase includes the direct labor adjustment explained in Exhibit A and its applicable overhead and G&A. It also includes an adjustment to travel. The contractor proposed travel of \$180. This was for 18 trips from Vienna, Virginia to Washington, D.C. In the proposal the contractor says the work would be performed in Cambridge, MA. We priced 18 roundtrips from Boston, MA to Washington, D.C. The airline fare guide listed a range for economy class from \$39 to \$128 one way. We used the \$128 one way fare, but did not price out any per diem or ground transportation costs.

Yellow, Inc.

The travel and ODC are in accordance with RFP specifications.

Lilac, Inc.

Proposed travel and ODC are in accordance with RFP specifications. We increased the ODC for Lilac by \$2,664. It is Lilac's company policy to direct charge indirect telephone based on direct labor hours. We used \$.37 per each direct labor hour. This rate was recently recommended by DCAA. The applicable G&A was added to the additional ODC.

Lilac used a composite rate for fringe benefits and G&A. Since the variance between each year is small and since he does not show which hours are in each year, we made no adjustment.

Orange Systems, Inc.

The proposed travel and ODC are in accordance with RFP specifications.

Aqua Associates

The proposed travel and ODC are in accordance with RFP specifications. The adjustments are for the proposed subcontractor and are explained in Exhibit A.

Peach, Inc.

The proposed travel and ODC are in accordance with RFP specifications.

Review of RFP's - Another function of the cost advisory offices is the review of RFP's prior to their publication in Commerce Business Daily. The contract specialist is provided with written comments from a cost analyst who may assist in clarifying ambiguous or erroneous statements in a given RFP, particularly in the instructions of cost proposal preparation. The clarification of RFP instructions may alleviate the subsequent submission by offerors of incomplete cost proposals and avoid delays in the acquisition process caused by the need to request additional information.

An example follows:

May 15, 1984

Comments on RFP WA84-XXXX: Waste Technology and Studies Support

John J. Smith  
Chief, Cost Advisory Operations

Procurement Branch X  
Attention: Rodney Craft

1. On page 10, paragraph F.4 - the end of the period of performance is missing.
2. Attachment C - We recommend adding the following sentences:
  - A. Under Travel Budget - the total amount for travel is \$360,000.
  - B. Under ODC Budget - The total amount for ODC is \$360,000.
  - C. Under Computer Budget - The total amount for computers is \$90,000.
  - D. On page 3 of Attachment C, add the following sentence to the first paragraph. Include a schedule showing the distribution of hours among the prime contractor, subcontractors and consultants.
3. On page 3 of attachment C. there is a typographical error - Standard Form 4411 should be 1411.
4. For the optional 45,000 hours in the base period, the RFP should provide more pricing guidance since this covers a two year period. Should the contractors assume 50% of the hours will be used in each of the base period years? Should the contractors assume all the hours will be used in year 2 of the base period? For pricing purposes, include an assumption as to when the hours will be used.

If we can be of further assistance, please contact Jane Doe on extension 382-3666.

### The Review Program for Cost and Price Analysis.

When the contracting officer requests cost analysis from the advisory office, the cost analyst performs a specific set of steps. This set of steps is the "Review Program".

Following the review program assures that at a minimum, specific techniques and analysis are applied to all cost proposals regardless of whom is performing the cost analysis. It also provides documentation to the extent a particular step was or was not performed.

Keep in mind the review program is only a guide and the degree of cost analysis depends on the particular situation encountered by the cost analysis.

When the circumstances are appropriate for contracting officers or contract specialists to perform their own cost or price analysis, it is suggested that the review program be used as a guide.

Environmental Protection Agency  
Cost Advisory Section  
Review Program  
(CONSOLIDATED)

Work Paper  
Reference  
(page ID No.)

A. GENERAL

1. Review request for cost analysis. Attached to the request should be the contractor's proposal (including subcontractors) and a copy of the RFP. Determine scope of review and areas to be covered. Determine priority. \_\_\_\_\_
2. Acknowledge request and if possible, give estimated completion date. \_\_\_\_\_
3. Determine if a formal PACER (Preliminary Analytical Cost Evaluation Report) was prepared. If so, review PACER report to determine if there were any deficiencies and/or corrections. If not, reconcile the proposal to determine if it is current and has been submitted in accordance with the instructions provided in the RFP. If the proposal does not reconcile to the RFP, the recommended costs should reflect the hours and costs as specified in the RFP. \_\_\_\_\_
4. Has a technical evaluation been incorporated for those instances in which tech technical input is necessary (generally non-LOE procurements)? If not the cost advisory report should be qualified accordingly. If a technical evaluation is not necessary, provide a statement to that effect with the reason(s). \_\_\_\_\_
5. Check computations and footings in proposal for accuracy. \_\_\_\_\_
6. Determine if a revised proposal is pending. If so, discuss with the requestor whether it would be in the government's best interest to review the original proposal or wait and review the revised proposal. \_\_\_\_\_
7. Where applicable, are significant differences between revised and original proposals adequately analyzed and explained. \_\_\_\_\_
8. Determine if the cost review can be performed in-house based on available cost and pricing data. If so, proceed to Section C. \_\_\_\_\_
9. If data in files is insufficient and/or not available, proceed to Section B - Assist Audits. \_\_\_\_\_

Environmental Protection Agency  
Cost Advisory Section  
Review Program  
(CONSOLIDATED)

Work Paper  
Reference  
(page ID No.)

B. ASSIST AUDITS

1. If data in files is insufficient and/or dollar thresholds are met, request an assist audit with the cognizant government audit agency. \_\_\_\_\_
2. For competitive procurements, stress the need in the request for the costs representative of the hours and ODCs as specified in the RFP and rates reflective of historical and/or actual experience. \_\_\_\_\_
3. Specifically address any audit areas of special concern (i.e. uncompensated labor and how it is handled, if any, indirect rate structure changes, etc.) \_\_\_\_\_
4. Upon receipt of the verbal results of audit, or written audit report, determine if the audit was performed as requested. \_\_\_\_\_

C. DIRECT LABOR

1. Determine the basis of the proposed labor rate(s), including the effective date of the rates. (category average, individual average, weighted average, straight average, etc.) \_\_\_\_\_
2. Verify the proposed rates with; the cognizant government audit agency (verbal and/or written), data available in EPA files, information (payroll verification) submitted by the contractor; or information/verification available through other government agencies. \_\_\_\_\_
3. Determine the reasonableness and acceptability of labor escalation. Determine the basis of the labor escalation, i.e. computed by employee anniversary date, annual increase date or common review date. \_\_\_\_\_
4. Determine where the contractor proposes and recovers their indirect time (vacation, sick and holidays). \_\_\_\_\_
5. Compute labor costs reflective of hours as specified in the RFP and hourly rates reflective of historical and/or actual experience. \_\_\_\_\_

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Reference  
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6. Does the contractor maintain the labor records necessary to record uncompensated overtime? If not, go to Section D - Indirect Cost Rates review.

If the answer is yes:

Evaluate uncompensated overtime under both cost realism provisions and the Evaluation of Compensation for Professional Employees clause (Federal Acquisition Regulation 52.222-46). If necessary, included specific questions in the audit request;

- Does the contractor pay its professional staff for hours worked in excess of 40 hours per week?
- Does the contractor record and, in turn, invoice for hours worked by its professional staff in excess of 40 per week?
- What is the average work week of the contractor's professional staff? If it exceeds 40 hours, is this factored into its billing rate?
- Does the contractor, by company policy, require professional employees to work in excess of your 40 hours per week and is that factored into its billing rate?

D. INDIRECT COST RATES

1. Determine the basis of the proposed indirect cost rates.
2. Verify proposed rates. Primary verification is a formal agreement for Forward Pricing Rates provided by the cognizant government audit agency.
3. If rates have not been reviewed or negotiated, determine reasonableness of the rates from historical rates, current experienced rates, budgets and/or input from Regional and/or cognizant auditors. (possibly in comparison to negotiated billing rate(s), if available)
4. Determine what impact, if any, the current proposal would have upon the indirect rates proposed.

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6. Compute the impact of the recommended indirect rates on the costs proposed. \_\_\_\_\_

E. OTHER DIRECT COSTS

1. Review the proposed other direct costs. Target areas for review. If ODC's are RFP specified, no further review is required. State this in the report. \_\_\_\_\_
2. Verify costs (unit prices) to vendor quotes, source documents, airline rates, etc. \_\_\_\_\_
3. On proposals that include RFP specified ODCs, determine if any of the ODC items are normally included in the contractor's indirect expense pool. \_\_\_\_\_
4. For consultants, obtain names of individuals. Verify the consultant rate proposed to the signed agreement (including the hourly rate). Determine if the proposed rate is an experienced rate (i.e. previously billed the government or other client) or a quoted rate. Obtain documentary support where feasible. \_\_\_\_\_

F. SUBCONTRACTOR COSTS

1. Review subcontractor costs proposed in the same manner as prime contractor. \_\_\_\_\_
2. Review subcontractor's proposed fee for reasonableness. Provide a copy of the weighted guidelines form with the Cost Advisory Report. \_\_\_\_\_
3. For any proposed subcontractor(s) determine the adequacy of their accounting system, their financial capability and CAS coverage. \_\_\_\_\_
4. Determine if subcontractor will allow the release of labor and/or indirect rate information to the prime contractor during the course of negotiations. \_\_\_\_\_

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G. FACILITIES CAPITAL COST OF MONEY (FCCM)

A. If the contractor proposes facility capital cost of money:

- 1) Verify the FCCM rate(s) with the cognizant government agency. Include FCCM rates in the indirect rate table in the report.
- 2) Determine that the FCCM rate is applied to the appropriate base.
- 3) Recommended reduction of the profit/fee objective by an amount equal to the amount of FCCM money allowed. (see EPAAR 1515.970-2)

B. If the contractor does not propose facilities capital cost of money:

- 1) Recommend the clause in FAR 52.215-31 which waives the right to claim FCCM be inserted in the contract/subcontract(s). \_\_\_\_\_

H. OTHER

1. Cost Accounting Standards

Determine if the contractor is subject to Cost Accounting Standards (CAS) under FAR 30.201-1 and FAR 52.230-1. (Small business and foreign governments are exempt from this requirement.) \_\_\_\_\_

A) If the contractor is subject to CAS, determine whether the contractor is subject to full or modified coverage. \_\_\_\_\_

- 1) If the contractor is subject to "full coverage" (all cost accounting standards apply), recommend the FAR clauses at 52.230-3 "Cost Accounting Standards" and 52.230-4 "Administration of Cost Accounting Standards." \_\_\_\_\_

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- 2) If the contractor is subject to "modified coverage" (only CAS 401 and 402 apply) recommend the FAR clauses at 52.230-5 "Disclosure and Consistency of Cost Accounting Practices" and 52.230-4 "Administration of Cost Accounting Standards."

H. OTHER

- 3) Initially, contact the cognizant auditor regarding the contractor's compliance or noncompliance with CAS. Detailed information regarding the contractor's response to noncompliance issues are available from the ACO.
- 4) Notify the requestor of any noncompliance issues and their impact, if any, on this procurement.
- 5) If the contractor is not subject to CAS, notify the requestor of this fact.

2. Accounting System

Determine if contractor has an acceptable cost accounting system for government contracts.

Where determination of adequacy of accounting system cannot be made, recommend an accounting system review audit be conducted, possibly in conjunction with the proposal audit, or after submission of the first cost voucher.

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3. Financially Capable

Determine if the contractor has the financial capability  
to perform the contract. \_\_\_\_\_

I. AUDIT STEPS UNIQUE TO THE INDIVIDUAL COST ADVISORY OFFICE  
REQUIREMENTS AND/OR THE REQUEST FOR PROCUREMENT (RFP).

CINCINNATI

RESEARCH TRIANGLE PARK (RTP)

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WASHINGTON - HEADQUARTERS

Determine the adequacy of the proposal in reference to FAR 15.804-6 TABLE 15-2 ("Instructions for Submission of a Contract Pricing Proposal" by element of cost).\*

\* Difficulty may be experienced in getting an assist audit from DCAA if the necessary detailed information is not available.

Significant changes in the total amount proposed between the original proposal and the BAFO (usually on competitive procurements) should be reviewed in detail to determine the specific differences, especially in the labor rates proposed. If significant changes have been made in the BAFO, this point should be noted in the report as an item which should be taken into consideration in comparison with the technical proposal.

J. CONCLUSION

1. Index and cross reference work papers.
2. Cross reference the file copy of report to work papers.
3. Draft and submit report.
4. Enclose Contracting Officer Response Sheet with report.
5. Include a copy of the instructions and form for reporting the resolution of preaward audits to the IG and EPA Management associated with DCAA assist audit reports and request the completed forms be returned to Chief - WCAS.
6. Prepare file.
7. Request a summary of negotiations.

What is the function of the Cost Policy and Rate Negotiation  
Section (CPRNS)?

The functions of CPRNS are:

- ° Contracts

when EPA is the cognizant agency, negotiate indirect cost rates for all Federal agencies; when EPA is not cognizant, serve as the Agency's contact point

- ° Grants

negotiate indirect cost rates and cost allocation plans with state and local governments for all Federal agencies where EPA is the cognizant agency

- ° formulate Agency policy on cost related issues and perform special projects as requested

- ° perform quality assurance reviews of the cost advisory functions at the three contract operation sites,

- assure quality of cost advisory for Federal Managers Financial Integrity Act certification

- assure EPA management of the quality of cost and price analysis

- assure EPA managers that cost and price analysis is performed consistently at each site

- ° coordinate audit responses and tracking of control system (ATCS) reporting for Procurement and Contracts Management Division

- ° assist cost analysts and contracting officers on indirect cost allocation and billing issues raised by the financial status monitoring reviews of superfund contractors

- ° provide a representative for A-76 matters to provide guidance, recommendations, information and advice to EPA programs



#### IV. SF 1411 - THE COST PROPOSAL

Prior to the implementation of the FAR on April 1, 1984, prospective EPA contractors provided cost and pricing data on Optional Form (OF) 60. FAR [FAR 15.804-6] requires that both civilian and military segments of the Federal Government provide price proposal information on SF 1411 "Contract Pricing Cover Sheet."

"(b)(1) Cost or pricing data shall be submitted on Standard Form 1411 (SF 1411), Contract Pricing Proposal Cover Sheet, unless required to be submitted on one of the termination forms specified in Subpart 49.6. Data supporting forward pricing rate agreements or final indirect cost proposals shall be submitted in a format acceptable to the contracting officer.

(2) Contract pricing proposals submitted on SF 1411 with supporting attachments shall be prepared to satisfy the instructions and appropriate format of Table 15-3."

An example of SF 1411 follows:

CONTRACT PRICING PROPOSAL COVER SHEET		1. SOLICITATION/CONTRACT/MODIFICATION NO.	FORM APPROVED OMB NO. 3090-0116
NOTE: This form is used in contract actions if submission of cost or pricing data is required. (See FAR 15.804-6(b))			
2. NAME AND ADDRESS OF OFFEROR (Include ZIP Code)		3A. NAME AND TITLE OF OFFEROR'S POINT OF CONTACT	3B. TELEPHONE NO.
4. TYPE OF CONTRACT ACTION (Check)			
5. TYPE OF CONTRACT (Check) <input type="checkbox"/> FFP <input type="checkbox"/> CPFF <input type="checkbox"/> CPIF <input type="checkbox"/> CPAF <input type="checkbox"/> FPI <input type="checkbox"/> OTHER (Specify)		<input type="checkbox"/> A. NEW CONTRACT <input type="checkbox"/> B. CHANGE ORDER <input type="checkbox"/> C. PRICE REVISION/REDETERMINATION	<input type="checkbox"/> D. LETTER CONTRACT <input type="checkbox"/> E. UNPRICED ORDER <input type="checkbox"/> F. OTHER (Specify)
7. PLACE(S) AND PERIOD(S) OF PERFORMANCE		6. PROPOSED COST (A+B+C)	
		A. COST \$	B. PROFIT/FEE \$
		C. TOTAL \$	
8. List and reference the identification, quantity and total price proposed for each contract line item. A line item cost breakdown supporting this record is required unless otherwise specified by the Contracting Officer. (Continue on reverse, and then on plain paper, if necessary. Use same headings.)			
A. LINE ITEM NO.	B. IDENTIFICATION	C. QUANTITY	D. TOTAL PRICE
E. REF.			
9. PROVIDE NAME, ADDRESS, AND TELEPHONE NUMBER FOR THE FOLLOWING (If available)			
A. CONTRACT ADMINISTRATION OFFICE		B. AUDIT OFFICE	
10. WILL YOU REQUIRE THE USE OF ANY GOVERNMENT PROPERTY IN THE PERFORMANCE OF THIS WORK? (If "Yes," identify)  <input type="checkbox"/> YES <input type="checkbox"/> NO		11A. DO YOU REQUIRE GOVERNMENT CONTRACT FINANCING TO PERFORM THIS PROPOSED CONTRACT? (If "Yes," complete Item 11B) <input type="checkbox"/> YES <input type="checkbox"/> NO 11B. TYPE OF FINANCING (If one) <input type="checkbox"/> ADVANCE PAYMENTS <input type="checkbox"/> PROGRESS PAYMENTS <input type="checkbox"/> GUARANTEED LOANS	
12. HAVE YOU BEEN AWARDED ANY CONTRACTS OR SUBCONTRACTS FOR THE SAME OR SIMILAR ITEMS WITHIN THE PAST 3 YEARS? (If "Yes," identify item(s), customer(s) and contract number(s))  <input type="checkbox"/> YES <input type="checkbox"/> NO		13. IS THIS PROPOSAL CONSISTENT WITH YOUR ESTABLISHED ESTIMATING AND ACCOUNTING PRACTICES AND PROCEDURES AND FAR PART 31 COST PRINCIPLES? (If "No," explain)  <input type="checkbox"/> YES <input type="checkbox"/> NO	
14. COST ACCOUNTING STANDARDS BOARD (CASB) DATA (Public Law 91-379 as amended and FAR PART 30)			
A. WILL THIS CONTRACT ACTION BE SUBJECT TO CASB REGULATIONS? (If "No," explain in proposal)  <input type="checkbox"/> YES <input type="checkbox"/> NO		B. HAVE YOU SUBMITTED A CASB DISCLOSURE STATEMENT (CASB DS-1 or 2)? (If "Yes," specify in proposal the office to which submitted and if determined to be adequate)  <input type="checkbox"/> YES <input type="checkbox"/> NO	
C. HAVE YOU BEEN NOTIFIED THAT YOU ARE OR MAY BE IN NON-COMPLIANCE WITH YOUR DISCLOSURE STATEMENT OR COST ACCOUNTING STANDARDS? (If "Yes," explain in proposal)  <input type="checkbox"/> YES <input type="checkbox"/> NO		D. IS ANY ASPECT OF THIS PROPOSAL INCONSISTENT WITH YOUR DISCLOSED PRACTICES OR APPLICABLE COST ACCOUNTING STANDARDS? (If "Yes," explain in proposal)  <input type="checkbox"/> YES <input type="checkbox"/> NO	
This proposal is submitted in response to the RFP contract, modification, etc. in Item 1 and reflects our best estimates and/or actual costs as of this date.			
15. NAME AND TITLE (If per)		16. NAME OF FIRM	
17. SIGNATURE		18. DATE OF SUBMISSION	

NSN 7540-01-142-9845

1411-101

STANDARD FORM 1411 (10-83)  
Prescribed by GSA  
FAR (48 CFR) 53.215-2(c)



V. PRICE ANALYSIS

1. Competition
2. Commercial Items
3. Comparative Analysis
4. Decision Flowchart



## V. PRICE ANALYSIS

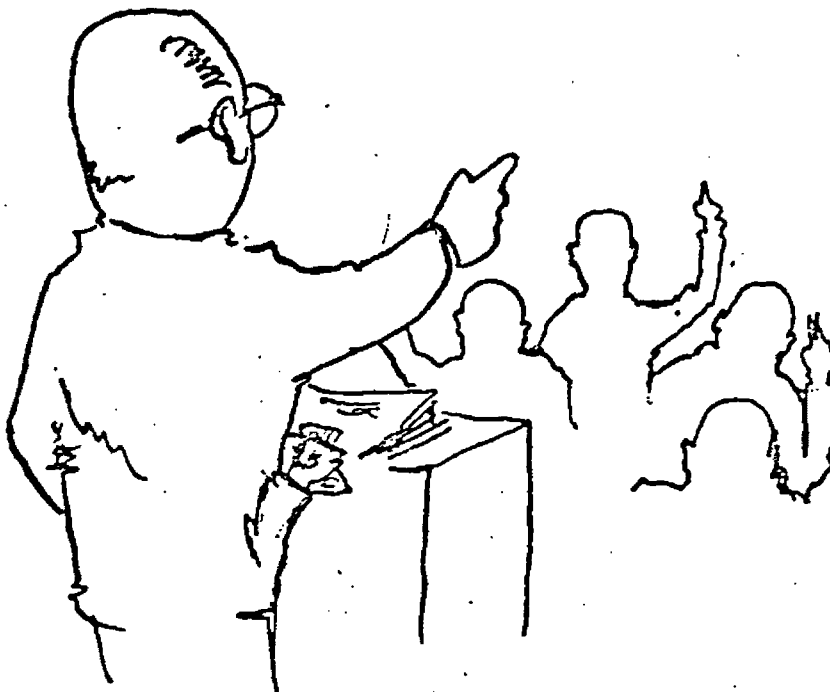
The contracting officer is responsible for selecting and using whatever price analysis techniques will insure a fair and reasonable price. [FAR 15.805-2]

Price analysis is the process of examining and evaluating a proposed price without evaluating its separate cost elements and proposed profit.

To do a good job of price analysis, the analyst must know what is being bought and what it does. It always helps to know what it looks like, how big it is and any other properties that can help to understand the probable costs of producing or otherwise acquiring it.

There is no substitute for an inquisitive attitude and the application of common sense. None of the techniques presented in and of themselves supply infallible answers.

Nonetheless, there are certain advantages to having these techniques laid out in a logical format that complies with the procurement laws and regulations. It is in this context that the following methods are presented.



## Price Analysis Techniques

Price analysis techniques can be classified into three broad categories...

- o COMPETITION
- o COMMERCIAL ITEM PURCHASES
- o COMPARATIVE PRICE ANALYSIS

When does competition exist?

- o Competition occurs when two or more offerors bid for the same contract.
- o Adequate competition occurs when
  - there are responsive offers
  - there are responsible offerors
  - the bids are independently submitted
- o If price competition exists, the contracting officer shall presume it is adequate unless
  - the solicitation unreasonably denies known qualified offerors from competing
  - the low offeror has such a decided advantage that it is immune from competition
  - there is a finding, supported by a statement of facts and approved at a level above the contracting officer, that the lowest price is unreasonable
- o [FAR 15.804-3(b)(3)] A price is "based on" adequate price competition if
  - it results directly from price competition
  - price analysis alone clearly demonstrates that the proposed price is reasonable in comparison with current or recent prices for the same or substantially the same items purchased in comparable quantities, terms and conditions under contracts that resulted from adequate price competition.

What are the steps for price analysis based on competition?

- o First determine that there is adequate competition. If the conditions for adequate price competition have been met, then you have made a finding of effective price competition. This finding in and of itself justifies the price as reasonable.
- o If not, refer to other price analysis techniques.

Any determinations of adequate competition or analysis should be thoroughly documented and filed.

What qualifies as a commercial item purchase?

FAR [15.804-3] defines a commercial item purchase as one in which price

- o is an established catalog or market price,
- o of commercial items,
- o sold in substantial quantities,
- o to the general public,
- o and has an end use by other than the Government.

Every item must be evaluated on a case-by-case basis to determine if it is a commercial item purchase.

How can a determination be made that an item is a commercial item purchase?

Established catalog price. A catalog price is included in a catalog, price list, schedule, or other form regularly maintained by the manufacturer or vendor, is either published or otherwise available for inspection by customers, and states prices at which sales are being or were last made to a significant number of buyers who constitute the general public. Those actual prices may be less than shown in the catalog; most sellers have separate schedules of discounts from list prices based on quantities and other factors.

Established market price. A market price is one currently established in the usual and ordinary course of trade between buyers and sellers free to bargain. It must be established from sources independent of the manufacturer or vendor.

Commercial item. A commercial item (the term includes both supplies and services) is one of a class or kind regularly used for other than Government purposes and sold or traded in the course of normal operations.

Substantial quantities. Supplies are sold in substantial quantities when the facts or circumstances support a reasonable conclusion that the quantities regularly sold are sufficient to constitute a real commercial market for the item. This test is usually in terms of total quantities sold, but it also should include the number of times the item has been sold, and how many times a given price or price structure has been accepted by buyers free to choose. Nominal quantities, like models, specimens, samples, and prototype or experimental units, cannot be considered to meet this requirement. Services sold in substantial quantities are those customarily provided by the company, with personnel regularly employed, and with equipment, if any is needed, regularly maintained either solely or principally to provide such services.

General public. An item is sold to the general public if it is sold to other than affiliates of the seller for end use by other than the Government. Items sold to affiliates of the seller and sales for end use by the Government are not sales to the general public.

If the above conditions have been met and the price is considered reasonable, then document the file for a complete analysis.

What are comparative price analysis methods?

Comparative price analysis techniques rely on the use of comparisons to some other acceptable standard. These include

- o past prices
- o Government estimates
- o visual analysis

Is the price reasonable in comparison with past prices?

This method requires access to price history records on a line item basis. If a past price is being used for comparison, be sure that the past price was fair and reasonable and is a valid standard against which to measure the offered price. Find out if the reasonableness of the previous prices was established by competition, detailed cost analysis, an engineering estimate, or market or catalog price. If not, it may not be appropriate to apply this method of price analysis.

Once you are satisfied that a previous price was reasonable, the next step is to compare it with the current prices. Price comparison techniques are the same, regardless of whether the standard is a past price, a purchase request estimate, or an independent estimate. Factors that might affect the comparison include: variations in specifications, quantities, or delivery schedules, inflation, whether it was Government-furnished materials or not and the effect of technological advances.

This type of comparison puts you in a position to request explanations for price differences. If you conclude that the past price is fair and reasonable and that any differences are justified, document the conclusion to justify the price analysis decision.

If not, the next question to ask is.....

Is the price fair and reasonable compared to a Government estimate?

The techniques for comparing a price with a Government estimate are the same as for comparing with past prices. It is necessary to establish the basis for the estimate and determine its reliability. If a product is susceptible to a realistic engineering estimate and that estimate has been carefully developed after a study of drawings, physical inspection, and reasonable projection, it may well be a reasonable standard. If this is the case, the price analysis is complete. Enter a memorandum in the file that explains the basis of the analysis and conclusion.

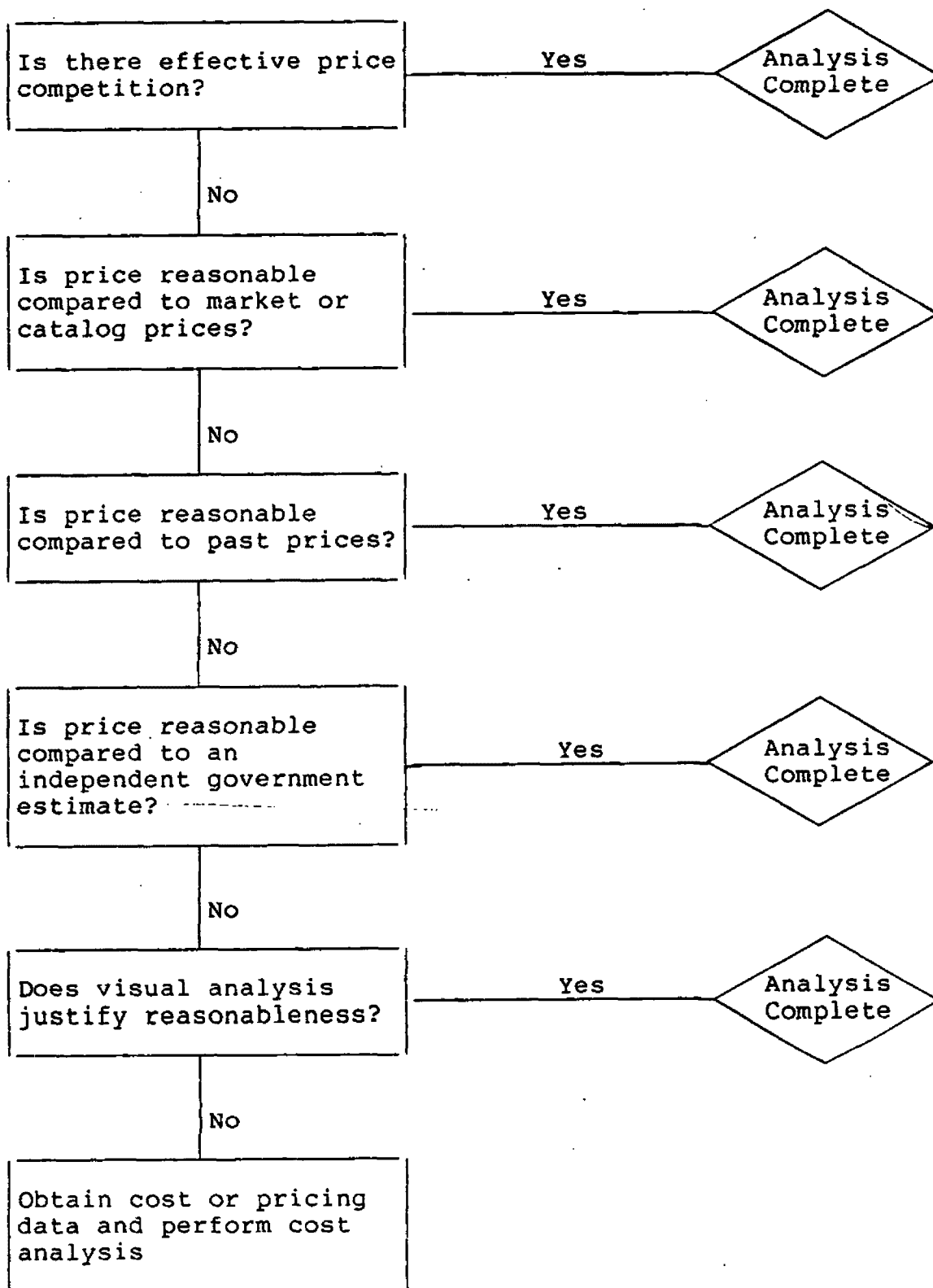
If price reasonableness still has not been established, then the next question is .....

Can a visual analysis justify the reasonableness of the price?

Visual analysis is a fancy name for what could be called "eyeballing." It means you can get familiar with an object by looking at one, or a picture of one, and talking to someone who knows how it's used. Based on this knowledge, you may be able to come up with a dollar figure as to its worth or value. This value becomes a standard you can use sometimes, when looking at an offered price, a market or catalog price, or a Government cost estimate in making a decision to accept the offered price or to negotiate a different price. It rarely is sufficient by itself, but if you were almost convinced by one or more of the previous methods, it may be enough to finally establish the reasonableness of the price.

The aforementioned price analysis techniques are summarized below:

#### PRICE ANALYSIS DECISION FLOWCHART





## VI. COST ANALYSIS TECHNIQUES

1. Definition
2. Concepts
  - a. Should Cost
  - b. Cost Normalization
3. Direct Labor Analysis
  - a. Direct Labor - Definition
  - b. Determination of Direct Labor Hourly Rate
  - c. Salary Escalation
  - d. Indefinite Quantity Contracts - Problems
  - e. Level of Effort Contracts - Problems
4. Direct Material and ODC
  - a. Material
  - b. Interdivisional Transfers
  - c. Subcontract Costs
  - d. Consultants
  - e. Special Equipment
  - f. Travel
5. Indirect Costs
  - a. Computation of Rates
  - b. Unallowable Costs
  - c. Billing Rates
  - d. Ceiling Rates
  - e. Rate Agreement



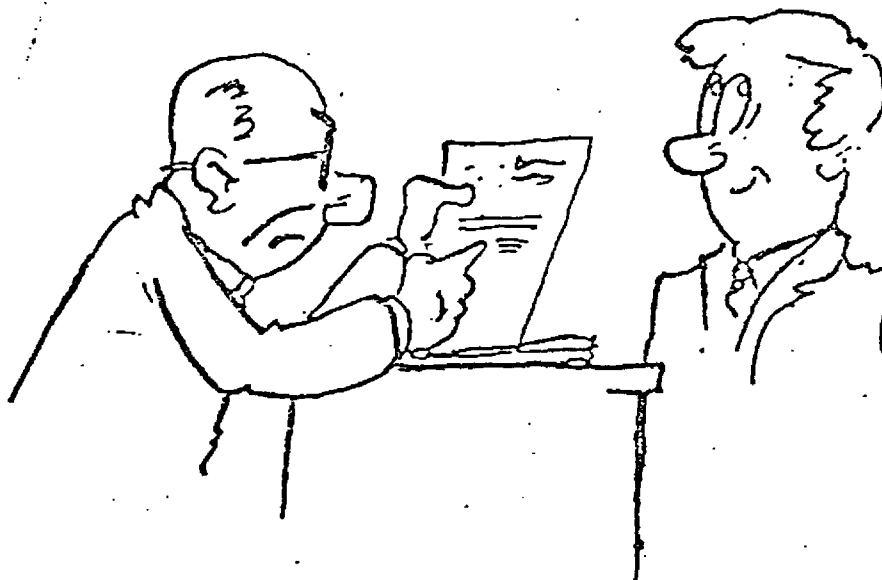
## VI. COST ANALYSIS TECHNIQUES

Cost Analysis is the review and evaluation of the separate cost elements and the proposed fee/profit of:

- a) an offeror's or contractor's cost or pricing data and
- b) the judgmental factors applied in projecting from the data to the estimated cost, in order to form an opinion on the degree to which the proposed costs represent what the contract should cost, assuring reasonable economy and efficiency. [FAR 15.801]

It is important to analyze proposed costs on cost reimbursement type contracts in terms of their cost realism since the Government will ultimately be liable for reimbursement of the contractor's actual allowable costs subject to the limitation of cost clause.

With this in mind, it is important to understand the concepts of should cost and cost normalization before proceeding to specific cost analysis techniques.



### Should Cost

FAR 15.810 has expanded the definition of should cost; however, this definition is more appropriate for major systems acquisition or production. For purposes of EPA cost analysis, the concept of "should cost" is as follows:

The objective of cost analysis is to arrive at a realistic price. A realistic price is a reasonable price. The judgment that a price is reasonable is based on a cost estimate that is attainable, an estimate of what it should cost if the contractor operates with reasonable economy and efficiency. That is where the term "should cost" originated.

Should cost is a concept, not a technique. How a conclusion is reached that the cost is reasonably attainable and reflects the best deal under the circumstances is not important. There is a relatively old concept in cost analysis that states one should attempt to establish what it should, not what it will, cost to do a job. What is important is that the method used results in a price that is based on what it should cost in the environment and under the conditions predicted for the performance of the contract.

## Cost Normalization

"Normalization" is a technique sometimes used within the cost adjustment process in an attempt to arrive at a greater degree of cost realism.

It involves the measurement of at least two offerors against the same cost standard or baseline in circumstances where there is no logical basis for differences in approach, or in situations where insufficient information is provided with proposals, leading to the establishment of common 'should have bid' estimates by the agency.

The proper goal in both instructing offerors as to proposal preparation and in conducting the probable cost evaluation itself is to segregate cost factors which are 'company unique' depending on variables resulting from dissimilar company policies from those which are generally applicable to all offerors and therefore subject to normalization.

Using the above definition is particularly pertinent to our CPFF Level of Effort (LOE) type contracts:

To implement the "Should Cost" concept, it is important to understand that if you are considering five proposals on a competitive RFP you should determine what each of the five proposals should cost given the individual circumstances for each offeror.

Cost normalization techniques are appropriate to adjust the proposals where there is no logical basis for differences in approach or when insufficient information is provided with the proposals. To avoid this problem we commonly instruct the contractors in the RFP to bid predetermined amounts for travel, ODC's etc. If these instructions are incorrectly followed or if they are not included in the RFP and it is later determined that no logical basis exists for different estimates, then an adjustment should be made. We should also be alert for contractors incorrectly bidding the level of effort.

A complete cost analysis should include [FAR 15.805-3]:

1. Verification of cost or pricing data and evaluation of 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, labor rates, and cost of money or other factors.
2. Evaluating the effect of the offeror's current practices on future costs. In conducting this evaluation, the contracting officer shall 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 contracting officer should 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) Other cost estimates received in response to the Government's request;
  - (d) Independent Government costs estimates by technical personnel; and
  - (e) Forecasts or planned expenditures.

4. Verification that the offeror's cost submissions are in accordance with the contract costs principles and procedures in Part 31 and, when applicable, the requirements and procedures in Part 30, Cost Accounting Standards.
5. Review to determine whether any cost or pricing data necessary to make the contractor's proposal accurate, complete, and current have not been either submitted or identified in writing by the contractor. If there are such data, the contracting officer shall attempt to obtain them and negotiate, using them or making satisfactory allowance for the incomplete data.

## DIRECT LABOR ANALYSIS

The amount representing the cost of an element of direct labor is the product of two quantities, namely the number of man-hours of labor and the wage rate per hour of labor. The cost analyst, then, must examine both factors in the review of direct labor costs.

How this is done depends on:

- the contractor's cost accounting system,
- the contractor's estimating system,
- the requirements of the acquisition.

This section will look at techniques applicable to the direct labor cost element of a cost proposal as well as specific considerations for level of effort (LOE) and fixed-rate indefinite quantity contracts.

What is direct labor cost?

- o Direct labor are those hours which can be associated with a specific job or task.
- o Direct labor costs are composed of 2 elements:
  - the unit of time of a worker's effort
  - the cost to the company for that unit of effort
- o The number of direct labor hours times the cost per hour equals Direct Labor Costs.

In most cases, there is more than one worker providing effort to the job; therefore, using an appropriate method (discussed later) the cost of all employees who contribute to the job is totaled to arrive at one summary amount for direct labor costs.

How do you determine a direct labor hourly rate?

Frequently, employers maintain a record of their employees' salaries only for the time period of the pay check or for the year. Since RFP's (request for proposals) usually require direct labor costs in terms of direct labor hours, it becomes necessary to convert the employee's salary to its equivalent hourly rate in order to determine the accuracy and reasonableness of the proposed direct labor costs. Examples of how to compute the hourly labor rate follow:

Example #1

J. Smith is paid a gross monthly salary of \$1,000. Smith's hourly rate then is:

$$\$1,000 \times 12 \text{ months} = \underline{\$12,000} \text{ per year}$$

Normally there are 2080 possible workhours in a year (52 weeks x 40 hours per week)

$$\text{Therefore, the Hourly Rate} = \frac{\$12,000/\text{yr.}}{2080 \text{ hrs/yr}} = \$5.77 \text{ per hr.}$$

Example #2

M. Brown's salary is recorded in the contractor's personnel and payroll records only at an annual rate of \$35,000 per year. Her hourly rate would then be:

$$\$35,000 \div 2080 \text{ hours} = \$16.83/\text{hour}$$

Notice in both of the examples that every potential workhour is used (52 weeks x 40 hours) to arrive at the hourly rate, even though some of these hours represent vacation time or holidays. Because some employees might be paid on the basis of more or less than 40 hours per week (8 hours per day), the analyst should be aware of the company's policy.

Both actual work hours, vacation and holiday hours are included in the hourly rate calculation because each hour is then charged (classified) to either a direct effort or indirect effort.

By recording costs this way, there is a record of the total amount of direct and indirect costs at the end of an accounting period.

If only the actual number of work hours is used to calculate the hourly rate, then that hourly rate also includes the cost of vacation and holiday time off. An illustration follows:

Mary Brown has an annual salary of \$40,000. She has 2 weeks vacation time per year and is allowed 10 holidays per year.

Her annual salary per year could be computed two ways:

$$\#1: \$40,000 - 2080 \text{ hours} = \$19.23/\text{hr.}$$

$$\#2: \$40,000 - (2080 - 160^*) = \frac{40,000}{1920} = \$20.83/\text{hr.}$$

Note that the higher hourly rate is due to the built in cost of vacation and holiday time. There could also be additional hours for personal days, sick leave, etc. (see next page). If "workable hours" are used to compute the hourly cost of labor, then any fringe benefit costs subsequently added to labor should be exclusive of the cost of vacation, holiday and other non-workable hours.

*2 weeks vacation	equals	80 hours
10 holidays	equals	80 hours
		<u>160 hours</u>

TYPICAL CALCULATION OF DIRECT LABOR HOURS

Total annual hours (52 weeks x 40 hrs/wk)	2,080 hrs.
Less: Vacation (2 weeks)	(80)*
Sick Pay (1 week)	(40)*
Holidays (8 days)	(64)*
Personal (3 days)	(24)*
Net amount of <u>Direct</u> hours available	1,872 hrs.
	=====
*Total hours charged to <u>Indirect</u> Accounts:	208 hrs.
	=====

How are labor rates weighted?

When several employees are proposed for one specific job category because each will contribute only a portion of the required direct labor hours, it becomes necessary to calculate a representative rate for that category.

Example:

The RFP estimates that 1000 hours of a senior engineer/scientist is required. The offeror decides to propose four of his engineer/scientists equally at 250 hours each for that category; however, they all earn different salaries. To arrive at a single hourly bid rate for that category, the offeror must weigh the hourly rates of the four employees.

		<u>Hrly. Wage</u>		<u>No. of Hrs.</u>		
Engineer	1	\$12.00	x	250 hrs	=	\$ 3,000
Engineer	2	\$13.25	x	250 hrs	=	3,313
Engineer	3	\$15.00	x	250 hrs	=	3,750
Engineer	4	\$14.60	x	250 hrs	=	3,650
						<u>\$13,713</u>
						=====

\$13,713 divided by 1000 hours = \$13.71 per hour.

The computed rate of \$13.71 represents the weighted average rate of the four employees based on the ESTIMATE of each employee providing 250 hours. If the estimated hours change, so would the weighted hourly rate.

Note that this computation could also have been calculated by a simple mathematical average of the hourly rates:

\$12.00  
 13.25  
 15.00  
14.60

\$54.85 divided by 4 employees = \$13.71 per hour

Now, suppose each of the four employees are to contribute different quantities of direct labor effort, then the "weighted" average rate would be computed:

		<u>Hours</u>		<u>Hrly. Rate</u>	<u>Total Direct Labor Cost</u>
Engineer	1	200	x	\$12.00	\$ 2,400
Engineer	2	300	x	\$13.25	3,975
Engineer	3	150	x	\$15.00	2,250
Engineer	4	350	x	\$14.60	5,110
		<u>1000</u>	hrs.		<u>\$13,735</u>

\$13,735 divided by 1000 hours = \$13.74

In this example, the weighted rate is larger because the "mix" of the individuals' hours has changed.

Therefore, the decision to alter the distribution of labor hours also affects the outcome of the average hourly rate.

If the proposed "mix" of direct labor hours results in a lower average hourly rate than what is actually provided on the contract, the potential exists for a cost overrun on a cost reimbursement contract.

When overhead, general and administrative expenses and fee are added, the monetary difference becomes even more significant.

Two points to keep in mind when evaluating direct labor mix:

- For Fixed Rate Indefinite Quality contracts, the offeror is motivated to weight the average labor rate to the higher end in order to "lock" in the rate for the period of performance. This does not guarantee that the proposed skill mix represented by that hourly cost will be received during contract performance.
- For cost type contracts, the offeror is motivated to propose the lowest rate possible for bidding purposes and would therefore manipulate the labor mix to reflect the lowest possible bid rate. This of course would make the offeror's cost proposal attractive; however, this does not guarantee that actual costs are going to be the proposed costs. The contractor may have been "buying in". (Without ceiling restrictions in the contract, the offeror could actually provide and be reimbursed for the higher level personnel.) With a cost-type contract, the Government will pay for the ACTUAL higher level personnel subject to the limitation of cost clause, even though the proposed and accepted direct labor costs were based on lower paid employees.

Conclusion:

In evaluating the composition of a direct labor category rate, determine that the appropriate method is reasonable in light of the contracting environment, i.e., (cost or fixed rate) for which it was computed.

What is escalation and how is it determined?

Escalation is a computed percentage rate to be applied to the current direct labor costs or hourly direct labor rates. The application of the percentage increases the direct labor cost estimate. The reason for increasing a direct labor cost is to estimate the cost of direct labor over a period of time by estimating future increases such as cost of living increases and promotions.

Escalation is determined by considering the factors which influence the cost of living decisions by management and the promotion policies and plans of the company. These factors must be considered if a proper cost analysis is being performed. An appropriate escalation rate is one which best reflects the future cost of labor with consideration to the promotion and salary policies of the company.

Here are two situations where escalation becomes an issue. In the first case, the proposed labor is scheduled for promotions at various times during the contract performance period. In the second case, the company plans on a company-wide cost of living increase.

Example #1: Four employees were proposed by the contractor as follows:

<u>Labor Category</u>	<u>Emp. #</u>	<u>Direct Labor Hrly. Rate</u>	<u>Proposed Direct Labor Hrs.</u>	<u>Direct Labor Costs</u>
Engineer	5	\$17.90	100	\$1,790
Engineer	3	\$14.36	50	718
Engineer	4	\$15.20	27	410
Engineer	1	\$ 9.26	94	870
271 hrs.				$\$3,788 \div 271 = \$13.98/\text{hr.}$
				=====

\$13.98 represents the current average hourly rate. However, the Engineer 5 employee is scheduled for a raise of 10%, 3 months into the contract performance year, the Engineer 3 employee is scheduled for a 6% raise 6 months into the year, Engineer 4 is receiving a 7% raise 10 months into the year, and Engineer 1 is to receive a 4% raise 2 months into the contract performance year. Below is an illustration of the projected promotion schedule:

	Jan.	Feb.	Mar.	Apr.	May	June	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.
Engineer 5	\$17.90	\$17.90	\$19.69	\$19.69	\$19.69	\$19.69	\$19.69	\$19.69	\$19.69	\$19.69	\$19.69	\$19.69
Engineer 3	\$14.36	\$14.36	\$14.36	\$14.36	\$14.36	\$15.22	\$15.22	\$15.22	\$15.22	\$15.22	\$15.22	\$15.22
Engineer 4	\$15.20	\$15.20	\$15.20	\$15.20	\$15.20	\$15.20	\$15.20	\$15.20	\$15.20	\$16.26	\$16.26	\$16.26
Engineer 1	\$ 9.26	\$ 9.63	\$ 9.63	\$ 9.63	\$ 9.63	\$ 9.63	\$ 9.63	\$ 9.63	\$ 9.63	\$ 9.63	\$ 9.63	\$ 9.63

Based on this information, it should be obvious that the labor cost per hour @ \$13.98 does not reflect what labor will cost during the contract period of performance for 12 months. Therefore, it is necessary to recompute the labor cost.

The most accurate computation of direct labor costs would involve using the actual rate for a given month times the number of hours estimated to be worked that month. This would be an extremely tedious technique and not cost beneficial for a large number of labor categories. The amount of money saved by being so precise is lost due to the additional administrative costs to achieve that preciseness.

A simpler estimation method is to calculate the average hourly rate over the period of performance and then use that average hourly rate to arrive at the total estimated direct labor costs. We've illustrated our point below:

Engineer 5:	\$17.90 x 2 mos.	= \$ 35.80	
	\$19.69 x 10 mos.	= \$196.90	
		<u>\$232.70</u>	÷ 12 = \$19.39
Engineer 3	\$14.36 x 5 mos.	= \$ 71.80	
	\$15.22 x 7 mos.	= \$106.54	
		<u>\$178.34</u>	÷ 12 = \$14.86
Engineer 4	\$15.20 x 9 mos.	= \$136.80	
	\$16.26 x 3 mos.	= \$ 48.78	
		<u>\$185.58</u>	÷ 12 = \$15.47
Engineer 1	\$9.26 x 1 mo.	= \$ 9.26	
	\$9.63 x 11 mos.	= \$105.93	
		<u>\$115.19</u>	÷ 12 = \$9.60

The calculated rates above represent the AVERAGE hourly rate for the ENTIRE 12-month period of performance and reflects the forecasted promotion plans of management.

From these rates direct labor costs can be calculated by applying the calculated direct labor hourly rates to the estimated number of hours.

Example #2:

The offeror has determined that current labor costs for the contract period of performance is \$114,950. This was determined based on the current salaries; however, the offeror is planning to award a company-wide cost of living increase of 5% in the 4th month of the 12-month contract performance period.

Therefore, it is necessary to project that increase in labor cost in the offeror's labor estimate. This calculation can be done as follows:

The 5% increase will take place in the 4th month; therefore,

$$\frac{8 \text{ months}}{12 \text{ months}} \times 5\% = 3.3\% \text{ escalation}$$

so escalated labor costs will be

$$\begin{aligned} \$114,950 \times 103.3\% &= \$118,743 \\ &===== \end{aligned}$$

Example 2:

The ARC Corp. performs their salary review for each employee on their anniversary date of hire. Historically, salary increases have averaged 7% on an annual basis. The proposed contract is expected to commence on January 1 and will have a base period of one year plus two option years. What is the acceptable labor for the base year and each of the option years?

Answer:

In the absence of data to the contrary, it can be reasonably assumed that salary increments will be evenly distributed throughout the period; therefore, on the average, employees will receive pay raises at the midpoint of performance. Assuming this to be the case, the escalation for the first year will be  $7\% \times 1/2 \times \$100,000$  or \$3,500. The acceptable labor for the first year is \$103,500 ( $\$100,000 + \$3,500$ ). The acceptable labor for the second would be \$110,745 ( $1.07 \times \$103,500$ ) and for the third year it would be \$118,497 ( $1.07 \times \$110,745$ ).

What basis is used to arrive at an appropriate escalation factor?

When promotions are forecasted for direct labor employees, look to the past promotion practices and percentages given by the contractor to determine if the escalation factor is reasonable and appropriate.

Cost of living raises are tied to inflation. The basis for granting such raises is to allow employees to maintain the purchasing power of their current salaries because inflation erodes the purchasing power of money. Since the basis for granting cost of living raises should be directly tied to inflation, it is important to be aware of the forecasted rate of inflation, not the historical rate of inflation.

One of the many erroneous assumptions used for proposing cost of living increases is that the past inflation rate is indicative of the rate and therefore should be used as the basis for estimating future costs.

- In determining a reasonable escalation rate, don't presume that 10% rate of inflation last year means 10% this year; this type of rationale is what fuels the inflationary spiral.
- In evaluating an inflation rate, look at future projections for the economy, particularly the costs of goods, services and the cost of labor. This type of information can be found in many of the publications put out by data forecasting services\*.

\*Commonly used forecasting services:

Data Resources, Inc. (DRI)  
Consumer Price Index (CPI)  
Labor Forecasts from the Bureau of Labor Statistics

Another common error made in evaluating escalation is the assumption of its permanence. Inflation characterized the late 60's and 70's. Prior to that there were periods of economic inflation but nothing like the rampant inflation of the 70's. Because of the long period of rising prices, people have become conditioned to thinking that wages and prices must always rise, and therefore expect wage increases.

- As a result of wage increases, the price of goods and services do rise and in effect inflation results.
- One of the goals of Federal Government auditors is to aggressively attack the direct labor salary "creep". In periods of recession in the economy, salary increases should reflect merit increases.

In summary, when evaluating escalation factors, consider the following:

- 1) What is the company policy for salary increases?
- 2) What has been awarded to employees in the past?
- 3) What are the forecasting services predicting for the next quarter or year?
- 4) What type of contract pricing arrangement is being anticipated?

What particular problems with direct labor cost estimates are associated with fixed rate indefinite quantity contracts?

The fixed rate indefinite quantity contract, where a labor hour is the product unit, "locks in" a labor rate for a specified period:

1. In circumstances where the type of labor is readily available in the commercial market place, a price analysis may be sufficient to determine the reasonableness of price. For example, guard service, custodians, computer technicians, electricians, etc.
2. When cost analysis is necessary to determine the reasonableness, the base labor rate (unescalated) should be evaluated carefully for the contractor's assumption for proposing a fixed rate.
3. The use of category averages for calculating the fixed rate is more appropriate than key personnel because the use of a particular employee's salary for determining a fixed rate implies the availability of that employee for the duration of contract performance.

The use of category averages as a basis for fixed rate assures a level of labor quality availability instead of the availability of the employee. However, it can also result in built-in profit if lower salaried people are provided. Therefore, when relying on category averages as a basis of determining fixed rates, caution should be exercised when there are wide variances in the individual rates comprising the fixed rate.

What particular problems with direct labor cost estimates are associated with CPFF - Level of Effort contracts?

The Level-of-Effort contract in EPA defines labor with general labor classification such as:

PL-1     (Professional Level One)  
TL-3     (Technical Level Three)

These labor categories do not encourage specific classification of employees. As a consequence, a contractor may propose a labor category rate which could be representative of a wide range of hourly rates and skills.

When evaluating LOE labor category rates:

1. Review the experience and educational levels as specified in the RFP's.
2. Review the disparity between the highest and lowest hourly rate in a particular category.
3. Remember that it is to the contractor's advantage to bid the lowest rates for award purposes because technical quality is usually more important than cost.

## DIRECT MATERIALS AND ODC

What items are considered direct material costs and other direct costs?

First let us go back to the definition of a direct cost...

"Any cost that is specifically identified with a particular final cost objective."

In other words, any incurred cost which can be directly associated with a contract.

Typical direct material and other direct costs include:

Direct Materials	{	Subcontracted parts and components
		Purchased parts
		Commercial item purchases
		Interdivisional transfers
		Raw materials

Other Direct Costs	{	Travel
		Supplies
		Consultants
		Xeroxing
		Special Equipment
		Printing and Reproduction
		Freight and Postage
Telephone		

How are material and other direct costs to be evaluated?

Material Costs:

- o Verify the unit prices to:
  - vendor quotes
  - recent purchase orders
  - current supplier lists
  - price lists and catalogs
- o Standard commercial items should be analyzed using price analysis techniques.
- o Review the number of units for consistency with the proposed effort.
- o Verify the mathematical extensions of price x quantity = total estimated cost.
- o If all of the above steps are met and if the costs proposed are considered fair and reasonable, then

Document the basis for acceptance of the proposed costs to complete the review.

### Interdivisional Transfer

An interdivisional transfer is a "sale" of materials or services between two divisions or segments of one company.

Interdivisional sales or transfers of materials should be ordinarily handled on a cost, no-profit basis to the transferor. However, transactions involving items that are regularly manufactured and widely sold by a contractor may be handled on a basis that recognizes a fair profit return if the contractor's organization is structured along profit center lines and the transferring segment is operated as a separate entity required to perform on a self-sufficient basis.

When reviewing an interdivisional transfer

- o determine the basis for pricing,
- o review the cost element(s) if the interdivisional transfer has more than one cost factor,
- o determine whether divisional profit is included or not and verify whether it is consistent with the contractor's company policy and any prior contractual agreement with the Government.

## Subcontractor Costs

Subcontractor's proposals over \$500,000 should be detailed in the same format as the prime contractor. But for any amount, you should obtain sufficient information from the prime contractor to satisfy yourself of the reasonableness of costs.

FAR 15.805-5(i) details the cost analysis responsibilities further....

The prime contractor or higher tier subcontractor is responsible for conducting appropriate cost analyses before awarding subcontracts. However, the contracting officer may request audit or field pricing support to analyze and evaluate the proposal of a subcontractor at any tier (notwithstanding availability of data or analyses performed by the prime contractor) if the contracting officer believes that such support is necessary to ensure reasonableness of the total proposed price. This step may be appropriate when, for example--

- (1) There is a business relationship between the contractor and subcontractor not conducive to independence and objectivity;
- (2) The contractor is a sole source and the subcontract costs represent a substantial part of the contract cost;
- (3) The contractor has been denied access to the subcontractor's records; or
- (4) The contracting officer determines that, because of factors such as the size of the proposed subcontractor price, audit or field pricing support for a subcontract or subcontracts at any tier is critical to a fully detailed analysis of the prime contract proposal.

- (j) When the contracting officer requests the cognizant ACO or auditor to review a subcontractor's cost estimates, the request shall include, when available, a copy of any review prepared by the prime contractor or higher tier subcontractor, the subcontractor's proposal, cost or pricing data provided by the subcontractor, and the results of the prime contractor's cost or price analysis.
- (k) When the Government performs the subcontract analysis, the Government shall furnish to the prime contractor or higher tier subcontractor reviewed, a summary of the analysis performed in determining any unacceptable costs, by element, included in the subcontract proposal. If the subcontractor withholds consent, the Government shall furnish a range of unacceptable costs for each element in such a way as to prevent giving away subcontractor proprietary data.

A price analysis should be performed for all significant proposed subcontracts.

A cost analysis should be performed on prospective subcontractor(s) when cost or pricing data is required or when the contractor is unable to perform an adequate price analysis. (FAR 15.805-1)

REMEMBER:

The proposed subcontractor fee/profit is an element of cost to the prime contractor; therefore, it should be evaluated like any element of cost by applying the appropriate EPA fee/profit guidelines.

## Consultants

When evaluating consultants:

- o Obtain the names of the individual consultants and/or the consulting firms,
- o Request a copy of the consultant agreement and/or a copy of the consultant's proposal,
- o Review any available information on the prior use of the consultant,
  - Is the proposed rate equal or appropriate to the rate charged previously to the Government or other clients.
  - Can the proposed number of hours realistically be provided?
- o Verify the mathematical calculation.

Document the findings for the file to complete the review.

### Special Equipment

Special equipment may require technical evaluation beyond the capacity of a cost and price analyst; therefore the cost analyst should seek the appropriate expertise to assist in the evaluation of the proposed costs for specialized equipment.

After a technical analysis on the equipment has been performed or acquired

- o Inquire as to whether the equipment is available from Government stock,
- o If the equipment will be contractor-purchased, will it be direct charged or capitalized,
- o Determine whether the proposed price is acceptable
  - Compare the price with two or more other quotes
  - Perform a lease vs. buy analysis
  - FAR 31.205-36 discusses Rental Costs (operating leases)
  - FAR 31.205-11 discusses Rental Costs (capital leases)
  - FAR 31.205-2 discusses ADPE Lease Costs
- o Verify mathematical extensions for accuracy.

Document the file to complete the analysis.

## Travel Costs

Travel costs include such items as:

airfares	meals
taxi fares	lodging
rental cars	mileage

- o Assure yourself of the reasonableness of the proposed travel based on the needs of the prospective contract.
- o Verify airfares to the Official Airlines Guide (OAG).
  - Use the standard coach fare as a guide for acceptance of proposed airfare
- o Review ground transportation for reasonableness and necessity.
  - Include corporate discounts for car rental (usually 20%).
- o Off-site subsistence must be in accordance with company policy and at rates which are not excessive. Also compare the rates against government travel rates.

If the costs are determined to be reasonable, then document the findings for the file.

In general, when reviewing other direct costs:

- o Review the necessity of the cost to the contract.
- o Are the proposed units consistent with the contract requirements?
- o Are the unit prices reasonable?
- o Verify the mathematical extensions.
- o Is the item a direct charge to the contract?
- o DOCUMENT the findings and conclusions.

## INDIRECT COSTS

[FAR 42.703] It is the policy under FAR that a single agency shall be responsible for establishing indirect cost rates and that these rates shall be binding on all agencies and their contracting officers unless otherwise prohibited by statute. [FAR 42.703]

[EPAAR 1542.705-1] Furthermore, it is the policy of EPA for Cost Policy and Rate Negotiation Section of P&CMD to be responsible for negotiating final indirect cost rates in accordance with EPA contracting officer procedures.

If a question arises regarding the appropriateness and applicability of any indirect cost rate or its allocation base, consult your EPA Cost Advisory Office. The staff of accountants possess the in-depth knowledge of accounting principles required to deal with indirect cost issues.

What is an indirect cost?

[FAR 31.203] "An indirect cost is any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective."

Illustration #1

Carl, an engineer with Clean-Up, Corporation spends all of his working hours on 3 projects: Contract 1, Contract 2 and Contract 3. So, Carl can attribute his workday to a specific final cost objective the completion of contract 1, 2, or 3.

THEREFORE, Carl's salary is a direct cost to contract 1, 2 or 3 based on the amount of time he spends on each contract.

In contrast, Joanna's time as president of Clean-Up Corporation is not spent on any particular contract. She spends her time in meetings and deciding the corporation's overall future. She could not attribute her workday to a specific final cost objective such as a particular contract. Her time and efforts benefit the company as a whole (several objectives); therefore, her salary is an indirect cost.

Illustration #2

The monthly office rent of Company XYZ is \$2,500. The office space is used for all company operations, direct and indirect. Because there are no designated usage areas of the office, the \$2,500 is considered beneficial to all operations of the company (several final cost objectives) and is classified as indirect.

Why are indirect costs referred to by many titles?

Indirect costs are generally titled:

- Overhead
- General and administration (G&A)
- Material overhead
- Subcontracting overhead
- Fringe benefits

The various titles distinguish the base and pool from which the indirect cost was derived. Note that the term "overhead" is also used in a general sense to describe indirect costs rather than a specific indirect cost pool as shown above.

What do the terms "base" and "pool" refer to and how are indirect rates determined?

An indirect rate, usually expressed as a percentage, is the result of dividing the indirect cost pool by the appropriate allocation base for a specific accounting period.

$$\text{Indirect Cost Rate} = \frac{\text{Indirect Cost Pool}}{\text{Allocation Base}}$$

An indirect cost pool is a grouping of incurred costs identified with two or more cost objectives but not specifically identified with any final cost objective.

The allocation base is the grouping of incurred costs benefited by the indirect cost pool.

Example of Indirect Cost Rate Development  
Total Company Cost Budget

	<u>Direct Costs</u>	<u>Indirect Costs</u>	
		<u>Overhead</u>	<u>G&amp;A</u>
Salaries (labor)	\$1,000,000	\$275,000	\$125,000
Fringe Benefits		400,000	
Travel	60,000	5,000	10,000
Supplies	9,000	4,000	2,000
Publications	20,000		13,000
Subcontracts	300,000		
Consultants Fees	40,000		20,000
Rent/Utilities		136,000	
Computer Charges	26,000		40,000
Insurance		10,000	10,000
Other Costs	<u>25,000</u>	<u>40,000</u>	<u>30,000</u>
Total Costs	\$1,480,000 =====	\$870,000 =====	\$250,000 =====

For a single indirect rate structure:

$$\text{Indirect Rate} = \frac{\$1,120,000}{\$1,000,000} \quad \begin{array}{l} (\$870,000 + \$250,000) \\ (\text{Direct Labor Costs}) \end{array}$$

$$\text{Indirect Rate} = 112.0\%$$

For a two-rate structure:

$$\begin{aligned} \text{Overhead Rate} &= \frac{\$870,000}{\$1,000,000} && \begin{array}{l} (\text{Overhead Costs}) \\ (\text{Direct Labor Costs}) \end{array} \\ &= 87\% \end{aligned}$$

$$\begin{aligned} \text{G\&A Rate} &= \frac{\$250,000}{\$2,350,000} && \begin{array}{l} (\text{G\&A Costs}) \\ (\text{Direct Costs \& Overhead Costs}) \end{array} \\ &= 10.6\% \end{aligned}$$

Once a rate has been determined, it is applied to the base used to calculate the rate.

Indirect Costs = 112% x Direct Labor Costs

Overhead Costs = 87% x Direct Labor Costs

G&A Expense = 10.6% x (Direct Costs &  
Overhead Costs)

What are unallowable costs?

Unallowable costs are those costs which are

- expressly unallowed by the cost principles, or
- mutually agreed to be unallowable.

Unallowable costs are to be identified and excluded from any billing, claim or proposal applicable to a government contract [FAR 31.206]

Some common unallowable costs found in a contractor's indirect cost proposal are:

Advertising	[31.205-1]
Bad Debts	[31.205-3]
Contingencies	[31.205-7]
Contributions	[31.205-8]
Entertainment	[31.205-14]
Idle Facilities Costs	[31.205-17]
Interest	[31.205-20]
Lobbying	[31.205.22]
Organization Costs	[31.205-27]

Costs which are not considered unallowable in a contractor's indirect cost proposal, but are often controversial, are:

Controversial Costs

Compensation	[31.205-6]
Depreciation	[31.205-11]
Research & Development	[31.205-18]
Related party transactions	[31.205-26(e)]
Selling Costs	[31.205-38]
Rental Costs	[31.205-36]

These costs are considered controversial for several reasons:

- magnitude of the cost
- basis for incurring the cost
- basis for calculation of the costs
- the degree of benefit received by the Government

### How is a billing rate established?

Before responding to this question, contract specialists should be reminded that the process of reviewing and negotiating indirect rates involves complex analysis, (i.e. knowledge of the contractor's accounting system, cost principles, cost accounting standards, etc.) therefore, the negotiation of billing rates should not be conducted without the advice of the cost analyst.

When reviewing the billing rates in a contractor's cost proposal, the cost analyst

- ° determines the contractor's basis for proposing the indirect cost rates
  - review the assumptions made
  - review the allocation base
- ° verifies the proposed rates to
  - the cognizant government audit agency (usually Defense Contract Audit Agency)
  - previously negotiated billing rates if they are applicable to the same accounting period
  - budgets submitted by the contractor which forecasts the indirect expense rates for the contract period of performance
- ° determines what impact the award of the contract may have on the contractor's indirect expense rates
  - if the potential contract award amount is significant relative to the contractor's other government and/or commercial sales, the indirect expense rates may decrease and this effect should be considered in negotiations
- ° determines if ceiling rates should be recommended using the guidelines of FAR 42.707 (see next page)

The cost analyst has the responsibility to review the proposed indirect expense rates even though another government agency has approved billing rates. If the assumptions for which the existing billing rates were established is valid, then the analyst may recommend the prevailing government approved indirect expense rates. Whatever recommendation is made, the analyst must thoroughly document the basis of the recommendation.

When may it be appropriate to provide for a ceiling on indirect cost rates beyond which the contractor will absorb the costs?

It may be appropriate if:

- (1) The proposed contractor is a new or recently reorganized company, and there is no past or recent record of incurred indirect costs.
- (2) The proposed contractor has a recent record of a rapidly increasing indirect cost rate due to a declining volume of sales without a commensurate decline in indirect expenses.
- (3) The proposed contractor seeks to enhance its competitive position in a particular circumstance by basing its proposal on indirect cost rates lower than those that may reasonably be expected to occur during contract performance, thereby causing a cost overrun.

When any of the above situations (or a comparable situation) is apparent, an equitable ceiling covering the final indirect costs rates should be negotiated and specified in the contract.

When ceiling provisions are utilized, the contract shall also provide that (1) the Government will not be obligated to pay any additional amount should the final indirect cost rates exceed the negotiated ceiling rates and, (2) in the event the final indirect cost rates are less than the negotiated ceiling rates, the negotiated rates will be reduced to conform with the lower rates. [FAR 42.707]

What is a negotiated indirect cost rate agreement?

On the following pages is an example of a negotiated indirect cost rate agreement. When EPA is the cognizant agency for a contractor's final indirect rates [FAR 42.703], the Cost Policy and Rate Negotiation Section negotiates the final indirect rates and issues the Agreement.

The Agreement will provide information such as:

- (1) The type of rate being agreed to, whether final indirect cost rates or interim billing rates.
- (2) The description of the rates being agreed to, i.e., overhead, fringe benefits, etc.
- (3) The effective period of the rate.
- (4) The rate itself, expressed as a percentage or dollar amount.
- (5) The allocation base for the rate.
- (6) The list of EPA cost reimbursement type contracts for which the rates apply. (see Attachment A)

The agreement may also provide information on any restrictions or ceilings which may supercede the agreement as explained in paragraphs 3 and 4.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C. 20460

NEGOTIATED INDIRECT COST RATE AGREEMENT

Contractor: XYZ Incorporated

Date: August 1, 19XX

1. This Agreement is entered into by and between the U.S. Environmental Protection Agency (EPA) and XYZ, Incorporated. The purpose of this Agreement is to establish negotiated indirect cost rates applicable to the EPA contracts shown on Attachment A.
2. This Agreement is entered into in accordance with Federal Procurement Regulations (FPR) 1-3.705 and 1-3.706.
3. Subject to the provisions listed elsewhere in this Agreement, the rates listed below are established as negotiated indirect cost rates, in effect for the period(s) specified, applicable to the contracts listed on Attachment A and are incorporated into the contracts in accordance with FPR 1-3.705(g).

<u>Type</u>	<u>Effective Period</u>		<u>Rate</u>	<u>Base</u>
	<u>From</u>	<u>To</u>		
Final:				
Fringe Benefits	7/1/81	6/30/82	13.97%	(a)
Overhead	7/1/81	6/30/82	88.66%	(b)
Overhead - Chicago	7/1/81	6/30/82	40.91%	(b)
Gen. & Administrative	7/1/81	6/30/82	16.11%	(c)

Basis for Application:

- (a) Direct labor dollars
- (b) Direct labor plus applicable fringe benefits
- (c) Total costs incurred exclusive of general and administrative expenses

4. Incorporation of this rate agreement in the contracts listed on Attachment A:

a. Shall not change any indirect cost rate ceiling, monetary ceiling, contract obligation, or specific allowance or disallowance provided in the terms and conditions of affected contracts. For those contracts containing indirect cost rate ceilings which are less than the rates contained in this Agreement, final and provisional rates shall not exceed the specified ceiling rates.

b. Is not a waiver by EPA of the Limitation of Cost Clause or authorization for the contractor to exceed the current estimated cost set forth in the contract.

FOR THE CONTRACTOR:

FOR THE U.S. ENVIRONMENTAL  
PROTECTION AGENCY:

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Signature of Contracting Officer

\_\_\_\_\_  
Vice President/Treasurer  
Name and Title

\_\_\_\_\_  
Name of Contracting Officer

\_\_\_\_\_  
August 1, 19XX  
Date

\_\_\_\_\_  
Date

Negotiated by: J. S. Smith  
Telephone: (202) 382-1111

XYZ, Incorporated

SCHEDULE OF EPA COST REIMBURSEMENT TYPE PRIME CONTRACTS

Contract Number

68-01-XXXX  
68-01-XXXX  
68-01-XXXX  
68-01-XXXX  
68-01-XXXX  
68-01-XXXX  
68-01-XXXX  
68-01-XXXX  
68-02-XXXX  
68-02-XXXX  
68-03-XXXX  
68-03-XXXX  
68-03-XXXX  
68-03-XXXX  
68-03-XXXX  
68-03-XXXX



## VII. FEE/PROFIT ANALYSIS TECHNIQUES

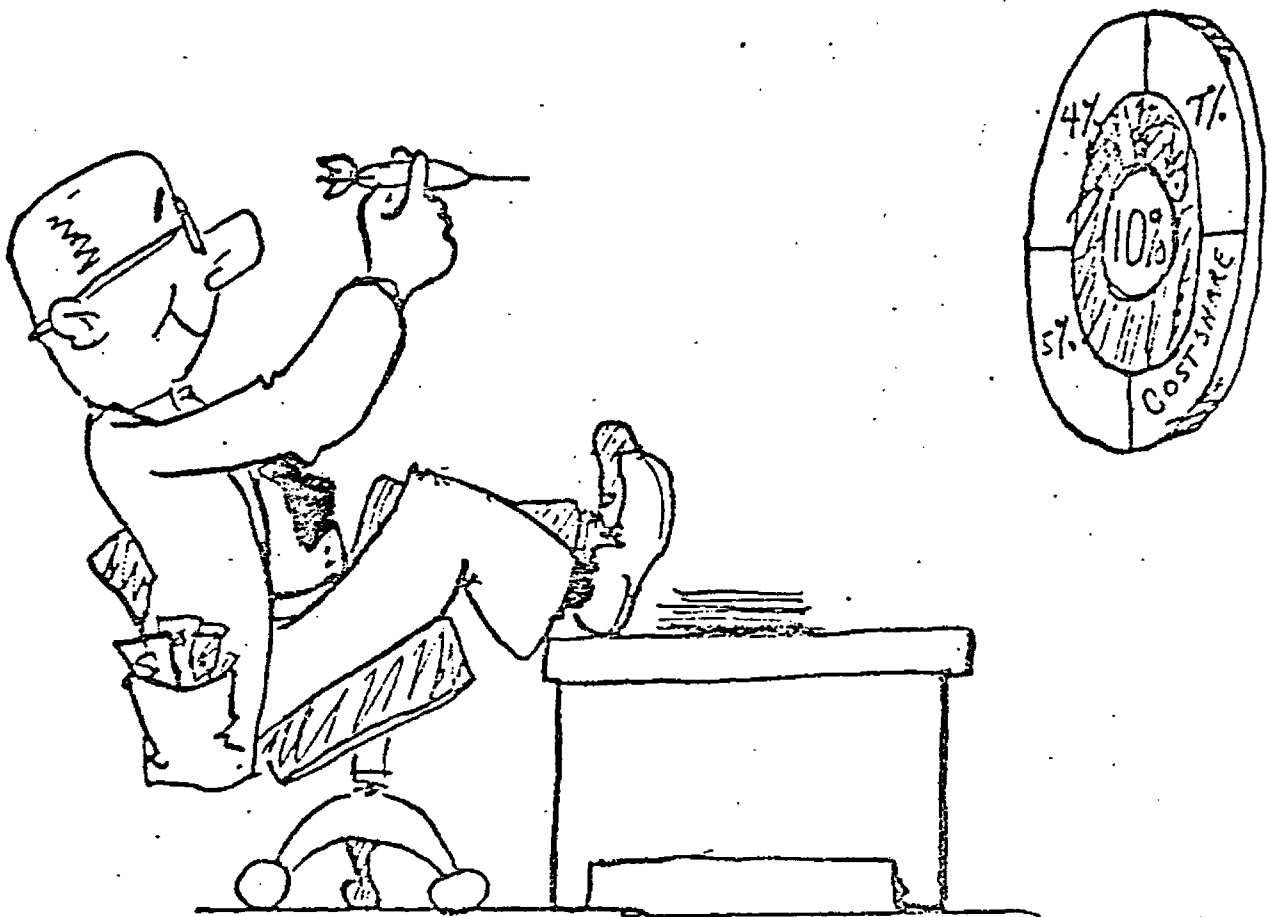
1. Definition
2. EPA Policy
3. Limitations
4. Profit Objective Guidelines
5. Subcontractor Fee/Profit
6. EPA Form

## VII. Fee/Profit Analysis Techniques

The FAR defines profit or fee as an element of the potential remuneration that contractors may receive for contract performance over and above allowable costs.

Profit serves the function of being [FAR 15.901]...

- a potential financial reward
- a stimulant for efficient contract performance
- an attractor of best capabilities



What is EPA's policy on fee/profit determination?

EPA policy elaborates on the fee profit factor...

[EPAAR 1515.970-1] It is the policy of the Agency to utilize profit to attract contractors who possess talents and skills necessary to the accomplishment of the objectives of the EPA, and to stimulate efficient contract performance. In negotiating profit or fee, it is necessary that all relative factors be considered, and that fair and reasonable amounts be negotiated which give the contractor a profit objective commensurate with the nature of the work to be done, the contractor's input to the total performance, and the risk assumed by the contractor.

[EPAAR 1515.902] Agencies are required to use the structured approach for determining the profit or fee objective in those acquisitions that require cost analysis.

The purpose of the structured approach is:

- (1) To provide a standard method of evaluation;
- (2) To ensure consideration of all relevant factors;
- (3) To provide a basis for documentation and explanation of the profit negotiation objective;
- (4) To allow contractors to earn profits commensurate with the assumption of risk;
- (5) To reward contractors who provide their own facilities, financing and personnel; and
- (6) To reward contractors who undertake more difficult work requiring higher risks.

[EPAAR 1515.9-2] Contracting Officers may use other methods than the structured approach for establishing profit/fee objectives under the following circumstances:

- (1) Architect-engineering contracts;
- (2) Personal or professional service contracts;
- (3) Management contracts, e.g., for maintenance or operation of Government facilities;
- (4) Termination settlements;
- (5) Engineering services, labor-hour, time and materials contracts which provide for payment on a man-hour, man-day, or man-month basis, and where the contribution by the contractor constitutes the furnishing of personnel rather than the output of an integrated research, engineering, or manufacturing operation;
- (6) Construction contracts; and
- (7) Cost-plus-award-fee contracts.

Are There Any Limitations on the Amount of Fee/Profit That Can Be Negotiated?

[FAR 15.903(d)(1)] The contracting officer shall not negotiate a price or fee/profit that exceeds the following statutory limitations imposed by 10 U.S.C. 2306(d) 41 U.S.C. 254(b).

- (1) For experimental, developmental, or research work performed under a cost-plus-fixed-fee contract, the fee shall not exceed 15 percent of the contract's estimated cost, excluding fee.
- (2) For architect-engineering services for public works or utilities, the contract price or the estimated cost and fee for production and delivery of designs, plans, drawings, and specifications shall not exceed 6 percent of the estimated cost of construction of the public work or utility, excluding fees.
- (3) For other cost-plus-fixed-fee contracts, the fee shall not exceed 10 percent of the contract's estimated cost, excluding fee.

The limitations above shall apply also to the maximum fees on cost-plus-incentive-fee and cost-plus-award-fee contracts. However, the maximum-fee limitation for a specific cost-plus-incentive-fee or cost-plus-award-fee contract may be waived in accordance with Subpart 1.4.

THE THREE MAJOR SEGMENTS OF PROFIT GUIDELINES ARE:

- I. COST INPUT TO TOTAL PERFORMANCE  
("Above the line" elements of cost)
- II. ASSUMPTION OF CONTRACT COST RISK  
(Type of contract and related risk factors)
- III. RECORD OF PERFORMANCE

## PROFIT OBJECTIVE GUIDELINES

### I. CONTRACTOR'S INPUT TO TOTAL PERFORMANCE:

Direct Materials	
Purchases	1% to 4%
Subcontracts	1% to 5%
Equipment	1% to 2%
Engineering Labor	8% to 15%
Engineering Overhead	6% to 9%
Manufacturing Labor	5% to 9%
Manufacturing Overhead	4% to 7%
Consultants	2% to 5%
Other Direct Costs	1% to 3%
G&A Expenses	5% to 8%

### II. CONTRACTOR'S ASSUMPTION OF CONTRACT COST RISK 0% to 6%

### III. RECORD OF CONTRACTOR'S PERFORMANCE: -2% to +2%

Cost efficiency  
Management  
Extent of contractor investment  
Reliability of cost estimates  
Inventive and developmental contributions  
Timely performance  
Small business participation  
Labor surplus area participation  
Extent of Government assistance  
Effect of competition

#### SELECTED FACTORS:

Source of resources  
Special technical achievement  
Extraordinary delivery schedule  
Competition  
Extent of Government assistance  
Extent of contractor's investment  
Character of the contractor's business  
Subcontracting

What Considerations are there for each major profit segment?

In evaluating the contractor's input to total performance, you should consider the elements addressed in each major segment area as discussed in detail in EPAAR 1515.970-2.

I. Cost Input to Total Performance

In assigning specific weights to each element of cost, consideration should be given to:

- o the assumption of risk should be commensurate with the amount of profit;
- o the degree of the contribution of the contractor's own facilities, financing and personnel; and
- o the difficulty of the work undertaken.

(1) Direct Materials (Purchased parts, subcontracted items and other materials)

- (a) The amount of managerial and technical effort required to obtain the materials;
- (b) Whether this requires new source development or existing source availability;
- (c) How much managerial/technical expertise is needed to administer subcontracts.

(2) Equipment

- (a) Refers to producing a test equipment, not end product.
- (b) The assignment of weights should reflect whether equipment is contractor furnished or government furnished.

(3) Labor

- (a) Consideration should be given to the quality and level of expertise and experience of the contractor's labor as a whole
- (b) Consideration should also be given to the amount of notable scientific talent.
- (c) Remember that the manufacturing labor includes all non-professional, secretaries, technicians and carpenters.

(4) Overhead

- (a) Evaluation should reflect the relationship of the items in the overhead pool to the contract performance; the closer the relationship, the greater the weight.
- (b) The contractor's accounting system does not have to correspond to the fee/profit guideline classification. When practicable, the Contracting Officer should break out the applicable sections of the indirect rate(s) which could be classified as engineering overhead, manufacturing overhead, and G&A expenses and follow the appropriate evaluation technique.

- (c) Once the fee/profit factors have been assigned for a particular contractor, the weight assigned may be used for future procurements with the same contractor until there is a change in the cost composition of the overhead pool or the contract performance.

(5) Consultants

- (a) The assignments of weights should reflect the talent and skill of the consultant.
- (b) The assignment of weights should also reflect whether the consultant is substituting for in-house personnel or whether there is a true contribution of expertise.

(6) Other Direct Cost

- (a) The analysis of these costs should be performed in a similar manner as direct materials.

## II. Contractor's Assumption of Cost Risk

- (1) Must consider the degree of cost responsibility the contractor is assuming.
- (2) Must consider the reliability of the cost estimates in relationship to the task assumed.
- (3) Must consider the chance of risk or failure.

The Government's intention is to shift the burden of risk as much as possible to the contractor and then compensate the contractor for that risk.

Therefore, consider that for a best efforts CPFF contract would be assigned 0. As risk is assured, the factor increases.

### III. Record of Contract Performance

- (1) The purpose of the fee/profit factor is to reward or penalize for past performance and in consideration of this the contractor would be motivated to improve his/her performance.
- (2) The assignment of this factor is judgmental.
- (3) A satisfactory rating merits a 0 weight.
- (4) The factors in arriving at a performance weight include:
  - cost efficiency
  - management
  - extent of the contractor's investment
  - reliability of cost estimates
  - inventive and developmental contributions
  - timely performance
  - small business participation
  - labor surplus, area participation
  - extent of government assistance

What are the factors to consider for the evaluation of subcontractor fee/profit?

When evaluating the fee or profit proposed by the subcontractor, remember that the proposed subcontractor's fee is an element of cost to the prime contractor and should be evaluated as such.

In evaluating the subcontractor's fee, remember

- ° the subcontractor's fee is an element of cost to the prime contractor and the Federal Government;
- ° the assignment of weight should reflect how much technical effort the subcontractor is contributing to the contract;
- ° the assignment of weight should reflect the nature of the subcontractor's contribution, i.e., labor, materials, etc.

What required forms are there for the profit determination process?

[EPAAR 1515.970-2] Contracting Officers should use EPA Form 1900-2, Profit/Fee Objectives, in their determination of a reasonable profit/fee.

# PROFIT/FEE OBJECTIVES

1. RFP OR CONTRACT NO.		2. CONTRACTOR			
3. COST INPUT TO TOTAL PERFORMANCE					
COST CATEGORY		GOVERNMENT'S COST OBJECTIVE (a)	WEIGHT RANGE (b)	ASSIGNED WEIGHT (c)	WEIGHTED PROFIT/FEE (Col. (a) x (c)) (d)
DIRECT MATERIALS	PURCHASES	\$	1% to 4%	%	\$
	SUBCONTRACTS		1% to 5%	%	
EQUIPMENT			1% to 2%	%	
ENG.	DIRECT LABOR		8% to 15%	%	
	OVERHEAD		6% to 9%	%	
MFG.	DIRECT LABOR		5% to 9%	%	
	OVERHEAD		4% to 7%	%	
CONSULTANTS			2% to 5%	%	
OTHER DIRECT COSTS			1% to 3%	%	
				%	
				%	
				%	
GENERAL AND ADMINISTRATIVE			5% to 8%	%	
TOTAL		\$			\$
4. COMPOSITE PROFIT/FEE ON COST INPUT TO TOTAL PERFORMANCE (Col. (d) + Col. (a))					PROFIT/FEE OBJECTIVE
5. COST RISK			0 to 6%		%
6. PERFORMANCE			-2 to +2%		%
7. SELECTED FACTORS					%
TOTAL PROFIT/FEE OBJECTIVES (Lines 4 thru 7)					%
REMARKS					
PREPARED BY (Name and Title)			SIGNATURE		DATE

REMEMBER

1. PROFIT/FEE IS AN AMOUNT, NOT A PERCENTAGE
  - Cost plus a percentage of cost is prohibited as a pricing arrangement.
2. Profit/fee determinations do not include any proposed amount for cost of money.
  - After the amount has been determined for profit/fee, it is reduced by the amount of allowable facilities capital cost of money proposed.



VIII. FACILITIES CAPITAL COST OF MONEY

1. Definition
2. Computation
3. History
4. EPA's Current Position
5. Contract Clauses
6. CPAF Contracts



## VIII. FACILITIES CAPITAL COST OF MONEY

### What is Cost of Money (COM)?

- ° COM is an imputed cost, not an incurred cost, determined by applying a COM rate to facilities capital employed in contract performance.
- ° COM is a cost allowed by the cost principles. We use CAS 414 for guidance and the form on how to compute the cost of money.
- ° The COM rate is computed, negotiated, and applied like an indirect cost rate. The COM will appear as an element of cost in the contractor's proposal.

How is COM computed?

Below is the form for computing cost of money.\*

FORM 4430-CMF

### FACILITIES CAPITAL COST OF MONEY FACTORS COMPUTATION

CONTRACTOR:		ADDRESS:					
BUSINESS UNIT:							
COST ACCOUNTING PERIOD:	1. APPLICABLE COST OF MONEY RATE _____ %	2. ACCUMULATION & DIRECT DISTRIBUTION OF R.S.V.	3. ALLOCATION OF UNDISTRIBUTED	4. TOTAL NET BOOK VALUE	5. COST OF MONEY FOR THE COST ACCOUNTING PERIOD	6. ALLOCATION BASE FOR THE PERIOD	7. FACILITIES CAPITAL COST OF MONEY FACTORS
BUSINESS UNIT FACILITIES CAPITAL	RECORDED		BASE OF ALLOCATION	COLUMNS 3 + 3	COLUMNS 12a	IN UNITS OF MEASURE	COLUMNS 8 + 8
	LEASED PROPERTY						
	CORPORATE OR GROUP						
	TOTAL						
	UNDISTRIBUTED						
	DISTRIBUTED						
OVERHEAD POOLS							
G&A EXPENSE POOLS							
TOTAL						////////	////////

\*(Found in CAS 414)

The steps in the form above translate to:

Net Book Value of of Tangible Capital Assets	x	U.S. Treasury P.L. 92-41 Rate	=	an Allocation Base	A rate applied like an indirect cost rate
--	---	-------------------------------------	---	--------------------------	---

Net Book Value of Tangible Capital Assets is the value of the contractor's tangible assets less the depreciated value.

U.S. Treasury PL 92-41 Rate is that rate which is set by the Secretary of the Treasury.

The Allocation Base is any base which is appropriate. This investment base shall be determined from the accounting data used for contract cost purposes.

What is the background of CAS 414 as it pertains to EPA?

Standard 414 was issued by the Board effective October, 1976. GSA added 414 to the FPR effective October, 1976. However, GSA also issued Temporary Regulation 40 effective the same date granting agencies the option whether to recognize COM as an allowable cost.

EPA elected not to recognize COM, and withdrew applicability of CAS 414.

In December of 1980, OFPP issued a policy letter (80-7) providing recognition of COM but with a fee offset. This policy letter is the basis for today's option to offset COM against profit or fee. The policy letter by OFPP states.....

"Agencies shall ensure that contractors are not compensated for facilities capital cost of money both as a direct or indirect cost and in profit or fee. Before the allowability of facilities capital cost of money, this cost was included in profits or fees. Therefore, profit and fee prenegotiation objectives shall be reduced if necessary to reflect this refinement in cost accounting practices. This reduction may be accomplished by means of offsets; that is, by (i) using a dollar-for-dollar offset in the Government's prenegotiation profit or fee objectives or (ii) incorporating a common offset factor under an agency's structured approach."

In May of 1981, GSA issued Temporary Regulation 61 incorporating the OFPP policy into FPR and later amended FPR codifying the temporary regulation. This took away the option of whether to recognize COM or not, but gave EPA the right to offset any claimed COM against fee or profit.

What is EPA's current position on COM?

- (1) COM is an offset to profit.
- (2) The contracting officer is responsible for assuring that the proper notices are put into the solicitation package and that the proper clause is included in the contract.
- (3) Every contractor is eligible to claim COM whether the contract is subject to CAS or not. Cost of Money is allowable under the cost principles.
- (4) How the contractor responds determines whether the COM waiver clause goes in the contract or not. It is the contracting officer's responsibility to assure that the proper notices are in the solicitation package and that the proper clause is included in the contract.
  - If the contractor does not propose Capital Cost of Money, FAR clause 52.215-31 which waives the right to claim COM should be inserted in the contract.
  - If the contractor requests COM, then the contracting officer's responsibility is to not include the COM waiver clause but to use the amount of COM proposed as an offset to profit.
  - The cost analysis report will inform the contracting officer of whether COM has/has not been proposed.

What is the proper clause under FAR and how does it differ from the FPR?

Following are the COM clauses under both the FAR and FPR:

Solicitation Notice - [FPR 1-3.808-5]

Facilities Capital Cost of Money

Facilities capital cost of money (see FPR §1-15.205-51(a)) will be an allowable cost under the contemplated contract but only if the contractor specifically identifies or proposes it in the cost proposal for the contract and elects to claim this cost by checking the appropriate box below. If the contractor does not specifically identify or propose facilities capital cost of money and does not elect to claim this cost, the contract will include the Waiver of Facilities Capital Cost of Money clause.

- ☐/ The prospective contractor has specifically identified or proposed facilities capital cost of money in its cost proposal and elects to claim this cost as an allowable cost under the contract.
- ☐/ The prospective contractor has not specifically identified or proposed facilities capital cost of money in its cost proposal and elects not to claim this cost as an allowable cost under the contract.

Waiver of Facilities Capital Cost of Money - FPR

The contractor is aware that facilities capital cost of money is an allowable cost but waives the right to claim it under this contract.

(End of clause)

Solicitation Notice - [FAR 52.215-30]

Facilities Capital Cost of Money

(a) Facilities capital cost of money will be an allowable cost under the contemplated contract, but only if the prospective contractor elects to claim it below. If the prospective contractor elects to claim this cost, the Waiver of Facilities Capital Cost of Money will be excluded from the contract. If the prospective contractor does not elect to claim this cost, the contract will include the Waiver of Facilities Capital Cost of Money.

(b) By including an item of proposed allowable cost in response to the solicitation, the prospective contractor will be deemed to have elected to claim facilities capital cost of money.

(End of clause)

Waiver of Facilities Capital Cost of Money - [FAR 52.215-31]

If the contractor did not include facilities capital cost of money as a proposed allowable cost, it shall be deemed that the contractor waived the right to claim it under this contract.

(End of clause)

As was mentioned earlier, any claim by the contractor for FCCOM is offset against fee or profit. EPAAR 1515.970-2 evaluates further:

[EPAAR 1515.970-2] EPA Structured System

(a)(1) Profit Factors. The factors set forth below and the weighted ranges listed after each factor shall be used in all instances where the profit is to be specifically negotiated.

(2) The Contracting Officer shall first measure the "Contractor's Input to Total Performance" by the assignment of a profit percentage within the designated weight ranges to each element of contract cost recognized by the Contracting Officer. Such costs are multiplied by the specific percentages to arrive at specific dollar profits. The amount calculated for facilities capital cost of money shall not be included as part of the cost base for computation of profit or fee. A complete discussion of how facilities capital cost of money is determined and how it is applied and administered is set forth in FAR 31.205-10.

(3) After computing a total dollar profit for the Contractor's Input to Total Performance, the Contracting Officer shall calculate the specific profit dollars assigned for cost risk and performance. This is accomplished by multiplying the total Government cost objective, exclusive of any facilities capital cost of money, by the specific weight assigned to cost risk and performance. The Contracting Officer shall then determine the profit or fee objective by adding the total profit dollars for the Contractor's Input to Total Performance to the specific dollar profits assigned to cost risk and performance. The profit of fee objective shall then be reduced by an amount equal to the amount of facilities capital cost of money allowed. EPA Form 1900-2 shall be used to facilitate the calculation of this profit or fee objective.

How is the offset determined on a CPAF contract?

The proposed revision to EPAAR 1515.903, Contracting Officer Responsibilities, reads as follows:

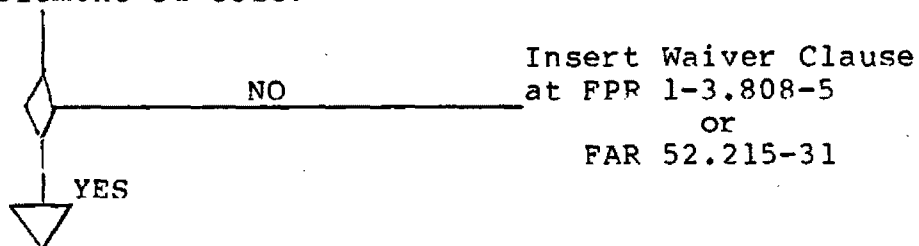
"(b) When facilities capital cost of money is included as an item of cost in the Contractor's proposal, the Contracting Officer shall reduce the profit or fee objective by an amount equal to the amount of facilities capital cost of money allowed. For cost-plus-award-fee contracts, the Contracting Officer will make the reduction in the combined base and award pool amount."

When final rule on the revision is published, the Cost Analysis Guide will be revised to incorporate the complete revision to EPAAR 1515.903.

In summary, when cost of money is proposed, your decision will be based on the following:

Facilities Capital Cost of Money

Is Cost of Money proposed  
as an element of cost?



1. Do not use waiver clause
2. Determine amount proposed
3. Offset COM proposed dollar-for-dollar against profit in making Weighted Guidelines computation

## IX. FAIR AND REASONABLE

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 allocable credits, plus any allocable cost of money pursuant to 31.205-10. [FAR 31.201-1]

A cost is considered allowable if it:

- (1) Is reasonable
- (2) Is allocable
- (3) Meets the standards of generally accepted accounting principles and practices
- (4) Is within the terms of the contract
- (5) Is within the limitations of FAR Part 31

Of the conditions set forth above, reasonableness has the broadest range of interpretation and it is this topic which will be discussed in this section.

Under the "general" cost principle for reasonableness [FAR 31-201-3], the following is given as an overall definition of "reasonableness":

"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. Reasonableness of specific costs must be examined with particular care in connection with firms or their separate divisions that may not be subject to effective competitive restraints. What is reasonable depends upon a variety of considerations and circumstances involving both the nature and amount of the cost in question. In determining the reasonableness of a specific cost, the contracting officer shall consider:

- (a) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance;
- (b) The restraints or requirements imposed by such factors as generally accepted sound business practices, arm's-length bargaining, Federal and State laws and regulations, and contract terms and specifications;
- (c) The action that a prudent business person, considering responsibilities to the owners of the business, employees, customers, the Government, and the public at large, would take under the circumstances; and
- (d) Any significant deviations from the established practices of the contractor that may unjustifiably increase the contract costs.

The above quotation does not clearly define the criteria for cost allowability based on reasonableness. What it does indicate is that the nature and the amount must both be considered in the context of the particular circumstances surrounding the cost.

The FAR describes four areas to consider when determining reasonableness.

First, the cost principle indicates that it should be determined whether "the cost is of a type generally recognized as ordinary and necessary for the conduct of the contractor's business or the performance of the contract." 1/

Second, the cost principle dictates consideration of "restraints or requirements imposed by such factors as generally accepted sound business practices, arm's length bargaining, Federal and State laws and regulations, and contract terms and specifications...." 2/

Third, the contractor's action in incurring a cost is to be compared with "the action that a prudent businessman would take in the circumstances, considering the responsibilities to the owners of the business, the employees, the customers, the Government and the public at large...." 3/

Fourth, the cost principle directs the consideration of significant "deviations from the established practices of the contractor which may unjustifiably increase the contract costs..." 4/

---

1/ FAR 31.201-3(a)

2/ FAR 31.201-3(b)

3/ FAR 31.201-3(c)

4/ FAR 31.201-3(d)

What factors should be considered in assessing the nature of a cost?

- o Examine whether there was a valid basis for incurring the cost to obtain the desired end.
  - normal business objectives alone are not a sufficient basis
- o Examine whether the cost is within Government contract policies (i.e., cost principles).

What factors should be considered in assessing a reasonable amount?

- o Assess whether the benefit derived from the cost is commensurate with the amount expended by comparing
  - the costs of other contractors in the industry
  - the cost of other contractors in the same geographical area
  - the contractor's cost in prior years
  - the costs of other vendors of the same product or service.
- o When comparing a particular cost, make sure the comparison is VALID.
- o When challenging the reasonableness of an amount of the contractor's cost, the Government cannot rely upon an abstract number or percentage, but must demonstrate in what way the cost is excessive.

IX. FAIR AND REASONABLE

1. Definition
2. Main Factors to Consider
3. Other Considerations



ABSCA 12292, 10 G.C. #424, 68-2 BCA #7081 Stanley Aviation Corporation illustrates this point:

"The contractor's actual overhead rate far exceeded its estimated rate and the Government challenged the contractor's overhead cost as unreasonable. The ASBCA rejected the Government's position because no showing had been made that the particular cost items were excessive. The Board enunciated its understanding of how the reasonableness of amounts was to be judged as follows:

'The proper way for applying the standard of reasonableness to [contractor's] overhead costs is to examine them on an item by item basis and exclude from the allowable overhead pools the specific overhead cost items or parts of items found to be unreasonable under the prevailing circumstances. The Government has not cited a single cost item in the overhead pools as having been incurred unnecessarily or in a larger amount than was necessary under the circumstances....

The Government argues that overhead costs actually incurred can be disallowed under a cost reimbursement contract on the grounds of over-all reasonableness, even though each and every action and decision taken by the contractor concerning its business was reasonable and prudent, and it says that the over-all reasonableness of overhead costs cannot be tested in terms of what steps the contractor could have taken to avoid the cost, but it cites no authority, legal or accounting, for this proposition. The Government seems to argue that, even though [contractor's] overhead costs went down some 82%, they are still unreasonably high, simply because contractor's direct costs went down much more than 82%, with the result that the ratio of indirect costs to direct costs increased greatly. We have not been referred to any provision of the contract or of the cost principles incorporated therein which provides for disallowance of costs on the ground of over-all unreasonableness when it cannot be shown that any single item of cost was unreasonably incurred or incurred in an unreasonable amount.'

It is recognized that the amount of an expense will vary as circumstances change. Usually high costs may be necessary where urgency is present or where no alternative sources are available. Indeed, there are innumerable events and conditions which could justify the expenditure of greater amounts. Accordingly, any examination of the reasonableness of the amount of a cost must examine the particular circumstances that prevailed. Absent that examination, there is little basis for questioning the reasonableness of amounts that were expended." 1/

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1/ Melvin Rishe, Government Contract Costs (Washington DC:Federal Publications, Inc., First Ed. 1984), p. 10-7.

What other considerations are there in determining a fair and reasonable amount?

- o When contractors incur an ordinary and necessary business cost, the Government generally has the burden of demonstrating why the cost is not reasonable. Moreover, if a cost is ordinary and necessary, the Government is generally on notice of the cost. The Government has some responsibility to challenge a cost before it is incurred.
- o Costs which may be attributable to mistakes and oversights can be considered reasonable as being ordinary and necessary business costs. The rationale being that some mistakes in business are unanticipated or unavoidable, and to disallow such costs would unjustly punish a contractor. (See General Dynamics Corp., ABSCA 5166, et. al., 2 G.C. ¶247, 60-1 BCA ¶2556)
  - obvious, frequent mistakes may be considered unreasonable
- o The existence of an established practice places the Government on notice of the cost and failure to object to the cost's incurrence implies approval.
  - While the existence of an established cost practice does not ensure the reasonableness of a cost, and the absence of an established practice does not indicate a cost's unreasonableness, where a practice does exist, contractor deviations from the practice may make the costs highly suspect. This can be seen in Aro, Inc., ASBCA 13623, et al., 69-2 BCA ¶7868. The contractor in this case had granted administrative leave to four employees to enable them to compete in a golf tournament. These costs were then claimed as employee fringe benefit costs allocable to Government contracts. It was found, however, that the contractor's administrative leave policy did not list this situation as one for which employee leave was permissible. Therefore, the costs were disallowed as having been unreasonably incurred.

- o When costs are incurred pursuant to an established practice, the reasonableness of the cost will be judged according to
  - the overall reasonableness of the practice
  - the particular circumstances attendant to the cost incurrence
- o If the Government contests reasonableness, it has the burden of proof of justifying its position.

The above is not a complete list of considerations in a fair and reasonableness determination; however, it should highlight some of the more frequent occurrences.

For further guidance on this issue, consult your cost advisory section and/or legal counsel.

## X. THE IMPORTANCE OF DOCUMENTATION

A thorough cost or price analysis is not complete without written documentation of the steps performed and the conclusions reached.

A written record provides:

- the basis for the conclusions reached  
and the basis for the prenegotiation plan
- a permanent record for future reference

THEREFORE, support your cost or price analysis conclusions with WRITTEN DOCUMENTATION to the files.

What is considered adequate documentation?

Adequate documentation tells

- o How
- o When
- o Why
- o Who

of a cost or price analysis decision.

HOW was the analysis performed?

- desk review
- assist audit
- cost analysis
- price analysis
- item by item or selected review

WHEN was the review conducted and was assistance requested?

WHY was the selected information used or not used in the analysis; and why were the decisions accepted which are the basis for the conclusions reached?

WHO was contacted as a knowledgeable source to verify information in the cost/price proposal (note: name, job title, day, time, etc.)?

Documentation is not limited to providing the answers to these questions. Documentation should include all the information necessary for someone else to understand the basis of the conclusions reached.

## XI. EPA FINANCIAL ANALYSIS SECTION

### Major Functions

- Financial Monitoring
- Contractor Purchasing System Reviews (CPRS)
- Final Audits
- Ad Hoc Contract Management Assistance
- Audit Resolution Coordination for PCMD

### Review results will lead to:

- Increased Compliance with Contract
- Improvements to Contractor Accounting and Purchasing Systems
- Basis for Improved Contract Policies and Procedures
- Timely Audit Resolution
- Final Settlement of Contract Costs
- Reduce Contract Costs
- Improved Management of EPA Contracts



## FINANCIAL MONITORING

### Contracts Greater than Five Million Dollars

Financial Monitoring is a review of contractor billings to ensure compliance with contract requirements and to ensure billed costs are adequately supported by appropriate systems and records.

We analyze the systems and contract costs incurred to date, and based on this analysis make determinations about incurred and future costs. To be eligible for review, EPA established a contract value threshold of \$5,000,000 (potential cost and fee assuming all options are exercised) for active cost price contracts. This guide is oriented towards reviews of cost-type contracts valued in excess of five million dollars.

The financial monitoring review is not an incurred cost audit. It is not the objective of this review to determine the allowability of costs incurred. An incurred cost audit will be performed based on a separate interim direct cost audit requested after completion of the financial monitoring review.

Financial monitoring reviews should be scheduled for each appropriate contract after at least 6 months of performance has been completed. Reviews should be scheduled with the objective of reviewing each contract at least once every two years of performance thereafter.



BACKGROUND DATA FOR POST AWARD AUDIT  
CONTRACT BRIEF

ASSGN. NO. \_\_\_\_\_

Contract Number: \_\_\_\_\_

RFP Number: \_\_\_\_\_

Contractor's Name/Phone #: \_\_\_\_\_

Contractor's Address: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Contractor's Contact: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Contract Adm./Specialist:  
(Include Phone Nos.) \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Program Mgr.'s Name & No.: \_\_\_\_\_

Proj. Officer's Name & No.: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Contracting Off.'s Name & No: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Performance Period:

Eff. Date of Contract: \_\_\_\_\_

Basic Contract: \_\_\_\_\_

Options: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Type of Contract: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

of CAS Coverage:

(a) Full or Modified

(b) N/A. Small Bus. Concern

BACKGROUND DATA FOR POST AWARD AUDIT  
CONTRACT BRIEF

Contract Amount w/mods.:

Base Amount: \_\_\_\_\_

Option Amounts: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Total Contract: \_\_\_\_\_

Type of Services:

Other Pertinent Contract Terms

(1) Any Pre-Contract Costs Allowed? Advanced Agreements?

(2) Any Related Party Affiliations?

(3) Did the Prime Contractor certify to Cost or Pricing Data?

(4) Any special Public Voucher terms?

II. SUBCONTRACTORS:

Subcontractor(s) Required to

Provide  
Certificate  
of Current

Approved/Authorized  
Subcontractors

Participation  
\$ Amount    %

Submit  
Progress Reports

Cost or Pricing  
Data to Prime

Applicable Contract Clause

(1) Subcontracts: \_\_\_\_\_  
\_\_\_\_\_

BACKGROUND DATA FOR POST AWARD AUDIT  
CONTRACT BRIEF

Applicable Contract Clause

(1) Indirect Costs:

(3) Direct Labor:

(a) LOE

(b) Key Personnel

(c)

(d)

(4) Other Direct Costs:

(a) Consultants

(b) Overtime

(c) Equipment

(d) Printing

(e) Travel

(f)

(g)

Applicable Contract Clause

(8) Other Items:

OUTLINE FOR PRE-REVIEW DISCUSSION WITH THE CO/PO

FINANCIAL MONITORING REVIEW

CONTRACTOR \_\_\_\_\_

CONTRACT NUMBER \_\_\_\_\_

PURPOSE OF REVIEW: A Financial Monitoring Review of contracts over \$5 million to determine if the contractor is billing actual costs incurred IAW the contract specifications.

PRELIMINARY STEPS

1. Inform the contractor of our review
2. Prepare and engagement letter
3. Hold and entrance conference with
  - i. EPA Contracts Personnel
  - ii. Subject Contractor

AUDIT STEPS

1. Review contract files
  - i. Contract
  - ii. Modifications
  - iii. Summary of Negotiations
  - iv. BAFO
  - v. Technical Evaluation
  - vi. Pre-award Cost Advisory Reports
2. Review Monthly Reports
  - i. Financial Management
  - ii. Progress Reports
  - iii. Current Status
3. Review of Internal Controls
4. Review and Analyze the Billing System
5. Review Direct Costs
  - i. Direct Labor
  - ii. Subcontract Costs
  - iii. Other Direct Costs
6. Review Indirect Costs
  - i. Trace Pool and Base Costs to Books
  - ii. Verify ceiling, if applicable
7. Review Contractor's Management of the Contract
  - i. Evaluate variances between Budget vs. Actual
  - ii. Cost-to-Complete Estimates
8. Summarize results of our review
  - i. Summarize workpapers
  - ii. Summary of Findings and recommend improvements to contract financial progress
  - iii. Hold exit conference
    - a. With the Contractor
    - b. With EPA Contract Personnel
9. Review and Approval of Draft Audit Report by Section Chief
10. Submit Audit Report to Contracting Officer



MAY 17 1980

LEGEND

\* - PRIORITY REVIEW  
E - ERCS only  
A - ARCS only

\_\_\_\_\_  
Signature and Date  
SECTION CHIEF APPROVAL

ENVIRONMENTAL PROTECTION AGENCY  
FINANCIAL ANALYSIS SECTION  
FINANCIAL MONITORING REVIEW PROGRAM

CONTRACTOR NAME \_\_\_\_\_

CONTRACT # \_\_\_\_\_

CONTRACT PROGRAM (ARCS, ERCS, TES and etc.) \_\_\_\_\_

AUDIT ASSIGNMENT # \_\_\_\_\_

AUDITOR(S) \_\_\_\_\_

AUDIT OBJECTIVES

- I. Review the Contract File including specific contract terms, prepare a contract brief, preaward notes, technical and BAFO proposal.
- II. Perform Preliminary Review Steps by reviewing the monthly progress reports, financial management reports and the contractor's financial statements. Determine if the contractor had or will have a CFSR and a Property/Equipment Compliance Review.
- III. Review contractors internal controls to determine the amount of substantive testing necessary to render an opinion on the billing system.
- IV. Review of Billing and Accounting Systems.
  - A. Review contractors billing system to determine if public vouchers are accurate, complete and timely as required by the contract.
  - B. Review contractors cost accounting system to determine if it is sufficient to accurately segregate, accumulate and report the contractor's actual costs incurred.
- V. Review direct costs charged to the contract to determine if they are allowable, allocable, and reasonable. (i.e. labor, subs and ODC's)
- VI. Review indirect costs to determine if they are properly allocated to the contract (i.e. Overhead and G&A)
- VII. Review the contractor's management of the contract.
  - A. Review established reports (monthly progress reports, public vouchers, etc.) to determine if they adequately provide all data relevant to the review of financial progress under the contract.
  - B. Review contractor's cost-to complete estimates
  - C. Review cost-to-complete estimate analysis of remaining work to be performed and determine how uncommitted costs and remaining labor hours are monitored.
  - D. Evaluate variances between budget and actual performance.
  - E. Ensure the contractor has adequate written policies and procedures to assure reasonably accurate estimates of costs at completion.

- VIII. Summarize results and recommend improvements to contract financial progress.
- IX. Draft and Issue the financial monitoring report.
- X. Draft specific requests for an interim audit.
- XI. Plan for Follow-Up review.
- XII. Follow-up response to advisory report.

I. Background Review

1. Review Contract Files

- a. Name of Contractor
- b. Address of contractor
- c. Telephone No. and Person of Contract
- d. Type of Contract
- e. Contract Term and Option Period (s)
- f. Contractor's CAS coverage
- g. Is contractor a small business
- h. Determine if contractor certified to cost or pricing data

2. Review the Preaward Audit Reports

- a. Cost Advisory Reports
  - b. DCAA Audit Reports
- Review the Preaward Audit and Cost Advisory Reports to determine if the contractor's accounting system is adequate and the system is reliable.

3. Review the BAFO

4. Review the Technical Evaluation

5. Review the Summary of Negotiations

6. Review the Award/Contract

Review for specific and/or pertinent clauses that may have a significant impact on the contract.

7. Prepare a summary of the contract modifications

\* 8. Determine if there are pre-contract costs and if so, if there is an advance agreement

9. For MODS with Cost Impacts such as Novation Agreements, Indirect Cost Changes, Reorganizations, Accounting System Changes, Pre-Contract Costs, etc., verify whether:

- A. The contractor provided adequate cost impact analysis
- B. There was timely negotiation before costs were actually incurred

10. Discuss the contract with the Project Officer (those aspects for which he/she is responsible)
  - a. Obtain any ideas or issues of concern to him/her and add audit steps as necessary.
  - b. Discuss prior auditor's findings with comments on how they may best be resolved
  - c. Discuss budget, monthly progress report, financial status report, estimates to complete suspensions and/or disallowances, transfers or deobligations and transfers
11. Obtain a Dun & Bradstreet Report. Identify and evaluate all related party affiliations.
12. Obtain copies of cognizant auditor's (DCAA, DHHS, DOE, etc.) reports on areas such as:
  - a. Accounting System Reviews
  - b. Estimating System Reviews
  - c. Procurement System Reviews
  - d. Cost Accounting System (CAS) Compliance Reviews
  - e. Floorchecks (Time Reporting Reviews)
  - f. Final and Interim cost audits
13. Review EPA files/discuss with specialist other relevant issues including:
  - a. Previous Financial Monitoring Reports
  - b. Indirect Cost Rate Agreements
  - c. CPSR Reviews
  - d. Property Reviews
  - e. Conflict of Interest Reviews
14. Send engagement letter requesting information from the contractor
15. Hold Entrance conference with the Contracting Officer and Contract Specialist.  
Obtain a list of their concerns and add audit steps as necessary.

## II. Preliminary Review Steps

1. Review the following reports:
  - a. Monthly Reports
  - b. Quarterly Reports
  - c. Interim Reports
  - d. Financial/Contract Management Reports
  - e. Individual Work Assignment/Delivery Order Status Reports
  - f. Actual Costs Incurred on Contract compared to Budgeted Costs
  - g. Executive Summary Report
  - h. Regional Summary Report
2. Determine if the contractor had or will have a Contract Purchasing System Review by EPA or DCAA; determine if approved.
3. Determine if the Contractor had or will have a Property/Equipment Compliance Review and obtain copy of most recent report
4. Review Prior Financial Monitoring Reports
5. Discuss contractor issues with Financial Administrative Contracting Officer (FACO).
6. Be aware of evidence of Conflict of Interest
  - A. Review list of all clients
  - B. Determine if the contractor is working for several customers simultaneously
  - C. Review Dun & Bradstreet Reports for affiliates.
7. Prepare the Audit Program based on Preliminary review to highlight significant review areas and steps planned.
8. Obtain Section Chief approval of audit review program.

III. Review of Internal Controls

- \* 1. Obtain a copy of most recent Certified Financial Statements:
  - a. Review CPA's opinion.
  - b. Alert C.O. to adverse changes in contractor's financial position.
  - c. Determine if CPA commented on internal controls.
- \* 2. Review EPA and DCAA audit reports to determine what reliance can be placed on the contractor's internal controls.
- 3. Determine if the contractor has established procedures to safeguard its assets, and check the accuracy and reliability of its accounting data.
- 4. Review contractor's written policies and procedures
  - A. Timekeeping
  - B. Travel
  - C. Subcontracting
- 5. Review pertinent Internal Audit Reports

\* IV. Review of Billing and Accounting System

1. Compare bills to contract terms/conditions
  - a. Determine if bills exceed any Contract Ceilings (i.e. Labor rates, ODC's, Overhead, G&A and Fees)
  - b. Determine compliance with Multiple appropriation/account requirements
  - c. Determine if Compliance with invoicing provisions
2. Obtain copies of contractor's bills (Public Vouchers)
  - a. Summarize all bills by cost element
  - b. Determine how frequently bills are submitted
  - c. Determine if fees are charged at contractual rates and applied to correct cost base
3. Trace billings to contractor's accounting records
4. Determine if Contractor's accounting system is sufficient to accumulate, segregate and report the contractor's actual costs incurred for the contract in total as well as by WA or DO
5. Review Journal Entries to determine if cost is being transferred between contracts, work assignments, delivery orders, etc. If so, determine why?
6. Determine what procedures are used to monitor when 75% of the contract ceiling has been reached.
7. Determine if there is an established system to correctly accumulate and bill site specific costs in accordance with contract requirements.

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\* IV. Review of Billing and Accounting System  
(continued)

- 
8. Determine if costs are being charged to the correct W/A or D/O
- A. Check for authorization of expenditures billed and proof in file
  - B. Review system to determine capability of identifying charges by W/A or D/O
  - C. Review the actual start date of charges to WAs or D/Os compared to Effective dates per contract
- 
9. Determine (from Billings, P.O. Comments, or Questions to Contractor) whether there is or whether there has been a history of suspended or disallowed billings and current status.
- 
10. Compare billed costs to estimated contract costs to determine
- a. Whether there may be excess funds that could be deobligated or transferred from one cost element to another
  - b. Whether the contractor has or may overrun the contract
  - c. Compute dollar values

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V. Review of Direct Contract Costs.

A. Review of Labor Charges.

1. Obtain and review copy of contractor's written time reporting policy.
2. Is the time reporting function separated from the personnel and payroll functions?
  - a. Who fills out the time sheet?
  - b. Who signs the time sheet?
  - c. Who approves time charged?
  - d. Does time sheet contain the detail necessary to allocate the labor costs to a contract, a work site, and multiple appropriations accounts.
3. For several months of bills, trace all direct labor costs to payroll records and time sheets.
  - a. Determine if labor charges are properly supported.
  - b. Determine if all labor charges are allowable, allocable, and reasonable.
  - c. Determine if the labor charges were for work performed on the contract.
  - d. Determine if labor categories were cross charged (i.e. clean-up tech as a chemist).
  - e. Determine if cross charging has any dollar impact on the contract.
  - f. Verify that employees charged meet educational and experience requirements for categories charged.
4. Compare time records to key personnel clause in contract. Make sure key personnel are being used to perform as required by contract.
5. Review overtime charges to determine if they are allowable under the contract
  - a. Determine contractor's written policy for authorizing overtime

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## V. Review of Direct Contract Costs

### A. Review of Labor Charges (continued)

- \_\_\_\_\_
5. b. Determine if the overtime charged on the sample of time sheets was properly authorized.
- c. Determine whether unpaid overtime is regularly worked and how it is accounted for.
- \_\_\_\_\_
6. Determine the contractor's actual wage experience
- a. Obtain copies of any written policies
- b. Based on the contractor's written or verbal policy, and available information, compute the contractor's wage escalation and compare to proposed values.
- \_\_\_\_\_
7. Determine whether management effort is being charged consistently with the BAFO (Direct or indirect and function, title, and quantity of hours charged)
- \_\_\_\_\_
8. Determine that Direct labor charges are for employees rather than consultants or sub-contractors
- \_\_\_\_\_
9. If LOE type contract, determine actual LOE and compare to contract to see if fee adjustment is applicable. Assure that contractor is computing and reporting actual LOE correctly.
- \_\_\_\_\_
10. Test whether the contractor is performing unauthorized work
- A. Test timing of work performed is covered by Period of Performance
- B. Be alert to services provided which are properly authorized in the Statement of Work.

If it appears that the work was not authorized by the contracting officer, try to determine if it was authorized by someone else.

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B. Review of Subcontractor's Costs

1. Review contract file and list subcontractors.
2. Obtain a copy of the contractor's written Subcontracting procedures.
  - a. Does the Prime monitor the performance of the subcontractor
  - b. Does the Prime require progress reports of the subcontractor
  - c. Did the subcontractor provide a Certificate of Current Cost or Pricing Data to the Prime
  - d. Determine if the Subcontract Plan is included in the contract as required by FAR. Make a Copy for the audit file.
3. Determine the actual dollar participation of each subcontractor. Compare the inception to date experience with the contractual limitations.
- \* 4. Determine whether subcontractors have been properly approved or appropriate notifications have been made in accordance with the terms of the contract.
- \* 5. Verify that any indirect costs or profit/fee allocated by the prime contractor to subcontractor costs is allocable and in accordance with contract provisions.
- \* 6. Determine whether the prime contractor procedures for determination of accurate and reasonable subcontractor accounting systems and billings are adequate and routinely followed.
7. Review the subcontractor's billings (invoices) to determine if they are adequate in detail to monitor/identify
  - a. any ceiling costs (ODC etc.)
  - b. Indirect rates
  - c. Specific cost elements (D/L, etc.)
  - d. LOE data

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- \_\_\_\_\_
- \* 8. Does the contractor (if large business) submit invoices for payment before paying its own subcontractors?
- a. Quantify, if applicable
  - b. Calculate lost interest
  - c. Have Contractor provide schedules which indicate the date costs were
    - i. Billed by prime to EPA
    - ii. Paid by prime to subcontractor
    - iii. Paid by EPA to prime contractor
- \_\_\_\_\_
- \* 9. Are subcontractor's applied indirect rates acceptable?
- \_\_\_\_\_
10. Determine how any fixed laboratory rates are established for subcontractors.

C. Review of Other Direct Costs

1. Review contract file to determine if there are any contractual ceilings placed on the ODC's. Determine cumulative amounts invoiced by cost element.
- \* 2. Trace sample of the ODC billings to the contractors accounts payable records and invoices.
  - a. Determine if all ODCs are actual, necessary and reasonable.
  - b. Determine if any expenses that should have been charged indirectly were charged as ODC expenses.
  - c. Determine if any contractual ceilings have been exceeded or are likely to be exceeded before completion of the contract.
- \* 3. Trace a sample of travel vouchers
  - a. Obtain copy of contractor's written travel procedures.
  - b. Determine if the sample travel expenses reviewed comply with contractual limitations, the contractor's written policies and the GTR.
- \* 4. Determine whether subcontractor fee has been billed in accordance with the contract.
- \* 5. Review direct purchases of supplies, materials, equipment, etc. to determine whether property has been purchased and properly approved under the contract.
- \* 6. Determine if computer charges are billed at actual rates; if not, are the estimated rates adjusted to actuals. If so, how and when? Are over/under absorbed costs allocated to cost objectives properly?

Have the contractor provide supporting data for all formulas and adjustments made.

- \_\_\_\_\_
- \* 7. Review Equipment Usage/Rental rates and determine how the costs are priced? Obtain adequate support from the contractor. IAW FASB 13, does the contractor get title to any property. If so, when, and is the title obtained after the government pays for the property?

A. Review Leases for Purchase Credits  
B. Determine if government holds title

- \_\_\_\_\_
8. Determine if Consultants provide evidence of the nature and extent of services offered.

\_\_\_\_\_

A 9. Laboratory Analysis.

A. Determine how the fixed laboratory rates are established and how we can assure that labor involved with the lab services is not billed as Direct Labor.

B. For Lab analysis costs based on the contractor's own catalog prices, determine if:

(a) the catalog has been approved for use.

(b) the contractor bills from the catalog.

(c) the billed prices are burdened with G&A or fee. If so, question the G&A and fee.

\_\_\_\_\_

A 10. Pollution Liability Insurance

Specific contractors (CDM, Malcom Pirnie, NUS, Weston, Ebasco, B&V, and Hill) have been identified to perform diligent efforts to obtain insurance from the private sector.

During the review of these identified contractors, determine:

(a) what they have done to obtain pollution liability insurance?

(b) if they have obtained it, how is it charged (direct/indirect) and what is the cost, coverage, etc.?

\* VI. Review of Indirect Costs

1. Determine the contractor's established indirect cost allocation bases and verify that such bases are consistent with the contract.
2. Determine from the cognizant contracting officer for indirect rates what the currently approved rates are and which years have final negotiated rates.
3. Determine if indirect expense charges are in accordance with applicable contractual limitations.
4. Review contractor's most recent:  
Interim Financial Statements (YTD)  
Certified Financial Statements  
Projected F/Y Financial Statements  
F/Y Budget
5. Calculation of most recent overhead/G&A Rates
  - a. Based on this data compute overhead and G&A rates to determine if current billing rates are reasonable.
    1. Remove all unallowable expenses.
    2. Remove expenses that are charged direct.
    3. Review expenses to make sure they were properly accrued.
    4. Trace allocation base to accounting records (i.e. if labor dollars is base, trace to general ledger and payroll register).
  - b. If rates were based on budget information, compare actual costs to the budget.
- \* 6. Verify that billings for indirect costs are consistent with the contract provisions and the BAFO.
7. Assure that Indirect Cost Submissions are current, not over 90 days after FYE

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\* VII. Review of Contractor's Management of the Contract

Review of Contractual Reporting Requirements to determine whether the established reports adequately provide all data relevant to the review of financial progress under the contract and are consistent with contractor's vouchers and accounting records.

A. Review the monthly progress reports to determine if:

1. the expenditure of costs and hours for both, contractor and subcontractor(s), appear to be accurately reported.
2. the reported hours are actuals or estimates?
3. the estimated costs and hours to be expended during the next reporting period are reported.
4. the additional estimated costs and hours needed to complete the work are reported. And if not, request the current cost-to-complete estimates from the contractor if appropriate

(a) Get the contractor's explanation of how they developed the cost-to-complete estimates.

- (i) Evaluate expense trends and relationships.
- (ii) Review any variance between budget and actual performance (i.e. labor skill mix, etc.).
- (iii) Review past three (3) months of cost to complete estimates.

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5. any problem(s) affecting completion of the work within the authorized budget are reported.

(a) Compare the contractor's current budget for the contract to actual expenses; follow up on any major variance.

6. sufficient data is reported to monitor the actual rate of expenditure of hours and dollars for the overall contract, as well as each individual work assignment.

(a) do the reports show the contractor's calculated hourly rate (Total Cost/Total Hours)?

Note: We should be able to compute this data if the above reporting requirements are being performed by the contractor.

If our review of the calculated hourly rates indicate that there is a need to redirect work efforts to complete the work within the budgeted amounts, the applicable Contracting Officer, Project Officer, and Work Assignment Managers should be informed immediately.

---

B. Review the public vouchers and assure that the costs are presented in the format required by the contract and being billed IAW government regulations.

1. Are individual cost elements adequately shown?

2. Are current month and cumulative costs adequately shown?

3. Are subcontractor's costs properly shown?

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#### VIII. SUMMARY

1. Summarize the results of the review.
2. Disclose contract issues that need interpretations or clarifications
3. Identify situations in which the contractor is in non-compliance with GAAP.
4. Recommend improvements to contract financial progress reports so that EPA may properly manage the contract:
  - a. Disclosure of the cost impact of actual indirect expense rates
  - b. Explanations for major variances between budget and actual variances.
  - c. Reporting of O/T hours and premium.
  - d. Detailed projected expenses for next three (3) months activity.
  - e. Graphs which detail variances between each month's performance.
5. Conduct an exit conference with the contractor to discuss the results of the review to obtain verification of any issues, facts, etc.

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IX. PREPARATION OF FINANCIAL MONITORING REPORT

1. Draft the financial monitoring report to cover findings obtained. Include qualifications on any limits to the program due to lack of data, time, etc.
2. Obtain the Section Head approval of the draft.
3. Discuss results (Draft Report) with the Contracting Officer, the Contract Specialist and the FACO for assurance of a thorough understanding of the issues.
4. Prepare and Issue the final report.
5. Prepare finding coding sheet for FASMIS.

X. DRAFT SPECIFIC REQUESTS FOR AN INTERIM AUDIT.

Prepare list of specific audit areas for the interim audit request and provide to Contract Close Out Monitor.

XI. FOLLOW UP REVIEW

1. Prepare file notes for identification of areas to be included in a follow up review.

XII. FOLLOW UP ON RESPONSE TO REPORT

1. Obtain Plan of Action and Milestones (POAM) from Contracting Officer/Contract Administrator if one is prepared.
2. Review the POAM and discuss it with the Contracting Officer/Administrator.
3. Track/Assist in resolution of findings until closed. Provide summary to Section Chief monthly.

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EXTRA STEPS TO COVER IF TIME PERMITS

- |       |   |
|-------|---|
| _____ | 1. Review justification for exercise of options   |
| _____ | A. Determine if a current analysis was performed by EPA Cost Advisory or DCAA on reasonableness of costs/rates.                                     |
| _____ | 2. If possible, talk to employees   |
| _____ | A. Talk to former employees   |
| _____ | B. Talk to employees that may be leaving the company in a few days/months and ask Why?  |
| _____ | C. Determine why there is turnover in the CPA firms, if applicable  |
| _____ | 3. Floor Check a sample of employees, both direct and indirect performing under this contract   |
| _____ | 4. Review the contractor's Tax Returns  |
| _____ | A. Check for Sale of Capital Assets and for \$ recovered that should offset depreciation  |
| _____ | 5. Review the contractor's Board of Director's Minutes  |
| _____ | 6. Use internal audit staff to identify some findings   |
| _____ | 7. Be aware of Idle Facilities  |
| _____ | E 8. Determine whether contractor system credits EPA (or no charge) equipment undergoing maintenance and repair and associated labor while on-site. |
| _____ | E 9. Determine the number and obtain list of new provisional equipment and labor rates proposed by contractor since inception of contract.          |
| _____ | Determine the number of these not yet established as fixed rates  |
| _____ | 10. Verify contractor payment to employees is consistent with wage determination rates and FLSA and CWHSSA  |

ENGAGEMENT LETTER

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
ATTN:

Dear \_\_\_\_\_

Contract number \_\_\_\_\_ has been selected for a financial monitoring review. In accordance with the audit clause 52.215-002 incorporated by reference in the contract, please make available your accounting records and other documentation supporting the amounts invoiced and your performance of the work under the contract.

The purpose of the review will be to determine if: (1) your billing and cost accounting systems are adequately creating accurate public vouchers and monthly progress reports, (2) you are maintaining proper supporting documentation for expenses charged directly to these contracts, (3) billing rates for indirect expenses are supported and reasonable, (4) cost to complete estimates are accurate and (5) you are generally in compliance with the terms of the contract.

In order to expedite our review please have the information requested in Attachment A available for our review at your Corporate Headquarters in \_\_\_\_\_ for the week of \_\_\_\_\_. Please provide all items identified with an asterisk \* to us within two weeks after receipt of this letter and any other items that are reasonably available prior to our scheduled review date. We will hold an entrance conference upon arrival at your office and immediately following the conference we will begin our field work. \_\_\_\_\_ will be the auditor-in-charge of this review. We will also hold a preliminary exit conference upon completion of our field work.

During our review we will want to review your payroll register, cash disbursements journal, general ledger, job cost ledger, time sheets, travel vouchers and vendor invoices. Additional information and records may also be requested during the course of this review. In order to expedite our review, your assistance in assuring timely access and response to the requested data would be extremely beneficial.

If you have any questions pertaining to this audit review, the auditor may be reached at (202) 475 - \_\_\_\_\_.



Please acknowledge receipt of this letter.

Thank you for your continued cooperation.

Sincerely,

Dale W. Roberson, Chief  
Financial Analysis Section

cc: All Contracting Officers involved with the contractor  
EPA Project Officer  
Contractor's Controller, Finance Officer, and/or Contracts Manager



## REQUESTED DATA FOR FINANCIAL MONITORING REVIEW

- \* 1. Copy of most recent Certified Financial Statements
  - A. Interim Financial Statements (Year-to-Date)
  - B. Budgets for Current Fiscal Year & Next Fiscal Year
- \* 2. Public Vouchers for the most recent three (3) months
- \* 3. Required Monthly Progress Reports for the same period indicated in #2
  - A. Monthly Progress Reports
  - B. Contract Financial/ Management Status Reports
  - C. Executive Summary Reports
  - D. Regional Summary Reports
  - E. Individual Work Assignment/Delivery Order Status Reports
  - F. Quality Assurance Reports
- 4. Written Policies and Procedures
  - A. Timekeeping
  - B. Travel
  - C. Subcontracting
  - D. Purchasing/Procurement
  - E. Equipment/ODC rates
- 5. Timesheets and Payroll records for period indicated in #2
- 6. Supporting cost records inclusive of paid invoices, cancelled checks, and ledgers for selected vouchers
- \* 7. Schedules illustrating pool and base costs calculating:
  - A. Current Actual Indirect Rates
  - B. Actual Rates for Last Fiscal Year
- \* 8. Current Cost-to-Complete Estimates for the Contract
  - A. An explanation of the actual procedures used for calculating the Cost-to-complete estimates
  - B. An explanation of any variances between Budgeted and Actual costs
  - C. An explanation of the actual procedures used to monitor costs when 75% of the contract ceiling has been reached
- \* 9. Reconciliation of Booked vs Billed Costs (Inception-to-Date)
- \* 10. Provide schedules identifying all Overtime Premium charges billed under this contract.
- \* 11. List of all consultants utilized on this contract.
  - A. Provide a copy of the consultant agreement
  - B. Provide the negotiated amount and period of performance
  - C. Costs billed to date by month for each consultant

- \* 12. Provide a list of all employees working on this contract
  - A. Name of employee
  - B. Identify employee by P-level
  - C. Provide current actual base labor rate
  - D. Hours billed to date by employee by P-level
- 13. Provide selected travel vouchers for the same period of vouchers reviewed as requested.
- \* 14. Provide current list of Key Personnel. If there have been any changes since contract award, provide MOD# with Contracting Officer approval. Are the key personnel being used to perform as required by the contract? Provide Resumes as requested.
- \* 15. Provide List of all Subcontractors
  - A. Provide negotiated amount of each subcontract
  - B. Copy of Subcontract Agreement (for subcontracts over \$200,000)
  - C. Period of Performance of each subcontract
- \* 16. Provide schedules showing LOE by contract performance periods and show calculated percentages of LOE delivered.
- \* 17. Provide schedules of ODC's by cost element since contract inception.
- \* 18. Provide a list of equipment utilized on the contract
  - a. Owned but previously leased
  - b. Leased
  - c. Owned
- \* 19. Provide Equipment Usage/Rental rates with data supporting how the rates are determined and adjusted.
- \* 20. Provide computer and other ODC billing rates with supporting data.
- \* 21. Provide copies of most recent Indirect Cost Submissions to EPA, DCAA or other cognizant agency.
- \* 22. Provide flow chart of accounting/billing system.
- \* 23. Provide an organization chart of the parent company and all subsidiaries.

NAME OF CONTRACTOR \_\_\_\_\_

CONTRACT NUMBER \_\_\_\_\_

QUESTIONS TO CONTRACTOR

- I. 1. Are there any Pre-contract costs incurred?  
If so, is there an advance agreement?
2. Are any contract modifications pending? Discuss.
- II. 1. Any follow-up questions from response to engagement letter?
2. When was your last Purchasing System Review performed by EPA or DCAA?  
Was your system approved? If so, provide approval.
3. Has there been any recent Property/Equipment Compliance Review  
performed by the Government? If so, please provide copy.
4. Discuss related party affiliations (if noted during review of Dun and  
Bradstreet Report) and conflict of interest (if determined from  
contractor's list of all clients and/or if the contractor work for  
several customers simultaneously).
- III. 1. What types of Internal Controls does the company have?  
Is there an Internal Audit Staff?  
Are there written Timekeeping Policies and Procedures?
- IV. 1. How are bills prepared? That is, what are the source records, the  
process followed, reconciliations, etc.?

Who prepares/reviews bills(invoices)?

Can the invoices be tied in directly to the job cost accounting  
system (contract in total as well as by DO or WA)?

2. Are the total costs (by cost element) incurred on this contract  
equivalent to the costs billed on the invoices?

If not, what differences exist?

How frequently are vouchers submitted?

- IV. 3. Have all of the Work Assignments and/or Delivery Orders being worked on been approved by the Contracting Officer?

Did you start working on any Work Assignment/Delivery Order prior to the effective date of the contract? If so, why?

4. Are there any excess funds (based on the comparison of billed costs to estimated contract costs) that could be deobligated or transferred

A. From one cost element to another?

B. From one work assignment to another?

5. Has there been any suspended or disallowed billings under this contract?

If so, what is the current status?

- W. A1. Is your timekeeping/time reporting function separate from the personnel and payroll functions? That is, does the same person(s) who handles the timekeeping function also handle the Personnel and/or Payroll functions?

Who fills out the timesheet?

Who signs the timesheet?

Who approves the time charged?

How often are timesheets prepared?

Do the timesheets contain necessary details to identify and allocate labor costs to a contract, a work site, and multiple appropriations accounts?

- A2. Have there been any changes in key personnel identified in the contract?

If so, provide Contract Mod # with CO approval.

Are the key personnel being used to perform as required by the contract?

- A3. What is the accounting treatment of unpaid overtime?  
What is the company's policy on unpaid overtime?

- V. A4. Are there any consultants, part time employees, or subcontractors billed under direct labor or as ODCs?

If so, identify who; how (what cost element) they were billed, what services they provided, and their cost.

- V. B1. What are your procedures for determination of accurate and reasonable subcontractor accounting systems and billings?

Are they adequate and are they being followed?

Was a copy of the Subcontract Plan submitted to EPA? If not, provide a copy if available.

(i) How do you monitor the subcontractors performance?

(ii) Do you require progress reports/billings for the subcontractors?

(iii) Did the subcontractors provide a certificate of current cost or pricing data to the prime?

- B2. If you are a large business, do you submit invoices to EPA for payment of subcontract costs before you pay the subcontractors?

- B3. Are any fixed laboratory rates used on this contract for subcontractors? If so, how are they established?

- V. C1. Have any contractual ceilings (on any cost elements) been exceeded or likely to be exceeded before completion of the contract?

If so, what cost element(s) and amounts?

- C2. Discuss direct purchases of supplies, materials, equipment, etc. to determine whether property has been purchased and properly approved under the contract?

- C3. Has there been any contractor acquired equipment previously leased for the contract?

If so, please provide a current listing.

- V. C4. Is there any leased equipment, from outside vendors or inter/intra company owned, being utilized on the contract?

If so, please provide a list of all leased equipment on this contract.

- (a) Is the equipment leased from outside vendors?
- (b) Is the equipment leased from an Inter/Intra Company?
- (c) Is the equipment owned by the contractor & leased to EPA?
- (d) Do you get title to any leased property? If so, when. And, is the title obtained after the government pays for the property?

C5. (a) Computer Charges:

Are they billed at actual rates or estimated rates?

If billed at estimated rates, are the estimated rates adjusted to actuals? How and when?

If billed at estimated rates and not adjusted to actuals, how are the over/under absorbed costs allocated (direct/indirect)?

That is, if the variance (over or under) is material in amount, is it adjusted to the applicable contracts or adjusted in the indirect pool(s) at least annually?

Note: If material, the contracts should be adjusted.

Are all clients being treated equally?

Provide supporting data for all formulas and adjustments made.

Verify that if depreciation is used as a part of the computer's actual cost, it is deducted from the overhead pool.

(b) Equipment Usage/Rental rates:

How are the costs priced?

Is equipment (such as field equipment) billed on a rate basis?

If so, what are the billed rates and what is the basis of the rates?

Provide supporting data.

C5. (c) Fixed Laboratory rates:

Have you incurred any Lab. Support (ex: mobile lab.) costs?

If so, are you using a fixed rate to bill these costs?

If you are using a fixed rate, what rate is being billed?

How are these rates established?

C6. Do Consultant supporting documentation provide evidence of the nature and extent of services offered?

C7. Does the contractor's travel expenses comply with contractual limitations, contractor's written policies and the GTR?

C8. Has fee (base fee, etc.) been billed in accordance with the contract? Discuss.

C9. What has the contractor done to obtain pollution liability insurance?

If it has been obtained, how is it charged (direct/indirect) and what is the cost, coverage, etc.?

VI. 1. Discuss overhead rates, billing vs actual, and reasons for any variances.

Are the billed rates the same as the contractual billing rates?

Have the FYE Indirect Cost Submissions been submitted on a current (not over 90 days after FYE) basis?

Determine who is the cognizant audit agency?

Which fiscal years have final negotiated rates?

VII. 1. Are the monthly progress, financial management and current status reports being submitted on time and do they contain adequate and sufficient data as required by the contract?

(a) Do the monthly progress reports tie to the applicable public vouchers?



## Contractor Purchasing System Reviews (CPSR)

### Objective

A CPSR is a review of a contractor's total purchasing, subcontracting and material control system.

The Federal Acquisition Regulation (FAR) covers the topic in Subpart 44.301, where it states the "the objective of the [CPSR] is to evaluate the efficiency and effectiveness with which the contractor spends government funds and complies with government policy when subcontracting". The CPSR assures that the contractor applies sound purchasing practices and provides maximum protection to the government. The FAR further states, "The review provides the administrative contracting officer (ACO) a basis for granting or withholding approval of the contractor's purchasing system.

Please refer to the Environmental Protection Agency (EPA) Manual for Performance of Contractor Purchasing System Reviews (CPSR) for guidance in the review of the contractor purchasing systems. It also provides the Contractor Purchasing System Review Program.



Cost Accounting StandardsWhat is a Cost Accounting Standard (CAS)?

A CAS is a fairly general guideline for cost accounting practices and procedures to assure more uniform treatment of costs by government agencies and their contractors.

PL-91-379 created the Cost Accounting Standards Board (CASB) as an agent of the Congress.

The CASB, while in existence from August 1970 until September 1980, issued nineteen standards.

What are the Nineteen Standards?CAS 401 - Consistency in Estimating, Accumulating and Reporting Costs

The purpose of this standard is to insure that practices used in estimating costs for a proposal are consistent with cost accounting practices used in accumulating and reporting costs.

CAS 402 - Consistency in Allocating Costs Incurred for the Same Purpose

The purpose of this standard is to require that each type of cost is allocated only once and on only one basis to any contract or other cost objective. The criteria for determining the allocation of costs to a product contract or cost objective should be the same for all cost objectives.

CAS 403 - Allocation of Home Office Expenses to Segments

The purpose of this standard is to establish criteria for the allocation of the expenses of a home office to the segments of the organization such as one or two, or more, divisions, plants or other sub-divisions which report directly to the home office.

CAS 404 - Capitalization of Tangible Assets

The purpose of this standard is to establish criteria for capitalization of tangible asset costs so that adherence to the policy will facilitate consistent measurement of costs over time.

#### CAS 405 - Accounting for unallowable costs

The purpose of this standard is to facilitate the negotiation, audit, administration and settlement of contract costs by establishing guidelines for the identification of unallowable costs and the consistent treatment of these costs using sound cost accounting principles. (This standard does not govern the allowability of costs.)

#### CAS 406 - Cost Accounting Period

The purpose of this standard is to provide guidelines for the selection and establishment of time periods for the use of cost estimating, accumulating and reporting. Through the establishment of time periods the effects of variations in the flow of costs will be reduced, the contract closing process will be more objective, consistent and reliable and contract cost measurements will be uniform in comparative analysis.

#### CAS 407 - Use of Standard Costs for Direct Material and Direct Labor

The purpose of this standard is to specify the conditions under which the contractors can employ standard costs for direct materials and direct labor.

#### CAS 408 - Accounting for costs of compensated personal absence

The purpose of this standard is to require that the costs of compensated personal absence be charged to the accounting period in which it was earned and that the cost for an entire cost accounting period be allocated on a pro-rata basis to the final cost objectives.

#### CAS 409 - Depreciation of Tangible Capital Assets

The purpose of this standard is to provide the guidelines for

- determining the service life of an asset
- selection of a depreciation method
- determining the residual value
- determining the disposition of gains or losses on retirement
- determining the allocation of depreciation to cost objective

CAS 410 - Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives

The purpose of this cost accounting standard is to provide criteria for the allocation of business unit general and administrative (G&A) expenses to business unit final cost objectives based on their beneficial or causal relationship.

CAS 411 - Accounting for Acquisition Costs of Material

The purpose of this standard is to assure the consistency of accounting for material costs and that the policies for accounting for material costs are in writing.

CAS 412 - Composition and Allocation of Pension Costs

The purpose of this cost accounting standard is to provide guidance on determining a period's pension cost.

CAS 413 - Adjustment and Allocation of Pension Cost

The purpose of this standard is to provide guidance on the assignment of actuarial gains and losses and the valuation of the assets in the pension fund. It also provides guidance on the allocation of pension costs to segments.

CAS 414 - Cost of Money as an Element of the Cost of Facilities Capital

The purpose of this standard is to provide some cost recognition of the impact of inflation upon fixed assets and makes some provision for the cost of money invested in fixed assets.

CAS 415 - Accounting for the Cost of Deferred Compensation

The purpose of this cost accounting standard is to provide the guidance for the identification, measurement, and allocation of compensation to employees (i.e. pensions).

#### CAS 416 - Accounting for Insurance Costs

The purpose of this standard is to provide criteria for the measurement of insurance costs, the assignment of such costs to cost accounting periods and their allocation to cost objectives. The application of these criteria should increase the probability that insurance costs are allocated to cost objectives in a uniform and consistent manner.

#### CAS 417 - Cost of Money as an Element of the Cost of Capital Assets Under Construction

This standard provides for the determination of an inputted cost of money to be included in the capitalized cost of acquisition of assets developed, fabricated or constructed for a contractor's own use. Application of this standard will provide increased uniformity in accounting for the acquisition costs of assets.

#### CAS 418 - Allocation of Direct and Indirect Costs

The purpose of this Cost Accounting Standard is (a) to provide for consistent determination of direct and indirect costs, (b) to provide criteria for the accumulation of indirect costs, including service center and overhead costs, in indirect cost pools, and (c) to provide guidance relating to the selection of allocation measures based on the beneficial or causal relationship between an indirect cost pool and cost objectives. Consistent application of these criteria and guidance will improve classification of costs as direct and indirect and the allocation of indirect costs.

#### CAS 420 - Accounting for Independent Research and Development and Bid and Proposal Costs

The purpose of this Cost Accounting Standard is to provide criteria for the accumulation of independent research and development costs and bid and proposal costs and for the allocation of such costs to cost objectives based on the beneficial or causal relationship between such costs and cost objectives. Consistent application of these criteria will improve cost allocation.

## How did Cost Accounting Standards evolve?

1968 - Admiral Rickover, at Defense Production Act hearing, was invited to comment on the general area of defense procurement. In his testimony, he made some specific comments on accounting practices. They were:

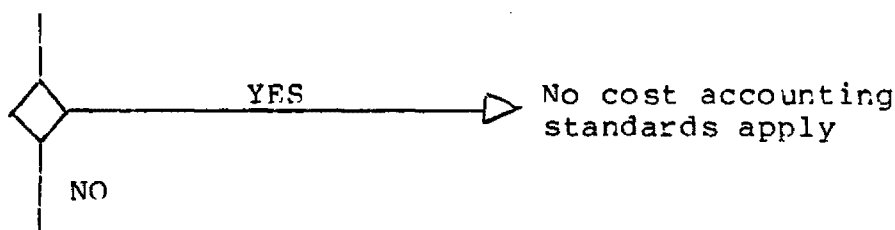
- "The lack of uniform accounting standards is the most serious deficiency in Government procurement today."
- "Industry will not establish such standards because it is not to their advantage to do so."
- "The accounting profession 'has had ample time and opportunity to establish effective standards' but pays 'only lip service to the concept.'"
- "If uniform accounting standards are ever to be established, the initiative will have to come from Congress."
- The Bill, however, as reported out by the House, contained nothing about accounting standards.
- In the Senate, Senator Proxmire added an amendment to the Bill requiring the Comptroller General to do a feasibility study for applying uniform cost accounting standards to all defense procurement of \$100,000 or more. (PL-91-370)
- GAO study was completed in August 1970, recommending the development of CAS. Congress agreed. The Cost Accounting Standards Board was established as an agent of Congress to develop standards for defense procurements. (PL-91-379)
- In July of 1972, GSA issued a temporary regulation making CAS applicable to non-defense contracts and subcontracts.
- In December of 1974, FPR Section 1-3.1200 was implemented formally extending CAS to civilian procurement.
- And now Federal Acquisition Regulation Part 30 implements CAS.

How does the Contracting Officer determine CAS applicability under FAR or FPR?

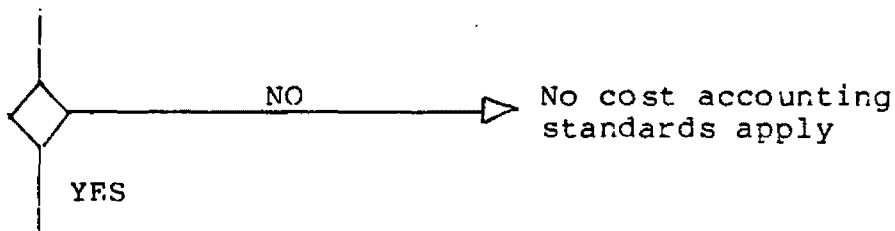
Cost Accounting Standards for Nondefense Contracts (FAR)

Is the contract:

- with a small business or,
- with an educational institution or,
- with a foreign government or,
- formally advertised or,
- \$100,000 or less or,
- awarded based on adequate price competition or,
- price set by law or regulation or,
- awarded pursuant to a labor surplus area set aside or,
- price based on established catalog or market prices of commercial items sold in substantial quantities to the general public?

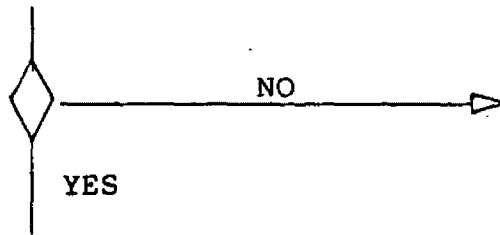


Is the business unit currently performing any CAS-covered national defense contracts?



Did the contractor receive:

- a single national defense CAS-covered contract award of \$10M or more, or
- \$10M or more in national defense CAS-covered contract awards during the preceeding accounting period, or
- Less than \$10M in national defense CAS-covered contracts in the preceeding accounting period but such awards were 10% or more of sales?



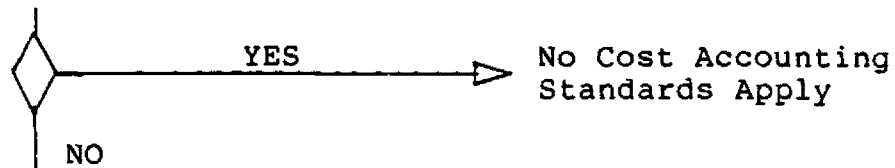
All Cost Accounting Standards Apply. Insert FAR clauses at 52.230-3 "Cost Accounting Standards" and 52.230-4 "Administration of Cost Accounting Standards".

Only Cost Accounting Standards 401 and 402 apply. Insert FAR clauses at 52.230-5 "Disclosure and Consistency of Cost Accounting Practices" and 52.230-4 "Administration of Cost Accounting Standards".

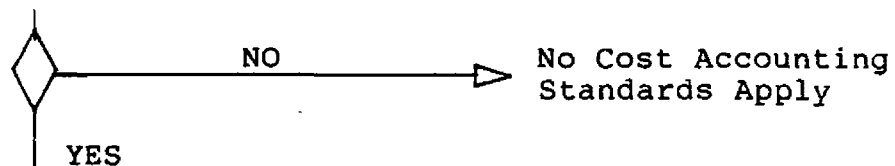
Cost Accounting Standards for Nondefense Contracts (FPR)

Is the contract:

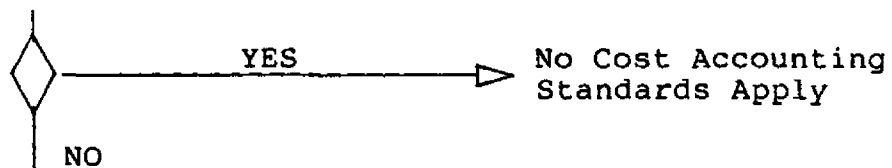
- with a small business, a State or local government, an educational institution, a foreign government, a hospital, the Canadian Commercial Corporation, or
- \$100,000 or less or,
- to be performed outside the U.S., possessions or territories or,
- price based on established catalog or market prices of commercial items sold in substantial quantities to the general public?



Is the business unit currently performing any CAS-covered national defense contracts or is this contract in excess of \$500,000?

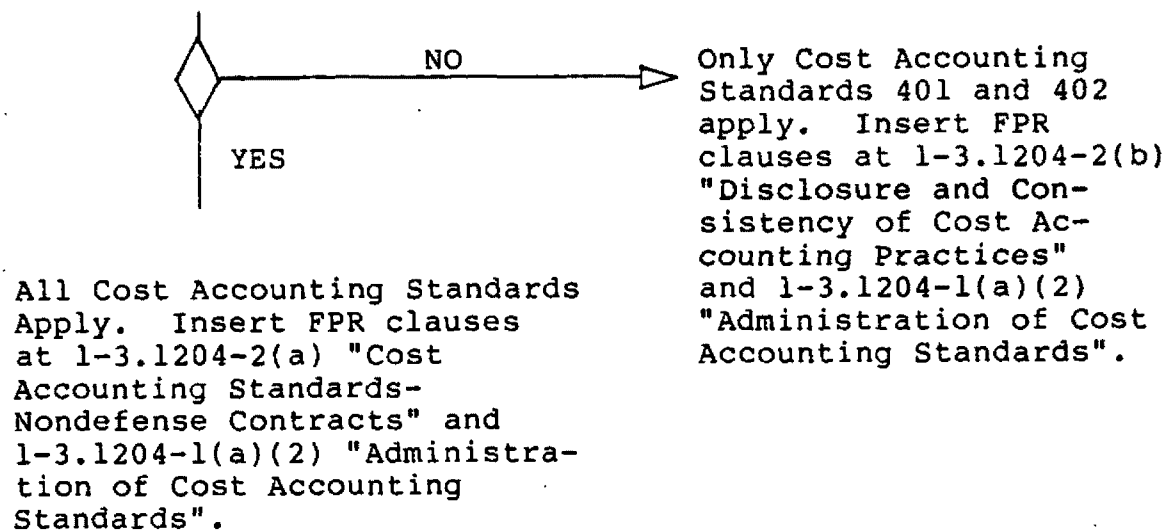


Is the contract fixed price after receiving at least two offers from the unassociated firms and, (1) the solicitation sent to all firms was identical, (2) price is the only consideration, (3) the lowest responsive offer is accepted, and (4) the business unit receiving the award is not performing under a CAS-covered national defense contract.



Did the contractor receive:

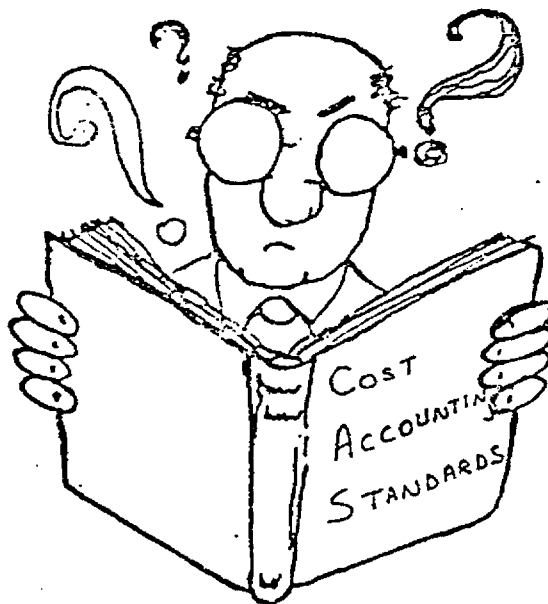
- a single national defense CAS-covered contract award of \$10M or more, or
- \$10M or more in national defense CAS-covered contract awards during the preceeding accounting period, or
- less than \$10M in national defense CAS-covered contracts in the preceeding accounting period but such awards were 10% or more of sales?



What are the CO's responsibilities for CAS at FPA?

- (1) The CO is responsible for the proper notices in the solicitation package and for assuring that the correct clauses go in the contract.
- (2) The process for contractors is self certification. You rely on the certifications given in the representations and certification section of the solicitation package.
- (3) How the contractor answers the question will determine which clauses should be inserted in the contract. The contractor will be subject to:

If .....	Then .....
Full Coverage	All standards apply
Modified Coverage	only CAS 401, 402 apply
No CAS coverage	waive all standards



SELECTED CLAUSES

This section highlights certain clauses under the Federal Acquisition Regulations and the EPAAR which are relevant to cost and price analysis.

The implementation of FAR brought many changes to the procurement process. Following are some of the more significant changes.

52.215-1 Examination of Records by Comptroller General

The Comptroller General shall have access to, and the right to examine any of the contractor's "directly pertinent books, documents, papers or other records" within 3 years after final payment or a shorter period specified in FAR Subpart 4.7.

- (a) applies to negotiated contracts exceeding \$10,000
- (b) applies to first tier subcontracts - excludes purchase orders less than \$10,000

52.215-2 Audit - Negotiation

The contractor shall maintain and the contracting officer shall have the right to examine and audit all pertinent data relating to the contract.

If the contractor was required to submit cost and pricing data, then the contracting officer has the right of examination.

The contractor shall make records available at all reasonable times.

- (a) includes all subcontracts over \$10,000.

52.214-26 Audit - Formal

Cost or pricing data is subject to examination for modifications over \$100,000 unless modification was competed, catalog or market price or set by law.

(a) Comptroller General has same rights

(b) applies to subcontracts over \$10,000

Records must be made available by the contractor.

52.215-24 Subcontractor Cost or Pricing Data

Any subcontract or modification expected to exceed \$500,000 requires cost and pricing data unless price is based on

(a) competition

(b) catalog or market

(c) set by law

Contractor shall require subcontractor certification.

52.216-5 Price Redetermination

52.216-6

Invokes Part 31 of the FAR, Contract Cost Principles, for both prospective and retroactive price adjustments.

52.215-22 Price Reduction for Defective Cost or Price Data

52.215-23

Applicable to a) contracts/subcontracts over \$500,000

b) required to certify current cost and pricing data

Contract price or cost may be reduced because of defective cost or pricing data submitted by either the prime contractor or subcontractor.

52.215.30 Facilities Capital Cost of Money  
Waiver of Facilities Capital Cost of Money

Discussed in section III

52.216-7 Allowable Cost and Payment

Part 31 of the FAR determines allowability of reimbursable costs, together with any specific provisions which may be contained in the contract.

52.216-10 Fixed Fee, Fixed Fee-Construction, Incentive Fee

Fee is paid in accordance with the contract award schedule, up to an amount equal to 85% of total fee, after which the contracting officer may withhold further payment of fee in a reserve amount that is considered necessary to protect the Government's interest.

- (a) the reserve amount shall not exceed 15% of total fee or \$100,000, whichever is less.

Reserve fee is liquidated upon settlement of final payment voucher.

1552.242-70 Indirect Cost Rates  
52.216-7(d)

Contracting officer shall insert EPAAR clause 1552.242-70, Indirect Costs in solicitations and contracts where indirect costs apply.

The operative term for indirect cost rates is no longer "provisional rates". It is "billing rates."

The policy under FAR 42.703 for establishing final indirect cost rates is:

- (a) a single agency shall bind all other agencies and their contracting officers unless otherwise specified by statute.
- (b) indirect costs for cost reimbursement contracts and fixed price contract progress payments shall be reimbursed by applying billing rates and final indirect cost rates.

It is the policy of EPA for the Cost Policy and Rate Negotiation Section of P&CMD to be responsible for negotiating indirect costs rates in accordance with EPA contracting officer determination procedures. (EPAAR 1542.705-1)

The EPA contract specialist, with the assistance of the cost advisory offices, shall place the established billing rates in newly awarded contracts.

- billing rates may be established or revised by the CPRN section, the auditing activity or another Federal Government agency.
- billing rates may be prospectively or retroactively revised by mutual agreement, at the request of either the Government or the contractor to prevent substantial overpayment or underpayment.

52.230      CAS Notices & Certification

Covered in Appendix A of this manual.

52.232-20    Limitation of Cost

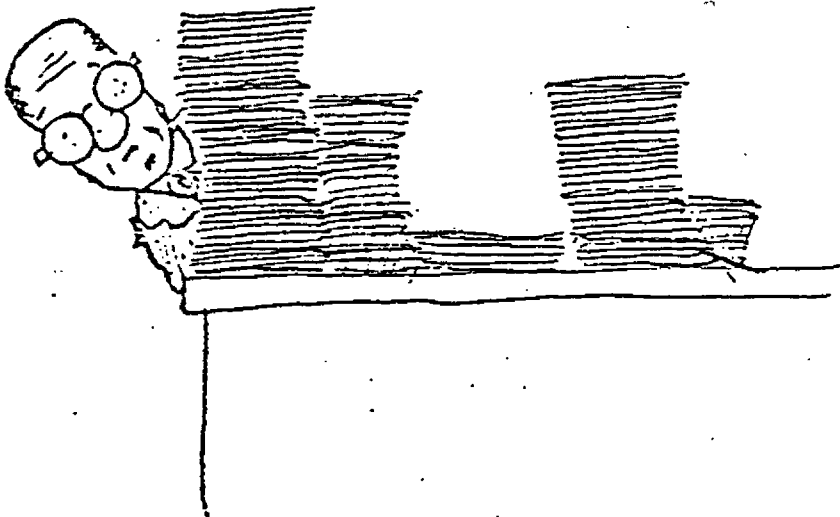
Requires the contractor to notify, in writing, the contracting officer.

- (a) 60 days prior to the time when 75% of the estimated cost will be exceeded, or if,
- (b) the total cost for the performance of this contract, exclusive of fee will be either greater or substantially less than had been previously estimated.

Requires the contractor to submit a revised proposal.

The Government is not obligated to reimburse the contractor for costs incurred in excess of estimated cost in the award schedule.

The contracting officer is the only person authorized to revise the estimated cost.



40 CFR Part 33 (EPA), Procurement  
Under Assistance Agreements

# ENVIRONMENTAL PROTECTION AGENCY

## 40 CFR Part 33

[OA-FRL 2210-3]

### Procurement Under Assistance Agreements

**AGENCY:** Environmental Protection Agency.

**ACTION:** Final rule.

**SUMMARY:** This document makes the Environmental Protection Agency's Part 33, "Procurement Under Assistance Agreements," a final rule. Part 33 establishes the rules for all procurement undertaken by recipients of EPA assistance agreements. In accordance with OMB Circular A-102, Attachment O, and OMB Circular A-110, Attachment O this rule is designed to rely heavily on recipients' procurement systems. Part 33 applies to all Catalog of Federal Domestic Assistance Programs in the 66,000 series.

**DATE:** This rule is effective for assistance agreements which EPA awards on and after March 28, 1983.

**FOR FURTHER INFORMATION CONTACT:** Richard A. Johnson, Grants Administration Division (PM-216), Environmental Protection Agency, Washington, D.C. 20460, (202) 382-5296.

**SUPPLEMENTARY INFORMATION:** On September 18, 1981, EPA published in the Federal Register (46 FR 45963) a Notice of Availability which made a draft of Part 33 available for public comment.

On March 2, 1982, EPA published a proposed Part 33 in the Federal Register (47 FR 8960) and on May 12, 1982, EPA published in the Federal Register (47 FR 20474) an interim-final Part 33. The May 12, 1982, interim-final rule became effective only for EPA's construction grants program.

On July 8, 1982, EPA reopened the comment period on Section 33.240 "Small, minority, women's and labor surplus area businesses" (47 FR 29668). The comment period on this section was extended 30 days because it significantly changes EPA's existing minority business and women's business policies.

We made numerous editorial changes throughout the interim-final rule in order to make this final rule easier to read and understand.

### Implementation

Because we published an interim-final and final Part 33 rule, we have added this section to explain when the interim-

final is effective and when the final rule is effective.

1. If EPA awarded a wastewater treatment construction grant under Title II of the Clean Water Act before May 12, 1982, the recipient has the following options:

(a) The recipient may follow the procurement requirements in effect when EPA awarded its construction grant, or

(b) The recipient may follow the procurement requirements in the May 12 interim-final rule, provided the recipient completed and submitted EPA Form 5700-48 to the award official before the effective date of this final rule, or

(c) The recipient may follow the procurement requirements in the final rule.

2. If EPA awarded a construction grant between May 12, 1982, and the effective date of this rule, the recipient has the following options.

(a) The recipient may follow the procurement requirements in the May 12 interim-final rule, provided the recipient completed and submitted EPA Form 5700-48 to the award official before the effective date of this final rule.

(b) If the recipient did not submit EPA Form 5700-48 before the effective date of this rule, the recipient must follow the procurement requirements in this final rule. The recipient must complete the appropriate part of EPA Form 5700-48 and submit the form to the award official as required in § 33.110.

3. Comprehensive Environmental Response, Compensation, and Liability Act of 1980, "Superfund" awards made after March 2, 1982, included the proposed Part 33 rule (47 FR 8960) as a special condition in each cooperative agreement.

Superfund awards made after May 12, 1982, included the interim-final Part 33 (47 FR 20474) as a special condition in each cooperative agreement.

Superfund awards made after the effective date of this final rule are subject to the final rule.

4. If EPA awarded any other assistance agreement (other than construction grants and Superfund awards) before the effective date of this rule, the recipient has the following options:

(a) The recipient may follow the procurement requirements in effect when EPA awarded the assistance agreement, or

(b) The recipient may follow the procurement requirements in the final rule. The recipient must complete the appropriate part of EPA Form 5700-48 and submit the form to the award official as required in § 33.110.

## EPA Form 5700-48 "Procurement System Certification"

This form implements the self-certification process. Subpart A "Procurement System Evaluation" explains how EPA and the recipient will use the form. For the reader's convenience, we have included a copy of the form after Appendix A.

### Description of Major Issues

#### Quality Assurance

On June 14, 1979, EPA established quality assurance requirements for all EPA extramural projects involving environmental measurements. The objective of the quality assurance (QA) program is to ensure that all environmentally related measurements which are required or funded by EPA are scientifically valid, defensible, and of known precision and accuracy. Under the program, contractors must submit QA plans to the recipient if contract activities will include environmentally related measurements. The reference to EPA's QA program is being added to § 33.1030, clause 13, "Responsibility of the Contractor," paragraph (a), in order to make contractors aware of the policy.

The QA requirements are specified in guideline documents available from: Sid Verner, Environmental Protection Agency, Office of Research and Development (RD-680), 401 M Street, S.W., Washington, D.C. 20460, (202) 382-5787.

### Major Comments Received

We received over 125 comments on the March 2, 1982, proposed rule. The preamble to the May 12, 1982, interim-final rule addressed some of these comments in detail. Since EPA's position on the issues discussed in that preamble is unchanged, we have not repeated those discussions here. The following discussion addresses the other areas of the regulation which received the greatest number of comments:

#### Section 33.005 Definitions.

We reserved the definitions of minority business enterprise (MBE) and women's business enterprise (WBE) in the May 12, 1982, interim-final regulation. We are adding those definitions now.

We received several comments on the definition of MBE in the September 9, 1981, draft regulation which was made available to the public for comment by notice in the Federal Register on September 18, 1981 (46 FR 45963). That definition used the Small Business Administration's (SBA) definition of minority group members, which

excluded persons from the Indian subcontinent from the definition of "Asian American." Because a number of people from the Indian subcontinent have participated in EPA's MBE program for construction grants, we are now revising the September 9, 1981, definition to include businesses owned and controlled by individuals from the Indian subcontinent. We understand that the SBA is now considering a petition to include persons from the Indian subcontinent in its definition of "Asian Americans."

We also received comments on the need for a definition of the terms "Intergovernmental Agreement" and "Supplies;" therefore, we added definitions for these terms.

#### *Section 33.110 Applicant and recipient certification.*

We received questions on the regulatory authority retained by the EPA award official when the recipient certifies its procurement system. To clarify the authority the award official retains, we have added paragraph (e) to § 33.110 "Applicant and recipient certification."

#### *Section 33.211 Recipient reporting requirements.*

This is a new section which gives the reporting requirements recipients must follow even if the recipient certifies its procurement system. Paragraph (a) through (d) of this section lists the information the Department of Labor (DoL) requires for each construction subagreement award which exceeds or is expected to exceed \$10,000. The DoL requires this information to implement the Davis-Bacon Act, Copeland Regulations, Work Hours and Safety Standards Act, and the equal employment opportunity requirements in Executive Order 11246, Executive Order 11375 and DOL regulations in 41 CFR Part 60. Paragraph (e) of this section requires that recipients submit to the award official a copy of the tabulation of bids or offerors and the name of the bidder or offeror for each subagreement the recipient awards. EPA needs this information to efficiently implement EPA's debarment and suspension regulation (40 CFR Part 32 "Debarment and Suspension Under EPA Assistance Programs").

#### *Section 33.230 Competition.*

We received several comments on the requirements in § 33.230(c) for the use of a prequalified list. We allow recipients to use prequalified lists of persons, firms or products because they play an important part in many State and local procurement systems. However,

because a prequalified list could unduly restrict competition, we require that recipients provide adequate public notice that they are maintaining a prequalified list, that the recipient update the list at least every six months and that the recipient review and act on each request for prequalification made more than 30 days before the closing date for receipt of proposals or bid opening. We believe that these requirements will allow potential contractors sufficient access to the list and will minimize the noncompetitive nature of such lists.

We also received several comments on the prohibition in § 33.230(b)(4) against the use of local or in-State bidders' or proposers' preference. We included this prohibition because a preference for local or in-State bidders unduly restricts competition. If the local or in-State bidder is more familiar with the local conditions, or can more readily mobilize its resources and can, therefore, provide the work more economically or efficiently, a preference is not necessary because its bid or proposal should reflect this familiarity or mobility.

#### *Section 33.240 Small, minority, women's and labor surplus area businesses.*

We are continuing to review EPA's minority and women's business enterprise (MBE/WBE) provisions in § 33.240. We reserved § 33.240(b) for any additional MBE/WBE requirements which the Agency may impose.

On December 17, 1982, President Reagan issued a Statement on Minority Business Enterprise Development which encourages Federal assistance agencies to achieve reasonable minority business participation in contracts under assistance agreements. The President noted that minority business procurement by recipients could amount to \$6 to \$7 billion through FY 1985. The President also indicated that an Executive Order on Minority Business Enterprise will be forthcoming, and that the Interagency Council for Minority Business Enterprise will establish uniform guidelines to implement the Order. EPA will then review and revise, if necessary, its MBE/WBE provisions in § 33.240 to assure that they are consistent with the requirements of Executive Order.

In this rule, § 33.240 contains only those provisions allowed by Attachment O, Paragraph 9. Therefore, the MBE policy (43 FR 60220, December 28, 1978) and the WBE policy (45 FR 51490, August 1, 1980) are no longer mandatory for recipients of construction grants who are subject to the interim-final or final

Part 33 rule. However, any EPA recipient may adopt these policies, in whole or in part, by including provisions in their solicitations and subagreements. In any event, recipients and contractors must comply with the affirmative step requirements in § 33.240 and any other requirements of the State or the recipient.

We also received a substantial number of comments on the absence of percentage goals in § 33.240 for MBE and WBE participation in EPA-funded work. We no longer require recipients to include goals in their specifications, nor will the EPA regions set goals for MBE or WBE participation. In the past, goals served as a tool to determine whether the affirmative steps required by OMB Circular A-102, Attachment O were adequately carried out by the assistance recipient and its contractors. In keeping with EPA's policy to transfer procurement responsibilities to recipients, the Agency believes that recipients and States should decide how to implement the required affirmative steps. Therefore, recipients may use their own goals, State goals, or other standards.

Several commenters noted that the regulation was not clear on whether the affirmative steps must be undertaken for each group of businesses—small, minority-owned and women-owned. Recipients must take the affirmative steps in § 33.240 for each group. For example, solicitation of MBE's alone will not satisfy the requirements of § 33.240; the recipient must also attempt to contract with small and women's businesses.

We also received several comments that § 33.240(a)(6) differs from OMB Circular A-102, Attachment O, section 9.a.(6). The commenters pointed out that Attachment O requires that the first tier contractor take the affirmative steps (1) through (5) only if the contractor plans to award subagreements. Therefore, we have revised § 33.240(a)(6) to make it consistent with OMB Circular A-102, Attachment O.

Several commenters suggested that we add a definition of "labor surplus area." The Secretary of Labor is responsible for defining labor surplus area. This definition is contained in 20 CFR Part 654, "Special Responsibilities of the Employment Service System."

With respect to EPA's construction grants program, we received comments concerning the use of MBE/WBE's in facilities planning and design work. As a result of the 1981 Amendments to the Clean Water Act, EPA cannot directly involve itself in the facilities planning and design activities preceding the

award of a construction grant. However, it is EPA's policy to encourage potential grant recipients to adopt procurement procedures that, at a minimum, include the affirmative steps in § 33.240 for all activities of their construction program.

#### *Section 33.255 Specifications.*

One commenter asked if the justification for the use of a restrictive specification had to be included in the specification itself. That is not the case. The justification for the use of a restrictive specification must be documented and included in the recipient's files.

We also receive a recommendation that we limit use of "brand name or equal" specifications to procurements for the acquisition of equipment and services, and prohibit the use of a brand name or equal specification for the procurement of pipe and similar materials.

We believe it is inappropriate to adopt this recommendation for two reasons. First, neither Attachment O nor the Clean Water Act, as amended, provide for any restriction of this nature. Second, there may be instances in the procurement of materials when the recipient's procuring official must resort to use of a "brand name or equal" specification.

Although we prefer the use of design or performance based specifications, we agree that use of a "brand name or equal" specification is generally not advisable in procurements for the acquisition of materials. Instead, the recipient should determine whether a national or industry standard has been developed. If developed, such a standard may provide both the recipient and prospective contractors a more accurate description of the material to be purchased than would a "brand name or equal" specification.

A "brand name or equal" specification can be used only when the recipient determines that it is impractical or uneconomical for it to make a clear and accurate description of its technical requirements in the specifications.

#### *Section 33.280 Payments to consultants.*

We received several comments that this section does not make it clear that consultants may receive compensation in excess of the GS-18 rate, but that the Federal government will limit its participation in a payment to a consultant to the maximum daily rate for a GS-18. We have, therefore, revised the wording in this section to make this clear.

We also revised paragraph (b) to clarify that the GS-18 rate limitation does not apply to firms.

#### *Section 33.295 Subagreements awarded by a contractor.*

We received questions about the applicability of Part 33 to subagreements awarded by a contractor. We revised § 33.295 to clarify and explain which procurement requirements apply and that they apply only to the tier immediately below the contractor (i.e. subagreements awarded by the contractor.) However, this section does not apply to a first tier subagreement awarded by the recipient to a supplier. That is, the section does not apply to a supplier's procurement of materials to produce equipment, materials, and catalog, off-the-shelf, or manufactured items.

We also added three requirements we inadvertently omitted from the proposed and interim-final rules. These three requirements existed in EPA's previous procurement regulations, in 40 CFR 30.340-2 (a) through (d), and (g) and are proposed in 40 CFR 30.301(a) (1) through (4) and (7)), the profit requirements in § 33.235, and the specification requirements in § 33.255.

#### *Section 33.520 Negotiation and award of subagreement.*

We reworded paragraph (a) to clarify that the recipient must state in the Request For Proposal (RFP) that he can make the award based on initial offers alone. If the recipient does not make such a statement in the RFP, the recipient must conduct meaningful negotiations with all of the best qualified offerors with acceptable proposals and permit revisions to obtain best and final offers.

#### *Section 33.525 Optional procedure for negotiation and award of subagreements for architectural and engineering services.*

Several commenters suggested that we revise this section to delete the word "optional" in the title. We included the word optional to make it clear that the procedures in this section are not mandatory. This is in keeping with OMB Circular A-102, Attachment O, paragraph 11.c.(5), which clearly states that these procedures are optional.

We also revised this section to explain the optional procedure in more detail.

#### *Section 33.715 Use of the same architect or engineer during construction.*

We received comments concerning § 33.715(a), which lists the circumstances under which a recipient

can use the same architect or engineer that performed any or all of the facilities planning or design services for the architectural or engineering services during Step 3 construction of the project. The concern was whether § 33.715(a)(4) applies to § 33.715(a) (1), (2) and (3) or to § 33.715(a)(3) only. Section 33.715(a)(4) applies to § 33.715(a)(3) only. Therefore, we restructured § 33.715(a) (3) and (4) to combine their requirements into a new § 33.715(a)(3).

Also, we changed this section to allow recipient's of either a Step 1 or a Step 2 grant to use the same architect or engineer (A/E) during construction of the project without further advertising or negotiations, if the recipient selected the A/E in accordance with the EPA procurement regulation in effect when EPA awarded the Step 1 or Step 2 grant.

#### *Subpart D—Requirements for Institutions of Higher Education and Other Nonprofit Organizations*

Several commenters stated that the requirements for nonprofit organizations exceed the requirements in OMB Circular A-110, Attachment O. While not all of the requirements in Part 33 are required by OMB Circular A-110, Attachment O, we believe that they are necessary to ensure efficient and effective program management. OMB reviewed and approved all of these requirements during the regulatory review process.

#### *Sections 33.1015 through 33.1021 Subagreement clauses.*

In the proposed and interim-final rules we included separate sections in Subpart F explaining the four labor standards provisions required by the Department of Labor (DoL). In these versions of the rule, we briefly explained each of these requirements and referred the recipient to the appropriate DoL regulation. The recipient then had to read the DoL regulation and develop a clause which met the requirement. However, since several of the DoL regulations require the use of a standard clause and because EPA has a form (EPA Form 5720-4 "Labor Standards Provisions For Federally Assisted Construction Contracts") which contains the appropriate DoL clauses and which has been approved by DoL, we added § 33.1016 "Labor standards provisions" which requires recipients to use EPA Form 5720-4. We believe this will reduce the burden on recipients and help implement the DoL requirements.

**Section 33.1030 Clause 3 Changes.**

Comments we received during an EPA internal review of this Part suggested that we change this clause to eliminate the reference to oral change orders in paragraph (a)(2). The change was suggested to improve the management of change orders and to reduce program costs. We agree that oral change orders may lead to mismanagement and add to program costs, and have, therefore, changed this clause. The subject of change order management was addressed in EPA's Office of Inspector General's September 21, 1982, report on change orders "Report on Audit and Administration of Change Orders Under EPA's Construction Grant Program." This report was undertaken as part of the President's Council on Integrity and Efficiency's study on change orders under construction programs.

**Section 33.1030 Clause 8 Price Reduction for Defective Cost or Pricing Data.**

We received comments that paragraph 10(b) of 40 CFR Part 35, Subpart E, Appendix C-1 should be added to the end of this clause in order to allow a disagreement over a reduction in price to fall under the remedies clause of the subagreement. We agree and have added a paragraph (b) to this clause.

Another commenter pointed out that by raising the effective level of this clause from \$100,000 to \$500,000, we were excluding most of the subagreements for services on Step 3 construction grant projects. We have, therefore, changed the effective level of this clause back to the \$100,000 level.

**Section 33.1030 Clause 9 Audit; Access to Records.**

We added a new paragraph (f) and revised paragraph (g) to clarify when the right of access clause applies.

**Meeting With Interest Groups**

On May 6, 1982, at the request of the Water and Wastewater Equipment Manufacturers Association (WWEMA), EPA held a public meeting to discuss several issues. Present at the meeting were representatives from groups with special interest in procurement under EPA assistance agreements, including the National Institute of Governmental Purchasing (NIGP), the Association of General Contractors (AGC), the American Consulting Engineers Council (ACEC), and the American Public Works Association (APWA). A tape of this meeting is on file with EPA's Docket Section in Docket No. G-81-4. In addition, the positions of the various

groups are contained in written comments also in the Docket. The sections discussed at this meeting were:

**Section 33.255 Specifications.**

The issue was whether to delete the requirement of § 33.255 that if a "brand name or equal" description is used, the salient characteristics of the named brand must also be stated. The requirement to include the named brand's salient characteristics in the specification is a requirement in Attachment O to OMB Circular A-102, and is specifically called for in House of Representatives Report No. 97-270, 97th Congress, 1st Session, October 12, 1982, (page 12), which accompanied the bill that became Public Law 97-117. Therefore, EPA cannot change the requirement to include the named brand's salient characteristics.

**Section 33.1015 Subagreement provisions clause.**

The issue was whether to mandate progress payments for undelivered, specifically manufactured items of equipment having long production times. One commenter believed that requiring recipients to make progress payments for such items would reduce equipment costs because manufacturers include in their equipment price the interest on money they borrow to produce the equipment. While progress payments could reduce the cost of some equipment, Treasury Circular 1075 does not require progress payments; therefore, EPA will not require them. This does not preclude recipients from making progress payments for such items and we encourage those who find it in their interest to allow progress payments.

**Section 33.1030(b) Clause 4 Differing Site Conditions.**

The issue was whether EPA should require a clause to cover situations where the actual characteristics of the influent to a wastewater treatment works differs significantly from those on which the original design was based. Participants in the meeting decided that a joint WWEMA/ACEC/AGC task group would provide EPA a suggested draft clause covering this issue. EPA considered the task group's suggestion and decided that, although the clause addresses an important issue, it is not an appropriate procurement under assistance agreement requirement.

**Section 33.005(b) Definition of architectural or engineering services.**

The issues were whether the definition of "architectural or engineering (A/E) services" should

include manufacturers and contractors and be revised to state that providers of A/E services need not be licensed by the State. The definition in § 33.005(b) is based on the definition for A/E services in the American Bar Association's "Model Procurement Code for State and Local Governments" and section 2 of the American Society of Civil Engineers' *Manual 45*. Because EPA's definition is based on the definitions in these widely accepted reference documents, we do not believe the definition should be changed.

**Section 33.525 Optional procedure for negotiation and award of a subagreement for architectural and engineering services.**

The issue was whether to eliminate the words "architectural and engineering." This section implements an option to the competitive negotiation process under OMB Circular A-102, Attachment O, which expressly limited the option to the procurement of A/E services. Therefore, EPA believes that a change to this section is not warranted.

**Regulation Development Process**

Under Executive Order 12291, EPA must judge whether a regulation is "major" and, therefore, subject to the regulatory impact analysis requirements of the Order or whether it may follow other development procedures. We determined that this regulation is not "major" because it will not have a substantial impact on the economy. Consequently, the regulation is not subject to the impact analysis requirements of Executive Order 12291.

Information collection requirements contained in § 33.110 have been approved by the Office of Management and Budget (OMB) under the provisions of the Paperwork Reduction Act of 1980 (44 U.S.C. 3501 *et seq.*) and have been assigned OMB control number 2000-0453.

The information provisions in § 33.211 "Recipient reporting requirements" and the requirement in § 33.420(f), § 33.510(b) and § 33.1016 to use EPA Form 5720-4 have been approved by OMB under the provisions of the Paperwork Reduction Act of 1980 (44 U.S.C. 3501 *et seq.*) and have been assigned OMB control number 2030-0004.

This regulation was submitted to OMB for review as required by Executive Order 12291.

**List of Subjects in 40 CFR Part 33**

Advertising, Conflict of interest, Environmental protection, Grants programs—Environmental protection,

Dated: March 11, 1983.

by W. Hernandez, Jr.,  
Acting Administrator.

Accordingly, Title 40 Chapter I is amended by revising Part 33 to read as follows:

### **PART 33—PROCUREMENT UNDER ASSISTANCE AGREEMENTS**

- 33.001 Applicability and scope of this part.  
33.005 Definitions.

#### **Subpart A—Procurement System Evaluation**

- 33.105 Applicability and scope of this subpart.  
33.110 Applicant and recipient certification.  
33.115 Procurement system review.

#### **Subpart B—Procurement Requirements**

- 33.205 Applicability and scope of this subpart.  
33.210 Recipient responsibility.  
33.211 Recipient reporting requirements.  
33.220 Limitation on subagreement award.  
33.225 Violations.  
33.230 Competition.  
33.235 Profit.  
33.240 Small, minority, women's, and labor surplus area businesses.  
33.245 Privity of subagreement.  
33.250 Documentation.  
33.255 Specifications.  
33.260 Intergovernmental agreements.  
33.265 Bonding and insurance.  
33.270 Code of conduct.  
33.275 Federal cost principles.  
33.280 Payment to consultants.  
33.285 Prohibited types of subagreements.  
33.290 Cost and price considerations.  
33.295 Subagreements awarded by a contractor.

#### **Small Purchases**

- 33.305 Small purchase procurement.  
33.310 Small purchase procedures.  
33.315 Requirements for competition.

#### **Formal Advertising**

- 33.405 Formal advertising procurement method.  
33.410 Public notice and solicitation of bids.  
33.415 Time for preparing bids.  
33.420 Adequate bidding documents.  
33.425 Public opening of bids.  
33.430 Award to lowest, responsive, responsible bidder.

#### **Competitive Negotiation**

- 33.505 Competitive negotiation procurement method.  
33.510 Public notice.  
33.515 Evaluation of proposals.  
33.520 Negotiation and award of subagreement.  
33.525 Optional selection procedure for negotiation and award of subagreements for architectural and engineering services.

#### **Noncompetitive Negotiation**

- 33.605 Noncompetitive negotiation procurement method.

#### **Subpart C—Requirements for Recipients of Assistance Agreements for Construction of Treatment Works**

##### **Sec.**

- 33.705 Applicability and scope of this subpart.  
33.710 Buy American.  
33.715 Use of the same architect or engineer during construction.

#### **Subpart D—Requirements for Institutions of Higher Education and Other Nonprofit Organizations**

- 33.805 Applicability and scope of this subpart.  
33.810 Nonapplicable subagreement clauses.  
33.815 Nonapplicable procurement provisions.  
33.820 Additional procurement requirements.

#### **Subpart E—Requirements for Recipients of Remedial Action Cooperative Agreements Under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980**

- 33.905 Applicability and scope of this subpart.  
33.910 Preference for formal advertising.  
33.915 Award official approval.

#### **Subpart F—Subagreement Provisions**

- 33.1005 Applicability and scope of this subpart.  
33.1010 Requirements for subagreement clauses.  
33.1015 Subagreement provisions clause.  
33.1016 Labor standards provisions.  
33.1019 Patents, data and copyrights clause.  
33.1020 Violating facilities clause.  
33.1021 Energy efficiency clause.  
33.1030 Model subagreement clauses.

#### **Subpart G—Protests**

- 33.1105 Applicability and scope of this subpart.  
33.1110 Recipient protest procedures.  
33.1115 Protest appeal.  
33.1120 Limitations on protest appeals.  
33.1125 Filing requirements.  
33.1130 Review of protest appeals.  
33.1140 Deferral of procurement action.  
33.1145 Award official's review.

#### **Appendix A—Procedural Requirements for Recipients Who Do Not Certify Their Procurement Systems, or for Recipients Who Have Their Procurement Certifications Revoked by EPA**

Authority: 7 U.S.C. 135 et seq.; 15 U.S.C. 2801 et seq.; 33 U.S.C. 1251 et seq.; 42 U.S.C. 241, 242b, 243, 246, 300j-1, 300j-2, 300j-3, 1857 et seq.; 6901 et seq.; and 42 U.S.C. 9601 et seq.

#### **§ 33.001 Applicability and scope of this Part.**

(a) This part applies to all assistance agreements awarded on or after the effective date of this part. For assistance agreements awarded before the effective date, this part will apply only to those procurement actions initiated by the recipient on or after the date the recipient complies with the self-certification requirements in § 33.110 of this part.

(b) This part:

(1) Describes EPA's procurement system evaluation process.

(2) Identifies the minimum requirements for the procurement of supplies, services, and construction under EPA assistance agreements.

(3) Identifies an additional specification requirement for procurement under assistance agreements for the construction of treatment works awarded under 40 CFR Part 35, Subparts E and I.

(4) Identifies the procurements standards that institutions of higher education and other nonprofit organizations must follow.

(5) Identifies the provisions that recipients of EPA assistance agreements must include in their subagreements.

(6) Describes the procedures that EPA will use to handle protest appeals concerning the award of a subagreement by the recipient of an EPA assistance agreement.

(c) This Part does not apply to work beyond the scope of the project for which an assistance agreement is awarded (i.e., ineligible work).

(d) This part does not apply to expenses for services for which the recipient will receive an allowance or a potential recipient will receive an advance of an allowance under 40 CFR Part 35, Subpart I.

(e) This part supplements the requirements in:

(1) 40 CFR Part 30 "General Regulation for Assistance Programs," and

(2) 40 CFR Part 32, "Debarments and Suspensions under EPA Assistance Programs."

(f) The following types of recipients must comply with the specified subparts in this part:

(1) Recipients of assistance agreements for the construction of treatment works awarded under 40 CFR Part 35, Subparts E and I, must follow the requirements in Subparts A, B, C, F and G.

(2) Recipients of remedial action cooperative agreements under the Comprehensive Environmental Response, Compensation, Liability Act of 1980 (Superfund 42 U.S.C. 6901 et seq.) must follow the requirements in Subparts A, B, E, F and G.

(3) State and local government recipients for other than construction grants and CERCLA remedial action cooperative agreements must follow the requirements in Subparts A, B, F and G.

(4) Institutions of higher education, hospitals, and other nonprofit organizations must follow the requirements in Subparts A, B, D and G.

In the construction of treatment program under the Clean Water Act (33 U.S.C. 1251 et. seq.), it is EPA's policy to delegate determinations on individual projects to State agencies to the maximum extent possible (see 40 CFR Part 35, Subpart F). This Part uses the term "award official." To the extent that the award official for a treatment works assistance agreement delegates responsibility for determining compliance with the requirements of this Part (except for § 33.115 "Procurement system review," § 33.211 "Recipient reporting requirements" and Subpart G "Protests") to a State agency under a delegation agreement (40 CFR 35.1130), the term "award official" may be read "State agency."

(h) This Part applies to a grant awarded under 40 CFR Part 35 Subpart E only if the recipient elects to follow the requirements in this Part. If the recipient of a Subpart E grant does not elect to follow the requirements in this Part, it is subject to the procurement requirements in 40 CFR Subpart E.

#### § 33.005 Definitions.

(a) Words and terms not defined below shall have the meaning given to in 40 CFR Part 30 and 40 CFR Part

(b) As used in this part, the following words and terms mean:

**Architectural or engineering (A/E) services.** Consultation, investigations; reports, or services for design-type projects within the scope of the practice of architecture or professional engineering as defined by the laws of the State or territory in which the recipient is located.

**Construction.** Erection, building, alteration, remodeling, improvement, or extension of buildings, structures or other property. Construction also includes remedial actions in response to a release, or a threat of a release, of a hazardous substance into the environment as determined by the Comprehensive Environmental Response, Compensation, and Liability Act of 1980.

**Contractor.** Any party to whom a recipient awards a subagreement.

**Cost analysis.** The review and evaluation of each element of subagreement cost to determine reasonableness, allocability and allowability.

**Intergovernmental Agreement.** Any agreement between units of government under which one public agency performs duties for or in concert with another public agency using EPA assistance. This includes substate and interagency agreements.

**Minority Business Enterprise.** A minority business enterprise is a business which is: (1) Certified as socially and economically disadvantaged by the Small Business Administration, (2) certified as a minority business enterprise by a State or Federal agency, or (3) an independent business concern which is at least 51 percent owned and controlled by minority group member(s). A minority group member is an individual who is a citizen of the United States and one of the following:

- (i) Black American;
- (ii) Hispanic American (with origins from Puerto Rico, Mexico, Cuba, South or Central America);
- (iii) Native American (American Indian, Eskimo, Aleut, native Hawaiian), or
- (iv) Asian-Pacific American (with origins from Japan, China, the Philippines, Vietnam, Korea, Samoa, Guam, the U.S. Trust Territories of the Pacific, Northern Marianas, Laos, Cambodia, Taiwan or the Indian subcontinent).

**Price analysis.** The process of evaluating a prospective price without regard to the contractor's separate cost elements and proposed profit. Price analysis determines the reasonableness of the proposed subagreement price based on adequate price competition, previous experience with similar work, established catalog or market price, law, or regulation.

**Profit.** The net proceeds obtained by deducting all allowable costs (direct and indirect) from the price. (Because this definition of profit is based on applicable Federal cost principles, it may vary from many firms' definition of profit, and may correspond to those firms' definition of "fee.")

**Services.** A contractor's labor, time, or efforts which do not involve the delivery of a specific end item, other than documents, (e.g., reports, design drawing, specifications). This term does not include employment agreements or collective bargaining agreements.

**Small business.** A business as defined in Section 3 of the Small Business Act, as amended (15 U.S.C. 632).

**Subagreement.** A written agreement between an EPA recipient and another party (other than another public agency) and any lower tier agreement for services, supplies, or construction necessary to complete the project. Subagreements include contracts and subcontracts for personal and professional services, agreements with consultants, and purchase orders.

**Supplies.** All property, including equipment, materials, printing, insurances and leases of real property,

but excluding land or a permanent interest in land.

**Women's Business Enterprise.** A women's business enterprise is a business which is certified as such by a State or Federal agency, or which meets the following definition: A women's business enterprise is an independent business concern which is at least 51 percent owned by a woman or women who also control and operate it. Determination of whether a business is at least 51 percent owned by a woman or women shall be made without regard to community property laws. For example, an otherwise qualified WBE which is 51 percent owned by a married woman in a community property state will not be disqualified because her husband has a 50 percent interest in her share. Similarly, a business which is 51 percent owned by a married man and 49 percent owned by an unmarried woman will not become a qualified WBE by virtue of his wife's 50 percent interest in his share of the business.

#### Subpart A—Procurement System Evaluation

##### § 33.105 Applicability and scope of this subpart.

(a) This subpart applies to all recipients of EPA assistance agreements.

(b) For procurements involving EPA funds, recipients shall use their own procurement policies and procedures if those policies and procedures reflect applicable Federal, State, and local laws and regulations, and at least meet the requirements set forth in this part.

(c) This subpart describes when EPA will review the recipient's procurement practices.

##### § 33.110 Applicant and recipient certification.

(a) It is the applicant's and recipient's responsibility to evaluate its own procurement system and to determine whether its system meets the applicable requirements in this part (see § 33.001).

(b) After evaluating its procurement system, the applicant or recipient will complete the "Procurement System Certification" (EPA Form 5700-48). The applicant or recipient will either certify that:

(1) Its system will meet the intent of all the requirements in this part before any procurement action with EPA assistance is undertaken, or

(2) Its current system does not meet the intent of the requirements of this part and, therefore, the applicant will follow the requirements of 40 CFR Part 33 and allow EPA preaward review of proposed procurement actions that will

use EPA funds. The additional requirements for EPA review and approval are contained in Appendix A to this part.

(c) The applicant must submit the signed certification form with the assistance application to the award official.

(d) The certification will be valid for two years or for the length of the project period specified in the assistance agreement, whichever is greater, unless the recipient substantially revises its procurement system or the award official determines that the recipient is not following the intent of the requirements in this part (see § 33.115(b)). If the recipient substantially revises its procurement system, the recipient must re-evaluate its system and submit a revised EPA Form 5700-48.

(e) Even when a recipient certifies its procurement system, the EPA award official retains the authority stated in:

(1) Section 33.210(b) "Recipient's procurement responsibilities," which requires the recipient to receive the award official's prior written approval if the recipient wants to use an innovative procurement method.

(2) Section 33.211 "Recipient reporting requirements," which requires the award official to notify the Department of Labor of certain construction subagreement awards, and obtain all bid or offer tabulations.

(3) Section 33.605(d) "Noncompetitive negotiation," to authorize a noncompetitive award.

(4) Section 33.820(b) "Additional procurement requirements," which requires the award official's prior approval for a sole source award over \$10,000 by an institute of higher education or other nonprofit organization.

(5) Section 33.915 "Award official approval," which requires the award official to approve the recipient's use of a procurement method other than formal advertising for a Superfund remedial action award, and

(6) Subpart G "Protests."

#### § 33.115 Procurement system review.

(a) EPA will not substitute its judgment for that of the recipient unless the matter is primarily a Federal concern.

(b) Even if a recipient has a certified procurement system, EPA reserves the right to review a recipient's procurement system or procurement action under an assistance agreement:

(1) To determine if the recipient is following the procurement requirements in this part; or

(2) When there is sufficient reason to believe that the recipient's system may be unacceptable based on:

(i) Information concerning the review or certification of the recipient's procurement system or actions by other Federal agencies or Congress;

(ii) Information from the recipient's cognizant audit agency;

(iii) Information from State agencies and organizations independent of the recipient's procurement activity;

(iv) Recipient responses to the procurement system certification form;

(v) Previous EPA experience with the recipient; or

(vi) Information from contractors or prospective contractors.

(c) If the award official determines that the recipient is not following the procurement requirements it certified it would follow, the award official shall revoke the recipient's certification and:

(1) Require that the recipient follow the procurement requirements in this part, including Appendix A, for future procurement actions and, if appropriate,

(2) Apply the sanctions in 40 CFR Part 30.

(d) The recipient may recertify its procurement system if it shows the award official that it has corrected the procurement deficiencies noted by the award official, and the award official accepts the recertification.

#### Subpart B—Procurement Requirements

##### § 33.205 Applicability and scope of this subpart.

This subpart contains:

(a) The recipient's and EPA's responsibilities, and

(b) The minimum procurement standards for each recipient's procurement system.

##### § 33.210 Recipient responsibility.

(a) The recipient is responsible for the settlement and satisfactory completion in accordance with sound business judgment and good administrative practice of all contractual and administrative issues arising out of subagreements entered into under the assistance agreement. This includes issuance of invitations for bids or requests for proposals, selection of contractors, award of subagreements, settlement of protests, claims, disputes and other related procurement matters.

(b) The recipient shall maintain a subagreement administration system to assure that contractors perform in accordance with the terms, conditions and specifications of their subagreements.

(c) The recipient shall review its proposed procurement actions to avoid purchasing unnecessary or duplicative items.

(d) The recipient shall consider consolidating its procurement or dividing it into parts to obtain a more economical purchase.

(e) Where appropriate, the recipient shall make an analysis of lease versus purchase alternatives in its procurement actions.

(f) A recipient of a remedial action cooperative agreement awarded under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 must obtain the EPA award official's approval to use a procurement method other than the formal advertising method (see Subpart E).

(g) A recipient may request technical and legal assistance from the award official for the administration and enforcement of any subagreement awarded under this Part. However, such assistance does not relieve the recipient of its responsibilities under this Part.

(h) A recipient may use innovative procurement methods or procedures only if it receives the award official's prior written approval.

##### § 33.211 Recipient reporting requirements.

Recipients shall notify the award official, in writing, of each construction subagreement which has or is expected to have an aggregate value over \$10,000 within a 12-month period. The recipient shall notify the award official within ten (10) calendar days after the award of each construction subagreement. The notice shall include:

(a) Name, address, telephone number and employee identification number of the construction contractor.

(b) Amount of the award.

(c) Estimated starting and completion dates.

(d) Project number, name and site location of the project, and

(e) Copy of the tabulations of bids or offerors and the name of each bidder or offeror.

##### § 33.220 Limitation of subagreement award.

(a) The recipient shall award subagreements only to responsible contractors that possess the potential ability to perform successfully under the terms and conditions of a proposed procurement. A responsible contractor is one that has:

(1) Financial resources, technical qualifications, experience, equipment and facilities adequate to carry out the project, or a demonstrated ability to obtain these;

(2) Resources to meet the completion schedule contained in the subagreement;

(3) A satisfactory performance record for completion of subagreements;

(4) Accounting and auditing procedures adequate to control property, funds and assets, as required in this Part and 40 CFR Part 30; and

(5) Demonstrated compliance or willingness to comply with the civil rights, equal employment opportunity, labor law and other statutory requirements under 40 CFR Part 30.

(b) The recipient shall not make awards to contractors who have been suspended, debarred, or voluntarily excluded under 40 CFR Part 32 nor shall it permit any portion of the work required by the subagreement to be performed at any facility listed on the EPA List of Violating Facilities (see 40 CFR Part 15).

#### § 33.225 Violations.

The recipient shall refer violations of law to the local, State or Federal authority with jurisdiction over the matter (see § 30.610).

#### § 33.230 Competition.

(a) The recipient shall conduct all procurement transactions in a manner that provides maximum open and free competition.

(b) Procurement practices shall not unduly restrict or eliminate competition. Examples of practices considered to be unduly restrictive include:

(1) Non-competitive practices between firms;

(2) Organizational conflicts of interest;

(3) Unnecessary experience and bonding requirements;

(4) State or local laws, ordinances, regulations or procedures which give local or in-State bidders or proposers preference over other bidders or proposers in evaluating bids or proposals; or

(5) Placing unreasonable requirements on firms in order for them to qualify to do business.

(c) The recipient may use a prequalification list(s) of persons, firms or products if it:

(1) Updates its prequalified list(s) at least every six months;

(2) Reviews and acts on each request for prequalification made more than 30 days before the closing date for receipt of proposals or bid opening; and

(3) Gives adequate public notice of its prequalification procedure in accordance with the public notice procedures in § 33.410 or § 33.510.

(d) A recipient may not use a prequalified list(s) of persons or firms if the procedure unnecessarily restricts competition. However, this restriction

does not apply to § 33.525 "Optional selection procedure for negotiation and award of subagreements for architectural and engineering services."

#### § 33.235 Profit.

(a) Recipients must assure that only fair and reasonable profits are paid to contractors awarded subagreements under EPA assistance agreements.

(b) The recipient shall negotiate profit as a separate element of price for each subagreement in which there is no price competition, or where price is based on cost analysis.

(c) Where the recipient receives two or more bids, profit included in a formally advertised, competitively bid, fixed price subagreement shall be considered reasonable.

(d) Off-the-shelf or catalog supplies are exempt from this section.

#### § 33.240 Small, minority, women's, and labor surplus area businesses.

(a) It is EPA policy to award a fair share of subagreements to small, minority, and women's businesses. The recipient must take affirmative steps to assure that small, minority, and women's businesses are used when possible as sources of supplies, construction and services. Affirmative steps shall include the following:

(1) Including qualified small, minority, and women's businesses on solicitation lists;

(2) Assuring that small, minority, and women's businesses are solicited whenever they are potential sources;

(3) Dividing total requirements, when economically feasible, into small tasks or quantities to permit maximum participation of small, minority, and women's businesses;

(4) Establishing delivery schedules, where the requirements of the work permit, which will encourage participation by small, minority, and women's businesses;

(5) Using the services and assistance of the Small Business Administration and the Office of Minority Business Enterprise of the U.S. Department of Commerce, as appropriate; and

(6) If the contractor awards subagreements, requiring the contractor to take the affirmative steps in paragraphs (a)(1) through (a)(5) of this section.

(b) [Reserved].

(c) EPA encourages recipients to procure supplies and services from labor surplus area firms.

#### § 33.245 Privilege of subagreement.

Neither EPA nor the United States shall be a party to any subagreement nor to any solicitation or request for proposals.

#### § 33.250 Documentation.

(a) Procurement records and files for procurements in excess of \$10,000 shall include the following:

(1) Basis for contractor selection;

(2) Written justification for selection of the procurement method;

(3) Written justification for use of any specification which does not provide for maximum free and open competition;

(4) Written justification for the type of subagreement;

(5) Basis for award cost or price, including a copy of the cost or price analysis made in accordance with § 33.290 and documentation of negotiations; and

(6) Written justification for rejecting bids.

(b) Recipients must state the reasons for rejecting any or all bids and the justification for procurements on a noncompetitively negotiated basis and make them available for public inspection.

#### § 33.255 Specifications.

(a) Recipients must incorporate in their specifications a clear and accurate description of the technical requirements for the material, product or service to be procured. Such description shall not, in competitive procurements, contain features which unduly restrict competition, unless the features are necessary to test or demonstrate a specific thing or to provide for necessary interchangeability of parts and equipment or to promote innovative technologies. The description shall include a statement of the qualitative nature of the material, product or service to be procured and, when necessary, shall set forth those minimum essential characteristics and standards to which it must conform if it is to satisfy its intended use.

(b) The recipient shall avoid the use of detailed product specifications if at all possible.

(c) When in the judgment of the recipient it is impractical or uneconomical to make a clear and accurate description of the technical requirements, recipients may use a "brand name or equal" description as a means to define the performance or other salient requirements of a procurement. The recipient need not establish the existence of any source other than the named brand. Recipients must clearly state in the specification the salient requirements of the named brand which must be met by offerors. (An additional specification requirement for recipients of assistance for the construction of treatment works under

40 CFR Part 35, Subparts E and I is contained in § 33.710.)

**§ 33.260 Intergovernmental agreements.**

(a) To foster greater economy and efficiency, EPA encourages recipients to enter into State and local intergovernmental agreements for common procurement or use of goods and services.

(b) Although intergovernmental agreements are not subject to the requirements in this part, all procurements under intergovernmental agreements are subject to the requirements in this part except for procurements that are:

(1) Incidental to the purpose of the assistance agreement, and

(2) Made through a central public procurement unit.

**§ 33.265 Bonding and insurance.**

(a) These requirements apply only to recipients and contractors with subagreements for construction.

(1) For construction subagreements of \$100,000 or less, the recipient shall follow its own requirements relating to bid guarantees, performance bonds and payment bonds.

(2) For those subagreements more than \$100,000, the award official may accept the recipient's bonding policy and requirements provided the award official makes a determination that the Federal Government's interest is adequately protected. If the award official does not make that determination, the minimum bonding requirements for subagreements more than \$100,000 are:

(i) A "bid guarantee" from each bidder equivalent to five percent of the bid price. The "bid guarantee" shall consist of a firm commitment such as a bid bond, certified check or other negotiable instrument accompanying a bid as assurance that the bidder will, upon acceptance of the bid, execute such contractual documents as the EPA recipient may require within the time specified.

(ii) A "performance bond" for 100 percent of the subagreement price. A "performance bond" is one that the contractor executes in connection with a subagreement to secure fulfillment of all its obligations under such subagreement.

(iii) A "payment bond" for 100 percent of the subagreement price. A "payment bond" is one that the contractor executes in connection with a subagreement to assure payment as required by law, to all persons supplying labor and material in the execution of the work provided for in the subagreement.

(3) Where bonds are required in the situations described above, bidders and contractors shall obtain them from companies holding certificates of authority as acceptable sureties (31 CFR Part 223).

(b) Recipients and contractors must follow the flood hazard area requirements of the Flood Disaster Protection Act of 1973 contained in 40 CFR Part 30.

**§ 33.270 Code of conduct.**

(a) Recipients shall maintain a written code or standards of conduct which shall govern the performance of its officers, employees, or agents engaged in the award and administration of subagreements supported by EPA funds. No employee, officer or agent of the recipient shall participate in the selection, award or administration of a subagreement supported by EPA funds if a conflict of interest, real or apparent, would be involved.

(b) Such a conflict would arise when:

(1) Any employee, officer or agent of the recipient, any member of their immediate families, or their partners have a financial or other interest in the firm selected for award, or

(2) An organization which may receive or has been awarded a subagreement employs, or is about to employ, any person under paragraph (b)(1) of this section.

(c) The recipient's officers, employees or agents shall neither solicit nor accept gratuities, favors or anything of monetary value from contractors, potential contractors or other parties to subagreements.

(d) Recipients may set minimum rules where the financial interest is not substantial or the gift is an unsolicited item of nominal intrinsic value.

(e) To the extent permitted by State or local law or regulations, the recipient's code of conduct shall provide for penalties, sanctions or other disciplinary actions for violations of the code by the recipient's officers, employees or agents or by contractors or their agents.

**§ 33.275 Federal cost principles.**

The following cost principles apply to assistance agreements and subagreements:

(a) State and local governments must comply with OMB Circular A-87 to determine allowable costs.

(b) Educational institutions must comply with OMB Circular A-21 to determine allowable costs and with OMB Circular A-88 for indirect cost rates.

(c) Nonprofit institutions must comply with OMB Circular A-122 to determine allowable costs.

(d) All other recipients, contractors and subcontractors must comply with the cost principles contained in the Federal Procurement Regulations (41 CFR 1-15.2 and, if appropriate, 1-15.4) to determine allowable costs.

**§ 33.280 Payment to consultants.**

(a) For all EPA assistance agreements, EPA will limit its participation in the salary rate (excluding overhead) paid to individual consultants retained by recipients or by a recipient's contractors or subcontractors to the maximum daily rate for a GS-18. (Recipients may, however, pay contractors and subcontractors more than this amount.) This limitation applies to consultation services of designated individuals with specialized skill who are paid at a daily or hourly rate. This rate does not include transportation and subsistence costs for travel performed; recipients will pay these in accordance with their normal travel reimbursement practices.

(b) Subagreements with firms for services which are awarded using the procurement requirements in this part are not affected by this limitation.

**§ 33.285 Prohibited types of subagreements.**

The cost-plus-percentage-of-cost (e.g., a multiplier which includes profit) and the percentage-of-construction-cost types of subagreements shall not be used.

**§ 33.290 Cost and price considerations.**

(a) The recipient shall conduct a cost analysis of all negotiated change orders and all negotiated subagreements estimated to exceed \$10,000.

(b) The recipient shall conduct a price analysis of all formally advertised procurements estimated to exceed \$10,000 if there are fewer than three bidders.

(c) For negotiated procurement, contractors and subcontractors shall submit cost or pricing data in support of their proposals to the recipient.

**§ 33.295 Subagreements awarded by a contractor.**

A contractor must comply with the following provisions in its award of subagreements. (This section does not apply to a supplier's procurement of materials to produce equipment, materials and catalog, off-the-shelf, or manufactured items.)

(a) 40 CFR Part 32 (Debarment and Suspension Under EPA Assistance Programs);

(b) The limitations on subagreement award in § 33.220 (a)(1) through (a)(5);

(c) The profit requirements in § 33.235;

- (d) The requirements for small, minority, women's and labor surplus businesses in § 33.240;
- (e) The specification requirements of § 33.255;
- (f) The requirements of Subpart C of this Part, if appropriate;
- (g) The Federal cost principles in § 33.275;
- (h) The prohibited types of subagreements in § 33.285;
- (i) The cost and price considerations in § 33.290, and
- (j) The applicable subagreement provisions in Subpart F of this part.

#### Small Purchases

##### § 33.305 Small purchase procurement.

If the aggregate amount involved in any one procurement transaction does not exceed \$10,000, including estimated handling and freight charges, overhead and profit, the recipient may use small purchase procedures.

##### § 33.310 Small purchase procedures.

Small purchase procedures are relatively simple procurement methods that are sound and appropriate for a procurement of services, supplies or other property costing in the aggregate not more than \$10,000.

##### § 33.315 Requirements for competition.

- (a) Recipients shall not divide a procurement into smaller parts to avoid the dollar limitation for competitive procurement.
- (b) Recipients shall obtain price or rate quotations from an adequate number of qualified sources.

#### Formal Advertising

##### § 33.405 Formal advertising procurement method.

- (a) The requirements in §§ 33.405 through 33.430 apply to all formally advertised subagreements in excess of \$10,000. Formal advertising means the public solicitation of sealed bids and the award of a subagreement based on a fixed price (lump sum, unit price, or a combination of the two) to the lowest, responsive, responsible bidder.

(b) Formal advertising requires at a minimum:

- (1) A complete, adequate and realistic specification or purchase description of what is required;
- (2) Two or more responsible bidders which are willing and able to compete effectively for the recipient's business;
- (3) A procurement that lends itself to the award of a fixed-price subagreement; and
- (4) That the selection of the successful bidder be made principally on the basis of price.

##### § 33.410 Public notice and solicitation of bids.

The recipient shall give adequate public notice of the solicitation, inviting bids and stating when and how the bidding documents may be obtained or examined.

##### § 33.415 Time for preparing bids.

The recipient must allow adequate time between the date the public notice is first published and the date by which bids must be submitted.

##### § 33.420 Adequate bidding documents.

Recipient's bidding documents shall include:

- (a) A complete statement of work to be performed including, where appropriate, design drawings and specifications and the required performance schedule;
- (b) The terms and conditions of the subagreement to be awarded, including payment, delivery schedules, point of delivery and acceptance criteria;
- (c) A clear explanation of the recipient's method of bidding and the method of evaluating bid prices, and its basis and method for awarding the subagreement;
- (d) Any other responsibility requirements or evaluation criteria which the recipient will use in evaluating bidders;
- (e) The prevailing wage determination, made under the Davis-Bacon Act, if applicable; and
- (f) The deadline and place to submit bids and a copy of § 33.295, Subparts F and G and, if appropriate, EPA Form 5720-4 "Labor Standard Provisions for Federally Assisted Contracts."

##### § 33.425 Public opening of bids.

The recipient shall publicly open bids at the place, date and time announced in the bidding documents.

##### § 33.430 Award to the lowest, responsive, responsible bidder.

- (a) The recipient shall evaluate all bids in accordance with the methods and criteria in the bidding documents.
- (b) The recipient shall award a fixed-price subagreement to the lowest, responsive, responsible bidder. Where specified in the bidding documents, recipients shall consider factors such as discounts, transportation costs and life cycle costs to determine the low bid. Payments discounts may be used to determine the low bid only when prior experience of the recipient indicates that it generally accepts such discounts.
- (c) The recipient may reject all bids only when it has sound, documented business reasons which are in the best interest of the program for which EPA

assistance is awarded (see § 33.250 "Documentation").

#### Competitive Negotiation

##### § 33.505 Competitive negotiation procurement method.

(a) The requirements in §§ 33.505 through 33.525 apply to all competitively negotiated subagreements in excess of \$10,000.

(b) Recipients may use competitive negotiation only if conditions are not appropriate for the use of the formal advertising method of procurement (see § 33.405).

##### § 33.510 Public notice.

(a) The recipient must give adequate public notice for competitively negotiated procurements.

(b) The notice of a request for proposals must state how to obtain associated documents, including a copy of § 33.295, Subparts F and G, the basis for subagreement award, and, if appropriate, EPA Form 5720-4 "Labor Standard Provisions for Federally Assisted Contracts."

(c) Requests for proposals must be written, contain enough information to enable a prospective offeror to prepare a proposal, contain all evaluation criteria and the relative importance attached to each, and clearly state the deadline and place to submit proposals.

##### § 33.515 Evaluation of proposals.

(a) Recipients must uniformly and objectively evaluate all proposals submitted in response to the request for proposals.

(b) Recipients must base their determinations of qualified offerors and acceptable proposals solely on the evaluation criteria stated in the request for proposals.

##### § 33.520 Negotiation and award of subagreement.

(a) Unless the request for proposals states that award may be based on initial offers alone, the recipient must conduct meaningful negotiations with the best qualified offerors with acceptable proposals within the competitive range, and permit revisions to obtain best and final offers. The best qualified offerors must have equal opportunities to negotiate or revise their proposals. During negotiations, the recipient must not disclose the identity of competing offerors or any information from competing proposals.

(b) The recipient must award the subagreement to the responsible offeror whose proposal is determined in writing to be the most advantageous to the recipient, taking into consideration price

and other evaluation criteria set forth in the request for proposal.

(c) The recipient must promptly notify unsuccessful offerors that their proposals were rejected.

(d) The recipient must document its procurement file to indicate how proposals were evaluated, what factors were used to determine the best qualified offerors within the competitive range, and what factors were used to determine the subagreement award.

**§ 33.525 Optional selection procedure for negotiation and award of subagreements for architectural and engineering services.**

(a) The recipient may evaluate and select an architect or engineer using the procedures in this section in place of the procedures in § 33.520, "Negotiation and award of subagreements."

(b) The recipient may use either a prequalified list developed in accordance with § 33.230(c) or responses to requests for statement of qualifications to determine the most technically qualified architects or engineers.

(c) After selecting and ranking the most qualified architects or engineers, the recipient will request technical proposals from those architects or engineers and inform them of the evaluation criteria the recipient will use to rank the proposals.

(d) The recipient shall then select and determine, in writing, the best technical proposal.

(e) After selecting the best proposal, the recipient shall attempt to negotiate fair and reasonable compensation with that offeror.

(f) If the recipient and the offeror of the best proposal cannot agree on the amount of compensation, the recipient shall formally terminate negotiations with that offeror. The recipient shall then negotiate with the offeror with the next best proposal. This process will continue until the recipient reaches agreement on compensation with an offeror with an acceptable proposal. Once the recipient terminates negotiations with an offeror, the recipient cannot go back and renegotiate with that offeror.

**Noncompetitive Negotiation**

**§ 33.605 Noncompetitive negotiation procurement method.**

Recipients may use noncompetitive negotiation to award a subagreement if the other three procurement methods are inappropriate because:

(a) The item is available only from a single source;

(b) A public exigency or emergency exists and the urgency for the

requirement will not permit a delay incident to competitive procurement;

(c) After solicitation from a number of sources, competition is inadequate; or

(d) The EPA award official authorizes noncompetitive negotiation, subject to the limitation in § 33.715(a)(2).

**Subpart C—Requirements for Recipients of Assistance Agreements for the Construction of Treatment Works**

**§ 33.705 Applicability and scope of this subpart.**

Recipients of assistance agreements awarded under 40 CFR Part 35, Subparts E and I must comply with the following requirements.

**§ 33.710 Buy American.**

Section 215 of the Clean Water Act requires that contractors give preference for the use of domestic material in the construction of EPA funded treatment works.

(a) Contractors must use domestic construction material in preference to nondomestic material if it is priced no more than 6 percent higher than the bid or offered price of the nondomestic material, including all costs of delivery to the construction site and any applicable duty, whether or not assessed. The recipient will normally base the computations on prices and costs in effect on the date of opening of bids or proposals.

(b) The award official may waive the Buy American provision based upon factors he considers relevant, including:

(1) Such use is not in the public interest;

(2) The cost is unreasonable;

(3) The Agency's available resources are not sufficient to implement the provision, subject to the Deputy Administrator's concurrence;

(4) The articles, materials or supplies of the class or kind to be used or the articles, materials or supplies from which they are manufactured are not mined, produced or manufactured in the United States in sufficient and reasonably available commercial quantities or satisfactory quality for the particular project; or

(5) Application of this provision is contrary to multilateral government procurement agreements, subject to the Deputy Administrator's concurrence.

(c) All bidding documents, subagreements, and, if appropriate, requests for proposals must contain the "Buy American" provision in § 33.1030.

**§ 33.715 Use of the same architect or engineer during construction.**

(a) If the recipient is satisfied with the qualifications and performance of

the architect or engineer who provided any or all of the facilities planning or design services for the project and wishes to retain that firm or individual during construction of the project, it may do so without further public notice and evaluation of qualifications, provided:

(1) The recipient received a facilities planning (Step 1) or design grant (Step 2), and selected the architect or engineer in accordance with EPA's procurement regulations in effect when EPA awarded the grant; or

(2) The award official approves noncompetitive procurement under § 33.605(d) for reasons other than simply using the same individual or firm that provided facilities planning or design services for the project; or

(3) The recipient attests that:

(i) The initial request for proposals clearly stated the possibility that the firm or individual selected could be awarded a subagreement for services during construction; and

(ii) The firm or individual was selected for facilities planning or design services in accordance with procedures in:

(A) Section 33.230 "Competition," and (B) Section 33.250(a)(1), (a)(2) & (a)(3), and (b) "Documentation," and one of the following:

(C) Section 33.305 through 33.315 "Small Purchases," or

(D) Section 33.405 through 33.430 "Formal Advertising," or

(E) Section 33.505 through 33.525 "Competitive Negotiation."

(iii) No employee, officer or agent of the recipient, any member of their immediate families, or their partners have financial or other interest in the firm selected for award; and

(iv) None of the recipient's officers, employees or agents solicited or accepted gratuities, favors or anything of monetary value from contractors or other parties to subagreements.

(b) However, if the recipient uses the procedures in paragraph (a) to retain an architect or engineer, any Step 3 subagreements between the architect or engineer and the recipient must meet all of the other procurement provisions in this part.

**Subpart D—Requirements for Institutions of Higher Education and Other Nonprofit Organizations**

**§ 33.805 Applicability and scope of this subpart.**

Recipients who are subject to the provisions of OMB Circular A-110, "Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit

organizations" are not subject to all of requirements in this part.

**§ 33.810 Nonapplicable subagreement clauses.**

The following clauses in Subpart F of this part do not apply to institutions of higher education and other nonprofit organizations:

- (a) Energy efficiency (§ 33.1024);
- (b) Changes (§ 33.1030.3);
- (c) Differing site conditions (§ 33.1030.4); and
- (d) Price reduction for defective cost or pricing data (§ 33.1030.8).

**§ 33.815 Nonapplicable procurement provisions.**

The following procurement provisions do not apply to institutions of higher education and other nonprofit organizations:

- (a) Subparts C and E;
- (b) Sections 33.405 through 33.430 "Formal advertising;"
- (c) Sections 33.505 through 33.525 "Competitive negotiation;"
- (d) Section 33.605 "Noncompetitive negotiation" (see § 33.820(b));
- (e) The requirement in § 33.270(a) "Code of conduct" to have a written code of conduct;
- (f) The provisions of § 33.240 "Small, minority, women's, and labor surplus area businesses" which:
  - (1) Encourage the award of a fair share of contracts to women's and labor surplus area businesses;
  - (2) Require the specific affirmative action steps in § 33.240(a)(1) through (a)(6); however, nonprofit organizations are required to make positive efforts to use small businesses and minority owned businesses as sources of supplies and services;
- (g) Subpart G "Protests."

**§ 33.820 Additional procurement requirements.**

- (a) Recipients must exclude contractors that develop or draft specifications, requirements, statements of work, invitation for bids, or requests for proposals from competing for awards resulting from the prior effort.
- (b) For all proposed sole source subagreements and where only one bid proposal is received, the recipient must request the award official's prior approval to award the subagreement if the aggregate expenditure is expected to exceed \$10,000.

**Subpart E—Requirements for Recipients of Remedial Action Cooperative Agreements Under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980**

**§ 33.905 Applicability and scope of this subpart.**

(a) The requirements in §§ 33.910 through 33.915 apply only to remedial actions which EPA funds as part of a cooperative agreement under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (Superfund).

(b) Studies, investigations, or engineering activities which precede a remedial action activity are not subject to the requirements in §§ 33.910 through 33.915, but are subject to the requirements in Subparts A, B, F and G of this part.

**§ 33.910 Preference for formal advertising.**

If a recipient wants to use a procurement method other than formal advertising, it must receive the EPA award official's concurrence with the determination.

**§ 33.915 Award official approval.**

The award official shall approve the recipient's use of a procurement method other than formal advertising only after the recipient has completed planning remedial activities and selected a cost-effective alternative.

**Subpart F—Subagreement Provisions**

**§ 33.1005 Applicability and scope of this subpart.**

(a) This subpart applies to all EPA recipients and describes the minimum content of each subagreement (contract and subcontract).

(b) Nothing in this subpart prohibits a recipient from requiring more assurances, guarantees, or indemnity or other contractual requirements from any party to a subagreement.

**§ 33.1010 Requirements for subagreement clauses.**

Recipients shall include clauses that meet the requirements of §§ 33.1015 through 33.1021, and the appropriate clauses in § 33.1030, in each procurement subagreement.

**§ 33.1015 Subagreement provisions clause.**

Each subagreement must include provisions defining a sound and complete agreement, including the:

- (a) Nature, scope, and extent of work to be performed;
- (b) Timeframe for performance;

(c) Total cost of the subagreement; and

(d) Payment provisions.

**§ 33.1016 Labor standards provisions.**

Recipients shall include a copy of EPA Form 5720-4 "Labor Standards Provisions for Federally Assisted Construction Contracts" in each subagreement for construction (as defined by the Secretary of Labor). The form contains the Davis-Bacon Act requirements (40 U.S.C. 278a-278a-7); the Copeland Regulations (29 CFR Part 3); the Contract Work Hours and Safety Standards Act—Overtime Compensation (940 U.S.C. 327-333) and the nondiscrimination provisions in Executive Order 11246, as amended.

**§ 33.1019 Patents data and copyrights clause.**

Except for construction grant subagreements, all subagreements shall include notice of EPA requirements and regulations pertaining to reporting and patent rights under any subagreement involving research, developmental, experimental or demonstration work with respect to any discovery or invention which arises or is developed in the conduct of work under a subagreement. This notice shall also include EPA requirements and regulations pertaining to copyrights and rights in data contained in 40 CFR Part 30.

**§ 33.1020 Violating facilities clause.**

Subagreements in excess of \$100,000 shall contain a provision which requires contractor compliance with all applicable standards, orders or requirements issued under Section 306 of the Clean Air Act (42 U.S.C. 1857(h)), Section 508 of the Clean Water Act (33 U.S.C. 1368), Executive Order 11738, and EPA regulations (40 CFR Part 15) which prohibit the use under nonexempt Federal contracts, grants or loans of facilities included on the EPA List of Violating Facilities.

**§ 33.1021 Energy efficiency clause.**

Subagreements shall comply with mandatory standards and policies on energy efficiency contained in the State's energy conservation plan issued in compliance with the Energy Policy and Conservation Act (Pub. L. 94-163).

**§ 33.1030 Model subagreement clauses.**

Recipients must include, when appropriate, the following clauses or their equivalent in each subagreement. Recipients may substitute other terms for "recipient and" "contractor" in their subagreements.

**1. Supersession**

The recipient and the contractor agree that this and other appropriate clauses in 40 CFR 33.1030 apply to that work eligible for EPA assistance to be performed under this subagreement and that these clause supersede any conflicting provisions of this subagreement.

**2. Privity of Subagreement**

This subagreement is expected to be funded in part with funds from the U.S. Environmental Protection Agency. Neither the United States nor any of its departments, agencies or employees is, or will be, a party to this subagreement or any lower tier subagreement. This subagreement is subject to regulations contained in 40 CFR Part 33 in effect on the date of the assistance award for this project.

**3. Changes**

*(a) The following clause applies only to subagreements for construction.* (1) The recipient may at any time, without notice to any surety, by written order designated or indicated to be a change order, make any change in the work within the general scope of the subagreement, including but not limited to changes:

- (i) In the specifications (including drawings and designs);
- (ii) In the time, method or manner of performance of the work;
- (iii) In the recipient-furnished facilities, equipment, materials, services or site, or
- (iv) Directing acceleration in the performance of the work.

(2) A change order shall also be any other written order (including direction, instruction, interpretation or determination) from the recipient which causes any change, provided the contractor gives the recipient written notice stating the date, circumstances and source of the order and that the contractor regards the order as a change order.

(3) Except as provided in this clause, no order, statement or conduct of the recipient shall be treated as a change under this clause or entitle the contractor to an equitable adjustment.

(4) If any change under this clause causes an increase or decrease in the contractor's cost or the time required to perform any part of the work under this contract, whether or not changed by any order, the recipient shall make an equitable adjustment and modify the subagreement in writing. Except for claims based on defective specifications, no claim for any change under paragraph (a)(2) above shall be allowed for any costs incurred more than 20 days before the contractor gives written notice as required in paragraph (a)(2). In the case of defective specifications for which the recipient is responsible, the equitable adjustment shall include any increased cost the contractor reasonably incurred in attempting to comply with those defective specifications.

(5) If the contractor intends to assert a claim for an equitable adjustment under this clause, he must, within 30 days after receipt of a written change order under paragraph (a)

(1) or the furnishing of a written notice under paragraph (a) (2), submit a written statement to the recipient setting forth the general nature and monetary extent of such claim. The recipient may extend the 30-day period. The contractor may include the statement of claim in the notice under paragraph (2) of this change clause.

(6) No claim by the contractor for an equitable adjustment shall be allowed if made after final payment under this subagreement.

*(b) The following clause applies only to subagreements for services.* (1) The recipient may at any time, by written order make changes within the general scope of this subagreement in the services or work to be performed. If such changes cause an increase or decrease in the contractor's cost or time required to perform any services under this subagreement, whether or not changed by any order, the recipient shall make an equitable adjustment and modify this subagreement in writing. The contractor must assert any claim for adjustment under this clause in writing within 30 days from the date it receives the recipient's notification of change, unless the recipient grants additional time before the date of final payment.

(2) No services for which the contractor will charge an additional compensation shall be furnished without the written authorization of the recipient.

*(c) The following clause applies only to subagreements for supplies.* (1) The recipient may at any time, by written order and without notice to the sureties, change the general scope of this subagreement in any one or more of the following:

- (i) Drawings, designs or specifications where the supplies to be furnished are specifically manufactured for the recipient;
- (ii) Method of shipment or packing; and
- (iii) Place of delivery.

(2) If any change causes an increase or decrease in the cost or the time required to perform any part of the work under this subagreement, whether or not changed by any such order, the recipient shall make an equitable adjustment in the subagreement agreement price or delivery schedule, or both, and modify the subagreement in writing. The contractor must assert any claim for adjustment under this clause within 30 days from the date the contractor receives the recipient's notification of change. If the recipient decides that the facts justify such action, the recipient may receive and act upon any such claim asserted at any time before final payment under this subagreement. Where the cost of property made obsolete or excess as a result of a change is included in the contractor's claim for adjustment, the recipient has the right to prescribe the manner of disposition of such property. Nothing in this clause shall excuse the contractor from proceeding with the subagreement as changed.

**4. Differing Site Conditions**

*The following clause applies only to construction subagreements.* (a) The

contractor shall promptly, and before such conditions are disturbed, notify the recipient in writing of:

(1) Subsurface or latent physical conditions at the site differing materially from those indicated in this subagreement, or

(2) Unknown physical conditions at the site, of an unusual nature, differing materially from those ordinarily encountered and generally recognized as inhering in work of the character provided for in this subagreement.

(b) The recipient shall promptly investigate the conditions. If it finds that conditions materially differ and will cause an increase or decrease in the contractor's cost or the time required to perform any part of the work under this subagreement, whether or not changed as a result of such conditions, the recipient shall make an equitable adjustment and modify the subagreement in writing.

(c) No claim of the contractor under this clause shall be allowed unless the contractor has given the notice required in paragraph (a) of this clause. However, the recipient may extend the time prescribed in paragraph (a).

(d) No claim by the contractor for an equitable adjustment shall be allowed if asserted after final payment under this subagreement.

**5. Suspension of Work**

*The following clause applies only to construction subagreements.* (a) The recipient may order the contractor in writing to suspend, delay or interrupt all or any part of the work for such period of time as the recipient may determine to be appropriate for the convenience of the recipient.

(b) If the performance of all or any part of the work is suspended, delayed or interrupted for an unreasonable period of time by an act of the recipient in administration of this subagreement, or by the recipient's failure to act within the time specified in this subagreement (or if no time is specified, within a reasonable time), the recipient shall make an adjustment for any increase in the cost of performance of this subagreement (excluding profit) necessarily caused by such unreasonable suspension, delay or interruption and modify the contract in writing. However, no adjustment shall be made under this clause for any suspension, delay or interruption to the extent (1) that performance would have been so suspended, delayed or interrupted by any other cause, including the fault or negligence of the contractor, or (2) for which an equitable adjustment is provided for or excluded under any other provision of this subagreement.

(c) No claim under this clause shall be allowed (1) for any costs incurred more than 20 days before the contractor notified the recipient in writing of the act, or failure to act, involved (this requirement does not apply to a claim resulting from a suspension order) and (2) unless the amount claimed is asserted in writing as soon as practicable after the termination of such suspension, delay or interruption, but not later than the date of final payment under the subagreement.

**6. Termination**

(a) This subagreement may be terminated in whole or in part in writing by either party in the event of substantial failure by the other party to fulfill its obligations under this subagreement through no fault of the terminating party, provided that no termination may be effected unless the other party is given (1) not less than ten (10) calendar days' written notice (delivered by certified mail, return receipt requested) of intent to terminate, and (2) an opportunity for consultation with the terminating party prior to termination.

(b) This subagreement may be terminated in whole or in part in writing by the recipient for its convenience, provided that the contractor is given (1) not less than ten (10) calendar days' written notice (delivered by certified mail, return receipt requested) of intent to terminate, and (2) an opportunity for consultation with the terminating party prior to termination.

(c) If termination for default is effected by the recipient, an equitable adjustment in the price provided for in this subagreement shall be made, but (1) no amount shall be allowed for anticipated profit on unperformed services or other work, and (2) any payment due to the contractor at the time of termination may be adjusted to cover any additional costs to the recipient because of the contractor's default. If termination for default is effected by the contractor, or if termination for convenience is effected by the recipient, the equitable adjustment shall include a reasonable profit for services or other work performed. The equitable adjustment for any termination shall provide for payment to the contractor for services rendered and expenses incurred prior to the termination, in addition to termination settlement costs reasonably incurred by the contractor relating to commitments which had become firm prior to the termination.

(d) Upon receipt of a termination action under paragraphs (a) or (b) above, the contractor shall (1) promptly discontinue all affected work (unless the notice directs otherwise), and (2) deliver or otherwise make available to the recipient all data, drawings, specifications, reports, estimates, summaries and such other information and materials as may have been accumulated by the contractor in performing this subagreement, whether completed or in process.

(e) Upon termination under paragraphs (a) or (b) above, the recipient may take over the work and may award another party a subagreement to complete the work under this subagreement.

(f) If, after termination for failure of the contractor to fulfill contractual obligations, it is determined that the contractor had not failed to fulfill contractual obligations, the termination shall be deemed to have been for the convenience of the recipient. In such event, adjustment of the subagreement price shall be made as provided in paragraph (c) of this clause.

**7. Remedies**

Unless otherwise provided in this subagreement, all claims, counter-claims, disputes and other matters in question between the recipient and the contractor

arising out of, or relating to, this subagreement or the breach of it will be decided by arbitration if the parties mutually agree, or in a court of competent jurisdiction within the State in which the recipient is located.

**8. Price Reduction for Defective Cost or Pricing Data**

*[Note.—The following clause applies to (1) any subagreement negotiated between the recipient and its contractor in excess of \$100,000; (2) negotiated subagreement amendments or change orders in excess of \$100,000 affecting the price of formally advertised, competitively awarded, fixed price subagreement, or (3) any lower tier subagreement or purchase order in excess of \$100,000 under a subagreement other than a formally advertised, competitively awarded, fixed price subagreement. This clause does not apply to subagreements awarded on the basis of effective price competition.]*

(a) The contractor and subcontractor, where appropriate, assure that the cost and pricing data submitted for evaluation with respect to negotiation of prices for negotiated subagreements, lower tier subagreements and change orders is based on current, accurate and complete data supported by their books and records. If the recipient or EPA determines that any price (including profit) negotiated in connection with this subagreement, lower tier subagreement or amendment thereunder was increased by any significant sums because the data provided was incomplete, inaccurate or not current at the time of submission, then such price or cost or profit shall be reduced accordingly and the recipient shall modify the subagreement in writing to reflect such action.

(b) Failure to agree on a reduction shall be subject to the remedies clause of this subagreement.

*[Note.—Since the subagreement is subject to reduction under this clause by reason of defective cost or pricing data submitted in connection with lower tier subagreements, the contractor may wish to include a clause in each lower tier subagreement requiring the lower tier subcontractor to appropriately indemnify the contractor. It is also expected that any lower tier subcontractor subject to such indemnification will generally require substantially similar indemnification for defective cost or pricing data submitted by lower tier contractors.]*

**9. Audit Access to Records**

(a) The contractor shall maintain books, records, documents and other evidence directly pertinent to performance on EPA funded work under this subagreement in accordance with generally accepted accounting principles and practices consistently applied, and 40 CFR Part 30 in effect on the date of execution of this subagreement. The contractor shall also maintain the financial information and data used in the preparation or support of the cost submission required under 40 CFR 33.290 for any negotiated subagreement or change order and a copy of the cost summary submitted to the recipient. The United States Environmental Protection Agency, the

Comptroller General of the United States, the United States Department of Labor, the recipient, and (the State) or any of their authorized representatives shall have access to all such books, records, documents and other evidence for the purpose of inspection, audit and copying during normal business hours. The contractor will provide proper facilities for such access and inspection.

(b) If this is a formally advertised, competitively awarded, fixed price subagreement, the contractor agrees to make paragraphs (a) through (g) of this clause applicable to all negotiated change orders and subagreement amendments affecting the subagreement price. In the case of all other types of prime subagreements, the contractor agrees to make paragraphs (a) through (g) applicable to all subagreements he awards in excess of \$10,000, at any tier, and to make paragraphs (a) through (g) of this clause applicable to all change orders directly related to project performance.

(c) Audits conducted under this provision shall be in accordance with generally accepted auditing standards and with established procedures and guidelines of the reviewing or audit agency(ies).

(d) The contractor agrees to disclose all information and reports resulting from access to records under paragraphs (a) and (b) of this clause to any of the agencies referred to in paragraph (a).

(e) Records under paragraphs (a) and (b) above shall be maintained by the contractor during performance on EPA assisted work under this subagreement and for the time periods specified in 40 CFR Part 30. In addition, those records which relate to any controversy arising under an EPA assistance agreement, litigation, the settlement of claim arising out of such performance or to costs or items to which an audit exception has been taken shall be maintained by the contractor for the time periods specified in 40 CFR Part 30.

(f) Access to records is not limited to the required retention periods. The authorized representatives designated in paragraph (a) of this clause shall have access to records at any reasonable time for as long as the records are maintained.

(g) This right of access clause applies to financial records pertaining to all subagreements (except formally advertised, competitively awarded, fixed price subagreements) and all subagreement change orders regardless of the type of subagreement, and all subagreement amendments regardless of the type of subagreement. In addition this right of access applies to all records pertaining to all subagreements, subagreement change order and subagreement amendments:

(1) To the extent the records pertain directly to subagreement performance;

(2) If there is any indication that fraud, gross abuse or corrupt practices may be involved; or

(3) If the subagreement is terminated for default or for convenience.

**10. Covenant Against Contingent Fees**

The contractor assures that no person or selling agency has been employed or retain

licit or secure this subagreement upon an agent or understanding for a commission, percentage, brokerage or contingent fee excepting bona fide employees or bona fide established commercial or selling agencies maintained by the contractor for the purpose of securing business. For breach or violation of this assurance, the recipient shall have the right to annul this agreement without liability or, at its discretion, to deduct from the contract price or consideration, or otherwise recover the full amount of such commission, percentage, brokerage or contingent fee.

#### 11. Gratuities

(a) If the recipient finds after a notice and hearing that the contractor or any of the contractor's agents or representatives offered or gave gratuities (in the form of entertainment, gifts or otherwise) to any official, employee or agent of the recipient, the State or EPA in an attempt to secure a subagreement or favorable treatment in awarding, amending or making any determinations related to the performance of this subagreement, the recipient may, by written notice to the contractor, terminate this subagreement. The recipient may also pursue other rights and remedies that the law or this subagreement provides. However, the existence of the facts on which the recipient bases such findings shall be in issue and may be reviewed in proceedings under the Remedies clause of this subagreement.

(b) In the event this subagreement is terminated as provided in paragraph (a), the recipient may pursue the same remedies against the contractor as it could pursue in the event of a breach of the subagreement by the contractor, and as a penalty, in addition to any other damages to which it may be entitled by law, be entitled to exemplary damages in an amount (as determined by the recipient) which shall be not less than three nor more than ten times the costs the contractor incurs in providing any such gratuities to any such officer or employee.

#### 12. Buy American

*This clause applies only to construction subagreements award under 40 CFR Part 35 Subparts E and I. In accordance with section 215 of the Clean Water Act (33 U.S.C. 1251 et seq.) and implementing EPA regulations, the contractor agrees that preference will be given to domestic construction material by the contractor, subcontractors, materialmen and suppliers in the performance of this subagreement.*

#### 13. Responsibility of the Contractor

(a) *The following clause applies only to subagreements for services.* (1) The contractor is responsible for the professional quality, technical accuracy, timely completion and coordination of all designs, drawings, specifications, reports and other services furnished by the contractor under this subagreement. If the subagreement involves environmental measurements or data generation, the contractor shall comply with EPA quality assurance requirements in 40 CFR 30.503. The contractor shall, without additional compensation, correct or revise any errors, omissions or other deficiencies in

his designs, drawings, specifications, reports and other services.

(2) The contractor shall perform the professional services necessary to accomplish the work specified in this subagreement in accordance with this subagreement and applicable EPA requirements in effect on the date of execution of the assistance agreement for this project.

(3) The owner's or EPA's approval of drawings, designs, specifications, reports and incidental work or materials furnished hereunder shall not in any way relieve the contractor of responsibility for the technical adequacy of his work. Neither the owner's nor EPA's review, approval, acceptance or payment for any of the services shall be construed as a waiver of any rights under this agreement or of any cause for action arising out of the performance of this subagreement.

(4) The contractor shall be, and shall remain, liable in accordance with applicable law for all damages to the owner or EPA caused by the contractor's negligent performance of any of the services furnished under this subagreement, except for errors, omissions or other deficiencies to the extent attributable to the owner, owner-furnished data or any third party. The contractor shall not be responsible for any time delays in the project caused by circumstances beyond the contractor's control.

(5) The contractor's obligations under this clause are in addition to the contractor's other express or implied assurances under this subagreement or State law and in no way diminish any other rights that the owner may have against the contractor for faulty materials, equipment or work.

(b) *The following clause applies only to subagreements for construction.* (1) The contractor agrees to perform all work under this subagreement in accordance with this agreement's designs, drawings and specifications.

(2) The contractor guarantees for a period of at least one (1) year from the date of substantial completion of the work that the completed work is free from all defects due to faulty materials, equipment or workmanship and that he shall promptly make whatever adjustments or corrections which may be necessary to cure any defects, including repairs of any damage to other parts of the system resulting from such defects. The owner shall promptly give notice to the contractor of observed defects. In the event that the contractor fails to make adjustments, repairs, corrections or other work made necessary by such defects, the owner may do so and charge the contractor the cost incurred. The performance bond shall remain in full force and effect through the guarantee period.

(3) The contractor's obligations under this clause are in addition to the contractor's other express or implied assurances under this subagreement or State law and in no way diminish any other rights that the owner may have against the contractor for faulty materials, equipment or work.

#### 14. Final Payment

Upon satisfactory completion of the work performed under this subagreement, as a

condition before final payment under this subagreement or as a termination settlement under this subagreement the contractor shall execute and deliver to the owner a release of all claims against the owner arising under, or by virtue of, this subagreement, except claims which are specifically exempted by the contractor to be set forth therein. Unless otherwise provided in this subagreement, by State law or otherwise expressly agreed to by the parties to this subagreement, final payment under this subagreement or settlement upon termination of this subagreement shall not constitute a waiver of the owner's claims against the contractor or his sureties under this subagreement or applicable performance and payment bonds.

#### Subpart G—Protests

##### § 33.1105 Applicability and scope of this subpart.

This subpart sets forth EPA's administrative process for the rapid resolution of protest appeals filed with the award official.

##### § 33.1110 Recipient protest procedures.

(a) Recipients must establish their own procedures for prompt consideration of initial protests concerning their solicitations or contract awards. A "protest" is a written complaint concerning the recipient's solicitation or award of a subagreement. It must be filed with the recipient by a party with a direct financial interest adversely affected by a recipient's procurement action (see § 33.1130 "Review of protest appeal").

(b) The recipient should review each protest received to determine whether it is appropriate to defer the protested procurement action.

(c) If the recipient does not defer the procurement action, it assumes the risk that the award official may disallow the cost of the protested procurement action if the protest appeal is upheld.

##### § 33.1115 Protest appeal.

(a) A party with a financial interest which is adversely affected by the recipient's decision on the initial protest may file a "protest appeal" with the award official.

(b) A "protest appeal" is a written complaint filed with the award official regarding the recipient's determination of a protest.

##### § 33.1120 Limitations on protest appeals.

(a) The award official shall not accept a protest appeal until the protester has exhausted all administrative remedies at the recipient level.

(b) A protest appeal is limited to the following:

(1) Issues arising under the procurement provisions of this Part, or

(2) Alleged violations of State or local law or ordinances where the award official determines that there is an overriding Federal requirement.

(c) A recipient of a lower tier subagreement (subcontract) may only file a protest appeal for issues which relate to the award of a subagreement by a contractor (see § 33.295 "Subagreements awarded by a contractor").

#### § 33.1125 Filing requirements.

(a) Protest appeals must be filed with the Assistant General Counsel for Grants for Headquarters-awarded assistance agreements and with the Office of Regional Counsel for regionally awarded assistance agreements.

(b) A protest appeal must:

- (1) Be written;
- (2) Include a copy of the recipient's determination of the protest;
- (3) State the basis for the appeal; and
- (4) Request a determination under this subpart.

(c) Upon filing a protest appeal with the Regional Counsel or Assistant General Counsel for Grants, as appropriate, the party filing the protest appeal must concurrently transmit a copy of all protest documents and any attachments to all other parties with a direct financial interest which may be adversely affected by the determination of the protest appeal.

(d) The award official will only consider written protest appeals received by the appropriate Counsel's office within seven calendar days after the adversely affected party receives the recipient's determination of protest. However, the adversely affected party can meet the seven-day notice requirement by telegraphing the Counsel within the seven-calendar-day period of its intent to file a protest appeal, provided the adversely affected party submits a complete protest appeal within seven calendar days of the date it sends the telegram. If the seventh day falls on a Saturday, Sunday or holiday, the next working day shall be the last day to submit a protest appeal.

(e) Any party which submits a document to the award official during the course of a protest appeal must simultaneously furnish all other affected parties with a copy of the document.

#### § 33.1130 Review of protest appeal.

(a) If the recipient does not receive the initial protest before bid opening or the closing date for receipt of proposals, the award official may dismiss as untimely a protest appeal based upon alleged improprieties in the solicitation which were clearly apparent before bid opening or before the deadline for

receipt of initial proposals. In negotiated procurements, protests of alleged improprieties which were incorporated in a new solicitation must have been received by the recipient by the closing date for receipt of proposals for the new solicitation.

(b) In cases not involving improprieties in the solicitation, the award official may dismiss as untimely a protest appeal if the adversely affected party did not file the initial protest with the recipient within seven calendar days of the date the basis for the protest was known or should have been known, whichever is earlier.

#### § 33.1140 Deferral of procurement action.

When the award official receives a protest appeal and the recipient has not deferred the procurement action under § 33.1110(b), the award official must promptly request that the recipient defer the protested procurement action until the award official notifies the recipient of the formal or informal resolution of the appeal. The request shall be limited to the award of the subagreement or subitem which is the basis of the protest appeal.

#### § 33.1145 Award official's review.

(a) The award official may establish rules of procedures or deadlines for the submission of materials or the arrangement of protest appeal conferences.

(b) The award official may summarily dismiss an appeal without proceedings under this subpart if:

- (1) The protest appeal is not reviewable, see § 33.1130, or addresses issues other than those allowed under § 33.1120(b);
- (2) The protester substantially fails to comply with the procedural requirements of this subpart; or
- (3) The protester does not agree to the recipient's request for a reasonable extension of the bid and bond period.

(c) The award official may summarily deny a protest appeal without proceedings under this subpart if, after considering the facts in a light most favorable to the protester, the award official believes that the protest lacks merit.

(d) The award official will give both the recipient and the protester, as well as any other party with a financial interest which may be adversely affected by the determination of protest, an opportunity to present arguments in support of their views in writing or at a conference.

(e) After the announced date for receipt of written arguments, the record shall be closed.

(f) The award official shall review the record considered by the recipient and any other documents or arguments presented by the parties to determine whether the recipient has complied with the procurement requirements of this part and has a rational basis for its determination of protest.

(g) The award official's determination shall constitute final EPA action from which there shall be no further administrative appeal. No party may appeal an award official's determination of appeal to the EPA Board of Assistance Appeals.

(h) Nothing in this subpart precludes the award official from reviewing the recipient's procurement action. (See § 33.115.)

(i) Noncompliance with the award official's determination of protest shall be cause for an action against the recipient under 40 CFR Part 30 or 32.

(j) If an appeal involves legal issues not explicitly addressed by this part, the award official shall resolve the issue by referring to other protest determinations under this section and decisions of the Comptroller General of the United States or of the Federal courts addressing Federal requirements comparable to procurement requirements of this part.

#### Appendix A.—Procedural Requirements for Recipients Who Do Not Certify Their Procurement Systems, or for Recipients Who Have Their Procurement Certifications Revoked By EPA

(a) The following procedural requirements apply to recipients who:

- (1) Do not certify to EPA that their procurement system meets the minimum procurement requirements in this part; or
- (2) Have their procurement certification revoked by the award official, as stated in § 33.116(b).

(b) Those recipients must comply with the requirements in this part plus the following procedural requirements. These procedural requirements supplement the requirements in the sections cited.

(1) To comply with § 33.250, "Documentation," the recipient must submit to the award official the records required by this section.

(2) To comply with § 33.290, "Cost and price considerations," the recipient's contractors and subcontractors must submit their cost or price data on EPA Form 5700-41, "Cost or Price Summary Format for Subagreements Under U.S. EPA Grants," or in another format which provides information similar to that required by EPA Form 5700-41.

(3) To comply with § 33.415, "Time for preparing bids," the recipient must allow at least 30 days between the date when it first publishes the public notice and the date by which bids must be submitted.

(4) To comply with § 33.415, "Public notice and solicitation of bids," the recipient must publish the notice in professional journals,

newspapers, or publications of general circulation over a reasonable area for at least 30 days before bid opening.

(5) To comply with § 33.510, "Adequate public notice," the recipient must publish the notice in professional journals, newspapers, or publications of general circulation over a reasonable area for at least 30 days before the deadline for receipt of proposals. The recipient may use posted public notices or written notification directed to interested persons, firms or professional organizations.

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33.235	<u>PROFITS</u> - System procedures must allow only fair and reasonable profits to contractors.
33.240	<u>SMALL, MINORITY, WOMEN'S, AND LABOR SURPLUS AREA BUSINESSES</u> - System must provide for use of these businesses as specified in this section.
33.250	<u>DOCUMENTATION</u> - System must require that procurement records and files for purchases over \$10,000 include items specified in this section.
33.255	<u>SPECIFICATIONS</u> - System procedures for establishing specifications for products or services to be procured must meet requirements of this section.
33.265	<u>BONDING AND INSURANCE</u> - System procedures and requirements related to bonding and insurance must meet requirements of this section.
33.270	<u>CODE OF CONDUCT</u> - System must have a written code or standards of conduct meeting the requirements of this section.
33.275	<u>FEDERAL COST PRINCIPLES</u> - System procedures for determining allowable costs must comply with the cost principles specified in this section.
33.285	<u>PROHIBITED TYPES OF CONTRACTS</u> - System may not allow use of cost-plus-percentage-of cost (multiplier) or percentage-of-construction-cost types of contracts.
33.290	<u>COST AND PRICE CONSIDERATIONS</u> - System procedures must allow for consideration of cost and price as required in this section.
33.295	<u>SUBAGREEMENTS AWARDED BY A CONTRACTOR</u> - System must provide that the contractor's subagreements comply with provisions specified in this section.
33.305-310	<u>SMALL PURCHASE</u> - System small purchase procedures must meet requirements of these sections.
33.405-435	<u>FORMAL ADVERTISING</u> - System procedures related to formal advertising, including those for bidding documents and contract awards, must meet the requirements of these sections.
33.505-535	<u>COMPETITIVE NEGOTIATION</u> - System procedures for competitive negotiation must meet the requirements of these sections.
33.605	<u>NONCOMPETITIVE NEGOTIATION</u> - System procedures for noncompetitive negotiation must meet the requirements of this section.
<b>SUBPARTS C - G</b>	<b>SYSTEM MUST COMPLY WITH REQUIREMENTS IN THESE SUBPARTS:</b>
<b>C</b>	<u>CLEAN WATER ACT REQUIREMENTS</u> - Subpart applies to procurement under assistance agreements for construction of treatment works under the Clean Water Act.
<b>D</b>	<u>REQUIREMENTS FOR INSTITUTIONS OF HIGHER EDUCATION AND OTHER NONPROFIT ORGANIZATION</u> - Subpart describes the procurement requirements for nonprofit organizations.
<b>E</b>	<u>REQUIREMENTS FOR RECIPIENTS OF REMEDIAL ACTION COOPERATIVE AGREEMENTS UNDER THE COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION AND LIABILITY ACT OF 1980</u> - Subpart describes the additional procurement requirements for recipients of these cooperative agreements.
<b>F</b>	<u>SUBAGREEMENT PROVISIONS</u> - Subagreements for procurement under EPA Assistance must contain the appropriate clauses, or their equivalent, specified in this subpart.
<b>G</b>	<u>PROTESTS</u> - Subpart applies to all applicants for EPA assistance except for nonprofit organizations.



OMB Circular A-122 "Cost Principles  
for Non-Profit Organizations"

## OMB CIRCULAR A-122, "COST PRINCIPLES FOR NONPROFIT ORGANIZATIONS"

## OFFICE OF MANAGEMENT AND BUDGET

## Circular A-122, "Cost Principles for Nonprofit Organizations"

AGENCY: Office of Management and Budget.

ACTION: Final Policy.

**SUMMARY:** This notice advises of a new OMB Circular dealing with principles for determining costs of grants, contracts, and other agreements with nonprofit organizations.

The Circular is the product of an interagency review conducted over a two-year period. Its purpose is to provide a set of cost principles to replace existing principles issued by individual agencies. These have often contained varying and conflicting requirements, and created confusion among agency administrators, auditors, and nonprofit officials. The new Circular will provide a uniform approach to the problem of determining costs, and promote efficiency and better understanding between recipients and the Federal Government.

**EFFECTIVE DATE:** The Circular becomes effective on issuance.

**FOR FURTHER INFORMATION CONTACT:** Palmer A. Marcantonio, Financial Management Branch, Office of Management and Budget, Washington, D.C. 20503, (202) 395-4773.

**SUPPLEMENTARY INFORMATION:** Before the Circular became final there was extensive coordination with the affected nonprofit organizations, professional associations, Federal agencies and others. All interested persons were given an opportunity to comment on the proposed Circular through informal consultations and a notice in the Federal Register. In response to our requests for comment, we received about 100 letters from Federal agencies, nonprofit organizations, associations, and other interested members of the public. These comments were considered in the final version of the Circular. There follows a summary of the major comments and the action taken on each.

In addition to the changes described, other changes have been made to improve the clarity and readability of the Circular. To the extent possible, we have tried to make the language of this Circular consistent with that of cost principles for educational institutions (Circular A-21), and State and local governments (Circular 74-4).

**Summary of Significant Changes:**

Set forth are changes that have been made in the final Circular as a result of

public comments. The more significant changes to the basic Circular and Attachment A include:

1. Paragraph 2, "Supersession" was added to the basic Circular to make it clear that this Circular supersedes cost principles issued by individual agencies.

2. Paragraph 4 of the basic Circular has been amended to make it clear that the absence of an advance agreement on any element of cost will not in itself affect the reasonableness of allocability of that element. Also, this paragraph was amended to make it clear that where an item of cost requiring prior approval is specified in the budget, approval of the budget constitutes approval of the cost.

3. Paragraph 5 of the basic Circular has been changed to remove any doubt as to which nonprofit organizations would not be covered by the Circular. Now, Appendix C to the Circular lists all exclusions.

4. Paragraph 8 was added to the basic Circular to permit Federal agencies to request exceptions from the requirements of the Circular.

5. Paragraph E.2. was added to Attachment A to cover the negotiation and approval of indirect cost rates, and to provide for cognizance arrangements.

The more significant changes to Attachment B to the Circular include:

1. Paragraph 5, *Compensation for Personal Services*, was modified to:

a. Permit Federal agencies to accept a substitute system for documenting personnel costs through means other than personnel activity reports.

b. Clarify provisions covering the allowability of costs for unemployment compensation or workmen's compensation, and costs of insurance policies on the lives of trustees, officers, or other employees.

c. Make unallowable any increased costs of pension plans caused by delayed funding.

d. Delete a paragraph dealing with review and approval of compensation of individual employees.

2. Paragraph 6, *Contingencies*, was changed to make it clear that the term "contingency reserves" excludes self-insurance reserves or pension funds.

3. Paragraph 10 was modified to provide that the value of donated services used in the performance of a direct cost activity shall be allocated a share of indirect cost only when (a) the aggregate value of the service is material, (b) the services are supported by a significant amount of the indirect cost incurred by the organization, and (c) the direct cost activity is not pursued primarily for the benefit of the Federal Government. Provisions were also added to this paragraph for the

cognizant agency and the recipient to negotiate when there is no basis for determining the fair market value of the services rendered, and to permit indirect costs allocated to donated services to be charged to an agreement or used to meet cost sharing or matching requirements.

4. Paragraph 31, *Equipment and Other Capital Expenditures*, was changed. Capital equipment is now defined as having an acquisition cost of \$500 and a useful life of more than two years.

5. Paragraph 26, *Meetings, Conferences*. The prior approval requirement for charging meetings and conferences as a direct cost was deleted. A sentence was added to make it clear such costs were allowable provided they meet the criterion for the allowability of cost shown in Attachment A.

6. Paragraph 27, *Organization Costs*, was amended to provide that organization costs may be allowable when approved in writing by the awarding agency.

7. Paragraph 30, *Page Charges in Professional Journals*, was revised to provide that page charges may be allowable.

8. Paragraph 37, *Public Information Service Costs*, was modified to make public information costs allowable as direct costs with awarding agency approval.

9. Paragraph 43, *Rental Costs*, was rewritten to:

a. Make it clear that rental costs under leases which create a material equity on the leased property are allowable only to the amount that the organization would have been allowed had they purchased the property; e.g., depreciation or use allowances, maintenance, taxes, insurance, etc.

b. Clarify the criteria for material equity leases.

10. Paragraph 51, *Travel Costs*, was amended to delete the prior approval requirement for domestic travel. In addition to the above, a number of editorial changes were made to the original document.

**Suggested Changes Not Considered Necessary.**

**Comment.** Several respondents questioned the provision that, for "less than arm's length" leases, rental costs are allowable only up to the amount that would be allowed had title to the property been vested in the grantee organization. In their opinion this rule will result in unnecessary cost to the Federal Government, since it would encourage an organization to lease space on the commercial market at higher rate.

**Response.** The cost principles are designed to cover most situations; however, there are always exceptions that must be considered on a case-by-case basis. The Circular contains a provision for Federal agencies to request exceptions.

**Comment.** Several respondents questioned why interest is not an allowable cost, since it is an ordinary and necessary cost of doing business.

**Response.** It has been a longstanding policy not to recognize interest as a cost. However, this policy has recently been revised for State and local governments in Circular 74-4, with respect to the cost of office space. The revision provides that "rental" rates for publicly owned buildings may be based on actual costs, including depreciation, interest, operation and maintenance costs, and other allowable costs. This revision was under consideration for some time. It was studied extensively by OMB, the General Accounting Office and others, and considerable analysis went into its formulation. Suggestions for extending it to nonprofit organizations would have to be examined with equal care. This has not yet been done, and we were reluctant to further delay issuance of this Circular.

**Comment.** Several respondents questioned why public information costs were not allowable as an indirect cost.

**Response.** Public information costs are often direct services to an organization's other programs. They are allowable, however, as a direct charge when they are within the scope of work of a particular agreement.

**Comment.** One respondent suggested that smaller grantees be excluded from complying with the Circular.

**Response.** Similar rules for the 50 selected items of cost would be needed regardless of the size of the grantee. To the extent possible, the Circular provides simplified methods for smaller grantees.

**Comment.** One respondent said the requirements of the Cost Accounting Standards Board should be applied to cover contracts with nonprofit organizations.

**Response.** It is unlikely that the type of grantees covered by this Circular would have contracts large enough to be covered by the CASB. In the event that they do, however, the regulations of the CASB would apply.

**Comment.** One respondent said the allocation of indirect cost to donated services would pose a tremendous difficulty to the organization. The organization relies on a corps of approximately 8,000 committee members to carry out obligations in response to Government requests. There is no

employer relationship in the arrangements for this assistance, nor are there committee members normally reimbursed for such services. Further, it was pointed out the committee members spend many thousands of hours outside the organization's premises conducting research.

**Response.** It would appear that this type of committee arrangement would not be considered in the determination of the organization's indirect cost rate provided that Federal agreements do not bear an unreasonable share of indirect cost. However, the cognizant agency will be responsible for evaluating the allocation of indirect cost where there are committee-type arrangements on a case-by-case basis.

**Comment.** One respondent suggested that wherever possible the language in the *Federal Procurement Regulations* be used for nonprofit organizations.

**Response.** The language in the *Federal Procurement Regulations* was designated primarily for commercial firms, and is not necessarily well suited to nonprofit organizations. At the suggestion of the General Accounting Office, the nonprofit cost principles were written to conform as closely as possible to those of educational institutions (Circular A-21), and State and local governments (Circular 74-4).  
John J. Loran,  
Chief, Financial Management Branch.

[Circular No. A-122]

June 27, 1980

To The Heads of Executive Departments and Establishments

Subject: Cost principles for nonprofit organizations.

1. **Purpose.** This Circular establishes principles for determining costs of grants, contracts and other agreements with nonprofit organizations. It does not apply to colleges and universities which are covered by Circular A-21; State, local, and federally recognized Indian tribal governments which are covered by Circular 74-4; or hospitals. The principles are designed to provide that the Federal Government bear its fair share of costs except where restricted or prohibited by law. The principles do not attempt to prescribe the extent of cost sharing or matching on grants, contracts, or other agreements. However, such cost sharing or matching shall not be accomplished through arbitrary limitations on individual cost elements by Federal agencies. Provision for profit or other increment above cost is outside the scope of this Circular.

2. **Supersession.** This Circular supersedes cost principles issued by

individual agencies for nonprofit organization.

3. **Applicability.** a. These principles shall be used by all Federal agencies determining the costs of work performed by nonprofit organizations under grant cooperative agreements, cost reimbursement contracts, and other contracts in which costs are used in pricing, administration, or settlement. All of these instruments are hereafter referred to as awards. The principles not apply to awards under which an organization is not required to account to the Government for actual costs incurred.

b. All cost reimbursement subawards (subgrants, subcontracts, etc.) are subject to those Federal cost principles applicable to the particular organization concerned. Thus, if a subaward is to a nonprofit organization, this Circular shall apply; if a subaward is to a commercial organization, the cost principles applicable to commercial concerns shall apply; if a subaward is a college or university, Circular A-2 shall apply; if a subaward is to a State, local, or federally recognized Indian tribal government, Circular 74-4 shall apply.

4. **Definitions.** a. "Nonprofit organization" means any corporation, trust, association, cooperative, or other organization which (1) is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest; (2) is not organized primarily for profit; and (3) uses its net proceeds to maintain, improve, and/or expand its operations. For this purpose, the term "nonprofit organization" excludes (i) colleges and universities; (ii) hospitals; (iii) State, local, and federally recognized Indian tribal governments; and (iv) those nonprofit organizations which are excluded from coverage of this Circular in accordance with paragraph 5 below.

b. "Prior approval" means securing the awarding agency's permission in advance to incur cost for those items that are designated as requiring prior approval by the Circular. Generally permission will be in writing. When item of cost requiring prior approval is specified in the budget of an award, approval of the budget constitutes approval of that cost.

5. **Exclusion of some nonprofit organizations.** Some nonprofit organizations, because of their size, nature of operations, can be considered to be similar to commercial concerns for purposes of applicability of cost principles. Such nonprofit organizations shall operate under Federal cost principles applicable to commercial concerns. A listing of these

organizations is contained in Attachment C. Other organizations may be added from time to time.

**6. Responsibilities.** Agencies responsible for administering programs that involve awards to nonprofit organizations shall implement the provisions of this Circular. Upon request, implementing instruction shall be furnished to the Office of Management and Budget. Agencies shall designate a liaison official to serve as the agency representative on matters relating to the implementation of this Circular. The name and title of such representative shall be furnished to the Office of Management and Budget within 30 days of the date of this Circular.

**7. Attachments.** The principles and related policy guides are set forth in the following Attachments:

Attachment A—General Principles

Attachment B—Selected Items of Cost

Attachment C—Nonprofit

Organizations Not Subject to This Circular

**8. Requests for exceptions.** The Office of Management and Budget may grant exceptions to the requirements of this Circular when permissible under existing law. However, in the interest of achieving maximum uniformity, exceptions will be permitted only in highly unusual circumstances.

**9. Effective Date.** The provisions of this Circular are effective immediately. Implementation shall be phased in by incorporating the provisions into new awards made after the start of the organization's next fiscal year. For existing awards the new principles may be applied if an organization and the cognizant Federal agency agree. Earlier implementation, or a delay in implementation of individual provisions is also permitted by mutual agreement between an organization and the cognizant Federal agency.

**10. Inquiries.** Further information concerning this Circular may be obtained by contacting the Financial Management Branch, Budget Review Division, Office of Management and Budget, Washington, D.C. 20503, telephone (202) 395-4773.

James T. McIntyre, Jr.,  
Director.

[Circular No. A-122]

#### Attachment A

##### General Principles

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##### A. Basic Considerations

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##### E. Negotiation and Approval of Indirect Cost Rates

1. Definitions
2. Negotiations and approval of rates

[Circular No. A-122]

#### Attachment A

##### General Principles

##### A. Basic Considerations.

**1. Composition of total costs.** The total cost of an award is the sum of the allowable direct and allocable indirect costs less any applicable credits.

##### 2. Factors affecting allowability of costs.

To be allowable under an award, costs must meet the following general criteria:

a. Be reasonable for the performance of the award and be allocable thereto under these principles.

b. Conform to any limitations or exclusions set forth in these principles or in the award as to types or amount of cost items.

c. Be consistent with policies and procedures that apply uniformly to both federally financed and other activities of the organization.

d. Be accorded consistent treatment.

e. Be determined in accordance with generally accepted accounting principles.

f. Not be included as a cost or used to meet cost sharing or matching requirements of any other federally financed program in either the current or a prior period.

g. Be adequately documented.

**3. Reasonable costs.** A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with organizations or separate divisions thereof which receive the preponderance of their support from awards made by Federal agencies. In determining the reasonableness of a given cost, consideration shall be given to:

a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award.

b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.

c. Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and

clients, the public at large, and the Government.

d. Significant deviations from the established practices of the organization which may unjustifiably increase the award costs.

##### 4. Allocable costs.

a. A cost is allocable to a particular cost objective, such as a grant, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a Government award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:

(1) Is incurred specifically for the award.

(2) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received.

(3) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.

b. Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the award.

##### 5. Applicable credits.

a. The term applicable credits refers to those receipts, or reduction of expenditures which operate to offset or reduce expenses items that are allocable to awards as direct or indirect costs. Typical examples of such transactions are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing or received by the organization relate to allowable cost they shall be credited to the Government either as a cost reduction or cash refund appropriate.

b. In some instances, the amounts received from the Federal Government to finance organizational activities or service operations should be treated as applicable credits. Specifically, the concept of netting such credit items against related expenditures should be applied by the organization in determining the rates or amounts to be charged to Federal awards for services rendered whenever the facilities or other resources used in providing such services have been financed directly, in whole or in part, by Federal funds.

a(c) For rules covering program income (i.e., gross income earned from federally supported activities) see Attachment D of OMB Circular A-110.

**6. Advance and understandings.** Under any given award the reasonableness and allocability of certain items of costs may be difficult to determine. This particularly true in connection with organizations that receive a preponderance of their support from Federal agencies. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, it is often desirable to seek a written agreement with the cognizant or awarding agency in advance of the incurrence of special or unusual costs. The absence of an advance agreement on any element of cost will not, in itself, affect the reasonableness or allocability of that element.

### B. Direct Costs

1. Direct costs are those that can be identified specifically with a particular final cost objective: i.e., a particular award, project, service, or other direct activity of an organization. However, a cost may not be assigned to an award as a direct cost if any other cost incurred for the same purpose, in like circumstance, has been allocated to an award as an indirect cost. Cost identified specifically with awards are direct cost of the awards and are to be assigned directly thereto. Cost identified specifically with other final cost objectives of the organization are direct costs of those cost objectives and are not to be assigned to other awards directly or indirectly.

2. Any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where the account treatment for such cost is consistently applied to all final cost objectives.

3. The cost of certain activities are not allowable as charges to Federal awards (see, for example, fund raising costs in paragraph B1 of Attachment B). However, even though these costs are unallowable for purposes of computing charges to Federal awards, they nonetheless must be treated as direct cost for purposes of determining indirect cost rates and be allocated their share of the organization's indirect costs if they represent activities which (1) include the salaries of personnel, (2) occupy space, and (3) benefit from the organization's indirect costs.

4. The costs of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the organization's mission must be treated as direct costs when or not allowable and be allocated an equitable share of indirect costs. Some examples of these types of activities include:

- a. Maintenance of membership rolls, subscriptions, publications, and related functions.
- b. Providing services and information to members, legislative or administrative bodies, or the public.
- c. Promotion, lobbying, and other forms of public relations.
- d. Meetings and conferences except those held to conduct the general administration of the organization.
3. Maintenance, protection, and investment of special funds not used in operation of the organization.
1. Administration of group benefits on behalf of members of clients including life and hospital insurance, annuity or retirement plans, financial aid, etc.

### C. Indirect Cost

1. Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective. Direct cost of minor amounts may be treated as indirect costs under the conditions described in paragraph B2. above. After direct costs have been determined and assigned directly to awards or other work as appropriate, indirect costs are those remaining to be allocated to benefiting cost objectives. A cost may not be allocated to an award as an indirect cost if any other cost incurred for the same purpose,

in like circumstances, has been assigned to an award as a direct cost.

2. Because of the diverse characteristics and accounting practices of nonprofit organizations, it is not possible to specify the types of cost which may be classified as indirect cost in all situations. However, typical examples of indirect cost for many nonprofit organizations may include depreciation or use allowances on buildings and equipment, the costs of operating and maintaining facilities, and general administration and general expenses, such as the salaries and expenses of executive officers, personnel administration, and accounting.

### D. Allocation of Indirect Cost and Determination of Indirect Cost Rates.

#### 1. General.

a. Where a nonprofit organization has only one major function, or where all its major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures as described in paragraph 2 below.

b. Where an organization has several major functions which benefit from its indirect costs in varying degrees, allocation of indirect costs may require the accumulation of such costs into separate cost groupings which then are allocated individually to benefiting functions by means of a base which best measures the relative degree of benefit. The indirect costs allocated to each function are then distributed to individual awards and other activities included in that function by means of an indirect cost rate(s).

c. The determination of what constitutes an organization's major functions will depend on its purpose in being; the types of services it renders to the public, its clients, and its members; and the amount of effort it devotes to such activities as fund raising, public information and membership activities.

d. Specific methods for allocating indirect costs and computing indirect cost rates along with the conditions under which each method should be used are described in paragraphs 2, through 5 below.

e. The base period for the allocation of indirect costs is the period in which such costs are incurred and accumulated for allocation work performed in that period. The base period normally should coincide with the organization's fiscal year, but in any event shall be so selected as to avoid inequities in the allocation of the costs.

#### 2. Simplified allocation method.

a. Where an organization's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished by (i) separating the organization's total costs for the base period as either direct or indirect, and (ii) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. The result of this process is an indirect cost rate which is used to distribute indirect costs to individual awards. The rate should be expressed as the percentage which the total amount of allowable indirect costs bears to the base selected. This method should also be used

where an organization has only one major function encompassing a number of individual projects or activities, and is used where the level of Federal award organization is relatively small.

b. Both the direct costs and the indirect costs shall exclude capital expenditures unallowable costs. However, unallowable costs which represent activities must be included in the direct costs under the conditions described in paragraph B3.

c. The distribution base may be total costs (excluding capital expenditures other distorting items, such as major subcontracts or subgrants), direct salaries and wages, or other base which result in equitable distribution. The distribution shall generally exclude participant costs as defined in paragraph 29 of Attachment B.

d. Except where a special rate(s) is required in accordance with paragraph below, the indirect cost rate developed under the above principles is applicable to awards at the organization. If a special rate(s) is required, appropriate modification shall be made in order to develop the rate(s).

#### 3. Multiple allocation base method.

a. Where an organization's indirect benefit its major functions in varying degrees, such costs shall be accumulated into cost groupings. Each grouping shall be allocated individually to benefiting functions by means of a base which best measures relative benefits.

b. The groupings shall be established to permit the allocation of each group of costs on the basis of benefits provided to the functions. Each grouping should consist of expenses that are of like character to the functions they benefit in terms of the allocation base which measures the relative benefits provided by each function. The number of separate groupings should be held within practical limits into consideration the materiality of amounts involved and the degree of desired.

c. Actual conditions must be taken into account in selecting the base to be used in allocating the expenses in each group of benefiting functions. When an allocation is made by assignment of a cost group directly to the function benefited, the allocation shall be made in that manner. When the expenses in a grouping are general in nature, the allocation shall be made through the use of a selected base which produces results that are equitable both to the Government and the organization. Any cost element or cost factor associated with the organization's work is potentially adaptable for allocation base provided (i) it can be expressed in terms of dollars or of quantitative measures (total direct salaries and wages, staff hours, square feet used, hours of usage, documents processed, population, etc.) and (ii) it is common to the benefiting functions during the base period.

d. Except where a special indirect cost rate(s) is required in accordance with paragraph D.5. below, the separate indirect cost rates allocated to each

function shall be aggregated and treated as a common pool for that function. The costs in the common pool shall then be distributed to individual awards included in that function by use of a single indirect cost rate.

e. The distribution base used in computing the indirect cost rate for each function may be the total direct costs (excluding capital expenditures and other distorting items such as major subcontracts and subgrants), direct salaries and wages, or other base which results in an equitable distribution. The distribution base shall generally exclude participant support costs as defined in paragraph 29, Attachment B. An indirect cost rate should be developed for each separate indirect cost pool developed. The rate in each case should be stated as the percentage which the amount of the particular indirect cost pool is of the distribution base identified with that pool.

#### 4. Direct allocation method.

a. Some nonprofit organizations treat all costs as direct costs except general administration and general expenses. These organizations generally separate their costs into three basic categories: (i) General administration and general expenses, (ii) fund raising, and (iii) other direct functions (including projects performed under Federal awards), joint costs, such as depreciation, rental costs, operation and maintenance of facilities, telephone expenses, and the like are prorated individually as direct cost to each category and to each award, or other activity using a base most appropriate to the particular cost being prorated.

b. This method is acceptable provided each joint cost is prorated using a base which accurately measures the benefits provided to each award or other activity. The bases must be established in accordance with reasonable criteria, and be supported by current data. This method is compatible with the Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations issued jointly by the National Health Council, Inc., the National Assembly of Voluntary Health and Social Welfare Organizations, and the United Way of America.

c. Under this method, indirect costs consist exclusively of general administration and general expenses. In all other respects, the organization's indirect cost rates shall be computed in the same manner as that described in paragraph D.2 above.

8. Special indirect cost rates. In some instances, a single indirect cost rate for all activities of an organization or for each major function of the organization may not be appropriate, since it would not take into account those different factors which may substantially affect the indirect costs applicable to a particular segment of work. For this purpose, a particular segment of work. For this purpose, a particular segment of work may be that performed under a single award or it may consist of work under a group of awards performed in a common environment, the factors may include the physical location of the work, the level of administrative support required, the nature of the facilities or order resources employed, the scientific disciplines or technical skills involved, the organizational arrangements

used, or any combination thereof. When a particular segment of work is performed in an environment which appears to generate a significantly different level of indirect costs, provisions should be made for a separate indirect cost pool applicable to such work. The separate indirect cost pool should be developed during the course of the regular allocation process, and the separate indirect cost rate resulting therefrom should be used provided it is determined that (i) the rate differs significantly from that which would have been obtained under paragraph D.2, 3, and 4 above, and (ii) the volume of work to which the rate would apply is material.

#### E. Negotiation and Approval of Indirect Cost Rates.

1. Definitions. As used in this section, the following terms have the meanings set forth below:

a. "Cognizant agency" means the Federal agency responsible for negotiating and approving indirect cost rates for a nonprofit organization on behalf of all Federal agencies.

b. "Predetermined rate" means an indirect cost rate, applicable to a specified current or future period, usually the organization's fiscal year. The rate is based on an estimate of the costs to be incurred during the period. A predetermined rate is not subject to adjustment.

c. "Fixed rate" means an indirect cost rate which has the same characteristics as a predetermined rate, except that the difference between the estimated costs and the actual costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period.

d. "Final rate" means an indirect cost rate applicable to a specified past period which is based on the actual costs of the period. A final rate is not subject to adjustment.

e. "Provisional rate" or billing rate means a temporary indirect cost rate applicable to a specified period which is used for funding, interim reimbursement, and reporting indirect costs on awards pending the establishment of a rate for the period.

f. "Indirect cost proposal" means the documentation prepared by an organization to substantiate its claim for the reimbursement of indirect costs. This proposal provides the basis for the review and negotiation leading to the establishment of an organization's indirect cost rate.

g. "Cost objective" means a function, organizational subdivision, contract, grant, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, projects, jobs and capitalized projects.

#### 2. Negotiation and approval of rates.

a. Unless different arrangements are agreed to by the agencies concerned, the Federal agency with the largest dollar value of awards with an organization will be designated as the cognizant agency for the negotiation and approval of indirect cost rates and, where necessary, other rates such as fringe benefit and computer charge-out rates. Once an agency is assigned cognizance for a particular nonprofit organization, the assignment will not be changed unless there

is a major long-term shift in the dollar volume of the Federal awards to the organization. All concerned Federal agencies shall be given the opportunity to participate in the negotiation process, but after a rate has been agreed upon it will be accepted by all Federal agencies. When a Federal agency has to believe that special operating factors affecting its awards necessitate special indirect cost rates in accordance with paragraph D.5 above, it will, prior to the time the rates are negotiated, notify the cognizant agency.

b. A nonprofit organization which has not previously established an indirect cost rate with a Federal agency shall after the organization is advised that an award will be made and, in no event, later than three months after the effective date of the award

c. Organizations that have previously established indirect cost rates must submit a new indirect cost proposal to the cognizant agency within six months after the close of each fiscal year.

d. A predetermined rate may be negotiated for use on awards where there is reasonable assurance, based on past experience and reliable projection of the organization's costs, that the rate is not likely to exceed a rate based on the organization's actual costs.

e. Fixed rates may be negotiated where predetermined rates are not considered appropriate. A fixed rate, however, shall not be negotiated if (i) all or a substantial portion of the organization's awards are expected to expire before the carry-forward adjustment can be made; (ii) the mix of Government and non-government work at the organization is too erratic to permit an equitable carry-forward adjustment; or (iii) the organization's operations fluctuate significantly from year to year.

f. Provisional and final rates shall be negotiated where neither predetermined nor fixed rates are appropriate.

g. The results of each negotiation shall be formalized in a written agreement between the cognizant agency and the nonprofit organization. The cognizant agency shall distribute copies of the agreement to all concerned Federal agencies.

h. If a dispute arises in a negotiation of an indirect cost rate between the cognizant agency and the nonprofit organization, the dispute shall be resolved in accordance with the appeals procedures of the cognizant agency.

i. To the extent that problems are encountered among the Federal agencies in connection with the negotiation and approval process, the Office of Management and Budget will lead assistance as required to resolve such problems in a timely manner. [Circular No. A-122]

#### Attachment B

##### Selected Items of Cost

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[Circular No. A-122]

#### Attachment B

##### Selected Items of Cost

Paragraphs 1 through 50 provide principles to be applied in establishing the allowability of certain items of cost. These principles apply whether a cost is treated as direct or indirect. Failure to mention a particular item of cost is not intended to imply that it is unallowable; rather determination as to allowability in each case should be based on the treatment or principles provided for similar or related items of cost.

##### 1. Advertising costs.

a. Advertising costs mean the costs of media services and associated costs. Media advertising includes magazines, newspapers, radio and television programs, direct mail, exhibits, and the like.

b. The only advertising costs allowable are those which are solely for (i) the recruitment of personnel when considered in conjunction with all other recruitment costs, as set forth

and services, (iii) the disposal of surplus materials acquired in the performance of the award except when organizations are reimbursed for disposals at a predetermined amount in accordance with Attachment N of OMB Circular A-110 or (iv) specific requirements of the award.

2. *Bad debts.* Bad debts, including losses (whether actual or estimated) arising from uncollectible accounts and other claims, related collection costs, and related legal costs, are unallowable.

##### 3. Bid and proposal costs. (reserved)

##### 4. Bonding costs.

a. Bonding costs arise when the Government requires assurance against financial loss to itself or others by reason of the act or default of the organization. They arise also in instances where the organization requires similar assurance. Included are such bonds as bid, performance, payment, advance payment, infringement, and fidelity bonds.

b. Costs of bonding required pursuant to the terms of the award are allowable.

c. Costs of bonding required by the organization in the general conduct of its operations are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

5. *Communication costs.* Costs incurred for telephone services, local and long distance telephone calls, telegrams, radiograms, postage and the like, are allowable.

##### 6. Compensation for personal services.

a. *Definition.* Compensation for personal services includes all compensation paid currently or accrued by the organization for services of employees rendered during the period of the award (except as otherwise provided in paragraph g. below). It includes, but is not limited to, salaries, wages, director's and executive committee member's fees, incentive awards, fringe benefits, pension plan costs, allowances for off-site pay, incentive pay, location allowances, hardship pay, and cost of living differentials.

b. *Allowability.* Except as otherwise specifically provided in this paragraph the costs of such compensation are allowable to the extent that:

(1) Total compensation to individual employees is reasonable for the services rendered and conforms to the established policy of the organization consistently applied to both Government and non-Government activities; and

(2) Charges to awards whether treated as direct or indirect costs are determined and supported as required in this paragraph.

##### a. Reasonableness.

(1) When the organization is predominantly engaged in activities other than those sponsored by the Government, compensation for employees on Government-sponsored work will be considered reasonable to the extent that it is consistent with that paid for similar work in the organization's other activities.

(2) When the organization is predominantly engaged in Government-sponsored activities and in cases where the kind of employees required for the Government activities are not found in the organization's other

activities, compensation for employ Government-sponsored work will be considered reasonable to the extent comparable to that paid for similar work in the labor markets in which the organization competes for the kind of employees.

d. *Special considerations in determining allowability.* Certain conditions require special consideration and possible limitation in determining costs under Federal awards where amounts or types of compensation appear unreasonable. Among such are the following:

(1) Compensation to members of an organization, trustees, directors, executive officers, or the immediate families thereof. Determination should be made that such compensation is reasonable for the actual personal services rendered rather than distribution of earnings in excess of cost.

(2) Any change in an organization's compensation policy resulting in a substantial increase in the organization level of compensation, particularly when concurrent with an increase in the level of Government awards to other activities of the organization or any change in the treatment of allowability of specific activity compensation due to changes in Government policy.

e. *Unallowable costs.* Costs which are unallowable under other paragraphs of Attachment shall not be allowable under paragraph solely on the basis that they constitute personal compensation.

##### 1. Fringe benefits.

(1) Fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the organization such as vacation leave, sick leave, military leave, and the like, are allowable provided such costs are absorbed by all organizational activities in proportion to the relative amount of time or effort actually devoted to each activity.

(2) Fringe benefits in the form of employee contributions or expenses for social security, employee insurance, workmen's compensation insurance, pension plan costs (see paragraph g. below), and the like, are allowable provided such benefits are granted in accordance with established written organization policies. Such benefits when treated as indirect costs or as direct costs shall be distributed to particular awards other activities in a manner consistent with the pattern of benefits accruing to the individuals or group of employees whose salaries and wages are chargeable to such awards and other activities.

(3)(a) Provisions for a reserve under a social insurance program for unemployment compensation or workmen's compensation are allowable to the extent that the provisions represent reasonable estimates of the liabilities for such compensation, and types of coverage, extent of coverage, and rates and premiums would have been allowable had insurance been purchased to cover the risks. However, provisions for insured liabilities which do not become payable for more than one year after the provision is made shall not exceed the present value of the liability.

(b) Where an organization follows a consistent policy of expensing actual payments to, or on behalf of, employees or

former employees for unemployment compensation or workmen's compensation, such payments are allowable in the year of payment with the prior approval of the awarding agency provided they are allocated to all activities of the organization.

(4) Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibility are allowable only to the extent that the insurance represents additional compensation. The costs of such insurance when the organization is named as beneficiary are unallowable.

**g. Pension plan costs.**

(1) Costs of the organization's pension plan which are incurred in accordance with the established policies of the organization are allowable, provided:

(a) Such policies meet the test of reasonableness;

(b) The methods of cost allocation are not discriminatory;

(c) The cost assigned to each fiscal year is determined in accordance with generally accepted accounting principles as prescribed in Accounting Principles Board Opinion No. 8 issued by the American Institute of Certified Public Accountants; and

(d) The costs assigned to a given fiscal year are funded for all plan participants within six months after the end of that year. However, increases to normal and past service pension costs caused by a delay in funding the actuarial liability beyond 30 days after each quarter of the year to which such costs are assignable are unallowable.

(2) Pension plan termination insurance premiums paid pursuant to the Employee Retirement Income Security Act of 1974 (Pub. L. 93-406) are allowable. Late payment charges on such premiums are unallowable.

(3) Excise taxes on accumulated funding deficiencies and other penalties imposed under the Employee Retirement Income Security Act are unallowable.

**h. Incentive compensation.** Incentive compensation to employees based on cost reduction, or efficient performance, suggestion awards, safety awards, etc., are allowable to the extent that the overall compensation is determined to be reasonable and such costs are paid or accrued pursuant to an agreement entered into in good faith between the organization and the employees before the services were rendered, or pursuant to an established plan followed by the organization so consistently as to imply, in effect, an agreement to make such payment.

**i. Overtime, extra pay shift, and multishift premiums.** See paragraph 27.

**j. Severance pay.** See paragraph 44.

**k. Training and education costs.** See paragraph 48.

**l. Support of salaries and wages.**

(1) Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports as prescribed in subparagraph (2) below, except when a substitute system has been approved in writing by the awarding agency. (See paragraph E.2 of Attachment A)

(2) Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards. In addition, in order to support the allocation of indirect costs, such reports must also be maintained for other employees whose work involves two or more functions or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization's indirect cost rate(s) (e.g., an employee engaged part-time in indirect cost activities and part-time in a direct function). Reports maintained by nonprofit organizations to satisfy these requirements must meet the following standards:

(a) The reports must reflect an *after-the-fact* determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.

(b) Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.

(c) The reports must be signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports.

(d) The reports must be prepared at least monthly and must coincide with one or more pay periods.

(3) Charges for the salaries and wages of nonprofessional employees, in addition to the supporting documentation described in subparagraphs (1) and (2) above, must also be supported by records indicating the total number of hours worked each day maintained in conformance with Department of Labor regulations implementing the Fair Labor Standards Act (29 CFR Part 516). For this purpose, the term "nonprofessional employee" shall have the same meaning as "nonexempt employee," under the Fair Labor Standards Act.

(4) Salaries and wages of employees used in meeting cost sharing or matching requirements on awards must be supported in the same manner as salaries and wages claimed for reimbursement from awarding agencies.

**7. Contingency provisions.** Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable. The term "contingency reserve" excludes self-insurance reserves (see paragraph 6.f.(3) and 1Aa.(2)(d)); pension funds (see paragraph 6.(g)); and reserves for normal severance pay (see paragraph 44.(b)(1)).

**8. Contributions.** Contributions and donations by the organization to others are unallowable.

**9. Depreciation and use allowances.**

**a. Compensation for the use of buildings, other capital improvements, and equipment**

on hand may be made through use allowances or depreciation. However, except as provided in paragraph f. below a combination of the two methods may not be used in connection with a single class of fixed assets (e.g., buildings, office equipment, computer equipment, etc.).

**b.** The computation of use allowances or depreciation shall be based on the acquisition cost of the assets involved. The acquisition cost of an asset donated to the organization by a third party shall be its fair market value at the time of the donation.

**c.** The computation of use allowances or depreciation will exclude:

(1) The cost of land;

(2) Any portion of the cost of buildings and equipment borne by or donated by the Federal Government irrespective of where title was originally vested or where it presently resides; and

(3) Any portion of the cost of buildings and equipment contributed by or for the organization in satisfaction of a statutory matching retirement.

**d.** Where the use allowance method is followed, the use allowance for buildings and improvement (including land improvements such as paved parking areas, fences, and sidewalks) will be computed at an annual rate not exceeding two percent of acquisition cost. The use allowance for equipment will be computed at an annual rate not exceeding six and two-thirds percent of acquisition cost. When the use allowance method is used for buildings, the entire building must be treated as a single asset; the building's components (e.g., plumbing system, heating and air conditioning, etc.) cannot be segregated from the building's shell. The two percent limitation, however, need not be applied to equipment which is merely attached or fastened to the building but not permanently fixed to it and which is used as furnishings, decorations or for specialized purposes (e.g., dentist chairs and dental treatment units, counters, laboratory benches bolted to the floor, dishwashers, carpeting, etc.). Such equipment will be considered as not being permanently fixed to the building if it can be removed without the need for costly or extensive alterations or repairs to the building or the equipment. Equipment that meets these criteria will be subject to the six and two-thirds percent equipment use allowance limitation.

**e.** Where depreciation method is followed, the period of useful service (useful life) established in each case for usable capital assets must take into consideration such factors as type of construction, nature of the equipment used, technological developments in the particular program area, and the renewal and replacement policies followed for the individual items or classes of assets involved. The method of depreciation used to assign the cost of an asset (or group of assets) to accounting periods shall reflect the pattern of consumption of the asset during its useful life. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater or lesser in the early portions of its useful life than in the later portions, the straight-line method shall be presumed to be the appropriate method. Depreciation

methods once used shall not be changed unless approved in advance by the cognizant Federal agency. When the depreciation method is introduced for application to assets previously subject to a use allowance, the combination of use allowances and depreciation applicable to such assets must not exceed the total acquisition cost of the assets. When the depreciation method is used for buildings, a building's shell may be segregated from each building component (e.g., plumbing system, heating, and air conditioning system, etc.) and each item depreciated over its estimated useful life; or the entire building (i.e., the shell and all components) may be treated as a single asset and depreciated over a single useful life.

f. When the depreciation method is used for a particular class of assets, no depreciation may be allowed on any such assets that, under paragraph e. above, would be viewed as fully depreciated. However, a reasonable use allowance may be negotiated for such assets if warranted after taking into consideration the amount of depreciation previously charged to the Government, the estimated useful life remaining at time of negotiation, the effect of increased maintenance charges or decreased efficiency due to age, and any other factors pertinent to the utilization of the asset for the purpose contemplated.

g. Charges for use allowances or depreciation must be supported by adequate property records and physical inventories must be taken at least once every two years (a statistical sampling basis is acceptable) to ensure that assets exist and are usable and needed. When the depreciation method is followed, adequate depreciation records indicating the amount of depreciation taken each period must also be maintained.

#### 10. Donations

##### a. Services received.

(1) Donated or volunteer services may be furnished to an organization by professional and technical personnel, consultants, and other skilled and unskilled labor. The value of these services is not reimbursable either as a direct or indirect cost.

(2) The value of donated services utilized in the performance of a direct cost activity shall be considered in the determination of the organization's indirect cost rate(s) and, accordingly, shall be allocated a proportionate share of applicable indirect costs when the following circumstances exist:

(a) The aggregate value of the services is material;

(b) The services are supported by a significant amount of the indirect costs incurred by the organization;

(c) The direct cost activity is not pursued primarily for the benefit of the Federal Government.

(3) In those instances where there is no basis for determining the fair market value of the services rendered, the recipient and the cognizant agency shall negotiate an appropriate allocation of indirect cost to the services.

(4) Where donated services directly benefit a project supported by an award, the indirect costs allocated to the services will be considered as a part of the total costs of the project. Such indirect costs may be

reimbursed under the award or used to meet cost sharing or matching requirements.

(5) The value of the donated services may be used to meet cost sharing or matching requirements under conditions described in Attachment E, OMB Circular No. A-110.

Where donated services are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

(6) Fair market value of donated services shall be computed as follows:

(a) Rates for volunteer services. Rates for volunteers shall be consistent with those regular rates paid for similar work in other activities of the organization. In cases where the kinds of skills involved are not found in the other activities of the organization, the rates used shall be consistent with those paid for similar work in the labor market in which the organization competes for such skills.

(b) Services donated by other organizations. When an employer donates the services of an employee, those services shall be valued at the employee's regular rate of pay (exclusive of fringe benefits and indirect costs) provided the services are in the same skill for which the employee is normally paid. If the services are not in the same skill for which the employee is normally paid, fair market value shall be computed in accordance with subparagraph (a) above.

##### b. Goods and space.

(1) Donated goods, i.e., expendable personal property/supplies, and donated use of space may be furnished to an organization. The value of the goods and space is not reimbursable either as a direct or indirect cost.

(2) The value of the donations may be used to meet cost sharing or matching share requirements under the conditions described in Attachment E, OMB Circular No. A-110. The value of the donations shall be determined in accordance with Attachment E. Where donations are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

11. Employee morale, health, and welfare, costs and credits. The costs of house publications, health or first-aid clinics, and/or infirmaries, recreational activities, employees' counseling services, and other expenses incurred in accordance with the organization's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance are allowable. Such costs will be equitably apportioned to all activities of the organization. Income generated from any of these activities will be credited to the cost thereof unless such income has been irrevocably set over to employee welfare organizations.

12. Entertainment costs. Costs of amusement, diversion, social activities, ceremonials, and costs relating thereto, such as meals, lodging, rentals, transportation, and gratuities are unallowable (but see paragraphs 11 and 25).

13. Equipment and other capital expenditures.

a. As used in this paragraph, the following terms have the meanings set forth below:

(1) "Equipment" means an article nonexpendable tangible personal property having a useful life of more than two years and an acquisition cost of \$500 or more. An organization may use its own definition provided that it is at least as nonexpendable tangible personal property defined herein.

(2) "Acquisition cost" means the invoice unit price of an item of equipment including the cost of any modification attachments, accessories, or auxiliary apparatus necessary to make it usable for the purpose for which it is acquired. Ancillary charges, such as taxes, duty, protection insurance, freight, and installation shall be included in or excluded from acquisition cost in accordance with the organization's regular written accounting practices.

(3) "Special purpose equipment" is equipment which is usable only for a medical, scientific, or technical activity. Examples of special purpose equipment include microscopes, x-ray machines, instruments, and spectrometers.

(4) "General purpose equipment" is equipment which is usable for other than research, medical, scientific, or technical activities, whether or not special modifications are needed to make the equipment suitable for a particular purpose. Examples of general purpose equipment include office equipment and furnishings, air conditioning equipment, reproduction and printing equipment, motor vehicles, and automatic data processing equipment.

b. (1) Capital expenditures for general purpose equipment are unallowable as a direct cost except with the prior approval of the awarding agency.

(2) Capital expenditures for special purpose equipment are allowable as direct costs provided that items with a unit cost of \$500 or more have the prior approval of the awarding agency.

c. Capital expenditures for land or buildings are unallowable as a direct cost except with the prior approval of the awarding agency.

d. Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or cost are unallowable as a direct cost except with the prior approval of the awarding agency.

e. Equipment and other capital expenditures are unallowable as indirect costs. However, see paragraph 9 for allowability of use allowances or depreciation on buildings, capital improvements, and equipment. Also, see paragraph 42 for allowability of rental for land, buildings, and equipment.

14. Fines and penalties. Costs of fine penalties resulting from violations of, or failure of the organization to comply with Federal, State, and local laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of an award or instructions in writing from the awarding agency.

15. Fringe benefits. See paragraph 8.

16. Idle facilities and idle capacity.

a. As used in this paragraph the following terms have the meanings set forth below:

(1) "Facilities" means land and buildings and any portion thereof, equipment indivi-

or collectively, or any other tangible capital asset, wherever located, and whether owned or leased by the organization.

(2) "Idle facilities" means completely unused facilities that are excess to the organization's current needs.

(3) "Idle capacity" means the unused capacity of partially used facilities. It is the difference between that which a facility could achieve under 100 per cent operating time on a one-shift basis less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays, and the extent to which the facility was actually used to meet demands during the accounting period. A multi-shift basis may be used if it can be shown that this amount of usage could normally be expected for the type of facility involved.

(4) "Costs of idle facilities or idle capacity" means costs such as maintenance, repair, housing, rent, and other related costs; e.g., property taxes, insurance, and depreciation or use allowances.

b. The costs of idle facilities are unallowable except to the extent that:

(1) They are unnecessary to meet fluctuations in workload; or

(2) Although not necessary to meet fluctuations in workload, they were necessary when acquired and are now idle because of changes in program requirements, efforts to achieve more economical operations, reorganization, termination, or other causes which could not have been reasonably foreseen. Under the exception stated in this subparagraph, costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending upon the initiative taken to use, lease, or dispose of such facilities (but see paragraphs 47.b. and d.).

c. The costs of idle capacity are normal costs of doing business and are a factor in the normal fluctuations of usage or indirect cost rates from period to period. Such costs are allowable, provided the capacity is reasonably anticipated to be necessary or was originally reasonable and is subject to reduction or elimination by subletting, renting, or sale, in accordance with sound business, economics, or security practices. Widespread idle capacity throughout an entire facility or among a group of assets having substantially the same function may be idle facilities.

17. *Independent research and development* [Reserved].

18. *Insurance and indemnification.*

a. Insurance includes insurance which the organization is required to carry, or which is approved, under the terms of the award and any other insurance which the organization maintains in connection with the general conduct of its operations. This paragraph does not apply to insurance which represents fringe benefits for employees (see paragraph 8.f. and 8.g.(2)).

(1) Costs of insurance required or approved, and maintained, pursuant to the award are allowable.

(2) Costs of other insurance maintained by the organization in connection with the general conduct of its operations are allowable subject to the following limitations.

(a) Types and extent of coverage shall be in accordance with sound business practice and the rates and premiums shall be reasonable under the circumstances.

(b) Costs allowed for business interruption or other similar insurance shall be limited to exclude coverage of management fees.

(c) Costs of insurance or of any provisions for a reserve covering the risk of loss or damage to Government property are allowable only to the extent that the organization is liable for such loss or damage.

(d) Provisions for a reserve under a self-insurance program are allowable to the extent that types of coverage, extent of coverage, rates, and premiums would have been allowed had insurance been purchased to cover the risks. However, provision for known or reasonably estimated self-insured liabilities, which do not become payable for more than one year after the provision is made shall not exceed the present value of the liability.

(e) Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibilities are allowable only to the extent that the insurance represents additional compensation (see paragraph 6). The cost of such insurance when the organization is identified as the beneficiary is unallowable.

(3) Actual losses which could have been covered by permissible insurance (through the purchase of insurance or a self-insurance program) are unallowable unless expressly provided for in the award, except:

(a) Costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound business practice are allowable.

(b) Minor losses not covered by insurance, such as spoilage, breakage, and disappearance of supplies, which occur in the ordinary course of operations, are allowable.

b. Indemnification includes securing the organization against liabilities to third persons and any other loss or damage, not compensated by insurance or otherwise. The Government is obligated to indemnify the organization only to the extent expressly provided in the award.

19. *Interest, fund raising, and investment management costs.*

a. Costs incurred for interest on borrowed capital or temporary use of endowment funds, however represented, are unallowable.

b. Costs of organized fund raising, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions are unallowable.

c. Costs of investment counsel and staff and similar expenses incurred solely to enhance income from investments are unallowable.

d. Fund raising and investment activities shall be allocated an appropriate share of indirect costs under the conditions described in paragraph B of Attachment A.

20. *Labor relations costs.* Costs incurred in maintaining satisfactory relations between the organization and its employees, including costs of labor management committees, employee publications, and other related activities are allowable.

21. *Losses on other awards.* Any excess of costs over income on any award is unallowable as a cost of any other award. This includes, but is not limited to, the organization's contributed portion by reason of cost sharing agreements or any underrecoveries through negotiation of sums for, or ceilings on, indirect costs.

22. *Maintenance and repair costs.* Costs incurred for necessary maintenance, repair, or upkeep of buildings and equipment (including Government property unless otherwise provided for) which neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are allowable. Costs incurred for improvements which add to the permanent value of the buildings and equipment or appreciably prolong their intended life shall be treated as capital expenditures (see paragraph 13).

23. *Materials and supplies.* The costs of materials and supplies necessary to carry out an award are allowable. Such costs should be charged at their actual prices after deducting all cash discounts, trade discounts, rebates, and allowances received by the organization. Withdrawals from general stores or stockrooms should be charged at cost under any recognized method of pricing consistently applied. Incoming transportation charges may be a proper part of material cost. Materials and supplies charged as a direct cost should include only the materials and supplies actually used for the performance of the contract or grant, and due credit should be given for any excess materials or supplies retained, or returned to vendors.

24. *Meetings, conferences.*

a. Costs associated with the conduct of meetings, and conferences, and include the cost of renting facilities, meals, speaker fees, and the like. But see paragraph 12. *Entertainment costs*, and paragraph 29. *Participant support costs*.

b. To the extent that these costs are identifiable with a particular cost objective, they should be charged to that objective. (See paragraph B. of Attachment A.) These costs are allowable provided that they meet the general tests of allowability, shown in Attachment A to this Circular.

c. Costs of meetings and conferences held to conduct the general administration of the organization are allowable.

25. *Memberships, subscriptions, and professional activity costs.*

a. Costs of the organization's membership in civic, business, technical and professional organizations are allowable.

b. Costs of the organization's subscriptions to civic, business, professional, and technical periodicals are allowable.

c. Costs of attendance at meetings and conferences, sponsored by others when the primary purpose is the dissemination of technical information, are allowable. This includes costs of meals, transportation, and other items incidental to such attendance.

26. *Organization costs.* Expenditures, such as incorporation fees, brokers' fees, fees to promoters, organizers or management consultants, attorneys, accountants, or investment counselors, whether or not employers of the organization, in connection

organization, are unallowable except with prior approval of the awarding agency.

27. *Overtime, extra-pay shift, and multishift premiums.* Premiums for overtime, extra-pay shifts, and multishift work are allowable only with the prior approval of the awarding agency except:

- a. When necessary to cope with emergencies, such as those resulting from accidents, natural disasters, breakdowns of equipment, or occasional operational bottlenecks of a sporadic nature.
- b. When employees are performing indirect functions such as administration, maintenance, or accounting.
- c. In the performance of tests, laboratory procedures, or other similar operations which are continuous in nature and cannot reasonably be interrupted or otherwise completed.
- d. When lower overall cost to the Government will result.

28. *Page charges in professional journals.* Page charges for professional journal publications are allowable as a necessary part of research costs, where:

- a. The research papers report work supported by the Government; and
- b. The charges are levied impartially on all research papers published by the journal, whether or not by Government-sponsored authors.

29. *Participant support costs.* Participant support costs are direct costs for items such as stipends or subsistence allowances, travel allowances, and registration fees paid to or on behalf of participants or trainees (but not employees) in connection with meetings, conferences, symposia, or training projects. These costs are allowable with the prior approval of the awarding agency.

30. *Patent costs.*

a. Costs of (i) preparing disclosures, reports, and other documents required by the award and of searching the art to the extent necessary to make such disclosures, (ii) preparing documents and any other patent costs in connection with the filing and prosecution of a United States patent application where title or royalty-free license is required by the Government to be conveyed to the Government, and (iii) general counseling services relating to patent and copyright matters, such as advice on patent and copyright laws, regulations, clauses, and employee agreements are allowable (but see paragraph 34).

b. Cost of preparing disclosures, reports, and other documents and of searching the art to the extent necessary to make disclosures, if not required by the award, are unallowable. Costs in connection with (i) filing and prosecuting any foreign patent application, or (ii) any United States patent application, where the award does not require conveying title or a royalty-free license to the Government, are unallowable (also see paragraph 43).

31. *Pension plans.* See paragraph 6, g.

32. *Plant security costs.* Necessary expenses incurred to comply with Government security requirements or for facilities protection, including wages, uniforms, and equipment of personnel are allowable.

33. *Preaward costs.* Preaward costs are those incurred prior to the effective date of the award directly pursuant to the negotiation and in anticipation of the award where such costs are necessary to comply with the proposed delivery schedule or period of performance. Such costs are allowable only to the extent that they would have been allowable if incurred after the date of the award and only with the written approval of the awarding agency.

34. *Professional service costs.*

a. Costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill, and who are not officers or employees of the organization, are allowable, subject to b, c, and d, of this paragraph when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Government.

b. In determining the allowability of costs in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the following factors are relevant:

- (1) The nature and scope of the service rendered in relation to the service required.
- (2) The necessity of contracting for the service, considering the organization's capability in the particular area.
- (3) The past pattern of such costs, particularly in the years prior to Government awards.
- (4) The impact of Government awards on the organization's business (i.e., what new problems have arisen).
- (5) Whether the proportion of Government work to the organization's total business is such as to influence the organization in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under Government grants and contracts.
- (6) Whether the service can be performed more economically by direct employment rather than contracting.
- (7) The qualifications of the individual or concern rendering the service and the customary fees charged, especially on non-Government awards.
- (8) Adequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required, rate of compensation, and termination provisions).

c. In addition to the factors in paragraph b above, retainer fees to the allowable must be supported by evidence of bona fide services available or rendered.

d. Cost of legal, accounting, and consulting services, and related costs incurred in connection with defense of antitrust suits, and the prosecution of claims against the Government, are unallowable. Costs of legal, accounting and consulting services, and related costs, incurred in connection with patent infringement litigation, organization and reorganization, are unallowable unless otherwise provided for in the award (but see paragraph 47e).

35. *Profits and losses on disposition of depreciable property or other capital assets.*

a. (1) Gains and losses on sale, retirement, or other disposition of depreciable property shall be included in the year in which they occur as credits or charges to cost grouping(s)

in which the depreciation applicable property was included. The amount gain or loss to be included as a charge to the appropriate cost group shall be the difference between the realized on the property and the undepreciated basis of the property.

(2) Gains and losses on the disposition of depreciable property shall not be as a separate credit or charge unless following conditions:

(a) The gain or loss is processed in the depreciation reserve account and in the depreciation allowable under paragraph 9.

(b) The property is given in exchange part of the purchase price of a similar asset and the gain or loss is taken into account in determining the depreciation cost of the new item.

(c) A loss results from the failure to maintain permissible insurance, or otherwise provided in paragraph 1.

(d) Compensation for the use of property was provided through use allowances in lieu of depreciation accordance with paragraph 9.

(e) Gains and losses arising from extraordinary sales, retirements, or dispositions shall be considered on a by-case basis.

b. Gains or losses of any nature from the sale or exchange of property shall be excluded in computing the depreciation cost of the property above shall be excluded in computing costs.

36. *Public information service costs.*

a. Public information service costs are the cost associated with pamphlets, releases, and other forms of information services. Such costs are normally in (1) Inform or instruct individuals, the general public.

(2) Interest individuals or groups participating in a service program of the organization.

(3) Disseminate the results of sponsored and nonsponsored activities.

b. Public information service costs are allowable as direct costs with the prior approval of the awarding agency. Such costs are unallowable as indirect costs.

37. *Publication and printing costs.*

a. Publication costs include the cost of printing (including the processes of composition, plate-making, press work, binding, and the end products produced by such processes), distribution, promotion, mailing, and general handling.

b. If these costs are not identifiable as particular cost objectives, they should be allocated as indirect costs to all benefit activities of the organization.

c. Publication and printing costs are unallowable as direct costs except with prior approval of the awarding agency.

d. The cost of page charges in journals addressed paragraph 26.

38. *Rearrangement and alteration costs.* Costs incurred for ordinary or normal rearrangement and alteration of facilities are allowable. Special rearrangement and alteration costs incurred specifically for a project are allowable with the prior approval of the awarding agency.

39. *Reconversion costs.* Costs incurred for the restoration or rehabilitation of the

organization's facilities to approximately the same condition existing immediately prior to commencement of Government awards, fair wear and tear excepted, are allowable.

40. *Recruiting costs.* The following recruiting costs are allowable: cost of "help wanted" advertising, operating costs of an employment office, costs of operating an educational testing program, travel expenses including food and lodging of employees while engaged in recruiting personnel, travel costs of applicants for interviews for prospective employment, and relocation costs incurred incident to recruitment of new employees (see paragraph 41c). Where the organization uses employment agencies, costs not in excess of standard commercial rates for such services are allowable.

41. *Relocation costs.*

a. Relocation costs are costs incident to the permanent change of duty assignment (for an indefinite period or for a stated period of not less than 12 months) of an existing employee or upon recruitment of a new employee. Relocation costs are allowable, subject to the limitation described in paragraphs b, c, and d, below, provided that:

- (1) The move is for the benefit of the employer.
- (2) Reimbursement to the employee is in accordance with an established written policy consistently followed by the employer.
- (3) The reimbursement does not exceed the employee's actual (or reasonably estimated) expenses.

b. Allowable relocation costs for current employees are limited to the following:

(1) The costs of transportation of the employee, members of his immediate family and his household, and personal effects to the new location.

(2) The costs of finding a new home, such as advance trips by employees and spouses to locate living quarters and temporary lodging during the transition period, up to a maximum period of 30 days, including advance trip time.

(3) Closing costs, such as brokerage, legal, and appraisal fees, incident to the disposition of the employee's former home. These costs, together with those described in (4) below, are limited to 8 per cent of the sales price of the employee's former home.

(4) The continuing costs of ownership of the vacant former home after the settlement or lease date of the employee's new permanent home, such as maintenance of buildings and grounds (exclusive of fixing up expenses), utilities, taxes, and property insurance.

(5) Other necessary and reasonable expenses normally incident to relocation, such as the costs of cancelling an unexpired lease, disconnecting and reinstalling household appliances, and purchasing insurance against loss of or damages to personal property. The cost of cancelling an unexpired lease is limited to three times the monthly rental.

c. Allowable relocation costs for new employees are limited to those described in (1) and (2) of paragraph b. above. When relocation costs incurred incident to the recruitment of new employees have been allowed either as a direct or indirect cost and the employee resigns for reasons within his

control within 12 months after hire, the organization shall refund or credit the Government for its share of the cost. However, the costs of travel to an overseas location shall be considered travel costs in accordance with paragraph 50 and not relocation costs for the purpose of this paragraph if dependents are not permitted at the location for any reason and the costs do not include costs of transporting household goods.

d. The following costs related to relocation are allowable:

(1) Fees and other costs associated with acquiring a new home.

(2) A loss on the sale of a former home.

(3) Continuing mortgage principal and interest payments on a home being sold.

(4) Income taxes paid by an employee related to reimbursed relocation costs.

42. *Rental costs.*

a. Subject to the limitations described in paragraphs b. through d. of this paragraph, rental costs are allowable to the extent that the rates are reasonable in light of such factors as: rental costs of comparable property, if any; market conditions in the area; alternatives available; and the type, life expectancy, condition, and value of the property leased.

b. Rental costs under sale and leaseback arrangements are allowable only up to the amount that would be allowed had the organization continued to own the property.

c. Rental costs under less-than-length leases are allowable only up to the amount that would be allowed had title to the property vested in the organization. For this purpose, a less-than-arms-length lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include, but are not limited to those between (i) divisions of an organization; (ii) organizations under common control through common officers, directors, or members; and (iii) an organization and a director, trustee, officer, or key employee of the organization or his immediate family either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest.

d. Rental costs under leases which create a material equity in the leased property are allowable only up to the amount that would be allowed had the organization purchased the property on the date the lease agreement was executed; e.g., depreciation or use allowances, maintenance, taxes, insurance but excluding interest expense and other unallowable costs. For this purpose, a material equity in the property exists if the lease is noncancelable or is cancelable only upon the occurrence of some remote contingency and has one or more of the following characteristics:

(1) The organization has the right to purchase the property for a price which at the beginning of the lease appears to be substantially less than the probable fair market value at the time it is permitted to purchase the property (commonly called a lease with a bargain purchase option);

(2) Title to the property passes to the organization at some time during or after the lease period;

(3) The term of the lease (initial term plus periods covered by bargain renewal options,

if any) is equal to 75 per cent or more of the economic life of the leased property, i.e., the period the property is expected to be economically usable by one or more users.

43. *Royalties and other costs for use of patents and copyrights.*

a. Royalties on a patent or copyright or amortization of the cost of acquiring by purchase a copyright, patent, or rights thereto, necessary for the proper performance of the award are allowable unless:

(1) The Government has a license or the right to free use of the patent or copyright.

(2) The patent or copyright has been adjudicated to be invalid, or has been administratively determined to be invalid.

(3) The patent or copyright is considered to be unenforceable.

(4) The patent or copyright is expired.

b. Special care should be exercised in determining reasonableness where the royalties may have been arrived at as a result of less than arm's length bargaining, e.g.:

(1) Royalties paid to persons, including corporations, affiliated with the organization.

(2) Royalties paid to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a Government award would be made.

(3) Royalties paid under an agreement entered into after an award is made to an organization.

c. In any case involving a patent or copyright formerly owned by the organization, the amount of royalty allowed should not exceed the cost which would have been allowed had the organization retained title thereto.

44. *Severance pay.*

a. Severance pay, also commonly referred to as dismissal wages, is a payment in addition to regular salaries and wages, organizations to workers whose employment is being terminated. Costs of severance pay are allowable only to the extent that in each case, it is required by (i) law, (ii) employer-employee agreement, (iii) established policy that constitutes, in effect, an implied agreement on the organization's part, or (iv) circumstances of the particular employment.

b. Costs of severance payments are divided into two categories as follows:

(1) Actual normal turnover severance payments shall be allocated to all activities or, where the organization provides for a reserve for normal severances such method will be acceptable if the charge to current operations is reasonable in light of payments actually made for normal severances over a representative past period, and if amounts charged are allocated to all activities of the organization.

(2) Abnormal or mass severance pay is of such a conjectural nature that measurement of costs by means of an accrual will not achieve equity to both parties. Thus, accruals for this purpose are not allowable. However, the Government recognizes its obligation to participate to the extent of its fair share, in any specific payment. Thus, allowability will be considered on a case-by-case basis in the event of occurrence.

45. *Specialized service facilities.*

a. The costs of services provided by highly complex or specialized facilities operated by the organization, such as electronic

provided the charges for the services meet the conditions of either b. or c. of this paragraph and, in addition, take into account any items of income or Federal financing that qualify as applicable credits under paragraph A.5. of Attachment A.

b. The costs of such services, when material, must be charged directly to applicable awards based on actual usage of the services on the basis of a schedule of rates or established methodology that (i) does not discriminate against federally supported activities of the organization, including usage by the organization for internal purposes, and (ii) is designed to recover only the aggregate costs of the services. The costs of each service shall consist normally of both its direct costs and its allocable share of all indirect costs. Advance agreements pursuant to paragraph A.5. of Attachment A are particularly important in this situation.

c. Where the costs incurred for a service are not material, they may be allocated as indirect costs.

#### 46. Taxes.

a. In general, taxes which the organization is required to pay and which are paid or accrued in accordance with generally accepted accounting principles, and payments made to local governments in lieu of taxes which are commensurate with the local government services received are allowable, except for (i) taxes from which exemptions are available to the organization directly or which are available to the organization based on an exemption afforded the Government and in the latter case when the awarding agency makes available the necessary exemption certificates, (ii) special assessments on land which represent capital improvements, and (iii) Federal income taxes.

b. Any refund of taxes, and any payment to the organization of interest thereon, which were allowed as award costs, will be credited either as a cost reduction or cash refund, as appropriate, to the Government.

47. Termination costs. Termination of awards generally give rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the award not been terminated. Cost principles covering these items are set forth below. They are to be used in conjunction with the other provisions of this Circular in termination situations.

a. Common items. The cost of items reasonably usable on the organization's other work shall not be allowable unless the organization submits evidence that it would not retain such items at cost without sustaining a loss. In deciding whether such items are reasonably usable on other work of the organization, the awarding agency should consider the organization's plans and orders for current and scheduled activity. Contemporaneous purchases of common items by the organization shall be regarded as evidence that such items are reasonably usable on the organization's other work. Any acceptance of common items as allocable to the terminated portion of the award shall be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirements of other work.

b. Costs continuing after termination. If in a particular case, despite all reasonable efforts by the organization, certain costs cannot be discontinued immediately after the effective date of termination, such costs are generally allowable within the limitations set forth in this Circular, except that any such costs continuing after termination due to the negligent or willful failure of the organization to discontinue such costs shall be unallowable.

c. Loss of useful value. Loss of useful value of special tooling, machinery and equipment which was not charged to the award as a capital expenditure is generally allowable if:

(1) Such special tooling, machinery, or equipment is not reasonably capable of use in the other work of the organization.

(2) The interest of the Government is protected by transfer of title or by other means deemed appropriate by the awarding agency.

d. Rental costs. Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated award less the residual value of such leases. If (i) the amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the award and each further period as may be reasonable, and (ii) the organization makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease. There also may be included the cost of alterations of such leased property, provided such alterations were necessary for the performance of the award, and of reasonable restoration required by the provisions of the lease.

e. Settlement expenses. Settlement expenses including the following are generally allowable:

(1) Accounting, legal, clerical, and similar costs reasonably necessary for:

(a) The preparation and presentation to awarding agency of settlement claims and supporting data with respect to the terminated portion of the award, unless the termination is for default. (See paragraph 4.a. of Attachment L, OMB Circular No. A-110; and

(b) The termination and settlement of subawards.

(2) Reasonable costs for the storage, transportation, protection, and disposition of property provided by the Government or acquired or produced for the award, except when grantees are reimbursed for disposals at a predetermined amount in accordance with Attachment N of OMB Circular A-110.

(3) Indirect costs related to salaries and wages incurred as settlement expenses in subparagraphs (1) and (2) of this paragraph. Normally, such indirect costs shall be limited to fringe benefits, occupancy cost, and immediate supervision.

f. Claims under subawards. Claims under subawards, including the allocable portion of claims which are common to the award, and to other work of the organization are generally allowable. An appropriate share of the organization's indirect expense may be allocated to the amount of settlements with subcontractor/subgrantees, provided that the amount allocated is otherwise consistent

with the basic guidelines contained in Attachment A. The indirect expense allocated shall exclude the same and costs claimed directly or indirectly as settlement expenses.

#### 48. Training and education costs.

a. Costs of preparation and maintenance of a program of instruction including but limited to on-the-job, classroom, and apprenticeship training, designed to test the vocational effectiveness of employes including training materials, textbook salaries or wages of trainees (excluding overtime compensation which might be therefrom), and (ii) salaries of the direct training and staff when the training is conducted by the organization; or (i) tuition and fees when the training is in institution not operated by the organization are allowable.

b. Costs of part-time education, at a undergraduate or postgraduate college, including that provided at the organization's own facilities, are allowable only where course or degree pursued is relative to field in which the employee is now working or may reasonably be expected to work are limited to:

(1) Training materials.

(2) Textbooks.

(3) Fees charged by the educational institution.

(4) Tuition charged by the educational institution, or in lieu of tuition, instructor salaries and the related share of indirect costs of the educational institution to the extent that the sum thereof is not in excess of the tuition which would have been paid participating educational institution.

(5) Salaries and related costs of instructors who are employees of the organization.

(6) Straight-time compensation of an employee for time spent attending classes during working hours not in excess of 1 hour per year and only to the extent if circumstances do not permit the operator classes or attendance at classes after working hours; otherwise such compensation is unallowable.

c. Costs of tuition, fees, training materials and textbooks (but not subsistence, and any other emoluments) in connection with full-time education, including that provided by the organization's own facilities, at a postgraduate (but not undergraduate) level, are allowable only when the course degree pursued is related to the field in which the employee is now working or may reasonably be expected to work, and where the costs receive the prior approval of the awarding agency. Such costs are limited to the costs attributable to a total period to exceed one school year for each employee so trained. In unusual cases the period may be extended.

d. Costs of attendance of up to 16 weeks per employee per year at specialized programs specifically designed to enhance the effectiveness of executives or managers or to prepare employees for such positions are allowable. Such costs include enrollment fees, training materials, textbooks and related charges, employees' salaries, subsistence, and travel. Costs allowable under this paragraph do not include those courses that are part of a degree-oriented

curriculum, which are allowable only to the extent set forth in b. and c. above.

e. Maintenance expense, and normal depreciation or fair rental, on facilities owned or leased by the organization for training purposes are allowable to the extent set forth in paragraphs 9, 22, and 42.

f. Contributions or donations to educational or training institutions, including the donation of facilities or other properties, and scholarships or fellowships, are allowable.

g. Training and education costs in excess of those otherwise allowable under paragraphs b. and c. of this paragraph may be allowed with prior approval of the awarding agency. To be considered for approval, the organization must demonstrate that such costs are consistently incurred pursuant to an established training and education program, and that the course or degree pursued is relative to the field in which the employee is now working or may reasonably be expected to work.

49. *Transportation costs.* Transportation costs include freight, express, cartage, and postage charges relating either to goods purchased, in process, or delivered. These costs are allowable. When such costs can readily be identified with the items involved, they may be directly charged as transportation costs or added to the cost of such items (see paragraph 23). Where identification with the materials received cannot readily be made, transportation costs may be charged to the appropriate indirect cost accounts if the organization follows a consistent, equitable procedure in this respect.

50. *Travel costs.*

a. Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the organization. Travel costs are allowable subject to paragraphs b. through e. below, when they are directly attributable to specific work under an award or are incurred in the normal course of administration of the organization.

b. Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used results

in charges consistent with those normally allowed by the organization in its regular operations.

c. The difference in cost between first-class air accommodations and less than first-class air accommodations is allowable except when less than first-class air accommodations are not reasonably available to meet necessary mission requirements, such as where less than first-class accommodations would (i) require circuitous routing, (ii) require travel during unreasonable hours, (iii) greatly increase the duration of the flight, (iv) result in additional costs which would offset the transportation savings, or (v) offer accommodations which are not reasonably adequate for the medical needs of the traveler.

d. Necessary and reasonable costs of family movements and personnel movements of a special or mass nature are allowable, pursuant to paragraphs 40 and 41, subject to allocation on the basis of work or time period benefited when appropriate. Advance agreements are particularly important.

e. Direct charges for foreign travel costs are allowable only when the travel has received prior approval of the awarding agency. Each separate foreign trip must be approved. For purposes of this provision, foreign travel is defined as any travel outside of Canada and the United States and its territories and possessions. However, for an organization located in foreign countries, the term "foreign travel" means travel outside that country.

[Circular No. A-122]

Attachment C

Nonprofit Organizations not Subject to this Circular

Aerospace Corporation, El Segundo, California  
Argonne Universities Association, Chicago, Illinois  
Associated Universities, Incorporated, Washington, D.C.  
Associated Universities for Research and Astronomy, Tucson, Arizona  
Atomic Casualty Commission, Washington, D.C.  
Battelle Memorial Institute, Headquartered in Columbus, Ohio

Brookhaven National Laboratory, Upton, New York

Center for Energy and Environmental Research (CEEK), (University of Puerto Rico)

Commonwealth of Puerto Rico, Charles Draper Laboratory, Incorporated, Cambridge, Massachusetts, Comparative Animal Research Laboratory (CARL) (University of Tennessee), Oakridge, Tennessee

Environmental Institute of Michigan, Ann Arbor, Michigan

Hanford Environmental Health Foundation, Richland, Washington

ITT Research Institute, Chicago, Illinois  
Institute for Defense Analysis, Arlington, Virginia

Institute of Gas Technology, Chicago, Illinois  
Midwest Research Institute, Headquartered in Kansas City, Missouri

Mitre Corporation, Bedford, Massachusetts  
Montana Energy Research and Development Institute, Inc. (MERDI), Butte, Montana

National Radiological Astronomy Observatory, Green Bank, West Virginia  
Oakridge Associated Universities, Oakridge, Tennessee

Project Management Corporation, Oakridge, Tennessee

Rand Corporation, Santa Monica, California  
Research Triangle Institute, Research Triangle Park, North Carolina

Riverside Research Institute, New York, New York

Sandia Corporation, Albuquerque, New Mexico

Southern Research Institute, Birmingham, Alabama

Southwest Research Institute, San Antonio, Texas

SRI International, Menlo Park, California  
Syracuse Research Corporation, Syracuse, New York

Universities Research Association, Incorporated (National Acceleration Lab), Argonne, Illinois

Universities Corporation for Atmospheric Research, Boulder, Colorado

Nonprofit Insurance Companies such as Blue Cross and Blue Shield Organizations  
Other nonprofit organizations as negotiated with awarding agencies.

STANDARDS FOR SELECTED ITEMS OF COSTS.

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STANDARDS FOR SELECTED ITEMS OF COSTS

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## STANDARDS FOR SELECTED ITEMS OF COST

### A. Purpose and applicability.

1. Objective. This Attachment provides standards for determining the allowability of selected items of cost.

2. Application. These standards will apply irrespective of whether a particular item of cost is treated as direct or indirect cost. Failure to mention a particular item of cost in the standards is not intended to imply that it is either allowable or unallowable, rather determination of allowability in each case should be based on the treatment of standards provided for similar or related items of cost. The allowability of the selected items of cost is subject to the general policies and principles stated in Attachment A of this Circular.

### B. Allowable costs.

1. Accounting. The cost of establishing and maintaining accounting and other information systems required for the management of grant programs is allowable. This includes costs incurred by central service agencies for these purposes. The cost of maintaining central accounting records required for overall State or Indian tribal government purposes, such as appropriation and fund accounts by the Treasurer, Comptroller, similar officials, is considered to be a general expense of government and is not allowable.

2. Advertising. Advertising media includes newspapers, magazines, radio and television programs, direct mail, trade papers, and the like. The advertising costs allowable are those which are solely for:

a. Recruitment of personnel required for the grant program.

b. Solicitation of bids for the procurement of goods and services required.

c. Disposal of scrap or surplus materials acquired in the performance of the grant agreement.

d. Other purposes specifically provided for in the grant agreement.

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3. Advisory councils. Costs incurred by State advisory councils or committees established pursuant to Federal requirements to carry out grant programs are allowable. The cost of like organizations is allowable when provided for in the grant agreement.

4. Audit service. The cost of audits necessary for the administration and management of functions related to grant programs is allowable.

5. Bonding. Costs of premiums on bonds covering employees who handle grantee agency funds are allowable.

6. Budgeting. Costs incurred for the development, preparation, presentation, and execution of budgets are allowable. Costs for services of a central budget office are generally not allowable since these are costs of general government. However, where employees of the central budget office actively participate in the grantee agency's budget process, the cost of identifiable services is allowable.

7. Building lease management. The administrative cost for lease management which includes review of lease proposals, maintenance of a list of available property for lease, and related activities is allowable.

8. Central stores. The cost of maintaining and operating a central stores organization for supplies, equipment, and materials used either directly or indirectly for grant programs is allowable.

9. Communications. Communication costs incurred for telephone calls or service, teletype service, wide area telephone service (WATS), centrex, telpak (tie lines), postage, messenger service and similar expenses are allowable.

10. Compensation for personal services.

a. General. Compensation for personal services includes all remuneration, paid currently or accrued, for services rendered during the period of performance under the grant agreement, including but not necessarily limited to wages, salaries, and supplementary compensation and benefits (Section B.13.). The costs of such compensation are allowable to the extent that total compensation for individual employees: (1) is reasonable for the services rendered; (2) follows an appointment made in accordance with State, local, or Indian tribal government

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laws and rules and which meets Federal merit system or other requirements, where applicable; and (3) is determined and supported as provided in b. below. Compensation for employees engaged in federally-assisted activities will be considered reasonable to the extent that it is consistent with that paid for similar work in other activities of the State, local, or Indian tribal government. In cases where the kinds of employees required for the federally-assisted activities are not found in the other activities of the State, local, or Indian tribal government, compensation will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor market in which the employing government competes for the kind of employees involved. Compensation surveys providing data representative of the labor market involved will be an acceptable basis for evaluating reasonableness.

b. Payroll and distribution of time. Amounts charged to grant programs for: personal services, regardless of whether treated as direct or indirect costs, will be based on payrolls documented and provided in accordance with generally accepted practice of the State, local, or Indian tribal government. Payrolls must be supported by time and attendance or equivalent records for individual employees. Salaries and wages of employees chargeable to more than one grant program or other cost objective will be supported by appropriate time distribution records. The method used should produce an equitable distribution of time and effort.

#### 11. Depreciation and use allowances.

a. Grantees may be compensated for the use of buildings, capital improvements, and equipment through use allowances or depreciation. Use allowances are the means of providing compensation in lieu of depreciation or other equivalent costs. However, a combination of the two methods may not be used in connection with a single class of fixed assets.

b. The computation of depreciation or use allowance will be based on acquisition cost. Where actual cost records have not been maintained, a reasonable estimate of the original acquisition cost may be used in the computation. The computation will exclude the cost or any portion of the cost of buildings and equipment donated or borne directly or indirectly by the Federal Government through charges to Federal grant programs or otherwise, irrespective of where title was originally vested or where it presently resides. In addition, the computation will also exclude the cost of land. Depreciation or a use allowance

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on idle or excess facilities is not allowable, except when specifically authorized by the grantor Federal agency.

c. Where the depreciation method is followed, adequate property records must be maintained, and any generally-accepted method of computing depreciation may be used. However, the method of computing depreciation must be consistently applied for any specific asset or class of assets for all affected federally-sponsored programs and must result in equitable charges considering the extent of the use of the assets for the benefit of such programs.

d. In lieu of depreciation, a use allowance for buildings and improvements may be computed at an annual rate not exceeding two percent of acquisition cost. The use allowance for equipment (excluding items properly capitalized as building cost) will be computed at an annual rate not exceeding six and two-thirds percent of acquisition cost of usable equipment.

e. No depreciation or use charge may be allowed on any assets that would be considered as fully depreciated, provided, however, that reasonable use charges may be negotiated for any such assets if warranted after taking into consideration the cost of the facility or item involved, the estimated useful life remaining at time of negotiation, the effect of any increased maintenance charges or decreased efficiency due to age, and any other factors pertinent to the utilization of the facility or item for the purpose contemplated.

12. Disbursing service. The cost of disbursing grant program funds by the Treasurer or other designated officer is allowable. Disbursing services cover the processing of checks or warrants, from preparation to redemption, including the necessary records of accountability and reconciliation of such records with related cash accounts.

13. Employee fringe benefits. Costs identified under a. and b. below are allowable to the extent that total compensation for employees is reasonable as defined in Section B.10.

a. Employee benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as for annual leave, sick leave, court leave, military leave, and the like, if they are: (1) provided pursuant to an approved leave system; and (2) the cost thereof is equitably allocated to all related activities, including grant programs.

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b. Employee benefits in the form of employees' contribution or expenses for social security, employees' life health insurance plans, unemployment insurance coverage, workmen's compensation insurance, pension plans, severance pay, and the like, provided such benefits are granted under approved plans and are distributed equitably to grant programs and to other activities.

14. Employee morale, health and welfare costs. The costs of health or first-aid clinics and/or infirmaries, recreational facilities, employees' counseling services, employee information publications, and any related expenses incurred in accordance with general State, local or Indian tribal policy, are allowable. Income generated from any of these activities will be offset against expenses.

15. Exhibits. Costs of exhibits relating specifically to the grant programs are allowable.

16. Legal expenses. The cost of legal expenses required in the administration of grant programs is allowable. Legal services furnished by the chief legal officer of a State, local or Indian tribal government or his staff solely for the purpose of discharging his general responsibilities as legal officer are unallowable. Legal expenses for the prosecution of claims against the Federal Government are unallowable.

17. Maintenance and repair. Costs incurred for necessary maintenance, repair, or upkeep of property which neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are allowable.

18. Materials and supplies. The cost of materials and supplies necessary to carry out the grant programs is allowable. Purchases made specifically for the grant program should be charged thereto at their actual prices after deducting all cash discounts, trade discounts, rebates, and allowances received by the grantee. Withdrawals from general stores or stockrooms should be charged at cost under any recognized method of pricing consistently applied. Incoming transportation charges are a proper part of material cost.

19. Memberships, subscriptions and professional activities.

a. Memberships. The cost of membership in civic, business, technical and professional organizations is allowable

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provided: (1) the benefit from the membership is related to the grant program; (2) the expenditure is for agency membership; (3) the cost of the membership is reasonably related to the value of the services or benefits received; and (4) the expenditure is not for membership in an organization which devotes a substantial part of its activities to influencing legislation.

b. Reference material. The cost of books, and subscriptions to civic, business, professional, and technical periodicals is allowable when related to the grant program.

c. Meetings and conferences. Costs are allowable when the primary purpose of the meeting is the dissemination of technical information relating to the grant program and they are consistent with regular practices followed for other activities of the grantee.

20. Motor pools. The costs of a service organization which provides automobiles to user grantee agencies at a mileage or fixed rate and/or provides vehicle maintenance, inspection and repair services are allowable.

21. Payroll preparation. The cost of preparing payrolls and maintaining necessary related wage records is allowable.

22. Personnel administration. Costs for the recruitment, examination, certification, classification, training, establishment of pay standards, and related activities for grant programs, are allowable.

23. Printing and reproduction. Costs for printing and reproduction services necessary for grant administration, including but not limited to forms, reports, manuals, and informational literature, are allowable. Publication costs of reports or other media relating to grant program accomplishments or results are allowable when provided for in the grant agreement.

24. Procurement service. The cost of procurement service, including solicitation of bids, preparation and award of contracts, and all phases of contract administration in providing goods, facilities and services for grant programs, is allowable.

25. Taxes. In general, taxes or payments in lieu of taxes which the grantee agency is legally required to pay are allowable.

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26. Training and education. The cost of in-service training, customarily provided for employee development, which directly or indirectly benefits grant programs is allowable. Out-of-service training involving extended periods of time is allowable only when specifically authorized by the grantor agency.

27. Transportation. Costs incurred for freight, cartage, express, postage and other transportation costs relating either to goods purchased, delivered, or moved from one location to another are allowable.

28. Travel. Travel costs are allowable for expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business incident to a grant program. Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip, and results in charges consistent with those normally allowed in like circumstances in non-federally sponsored activities. The difference in cost between first-class air accommodations and less-than-first-class air accommodations is unallowable except when less-than-first-class air accommodations are not reasonably available. Notwithstanding the provisions of paragraphs D.6. and 8., travel costs of officials covered by those paragraphs, when specifically related to grant programs, are allowable with the prior approval of a grantor agency.

C. Costs allowable with approval of grantor agency.

1. Automatic data processing. The cost of data processing services to grant programs is allowable. This cost may include rental of equipment or depreciation on grantee-owned equipment. The acquisition of equipment, whether by outright purchase, rental-purchase agreement or other method of purchase, is allowable only upon specific prior approval of the grantor Federal agency as provided under the selected item for capital expenditures.

2. Building space and related facilities. The cost of space in privately or publicly owned buildings used for the benefit of the grant program is allowable subject to the conditions stated below. The total cost of space, whether in a privately or publicly owned building, may not exceed the rental cost of comparable space and facilities in a privately-owned building in the same locality. The cost of space procured for grant program usage may not be charged to the program for periods of

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nonoccupancy, without authorization of the grantor Federal agency.

a. Rental cost. The rental cost of space in a privately-owned building is allowable. Similar costs for publicly owned buildings newly occupied on or after October 1, 1980, are allowable where "rental rate" systems, or equivalent systems that adequately reflect actual costs, are employed. Such charges must be determined on the basis of actual cost (including depreciation based on the useful life of the building, interest paid or accrued, operation and maintenance, and other allowable costs). Where these costs are included in rental charges, they may not be charged elsewhere. No costs will be included for purchases or construction that were originally financed by the Federal Government.

b. Maintenance and operation. The cost of utilities, insurance, security, janitorial services, elevator service, upkeep of grounds, normal repairs and alterations and the like, are allowable to the extent they are not otherwise included in rental or other charges for space.

c. Rearrangements and alterations. Costs incurred for rearrangement and alteration of facilities required specifically for the grant program or those that materially increase the value or useful life of the facilities (Section C.3.) are allowable when specifically approved by the grantor agency.

d. Depreciation and use allowances on publicly-owned buildings. The costs are allowable as provided in Section B.11.

e. Occupancy of space under rental-purchase or a lease with option-to-purchase agreement. The cost of space procured under such arrangements is allowable when specifically approved by the Federal grantor agency.

3. Capital expenditures. The cost of facilities, equipment, other capital assets, and repairs which materially increase the value or useful life of capital assets is allowable when such procurement is specifically approved by the Federal grantor agency. When assets acquired with Federal grant funds are (a) sold; (b) no longer available for use in a federally-sponsored program; or (c) used for purposes not authorized by the grantor agency, the Federal grantor agency's equity in the asset will be refunded in the same proportion as Federal participation in its cost. In case any assets are traded on new items, only the net cost of the newly-acquired assets is allowable.

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#### 4. Insurance and indemnification.

a. Costs of insurance required, or approved and maintained pursuant to the grant agreement, are allowable.

b. Costs of other insurance in connection with the general conduct of activities are allowable subject to the following limitations:

(1) Types and extent and cost of coverage will be in accordance with general State or local government policy and sound business practice.

(2) Costs of insurance or of contributions to any reserve covering the risk of loss of, or damage to, Federal Government property are unallowable except to the extent that the grantor agency has specifically required or approved such costs.

c. Contributions to a reserve for a self-insurance program approved by the Federal grantor agency are allowable to the extent that the type of coverage, extent of coverage, and the rates and premiums would have been allowed had insurance been purchased to cover the risks.

d. Actual losses which could have been covered by permissible insurance (through an approved self-insurance program or otherwise) are unallowable unless expressly provided for in the grant agreement. However, costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound management practice, and minor losses not covered by insurance, such as spoilage, breakage and disappearance of small hand tools which occur in the ordinary course of operations, are allowable.

e. Indemnification. Includes securing the grantee against liabilities to third persons and other losses not compensated by insurance or otherwise. The Government is obligated to indemnify the grantee only to the extent expressly provided for in the grant agreement, except as provided in d. above.

5. Management studies. The cost of management studies to improve the effectiveness and efficiency of grant management for ongoing programs is allowable except that the cost of studies performed by agencies other than the grantee department or outside consultants is allowable only when authorized by the Federal grantor agency.

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6. Preagreement costs. Costs incurred prior to the effective date of the grant or contract, whether or not they would have been allowable thereunder if incurred after such date, are allowable when specifically provided for in the grant agreement.

7. Professional services. Costs of professional services rendered by individuals or organizations not a part of the grantee department are allowable subject to such prior authorization as may be required by the Federal grantor agency.

8. Proposal costs. Costs of preparing proposals on potential Federal Government grant agreements are allowable when specifically provided for in the grant agreement.

D. Unallowable costs.

1. Bad debts. Any losses arising from uncollectible accounts and other claims, and related costs, are unallowable.

2. Contingencies. Contributions to a contingency reserve or any similar provision for unforeseen events are unallowable.

3. Contributions and donations. Unallowable.

4. Entertainment. Costs of amusements, social activities, and incidental costs relating thereto, such as meals, beverages, lodgings, rentals, transportation, and gratuities, are unallowable.

5. Fines and penalties. Costs resulting from violations of, or failure to comply with Federal, State and local laws and regulations are unallowable.

6. Governor's expenses. The salaries and expenses of the Office of the Governor of a State, or the chief executive of a political subdivision, are considered a cost of general State or local government and are unallowable. However, for a federally-recognized Indian tribal government, only that portion of the salaries and expenses of the office of the chief executive that is a cost of general government is unallowable. The portion of salaries and expenses directly attributable to managing and operating programs by the chief executive and his staff is allowable. The allowable portion shall be determined by the Federal cognizant agency and the Indian government representatives on a reasonable basis.

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7. Interest and other financial costs. Interest on borrowings (however represented), bond discounts, cost of financing and refinancing operations, and legal and professional fees paid in connection therewith, are unallowable except when authorized by Federal legislation and except as provided for in paragraph C.2.a. of this Attachment.

8. Legislative expenses. Salaries and other expenses of the State legislature or similar local governmental bodies such as county supervisors, city councils, school boards, etc., whether incurred for purposes of legislation or executive direction, are unallowable.

9. Underrecovery of costs under grant agreements. Any excess of cost over the Federal contribution under one grant agreement is unallowable under other grant agreements.



OMB Circular A-87 "Cost Principles  
for State and Local Governments"



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

January 15, 1981

CIRCULAR NO. A-87  
Revised

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Cost principles for State and local governments

1. Purpose. This Circular establishes principles and standards for determining costs applicable to grants, contracts, and other agreements with State and local governments and federally-recognized Indian tribal governments.
2. Supersession. This Circular supersedes Federal Management Circular 74-4 as revised. The Circular is reissued under its original designation of OMB Circular A-87.
3. Summary of changes. No substantive changes are made in the Circular.
4. Policy intent. This Circular provides principles for determining the allowable costs of programs administered by State, local, and federally-recognized Indian tribal governments under grants from and contracts with the Federal Government. They are designed to provide the basis for a uniform approach to the problem of determining costs and to promote efficiency and better relationships between grantees and the Federal Government. The principles are for determining costs only and are not intended to identify the circumstances nor to dictate the extent of Federal and State or local participation in the financing of a particular project. They are designed to provide that federally-assisted programs bear their fair share of costs recognized under these principles except where restricted or prohibited by law. No provision for profit or other increment above cost is intended.

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5. Applicability and scope.

a. The provisions of this Circular apply to all Federal agencies responsible for administering programs that involve grants and contracts with State, local, and federally-recognized Indian tribal governments.

b. Its provisions do not apply to grants and contracts with:

(1) Publicly-financed educational institutions subject to Office of Management and Budget Circular A-21, and

(2) Publicly owned hospitals and other providers of medical care subject to requirements promulgated by the sponsoring Federal agencies.

Any other exceptions will be approved by the Office of Management and Budget in particular cases where adequate justification is presented.

6. Attachments. The principles and related policy guides are set forth in the attachments, which are:

Attachment A - Principles for determining costs applicable to grants and contracts with State, local, and federally-recognized Indian tribal governments.

Attachment B - Standards for selected items of cost.

7. Inquiries. Further information concerning this Circular may be obtained by contacting the Financial Management Branch, Budget Review Division, Office of Management and Budget, Washington, D.C. 20503, telephone 202-395-4773.

  
James T. McIntyre, Jr.  
Director

Attachments

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ATTACHMENT A  
CIRCULAR NO. A-87

PRINCIPLES FOR DETERMINING COSTS APPLICABLE  
TO GRANTS AND CONTRACTS WITH STATE, LOCAL, AND  
FEDERALLY RECOGNIZED INDIAN TRIBAL GOVERNMENTS

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PRINCIPLES FOR DETERMINING COSTS APPLICABLE  
TO GRANTS AND CONTRACTS WITH STATE, LOCAL, AND  
FEDERALLY RECOGNIZED INDIAN TRIBAL GOVERNMENTS

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PRINCIPLES FOR DETERMINING COSTS APPLICABLE TO  
GRANTS AND CONTRACTS WITH STATE, LOCAL, AND  
FEDERALLY RECOGNIZED INDIAN TRIBAL GOVERNMENTS

A. Purpose and scope.

1. Objectives. This Attachment sets forth principles for determining the allowable costs of programs administered by State, local, and federally-recognized Indian tribal governments under grants from and contracts with the Federal Government. The principles are for the purpose of cost determination and are not intended to identify the circumstances or dictate the extent of Federal and State or local participation in the financing of a particular grant. They are designed to provide that federally-assisted programs bear their fair share of costs recognized under these principles, except where restricted or prohibited by law. No provision for profit or other increment above cost is intended.

2. Policy guides. The application of these principles is based on the fundamental premises that:

a. State, local, and federally-recognized Indian tribal governments are responsible for the efficient and effective administration of grant and contract programs through the application of sound management practices.

b. The grantee or contractor assumes the responsibility for seeing that federally-assisted program funds have been expended and accounted for consistent with underlying agreements and program objectives.

c. Each grantee or contractor organization, in recognition of its own unique combination of staff facilities and experience, will have the primary responsibility for employing whatever form of organization and management techniques may be necessary to assure proper and efficient administration.

3. Application. These principles will be applied by all Federal agencies in determining costs incurred by State, local, and federally recognized Indian tribal governments under Federal grants and cost reimbursement type contracts (including subgrants and subcontracts) except those with (a) publicly-financed educational institutions subject to Office of Management and Budget Circular A-21, and (b) publicly-owned hospitals and other

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providers of medical care subject to requirements promulgated the sponsoring Federal agencies.

**B. Definitions.**

1. Approval or authorization of the grantor Federal agency means documentation evidencing consent prior to incurring specific cost.

2. Cost allocation plan means the documentation identifying, accumulating, and distributing allowable costs under grants and contracts together with the allocation methods used.

3. Cost, as used herein, means cost as determined on a cash, accrual, or other basis acceptable to the Federal grantor agency as a discharge of the grantee's accountability for Federal funds.

4. Cost objective means a pool, center, or area established for the accumulation of cost. Such areas include organizational units, functions, objects or items of expense, as well as ultimate cost objectives including specific grants, projects, contracts, and other activities.

5. Federal agency means any department, agency, commission, or instrumentality in the executive branch of the Federal Government which makes grants to or contracts with State, local, or federally-recognized Indian tribal governments.

6. Federally-recognized Indian tribal governments means the governing body or a governmental agency of any Indian tribe, band, nation, or other organized group or community (including any native village as defined in Section 3 of the Alaska Native Claims Settlement Act, 85 Stat. 688) certified by the Secretary of the Interior as eligible for the special programs and services provided by him through the Bureau of Indian Affairs.

7. Grant means an agreement between the Federal Government and a State, local, or federally-recognized Indian tribal government whereby the Federal Government provides funds or aid in kind to carry out specified programs, services, or activities. The principles and policies stated in this Circular as applicable to grants in general also apply to any federally-sponsored cost reimbursement-type of agreement performed by a State, local, or federally-recognized Indian tribal government.

8. Grant program means those activities and operations of the grantee which are necessary to carry out the purposes of the

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grant, including any portion of the program financed by the grantee.

9. Grantee means the department or agency of State, local, or federally recognized Indian tribal government which is responsible for administration of the grant.

10. Local unit means any political subdivision of government below the State level.

11. Other State or local agencies means departments or agencies of the State or local unit which provide goods, facilities, and services to a grantee.

12. Services, as used herein, means goods and facilities, as well as services.

13. Supporting services means auxiliary functions necessary to sustain the direct effort involved in administering a grant program or an activity providing service to the grant program. These services may be centralized in the grantee department or in some other agency, and include procurement, payroll, personnel functions, maintenance and operation of space, data processing, accounting, budgeting, auditing, mail and messenger service, and the like.

#### C. Basic guidelines.

1. Factors affecting allowability of costs. To be allowable under a grant program, costs must meet the following general criteria:

a. Be necessary and reasonable for proper and efficient administration of the grant programs, be allocable thereto under these principles, and, except as specifically provided herein, not be a general expense required to carry out the overall responsibilities of State, local, or federally-recognized Indian tribal governments.

b. Be authorized or not prohibited under State or local laws or regulations.

c. Conform to any limitations or exclusions set forth in these principles, Federal laws, or other governing limitations as to types or amounts of cost items.

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d. Be consistent with policies, regulations, and procedures that apply uniformly to both federally assisted and other activities of the unit of government of which the grantee is a part.

e. Be accorded consistent treatment through application of generally accepted accounting principles appropriate to the circumstances.

f. Not be allocable to or included as a cost of any other federally financed program in either the current or a prior period.

g. Be net of all applicable credits.

## 2. Allocable costs.

a. A cost is allocable to a particular cost objective to the extent of benefits received by such objective.

b. Any cost allocable to a particular grant or cost objective under the principles provided for in this Circular may not be shifted to other Federal grant programs to overcome fund deficiencies, avoid restrictions imposed by law or grant agreements, or for other reasons.

c. Where an allocation of joint cost will ultimately result in charges to a grant program, an allocation plan will be required as prescribed in Section J.

## 3. Applicable credits.

a. Applicable credits refer to those receipts or reduction of expenditure-type transactions which offset or reduce expense items allocable to grants as direct or indirect costs. Examples of such transactions are: purchase discounts; rebates or allowances; recoveries or indemnities on losses; sale of publications, equipment, and scrap; income from personal or incidental services; and adjustments of overpayments or erroneous charges.

b. Applicable credits may also arise when Federal funds are received or are available from sources other than the grant program involved to finance operations or capital items of the grantee. This includes costs arising from the use or depreciation of items donated or financed by the Federal Government to fulfill matching requirements under another grant

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program. These types of credits should likewise be used to reduce related expenditures in determining the rates or amounts applicable to a given grant.

#### **D. Composition of cost.**

1. Total cost. The total cost of a grant program is comprised of the allowable direct cost incident to its performance, plus its allocable portion of allowable indirect costs, less applicable credits.

2. Classification of costs. There is no universal rule for classifying certain costs as either direct or indirect under every accounting system. A cost may be direct with respect to some specific service or function, but indirect with respect to the grant or other ultimate cost objective. It is essential, therefore, that each item of cost be treated consistently either as a direct or an indirect cost. Specific guides for determining direct and indirect costs allocable under grant programs are provided in the sections which follow.

#### **E. Direct costs.**

1. General. Direct costs are those that can be identified specifically with a particular cost objective. These costs may be charged directly to grants, contracts, or to other programs against which costs are finally lodged. Direct costs may also be charged to cost objectives used for the accumulation of costs pending distribution in due course to grants and other ultimate cost objectives.

2. Application. Typical direct costs chargeable to grant programs are:

- a. Compensation of employees for the time and effort devoted specifically to the execution of grant programs.
- b. Cost of materials acquired, consumed, or expended specifically for the purpose of the grant.
- c. Equipment and other approved capital expenditures.
- d. Other items of expense incurred specifically to carry out the grant agreement.

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e. Services furnished specifically for the grant program by other agencies, provided such charges are consistent with criteria outlined in Section C of these principles.

F. Indirect costs.

1. General. Indirect costs are those (a) incurred for a common or joint purpose benefiting more than one cost objective, and (b) not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved. The term "indirect costs," as used herein, applies to costs of this type originating in the grantee department, as well as those incurred by other departments in supplying goods, services, and facilities, to the grantee department. To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect cost within a grantee department or in other agencies providing services to a grantee department. Indirect cost pools should be distributed to benefiting cost objectives on bases which will produce an equitable result in consideration of relative benefits derived.

2. Grantee departmental indirect costs. All grantee departmental indirect costs, including the various levels of supervision, are eligible for allocation to grant programs provided they meet the conditions set forth in this Circular. In lieu of determining the actual amount of grantee departmental indirect cost allocable to a grant program, the following methods may be used:

a. Predetermined fixed rates for indirect costs. A predetermined fixed rate for computing indirect costs applicable to a grant may be negotiated annually in situations where the cost experience and other pertinent facts available are deemed sufficient to enable the contracting parties to reach an informed judgment (1) as to the probable level of indirect costs in the grantee department during the period to be covered by the negotiated rate, and (2) that the amount allowable under the predetermined rate would not exceed actual indirect cost.

b. Negotiated lump sum for overhead. A negotiated fixed amount in lieu of indirect costs may be appropriate under circumstances where the benefits derived from a grantee department's indirect services cannot be readily determined as in the case of small, self-contained or isolated activity. When this method is used, a determination should be made that the amount negotiated will be approximately the same as the actual

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indirect cost that may be incurred. Such amounts negotiated in lieu of indirect costs will be treated as an offset to total indirect expenses of the grantee department before allocation to remaining activities. The base on which such remaining expenses are allocated should be appropriately adjusted.

### 3. Limitation on indirect costs.

a. Federal grants may be subject to laws that limit the amount of indirect costs that may be allowed. Agencies that sponsor grants of this type will establish procedures which will assure that the amount actually allowed for indirect costs under each such grant does not exceed the maximum allowable under the statutory limitation or the amount otherwise allowable under this Circular, whichever is the smaller.

b. When the amount allowable under a statutory limitation is less than the amount otherwise allocable as indirect costs under this Circular, the amount not recoverable as indirect costs under a grant may not be shifted to another federally-sponsored grant program or contract.

### G. Cost incurred by agencies other than the grantee.

1. General. The cost of service provided by other agencies may only include allowable direct costs of the service plus a pro rata share of allowable supporting costs (Section E.12.) and supervision directly required in performing the service, but not supervision of a general nature such as that provided by the head of a department and his staff assistants not directly involved in operations. However, supervision by the head of a department or agency whose sole function is providing the service furnished would be an eligible cost. Supporting costs include those furnished by other units of the supplying department or by other agencies.

2. Alternative methods of determining indirect cost. In lieu of determining actual indirect cost related to a particular service furnished by another agency, either of the following alternative methods may be used provided only one method is used for a specific service during the fiscal year involved.

a. Standard indirect rate. An amount equal to ten percent of direct labor cost in providing the service performed by another State agency (excluding overtime, shift, or holiday premiums and fringe benefits) may be allowed in lieu of actual allowable indirect cost for that service.

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D. Predetermined fixed rate. A predetermined fixed rate for indirect cost of the unit or activity providing service may be negotiated as set forth in Section F.2.a.

H Cost incurred by grantee department for others.

1. General. The principles provided in Section G will also be used in determining the cost of services provided by the grantee department to another agency.

J. Cost allocation plan.

1. General. A plan for allocation of costs will be required to support the distribution of any joint costs related to the grant program. All costs included in the plan will be supported by formal accounting records which will substantiate the propriety of eventual charges.

2. Requirements. The allocation plan of the grantee department should cover all joint costs of the department as well as costs to be allocated under plans of other agencies or organizational units which are to be included in the costs of federally-sponsored programs. The cost allocation plans of all the agencies rendering services to the grantee department, to the extent feasible, should be presented in a single document. The allocation plan should contain, but not necessarily be limited to, the following:

a. The nature and extent of services provided and their relevance to the federally-sponsored programs.

b. The items of expense to be included.

c. The methods to be used in distributing cost.

3. Instructions for preparation of cost allocation plans. The Department of Health and Human Services in consultation with the other Federal agencies concerned, will be responsible for developing and issuing the instructions for use by grantees in preparation of cost allocation plans. This responsibility applies to both central support services at the State, local, and Indian tribal level and indirect cost proposals of individual grantee departments.

**4. Negotiation and approval of indirect cost proposals for States.**

a. The Department of Health and Human Services, in collaboration with the other Federal agencies concerned, will be responsible for negotiation, approval, and audit of cost allocation plans, which will be submitted to it by the States. These plans will cover central support service costs of the State.

b. At the grantee department level in a State, a single cognizant Federal agency will have responsibility similar to that set forth in a, above, for the negotiation, approval, and audit of the indirect cost proposal. A current list of agency assignments is maintained by the Office of Management and Budget.

c. Questions concerning the cost allocation plans approved under a. and b. above, should be directed to the agency responsible for such approvals.

**5. Negotiation and approval of indirect cost proposals for local governments.**

a. Cost allocation plans will be retained at the local government level for audit by a designated Federal agency except in those cases where that agency requests that cost allocation plans be submitted to it for negotiation and approval.

b. A list of cognizant Federal agencies assigned responsibility for negotiation, approval and audit of central support service cost allocation plans at the local government level is maintained by the Office of Management and Budget.

c. At the grantee department level of local governments, the Federal agency with the predominant interest in the work of the grantee department will be responsible for necessary negotiation, approval and audit of the indirect cost proposal.

**6. Negotiation and approval of indirect cost proposals for federally recognized Indian tribal governments.** The Federal agency with the predominant interest in the work of the grantee department will be responsible for necessary negotiation, approval and audit of the indirect cost proposal.

**7. Resolution of problems.** To the extent that problems are encountered among the Federal agencies in connection with 4 and 5

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above, the Office of Management and Budget will lend assistance as required.

(No. A-67)

OMB Circular A-21 "Cost Principles  
for Educational Institutions"





EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

July 28, 1982

MEMORANDUM

FROM: JOHN J. LORDAN *John*

SUBJECT: Circular A-21, "Cost principles for educational institutions"

Enclosed is an advance copy of revisions that have been made to Circular A-21, "Cost principles for educational institutions." The revisions were approved by the Director on July 23, 1982, and are expected to be published in the Federal Register in about a week.

As you know, the revisions pertaining to personal service costs are based on recommendations of a university group composed of representatives from the Association of American Universities and Council of Scientific Society Presidents. It gives universities more flexibility in selecting the method to be used in accounting for salary costs, but still provides strict accountability for Federal funds. The revised Circular also makes allowable interest costs related to newly constructed or acquired buildings, major building renovations, and major equipment purchases.

Enclosure





EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

CIRCULAR NO. A-21  
Revised

July 23, 1982

Transmittal Memorandum No. 1

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Cost principles for universities

This Transmittal Memorandum revises OMB Circular No. A-21,  
"Cost principles for educational institutions."

The revision changes the procedures covering allocation of  
personal service costs and recognizes interest costs in  
certain circumstances.

David A. Stockman  
Director

Attachment



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

**Circular A-21 - Cost Principles for Educational Institutions**

Circular A-21 is revised as follows:

Paragraph B.1.

The following replaces section B.1:

**B. Definition of Terms**

1. Major functions of an institution refers to instruction, organized research, other sponsored activities, and other institutional activities as defined below:

a. Instruction means the teaching and training activities of an institution. Except for research training as provided in c. below, this term includes all teaching and training activities, whether they are offered for credits toward a degree or certificate or on a non-credit basis, and whether they are offered through regular academic departments or separate divisions, such as a summer school division or an extension division. Also considered part of this major function are departmental research, and, where agreed to, university research.

(1) Sponsored instruction and training means specific instructional or training activity established by grant, contract, or cooperative agreement. For purposes of the cost principles, this activity may be considered a major function even though an institution's accounting treatment may include it in the instruction function.

(2) Departmental research means research development and scholarly activities that are not organized research and, consequently, are not separately budgeted and accounted for. Departmental research, for purposes of this document, is not considered as a major function, but as a part of the instruction function of the institution.

b. Organized research means all research and development activities of an institution that are separately budgeted and accounted for. It includes:

(1) Sponsored research means all research and development activities that are sponsored by Federal and non-Federal agencies and organizations. This term includes activities involving the training of individuals in research techniques (commonly called research training) where such activities utilize the same facilities as other research and development activities and where such activities are not included in the instruction function.

(2) University research means all research and development activities that are separately budgeted by the institution under an internal application of institutional funds. University research, for purposes of this document, may be considered a part of the instruction function, or may be combined with sponsored research under the function of organized research, or may be treated as a separate major function, as agreed to with the cognizant agency.

c. d. becomes c.

d. e. becomes d.

Paragraph J. 6.

The following replaces sections J. 6. b. through d.

J. Compensation for Personal Services

6. b. (1) General Principles

(a) The distribution of salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with the generally accepted practices of colleges and universities. Institutions may include in a residual category all activities that are not directly charged to

sponsored agreements, and that need not be distributed to more than one activity for purposes of identifying indirect costs and the functions to which they are allocable. The components of the residual category are not required to be separately documented.

(b) The apportionment of employees' salaries and wages which are chargeable to more than one sponsored agreement or other cost objective will be accomplished by methods which will (1) be in accordance with Sections A-2 and C above, (2) produce an equitable distribution of charges for employees' activities, and (3) distinguish the employees' direct activities from their indirect activities.

(c) In the use of any methods for apportioning salaries, it is recognized that, in an academic setting, teaching, research, service, and administration are often inextricably intermingled. A precise assessment of factors that contribute to costs is not always feasible, nor is it expected. Reliance, therefore, is placed on estimates in which a degree of tolerance is appropriate.

(d) There is no single best method for documenting the distribution of charges for personal services.

Methods for apportioning salaries and wages, however, must meet the criteria specified in J.6.b.(2) below. Examples of acceptable

methods are contained in J.6.c. below. Other methods which meet the criteria specified in J.6.b.(2) below also shall be deemed acceptable, if a mutually satisfactory alternative agreement is reached.

(2) Criteria for Acceptable Methods

(a) The payroll distribution system will (i) be incorporated into the official records of the institution, (ii) reasonably reflect the activity for which the employee is compensated by the institution, and (iii) encompass both sponsored and all other activities on an integrated basis, but may include the use of subsidiary records. (Compensation for incidental work described in J.6.a. need not be included.)

(b) The method must recognize the principle of after-the-fact confirmation or determination so that costs distributed represent actual costs, unless a mutually satisfactory alternative agreement is reached.

Direct cost activities and indirect cost activities may be confirmed by responsible persons with suitable means of verification that the work was performed. Confirmation by the employee is not a requirement for either direct or indirect cost activities if other responsible persons make appropriate confirmations.

(c) The payroll distribution system will allow confirmation of activity allocable to each sponsored agreement and each of the categories of activity needed to identify indirect costs and the functions to which they are allocable. The activities chargeable to indirect cost categories or the major functions of the institution for employees whose salaries must be apportioned (see J.6.b.1.(b) above), if not initially identified as separate categories, may be subsequently distributed by any reasonable method mutually agreed to, including, but not limited to, suitably conducted surveys, statistical sampling procedures, or the application of negotiated fixed rates.

(d) Practices vary among institutions and within institutions as to the activity constituting a full workload. Therefore, the payroll distribution system may reflect categories of activities expressed as a percentage distribution of total activities.

(e) Direct and indirect charges may be made initially to sponsored agreements on the basis of estimates made before services are performed. When such estimates are used, significant changes in the corresponding work activity must be identified and entered into the payroll distribution system. Short-term (such as one or two months) fluctuation between workload categories need not be considered as long as the distribution of salaries and

wages is reasonable over the longer term, such as an academic period.

(f) The system will provide for independent internal evaluations to ensure the system's effectiveness and compliance with the above standards.

(g) For systems which meet these standards, the institution will not be required to provide additional support or documentation for the effort actually performed.

J. 6. c. Examples of Acceptable Methods for Payroll Distribution:

1. Plan - Confirmation: Under this method, the distribution of salaries and wages of professorial or professional staff applicable to sponsored agreements is based on budgeted, planned, or assigned work activity, updated to reflect any significant changes in work distribution. A plan-confirmation system used for salaries and wages charged directly or indirectly to sponsored agreements will meet the following standards:

(a) A system of budgeted, planned, or assigned work activity will be incorporated into the official records of the institution and encompass both sponsored and all other activi-

ties on an integrated basis. The system may include the use of subsidiary records.

(b) The system will reasonably reflect only the activity for which the employee is compensated by the institution (compensation for incidental work described in J.6.a. need not be included). Practices vary among institutions and within institutions as to the activity constituting a full workload. Hence, the system will reflect categories of activities expressed as a percentage distribution of total activities. (But see Section H for treatment of indirect costs under the simplified method for small institutions.)

(c) The system will reflect activity applicable to each sponsored agreement and to each category needed to identify indirect costs and the functions to which they are allocable. The system may treat indirect cost activities initially within a residual category and subsequently determine them by alternate methods as discussed in J.6.b.(2)(c).

(d) The system will provide for modification of an individual's salary or salary distribution commensurate with any significant change in the employee's work activity. Short-term (such as one or two months) fluctuation between workload categories need not be considered as long as the distribution of salaries and wages is reasonable over the longer term such as an

academic period. Whenever it is apparent that a significant change in work activity which is directly or indirectly charged to sponsored agreements will occur or has occurred, the change will be documented over the signature of a responsible official and entered into the system.

(e) At least annually a statement will be signed by the employee, principal investigator, or responsible official(s) using suitable means of verification that the work was performed, stating that salaries and wages charged to sponsored agreements as direct charges, and to residual, indirect cost or other categories are reasonable in relation to work performed.

(f) The system will provide for independent internal evaluation to ensure the system's integrity and compliance with the above standards.

(g) In the use of this method, an institution shall not be required to provide additional support or documentation for the effort actually performed.

2. After-the-fact Activity Records: Under this system the distribution of salaries and wages by the institution will be supported by activity reports as prescribed below.

(a) Activity reports will reflect the distribution of activity expended by employees covered by the system (compensation for incidental work as described in J.6.a. need not be included).

(b) These reports will reflect an after-the-fact reporting of the percentage distribution of activity of employees. Charges may be made initially on the basis of estimates made before the services are performed, provided that such charges are promptly adjusted if significant differences are indicated by activity records.

(c) Reports will reasonably reflect the activities for which employees are compensated by the institution. To confirm that the distribution of activity represents a reasonable estimate of the work performed by the employee during the period, the reports will be signed by the employee, principal investigator, or responsible official(s) using suitable means of verification that the work was performed.

(d) The system will reflect activity applicable to each sponsored agreement and to each category needed to identify indirect costs and the functions to which they are allocable. The system may treat indirect cost activities initially within a residual category and subsequently determine them by alternate methods as discussed in J.6.b.(2)(c).

(e) For professorial and professional staff, the reports will be prepared each academic term, but no less frequently than every six months. For other employees, unless alternate arrangements are agreed to, the reports will be prepared no less frequently than monthly and will coincide with one or more pay periods.

(f) Where the institution uses time cards or other forms of after-the-fact payroll documents as original documentation for payroll and payroll charges, such documents shall qualify as records for this purpose provided that they meet the requirements in (a) through (e) above.

3. Multiple Confirmation Records: Under this system the distribution of salaries and wages of professorial and professional staff will be supported by records which certify separately for direct and indirect cost activities as prescribed below.

(a) For employees covered by the system, there will be direct cost records to reflect the distribution of that activity expended which is to be allocable as direct cost to each sponsored agreement. There will also be indirect cost records to reflect the distribution of that activity to indirect costs. These records may be kept jointly or separately (but are to be certified separately, see below).

(b) Salary and wage charges may be made initially on the basis of estimates made before the services are performed provided that such charges are promptly adjusted if significant differences occur.

(c) Institutional records will reasonably reflect only the activity for which employees are compensated by the institution (compensation for incidental work as described in J.6.a. need not be included).

(d) The system will reflect activity applicable to each sponsored agreement and to each category needed to identify indirect costs and the functions to which they are allocable.

(e) To confirm that the distribution of activity represents a reasonable estimate of the work performed by the employee during the period, the record for each employee will include:

(1) The signature of the employee or of a person having direct knowledge of the work, confirming that the record of activities allocable as direct costs of each sponsored agreement is appropriate.

(2) The record of indirect costs will include the signature of responsible person(s) who use suitable means of

verification that the work was performed and is consistent with the overall distribution of the employee's compensated activities.

These signatures may all be on the same document.

(f) The reports will be prepared each academic term, but no less frequently than every six months.

(g) Where the institution uses time cards or other forms of after-the-fact payroll documents as original documentation for payroll and payroll charges, such documents shall qualify as records for this purpose provided they meet the requirements in (a) through (f) above.

RELATED CHANGES:

Change F.4.a.(2)(a) (in Departmental Administration Expenses), sentence 2, to read:

Salaries of professorial and professional staff whose responsibilities to the institution require administrative work that benefits sponsored projects may also be included to the extent that the portion charged to departmental administration is determined in accordance with Section J.6.

F.	<u>Indirect costs</u>	
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PRINCIPLES FOR DETERMINING COSTS APPLICABLE TO  
GRANTS AND CONTRACTS WITH STATE, LOCAL, AND  
FEDERALLY RECOGNIZED INDIAN TRIBAL GOVERNMENTS

A. Purpose and scope.

1. Objectives. This Attachment sets forth principles for determining the allowable costs of programs administered by State, local, and federally-recognized Indian tribal governments under grants from and contracts with the Federal Government. The principles are for the purpose of cost determination and are not intended to identify the circumstances or dictate the extent of Federal and State or local participation in the financing of a particular grant. They are designed to provide that federally-assisted programs bear their fair share of costs recognized under these principles, except where restricted or prohibited by law. No provision for profit or other increment above cost is intended.

2. Policy guides. The application of these principles is based on the fundamental premises that:

a. State, local, and federally-recognized Indian tribal governments are responsible for the efficient and effective administration of grant and contract programs through the application of sound management practices.

b. The grantee or contractor assumes the responsibility for seeing that federally-assisted program funds have been expended and accounted for consistent with underlying agreements and program objectives.

c. Each grantee or contractor organization, in recognition of its own unique combination of staff facilities and experience, will have the primary responsibility for employing whatever form of organization and management techniques may be necessary to assure proper and efficient administration.

3. Application. These principles will be applied by all Federal agencies in determining costs incurred by State, local, and federally recognized Indian tribal governments under Federal grants and cost reimbursement type contracts (including subgrants and subcontracts) except those with (a) publicly-financed educational institutions subject to Office of Management and Budget Circular A-21, and (b) publicly-owned hospitals and other

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providers of medical care subject to requirements promulgated the sponsoring Federal agencies.

**B. Definitions.**

1. Approval or authorization of the grantor Federal agency means documentation evidencing consent prior to incurring specific cost.

2. Cost allocation plan means the documentation identifying, accumulating, and distributing allowable costs under grants and contracts together with the allocation methods used.

3. Cost, as used herein, means cost as determined on a cash, accrual, or other basis acceptable to the Federal grantor agency as a discharge of the grantee's accountability for Federal funds.

4. Cost objective means a pool, center, or area established for the accumulation of cost. Such areas include organizational units, functions, objects or items of expense, as well as ultimate cost objectives including specific grants, projects, contracts, and other activities.

5. Federal agency means any department, agency, commission, or instrumentality in the executive branch of the Federal Government which makes grants to or contracts with State, local, or federally-recognized Indian tribal governments.

6. Federally-recognized Indian tribal governments means the governing body or a governmental agency of any Indian tribe, band, nation, or other organized group or community (including any native village as defined in Section 3 of the Alaska Native Claims Settlement Act, 85 Stat. 688) certified by the Secretary of the Interior as eligible for the special programs and services provided by him through the Bureau of Indian Affairs.

7. Grant means an agreement between the Federal Government and a State, local, or federally-recognized Indian tribal government whereby the Federal Government provides funds or aid in kind to carry out specified programs, services, or activities. The principles and policies stated in this Circular as applicable to grants in general also apply to any federally-sponsored cost reimbursement-type of agreement performed by a State, local, or federally-recognized Indian tribal government.

8. Grant program means those activities and operations of the grantee which are necessary to carry out the purposes of the

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grant, including any portion of the program financed by the grantee.

9. Grantee means the department or agency of State, local, or federally recognized Indian tribal government which is responsible for administration of the grant.

10. Local unit means any political subdivision of government below the State level.

11. Other State or local agencies means departments or agencies of the State or local unit which provide goods, facilities, and services to a grantee.

12. Services, as used herein, means goods and facilities, as well as services.

13. Supporting services means auxiliary functions necessary to sustain the direct effort involved in administering a grant program or an activity providing service to the grant program. These services may be centralized in the grantee department or in some other agency, and include procurement, payroll, personnel functions, maintenance and operation of space, data processing, accounting, budgeting, auditing, mail and messenger service, and the like.

#### C. Basic guidelines.

1. Factors affecting allowability of costs. To be allowable under a grant program, costs must meet the following general criteria:

a. Be necessary and reasonable for proper and efficient administration of the grant programs, be allocable thereto under these principles, and, except as specifically provided herein, not be a general expense required to carry out the overall responsibilities of State, local, or federally-recognized Indian tribal governments.

b. Be authorized or not prohibited under State or local laws or regulations.

c. Conform to any limitations or exclusions set forth in these principles, Federal laws, or other governing limitations as to types or amounts of cost items.

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d. Be consistent with policies, regulations, and procedures that apply uniformly to both federally assisted and other activities of the unit of government of which the grant is a part.

e. Be accorded consistent treatment through application of generally accepted accounting principles appropriate to the circumstances.

f. Not be allocable to or included as a cost of any other federally financed program in either the current or a prior period.

g. Be net of all applicable credits.

## 2. Allocable costs.

a. A cost is allocable to a particular cost objective to the extent of benefits received by such objective.

b. Any cost allocable to a particular grant or cost objective under the principles provided for in this Circular may not be shifted to other Federal grant programs to overcome fund deficiencies, avoid restrictions imposed by law or grant agreements, or for other reasons.

c. Where an allocation of joint cost will ultimately result in charges to a grant program, an allocation plan will be required as prescribed in Section J.

## 3. Applicable credits.

a. Applicable credits refer to those receipts or reduction of expenditure-type transactions which offset or reduce expense items allocable to grants as direct or indirect costs. Examples of such transactions are: purchase discounts; rebates or allowances; recoveries or indemnities on losses; sale of publications, equipment, and scrap; income from personal or incidental services; and adjustments of overpayments or erroneous charges.

b. Applicable credits may also arise when Federal funds are received or are available from sources other than the grant program involved to finance operations or capital items of the grantee. This includes costs arising from the use or depreciation of items donated or financed by the Federal Government to fulfill matching requirements under another grant

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program. These types of credits should likewise be used to reduce related expenditures in determining the rates or amounts applicable to a given grant.

**D. Composition of cost.**

1. Total cost. The total cost of a grant program is comprised of the allowable direct cost incident to its performance, plus its allocable portion of allowable indirect costs, less applicable credits.

2. Classification of costs. There is no universal rule for classifying certain costs as either direct or indirect under every accounting system. A cost may be direct with respect to some specific service or function, but indirect with respect to the grant or other ultimate cost objective. It is essential, therefore, that each item of cost be treated consistently either as a direct or an indirect cost. Specific guides for determining direct and indirect costs allocable under grant programs are provided in the sections which follow.

**E. Direct costs.**

1. General. Direct costs are those that can be identified specifically with a particular cost objective. These costs may be charged directly to grants, contracts, or to other programs against which costs are finally lodged. Direct costs may also be charged to cost objectives used for the accumulation of costs pending distribution in due course to grants and other ultimate cost objectives.

2. Application. Typical direct costs chargeable to grant programs are:

a. Compensation of employees for the time and effort devoted specifically to the execution of grant programs.

b. Cost of materials acquired, consumed, or expended specifically for the purpose of the grant.

c. Equipment and other approved capital expenditures.

d. Other items of expense incurred specifically to carry out the grant agreement.

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e. Services furnished specifically for the grant program by other agencies, provided such charges are consistent with criteria outlined in Section G of these principles.

F. Indirect costs.

1. General. Indirect costs are those (a) incurred for a common or joint purpose benefiting more than one cost objective, and (b) not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved. The term "indirect costs," as used herein, applies to costs of this type originating in the grantee department, as well as those incurred by other departments in supplying goods, services, and facilities, to the grantee department. To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect cost within a grantee department or in other agencies providing services to a grantee department. Indirect cost pools should be distributed to benefiting cost objectives on bases which will produce an equitable result in consideration of relative benefits derived.

2. Grantee departmental indirect costs. All grantee departmental indirect costs, including the various levels of supervision, are eligible for allocation to grant programs provided they meet the conditions set forth in this Circular. In lieu of determining the actual amount of grantee departmental indirect cost allocable to a grant program, the following methods may be used:

a. Predetermined fixed rates for indirect costs. A predetermined fixed rate for computing indirect costs applicable to a grant may be negotiated annually in situations where the cost experience and other pertinent facts available are deemed sufficient to enable the contracting parties to reach an informed judgment (1) as to the probable level of indirect costs in the grantee department during the period to be covered by the negotiated rate, and (2) that the amount allowable under the predetermined rate would not exceed actual indirect cost.

b. Negotiated lump sum for overhead. A negotiated fixed amount in lieu of indirect costs may be appropriate under circumstances where the benefits derived from a grantee department's indirect services cannot be readily determined as in the case of small, self-contained or isolated activity. When this method is used, a determination should be made that the amount negotiated will be approximately the same as the actual

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indirect cost that may be incurred. Such amounts negotiated in lieu of indirect costs will be treated as an offset to total indirect expenses of the grantee department before allocation to remaining activities. The base on which such remaining expenses are allocated should be appropriately adjusted.

3. Limitation on indirect costs.

a. Federal grants may be subject to laws that limit the amount of indirect costs that may be allowed. Agencies that sponsor grants of this type will establish procedures which will assure that the amount actually allowed for indirect costs under each such grant does not exceed the maximum allowable under the statutory limitation or the amount otherwise allowable under this Circular, whichever is the smaller.

b. When the amount allowable under a statutory limitation is less than the amount otherwise allocable as indirect costs under this Circular, the amount not recoverable as indirect costs under a grant may not be shifted to another federally-sponsored grant program or contract.

G. Cost incurred by agencies other than the grantee.

1. General. The cost of service provided by other agencies may only include allowable direct costs of the service plus a pro rata share of allowable supporting costs (Section B.12.) and supervision directly required in performing the service, but not supervision of a general nature such as that provided by the head of a department and his staff assistants not directly involved in operations. However, supervision by the head of a department or agency whose sole function is providing the service furnished would be an eligible cost. Supporting costs include those furnished by other units of the supplying department or by other agencies.

2. Alternative methods of determining indirect cost. In lieu of determining actual indirect cost related to a particular service furnished by another agency, either of the following alternative methods may be used provided only one method is used for a specific service during the fiscal year involved.

a. Standard indirect rate. An amount equal to ten percent of direct labor cost in providing the service performed by another State agency (excluding overtime, shift, or holiday premiums and fringe benefits) may be allowed in lieu of actual allowable indirect cost for that service.

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D. Predetermined fixed rate. A predetermined fixed rate for indirect cost of the unit or activity providing service must be negotiated as set forth in Section F.2.a.

H Cost incurred by grantee department for others.

1. General. The principles provided in Section G will also be used in determining the cost of services provided by the grantee department to another agency.

J. Cost allocation plan.

1. General. A plan for allocation of costs will be required to support the distribution of any joint costs related to the grant program. All costs included in the plan will be supported by formal accounting records which will substantiate the propriety of eventual charges.

2. Requirements. The allocation plan of the grantee department should cover all joint costs of the department as well as costs to be allocated under plans of other agencies or organizational units which are to be included in the costs of federally-sponsored programs. The cost allocation plans of all the agencies rendering services to the grantee department, to the extent feasible, should be presented in a single document. The allocation plan should contain, but not necessarily be limited to, the following:

a. The nature and extent of services provided and their relevance to the federally-sponsored programs.

b. The items of expense to be included.

c. The methods to be used in distributing cost.

3. Instructions for preparation of cost allocation plans. The Department of Health and Human Services in consultation with the other Federal agencies concerned, will be responsible for developing and issuing the instructions for use by grantees in preparation of cost allocation plans. This responsibility applies to both central support services at the State, local, and Indian tribal level and indirect cost proposals of individual grantee departments.

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**4. Negotiation and approval of indirect cost proposals for States.**

a. The Department of Health and Human Services, in collaboration with the other Federal agencies concerned, will be responsible for negotiation, approval, and audit of cost allocation plans, which will be submitted to it by the States. These plans will cover central support service costs of the State.

b. At the grantee department level in a State, a single cognizant Federal agency will have responsibility similar to that set forth in a, above, for the negotiation, approval, and audit of the indirect cost proposal. A current list of agency assignments is maintained by the Office of Management and Budget.

c. Questions concerning the cost allocation plans approved under a. and b. above, should be directed to the agency responsible for such approvals.

**5. Negotiation and approval of indirect cost proposals for local governments.**

a. Cost allocation plans will be retained at the local government level for audit by a designated Federal agency except in those cases where that agency requests that cost allocation plans be submitted to it for negotiation and approval.

b. A list of cognizant Federal agencies assigned responsibility for negotiation, approval and audit of central support service cost allocation plans at the local government level is maintained by the Office of Management and Budget.

c. At the grantee department level of local governments, the Federal agency with the predominant interest in the work of the grantee department will be responsible for necessary negotiation, approval and audit of the indirect cost proposal.

**6. Negotiation and approval of indirect cost proposals for federally recognized Indian tribal governments.** The Federal agency with the predominant interest in the work of the grantee department will be responsible for necessary negotiation, approval and audit of the indirect cost proposal.

**7. Resolution of problems.** To the extent that problems are encountered among the Federal agencies in connection with 4 and 5

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above, the Office of Management and Budget will lend assistance as required.

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Change F.5.a. (in Sponsored Projects Administration), sentence 3, to read:

The salaries of professorial and professional staff whose responsibilities to the institution require administrative work that benefits sponsored projects may also be included to the extent that the portion charged to sponsored agreements administration is determined in accordance with Section J.6.

Change F.7.a. (in Student Administration and Services), sentence 2, to read:

The salaries of members of the academic staff whose responsibilities to the institution require administrative work that benefits sponsored projects may also be included to the extent that the portion charged to Student Administration is determined in accordance with Section J.6.

Delete J.6.c. Monitored Workload.

Delete J.6.d. Personnel Activity Reports.

Relabel J.6.e. as J.6.d.

Relabel J.6.f. as J.6.e.

Paragraph J.17

Add at the end of section a., "except as indicated in e. below."

Add a new section e., as follows:

J. 17. e. The cost of interest paid to an external party is allowable where associated with the following assets, provided the assets are used in support of sponsored agreements, and the total cost (including depreciation or use allowance, operation and maintenance costs, interest, etc.,) does not exceed the rental cost of comparable assets in the same locality.

(1) Buildings acquired or completed on or after July 1, 1982.

(2) Major reconstruction and remodeling of existing buildings completed on or after July 1, 1982.

(3) Acquisition or fabrication of capital equipment (as defined in paragraph J.13, "Equipment and other capital expenditures") completed on or after July 1, 1982, costing \$10,000 or more, if agreed to by the Government.

ADVANCED STATISTICAL TOOLS

The purpose of this section is to discuss analytical tools that are useful when analysis of data is required. The discussion will indicate the range of available tools, provide a description of what they are intended to do, and point out some of the limitations and assumptions implicit in their use.

The tools involve rather straightforward computations made according to rigid formulas. They perform their functions regardless of whether they are the wrong tool for the right problem or whether there are errors or inconsistencies in the data utilized. Using an analytical tool requires a basic understanding of the problem.

The statistical tools in this section will be explained but they will not be covered in depth. It is recommended that a formal course be taken to effectively apply the statistical tools.

## Background

The two broad groups of analytical tools are classified according to the type of relationship that is involved; tools are either qualitative or quantitative. A qualitative relationship is one in which two or more things are related but in some nonquantitative manner. An example is the apparent relationship between stress and heart attacks. On the other hand, a quantitative relationship implies that two or more things are not only related qualitatively, but that the relationship can be measured and expressed in numerical terms. An example is the learning or improvement curve theory, which states that as production quantity doubles, recurring manhours per unit decrease at a constant rate. This quantitative relationship has been measured and verified literally hundreds of times in cost and price analysis.

It is necessary to distinguish between the relationships described above and causal relationships. A causal relationship implies that one thing causes another to happen. Many of us tend to say that because A and B are related, A causes B or vice versa. The fact is that causality cannot be established by any analytical technique. Analysis may be used as evidence to support an assertion of causality, but it must also be supported by strong, logical arguments as well.

There are three basic statistical tools for establishing a qualitative relationship between two or more variables. They are distinguished by the types of questions they answer about the relationship.

2

### THE X<sup>2</sup> (CHI SQUARED) TEST

This is a relatively simple test which can answer the question: Is one variable independent of another (or others)? By independent, we mean that one thing does not appear to influence or occur in concert with the other. The procedure is incapable of determining the strength or quantitative nature of dependence, if it exists. Some questions to which this procedure might apply are:

- a. Is there a relationship between absenteeism and productivity?
- b. Is there a relationship between contract type and the nature of the work?
- c. Is there a relationship between cost growth and contract type (or nature of the work)?

### CORRELATION ANALYSIS

This is similar to the procedure described above, except that the strength (as measured by a statistic called the correlation coefficient) and direction (either direct or inverse of the relationship can be determined. Correlation analysis is useful when the variables of interest are nonquantitative (such as contract type), or when the sole interest lies in establishing that two things are correlated.

### ANALYSIS OF VARIANCE

This is analytic technique to compare different sets of data to determine whether they came from the same population or from populations with similar characteristics. Questions to which this procedure would apply are:

- a. Is there a significant difference between the wages of men and women at a particular plant?
- b. Is there a significant difference between the annual income of different classes of workers in different industries?
- c. Is there a significant difference between tooling requirements for machine X versus machine Y?

A quantitative relationship is expressed as an equation. It may be a ratio, a straight line or a very complicated mathematical function. All that the statistical tools will accomplish is to confirm or deny that a particular set of data can be associated with or described by a particular



equation. It is your responsibility to specify and justify your selection of an equation to be used in any analysis involving a quantitative relationship. The tools are flexible enough to accommodate virtually any reasonable equation relating two or more variables.

The basic tool for establishing a quantitative relationship between two or more variables is regression analysis, which involves finding the coefficients (constants) of a specified equation so that the sum of the squares of the deviations from that equation are minimized. Regression analysis is a significant analytical tool that can be categorized into four groupings: simple linear, simple curvilinear, multiple linear and multiple curvilinear regression.

Simple linear regression involves relating two variables (X and Y) by a straight line equation:

$$Y=A+BX$$

The regression analysis provides numeric values of the constants A and B, measures of the strength of the relationship between the two variables (such as the correlation coefficient), and provides statistics that indicate whether the relationship is significant in a statistical sense. The equation itself is used to make projections of the variable Y, given values of the variable X. Other statistics can be used to develop interval estimates based on selected levels of probability for those projections.

Simple curvilinear regression is any regression analysis that employs only one independent (X) variable. For example, the equation:

$$Y=AX^B$$

is used in learning curve application to predict labor-hour requirements.

Multiple linear regression is similar to simple linear regression with the exception that there is more than one driving, or independent, variable. For example, the equation:

$$Y=A+B_1X_1+B_2X_2$$

depicts a relationship where the variable Y is determined

by not one, but two variables,  $X_1$  and  $X_2$ .

An example of the application of this relationship is the classic skill mix problem in the analysis of labor rates where:

Y = Labor rate  
 $X_1$  = Time period  
 $X_2$  = Number of employees

An equation of this kind would allow you to adjust your rate projections not only for the effect of increases over time, but for changes in the size of the work force.

Multiple curvilinear regression is a combination of the two preceding approaches and involves two or more driving variables, at least one of which is raised to a power. An example of this equation is:

$$Y = A + B_1 X_1 + B_2 X_1^2 + B_3 X_2$$

This relationship is perhaps too exotic for most applications, but is presented here to complete the discussion of the different types of regression analysis.

#### ANALYSIS OF COVARIANCE

This is a statistical tool which combines some of the aspects of analysis of variance and regression analysis. It can be extremely useful when you want to relate a variable, say cost, to driving variables of which some are quantitative and others are qualitative, as in the following example:

Y = Cost/unit  
 $X_1$  = Quantity procured (quantitative variable)  
 $X_2$  = Type of procurement (e. g., sole source, competitive, etc., a nonquantitative variable)

A number of well-documented computer programs are generally available to perform the calculations involved in applying any of these statistical tools. If you are considering one of these procedures, consult an appropriate text for a more detailed explanation of the particular tool you are interested in. Match that explanation with the documentation for the computer program you are using to insure that you fully understand the tool and the nature of the result.

## FORECASTING

Forecasting merits special treatment because so much of pricing involves forecasting. Forecasting is a projection over time. Examples are a projection of a labor rate or a price index number. The many approaches to forecasting range from the totally subjective to the totally mathematical. There are two primary approaches to forecasting any series of data over time: time series and causal models.

Time series analysis, the first approach, treats time as the driving variable and attempts to measure changes that occur in the data over time by considering the following four factors: secular trends; cyclical variations; seasonal variations; and irregular fluctuations.

The secular trend is the gradual growth or decline of a series over a long period of time.

Cyclical variations are expansions followed by contractions that merge into the next expansion. This sequence of changes is recurring, but not necessarily periodic. Many series of labor rates, for example, have strong cyclic components, the period of which coincides with the length of union contracts in that industry.

Seasonal variations are those variations in time series data that result from natural forces such as the seasons themselves, or from man-made conventions such as the different numbers of workdays in a particular month. These factors make month-to-month comparisons of economic data misleading unless the data is seasonally adjusted.

Irregular fluctuations in time series are caused by such factors as unusual weather, labor strife, war, Government intervention and all forms of unpredictable events. These fluctuations can be divided into those that are identifiable and the remaining fluctuations that are the unidentifiable (or random) residue of the series.

The second approach to forecasting involves the use of causal models, in which quantitative factors other than or in addition to time are used as a basis for explaining the behavior of the series over time. This approach is extremely useful when causative factors can be identified and projected. For example, a company may use GNP projections

from one of the existing large-scale econometric models as a basis for long-term sales forecasts, rather than simply extrapolate their historical sales data. Causal models will usually employ some type of regression analysis to correlate the time series with one or more causal variables.

The need for time series projections occurs time and again. The techniques employed depend to some extent on the time periods for which the projection is needed and the degree of accuracy required for the forecast. In any analysis of time series, it is important to edit from the data the effect of any events that you know will occur again and whose magnitude you can determine from other sources. For example, if you are working with a series of labor rates, you should edit the series to remove step and cost of living increases (if you have projections of these factors available from union agreements or other sources) and you should analyze the residual variation in the data.

Most projections of time series only attempt to project the secular trend of edited data, ignoring seasonal, cyclical or irregular effects. A projection of the secular trend is indeed necessary for any time series analysis, but you should recognize that a trend projection by itself is subject to considerable variation from reality if strong cyclical, seasonal or irregular effects have been ignored.

Methods used for trend projections range from freehand extrapolation to sophisticated mathematical models. Linear or curvilinear regression analyses are recommended for projections beyond two years. For short-term projections, regression analysis may prove inadequate because of cyclical effects. A technique called exponential smoothing is often used for short-term trend projections. This technique considers various weights on the most recent data and produces a different projection equation at each time period. This contrasts with regression analysis, which uses a single equation to describe the whole series of data.

Cyclical effects are the most difficult to analyze and for this reason are usually ignored in all but the most sophisticated analyses. A technique called spectral analysis has been found useful for measuring the length and intensity of cycles, but it is difficult to use in making projections.

Seasonal effects should be considered in any data that are

representative of a time period less than a year: quarterly, monthly or weekly data, for example. In some cases, it also may be necessary to adjust annual data. Seasonal effects usually are analyzed by developing a series of index numbers that can be used to eliminate seasonal variations in data.

Another method of seasonally adjusting data is to use a moving average when the periods averaged correspond to the number of seasons. For example, a four quarter moving average would adjust quarterly data seasonally. This can be illustrated as follows:

<u>Year</u>	<u>Qtr.</u>	<u>Unadjusted Data</u>	<u>Four Quarter Moving Average</u>
19X1	1	36	-
	2	44	-
	3	45	-
	4	106	57.75
19X2	1	38	58.25
	2	46	58.75
	3	47	59.25
	4	112	60.75

Note how the moving average smooths out the severe seasonal swing. It is easier to develop a trend from the moving average than from the unadjusted data.

A moving average should first be used to smooth data. After smoothing, the data can be used to develop trends. There is great danger that a moving average will be identified as the trend and used as a basis for establishing prices. The danger can be illustrated by the following example, in which a moving average called the cumulative average is used.

<u>Unit No.</u>	<u>Actual Hours</u>	<u>Cumulative Average Hours</u>
1	100	100.0
2	95	97.5
3	90	95.0
4	85	92.5
5	80	90.0

There are four approaches to estimating the cost of Unit 6 based on this data:

	<u>Hour</u>
Last actual	80
Trend from actuals	75
Cumulative average to last actual	90
Trend from cumulative average	87.5

A cumulative average will tend to obscure the effect of a trend in data. It is for this reason that any type of moving average should be carefully evaluated before it is used as a basis for pricing.

Irregular variations must be considered on a case by case basis and a great deal of judgment applied when they are considered in forecasting.

#### THE LEARNING CURVE

The learning curve is a tool used primarily to project resource requirements. It has been used successfully to project the direct manufacturing labor hours needed to produce a known quantity of a product, and is sometimes used to project the quantity of material required for a production run. It has been used to project the dollar costs of subcontracted items after adjustment of the historical cost data for inflation.

Historically, the term "learner's curve" was adapted from the observation that individuals who perform repetitive tasks exhibit a rate of improvement due to increased manual dexterity. The mental and muscular adjustments an individual makes from the time he first performs his task to the time he has repeated it a number of times result in a reduction in the time required for each repetition of a uniform unit of work. Psychologists, teachers, personnel directors, manpower planners and others have used this principle for a long time. When the improvement factor in a manufacturing process is subjected to detailed observation and analysis, the causes of improvement become clear.

Dexterity on the part of individual workers is only one of the reasons for reduced manhours per unit of production. Changes in the worker's environment and morale,

changes in the flow process and in work setup, work simplification and engineering changes may all contribute to improvement (or contribute to disimprovement), but they are nearly always induced by management actions. Thus, the learning curve measures and projects not only the cost effects of improved manual dexterity and a broad group of factors that might be called management innovations, but also the interaction between manual dexterity and management innovations. For this reason, the term "learning curve" is a misnomer. Other terms more nearly describe the actual meaning: improvement curve, cost or time reduction curve, or experience curve. However, the term "learning curve" (or "learner's curve") is used so widely that it is imperative to use it here. Remember, when you read it, that all the complexities of causal relationships are embodied in its meaning. In essence, it represents the learning of the firm and is not specifically pinned to the learning of individuals.

T. P. Wright has contributed much in establishing the learning curve as a cost measurement device in the aircraft industry. His article pioneering the idea was published in the Journal of Aeronautical Sciences, February, 1936, under the title "Factors Affecting the Cost of Airplanes." Wright's findings showed that as the number of aircraft produced in sequence increased, the cumulative average direct labor input per airplane decreased in a regular pattern. The regularity of the pattern existed in a ratio relationship that was exponential (e.g., it revealed a linear function only when ratios of changes were considered). Learning curve theory and practice as it is known today received its initial impetus from this pioneering work.

Both aircraft companies and the Government became interested in the regular and predictable nature of production cost reduction because, among other considerations, the phenomenon implies that during a time of mobilization a fixed application of labor and facilities could be expected to produce greater and greater quantities of defense products in each successive time period. Accordingly, the Government engaged the Stanford Research Institute to study the validity of the learning curve concept. The method adopted for this study was a statistical analysis of essentially all World War II airframe direct labor input data to determine whether there was sufficient conformity in the data to establish a standard.

The study confirmed that the direct labor cost (hours) declines by some constant percentage over the successively doubled quantities of units produced. The Stanford study also validated the concept of a standard or model based on the World War II findings that could be used as a tool for cost analysis.

Since World War II, the learning curve concept has been used by Government procurement agencies to aid in pricing selected Government contracts. Its application has been most conspicuous in airframe production where conditions were most favorable for its use. More recently, the learning curve has been used as a cost analysis tool in such production industries as electronics systems, machine tools, ship building, missile systems and depot level maintenance of equipment.

The learning curve theory was developed from observations of cost behavior as a function of sequential aircraft produced. Certain factors associated with the airframe industry seem to be necessary to that cost behavior. The first is the building of a sizable, complex end-item that requires large numbers of direct labor hours. The many individual tasks associated with these hours provide myriad opportunities to learn. A second factor is production in which unmechanized assembly operations predominate. If the operations are mechanized or machine paced as are many fabrication operations, the learning process is inhibited.

Learning curve applications are not limited, however, to sizable complex end-items. Numerous applications have been made to relatively simple and stable items such as shells, trucks and radios. A Defense Contract Audit Agency publication (DCAAP 7641.14) provides information on more than 440 learning curve applications covering a broad spectrum of weapon systems, subsystems and other items.

Another factor that influences learning is a continuous manufacturing process with constant pressure to reduce manhours. If production breaks are common or long, the accrued learning is dispersed through reassignment of workers or even forgetfulness. A fourth factor is the element of constant change in the product.

One other observation concerning major engineering

changes or model changes is worthy of note. Airframe production is characterized by short model/series production runs. With each change in model the learning curve phenomenon tends to repeat itself. That is, when a production program is completed for a particular airframe model and a new production is set up for a similar but new model, it cannot be expected that the first unit of the new model will continue where the old model left off.

It should be emphasized that while the learning curve is essentially a trend concept, it is not a time series trend. Rather, the independent variable is the number of opportunities to learn, while the dependent variable is cost input per constant unit of production. At first this independent-dependent variable relationship may seem obscure. At best it is not likely to seem quite as straightforward as a simple cost per unit time series. You are cautioned to study this relationship, for it is one of the key concepts that make the learning curve a useful device for measuring and predicting change in production cost input.

The Stanford study validated a learning curve model that is known as the "unit curve" or "Boeing" theory. The theory can be stated as follows:

As the total quantity of units produced doubles, the cost per unit decreases by some constant percentage.

The constant percentage by which the costs of doubled quantities decrease is called the rate of learning. Another useful term, the "slope" of the learning curve, is related to the rate of learning. It can be expressed as the difference between 100 and the rate of learning.

The unit curve theory can be expressed in equation or model form as

$$y = Ax^B$$

where

y represents the unit cost (usually expressed in hours) of the Xth unit,

x represents the unit number,

A is a coefficient (constant) that represents the theoretical cost (also usually expressed in hours) of the first unit, and

B is a coefficient (constant) that is related to the slope and the rate of change of the learning curve. It can be calculated from the relationship

$$B = \frac{\text{logarithm "slope"}}{\text{logarithm 2}}$$

In this last equation, the slope must be expressed in decimal form rather than the percentage form.

Observations (values of x and y) that are related by the model

$$y = Ax^B$$

with numerical values for the coefficients, form a straight line when plotted on log-log paper. The fact that a learning curve is a straight line on log-log paper has the tremendous advantage that projection of manhour figures at a future stage of production can be accomplished simply by extending the line into the future. This can be done mechanically by physically extending the line, mathematically, or, for ultimate precision, with the aid of a computer.

Another frequently encountered learning curve model is the "cumulative average" or "Northrop" theory. This is the model that was described by T. P. Wright in 1936. The theory can be stated as follows:

As the total quantity of units doubles, the average cost per unit decreases by some constant percentage.

The cumulative average curve theory can be expressed in equation form as

$$\bar{y} = Ax^B$$

where  $\bar{y}_x$  is the cumulative average cost of all production up to and including the Xth unit. The other parameters are the same as for the unit curve theory. Observations related by this model also form a straight line on log-log paper,

to the difference between unit and cumulative average cost, because each theory will project a totally different result.

When manhour figures that conform to the learning process are plotted on log-log paper against the units of production to which they apply, the points produced lie on a straight line called the learning curve. There is no anomaly in calling it a curve when it is a straight line; in mathematical terminology a straight line is a particular case of a curve, having a curvature of zero. As previously indicated, data that conform to the theory of the learning curve (the cost of doubled quantities decreased by some constant percentage) form a straight line when plotted on log-log paper. With careful attention to detail, the graphical approach to learning curve analysis will yield estimates which approximate those derived through mathematical or computer-assisted techniques. Accordingly, it is of value to understand the mechanics of using log-log paper.

The Stanford study revealed that different manufacturers experienced many different slopes, sometimes on similar manufacturing programs. In fact, manufacturing data collected from the World War II aircraft manufacturing industry had slopes ranging from 69.7% to almost 100%. The slopes averaged 80%, giving rise to an industry average curve of 80%. Unfortunately, this industry average curve is frequently misapplied by practitioners who use it as a standard or norm. For use in estimating slopes without data on the production cost of the item at the plant of manufacture, learning curve slopes of similar items at the manufacturer's plant are a better indicator than industry averages for the production of the same item in other plants.

You need to know the slope of the learning curve for a number of reasons. For one, it facilitates communication; it is part of the language of learning curve theory. The steeper the slope (lower the percent), the more rapidly the resource requirements (hours) decline as production increases. Accordingly, the slope of the learning curve is usually an issue in a negotiation.

The slope of the learning curve also is needed to project follow-on costs using either learning tables or a computer. As another example, in many production situations, a given

slope may be established as a standard based on reliable historical experience. Learning curves developed from actual experience on current production can then be compared against the standard slope to determine whether the improvement on a particular contract is or is not reasonable.

The primary purpose for developing the learning curve as a pricing tool is to permit you to predict the cost of future production. The prediction is based upon the assumption (not always true) that the future will behave as did the past. In terms of the learning curve theory, this assumption means that the cost (hours) of doubled quantities will continue to decrease by some constant percentage.

As with any method of projecting the future, the theory of the learning curve falls short of perfection. Such a simple model of the real world cannot hope to cover all pricing situations. However, the learning curve method provides a reasonable approach to predicting the future if the historical data approximate a straight-line trend. The farther historical data points lie from the trend line, the less confidence you should place in your prediction.

The use of the learning curve is dependent on the methods companies use to record costs. An accounting or statistical record system must be devised by a company so that data are available for learning curve purposes. Otherwise, it may be impossible to construct a learning curve. Such costs as manhours per unit or dollars per unit must be identified with the unit product. It is preferable to use manhours rather than dollars. The latter contain an additional variable, the effect of inflation or deflation (wage rate changes), which is absent in the former.

In any event, the record system must have definite cut-off points for such costs that will permit identification of the costs with the units involved. Most companies use a lot release system whereby costs are accumulated on a job order in which the number of units completed is specified and costs are cut off at the completion of that number of units. The continuous process method, as distinguished from the job order system, also yields costs identified with end-item units, but in this case the costs usually are equated with "equivalent" rather than actual units.

Because a job order system commonly is used, the unit

cost is not the actual cost per unit for any particular unit in the lot. Rather, it is an average cost for all units in the lot. This means that when lots are plotted on graph paper, the unit value corresponding with the average cost value must be found. In nearly all cases this unit value (x) is the median within the lot that should be given the average value. Thus, as the program progresses, the midpoint of each succeeding lot is taken as the plot point for the quantity (x). For example, if a lot is made up of units 91 through 100 of a given contract, the unit value of the plot point would be 95. The calculation is based on the cumulated number of units in all preceding lots plus one-half the number in the lot under consideration:

$$(90 + \frac{10}{2} = 95)$$

Because the early units in the first lot usually decline very rapidly (arithmetically speaking), some distortion may occur in locating the representative value at the midpoint of the first lot. This is especially true if the first lot contains ten or more units. The distortion is compensated for by a rule of thumb, which states that when the first lot contains ten or more units, one-third the lot size should be chosen as the unit value estimate of the first lot plot point. Conversely, when the first lot contains less than ten units, one-half of the lot size should be chosen as the unit value for the first lot plot point. It is an arbitrary rule, which applies to the first lot only, but it approaches the true midpoint more closely than the other arbitrary rule of taking half the lot size in every case. True lot plot points can be calculated from a rather complicated formula, or by a computer. However, use of a computer to determine the historical trend line and project the future cost eliminates the need to complete lot midpoints.

The preceding discussion of the learning curve theory has been limited to basic considerations. You will need to explore and understand the following topics before you can apply the learning curve technique successfully in all situations.

- a. Fitting the best straight line through learning data using regression analysis.
- b. Unit versus cumulative average data as a straight line.

c. The use of unit, lot, cumulative average and cumulative total data.

d. Adjusting the projection for major changes in the item.

e. Adjusting the projection for breaks in production.

f. The use of ratio tables to assist in the projection of trends.

g. The use of computer-assisted computations in analysis.

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Federal Acquisition Regulations  
Subpart 15.8  
Price Negotiation

The price negotiation clause in the Federal Regulations is the clause which gives us our authority to review contractor books and records and details the requirements for cost and price analysis.

Under the Federal Procurement Regulations the applicable section was Subpart 1-3.8-Price Negotiation Policies and Techniques. When the Federal Government switched to the Federal Acquisition Regulations the operating clause became Subpart 15.8-Price Negotiation.

There were a number of changes between FPR and FAR. Generally, FAR added definitions, reworded the regulations in a clearer format and in doing so provided a better understanding of the regulations, and grouped the clauses according to subject matter.

Two important changes were made. The OF-60 was replaced by SF-1411. The SF-1411 is formatted as a cover sheet without the detail of the OF-60. The specific requirement for audits was deleted. Instead of \$100,000 and \$500,000 audit thresholds, for fixed price and cost type proposals, respectively, FAR only states \$500,000 is the threshold for field pricing support, without any specific mention of audits.

## FAR Subpart 15.8-Price Negotiation

We will be summarizing each clause in Subpart 15.8-Price Negotiation.

Any significant deviations from the FPR will be explained and any new or different requirements will be explained.

Attached are three appendices-Appendix 1 is the Federal Acquisition Regulations Subpart 15.8-Price Negotiation, Appendix 2 is a cross index of FPR 1-3.8 to FAR 15.8, and Appendix 3 is a cross index of FAR 15.8 to FPR 1-3.8.

Appendix 2 illustrates where the FAR regulations came from and Appendix 3 illustrates where the FPR provisions went.

15.800-Scope of subpart-From FPR 1-3.8 and quoted below:

"This subpart prescribes the cost and price negotiation policies and procedures applicable to initial and revised pricing of (a) negotiated prime contracts (including subcontract pricing under them when required) and (b) contract modifications (including modifications to contracts awarded by formal advertising)."

15.801-Definitions-FPR 1-3.807

This clause provides definitions for the various terms used in the price-negotiation process. Among the terms are cost analysis, price analysis, and field pricing support, which is a new term. In the FAR field pricing support is defined as "... a review and evaluation of the contractor's... proposal by...field support personnel."

Although field support personnel is never truly defined it seems to be anyone other than the Contracting Officer.

15.802-Policy-FPR 1-3.801 and 1-3.807

Basically it states the Contracting Officer should purchase goods and services for a fair and reasonable price, price each contract separately, and don't include contingencies in the contract price.

15.803-General-FPR 1-3.801 and 1-3.809

This clause provides general guidance for the Contracting Officer. The guidance consists of general steps and procedures to follow while

the procurement process is ongoing.

#### 15.804-Cost or Pricing Data-FPR 1-3.807

Some changes have been made to this clause on cost and pricing data.

Cost or pricing data is defined as "all facts as of the time of price agreement that prudent buyers and sellers would reasonably expect to affect price negotiations significantly."

FAR 15.804 describes the requirements for certified cost or pricing data.

The requirements for cost or pricing data remains the same as under FPR-negotiated contracts over \$500,000, or any contract modification over \$500,000. The exemptions to submission of cost or price analysis remains the same-adequate price competition, catalog or market prices of commercial items sold to the general public, or set by law or regulation. FAR does add in the regulations specific percentages to be used in determining when items qualify as sold to the general public in substantial quantities (FAR 15.803(f)).

Even if an item is exempt from submission of a certificate of current cost or pricing data, the requirement still exists that a price analysis must be performed on the item to determine the reasonableness of the price. In addition, the SF 1411 is included the Subpart 15.8 along with the instructions. The SF 1411 replaces the OF-60.

#### 15.805-Proposal Analysis-FPR 1-3.807 and 1-3.809

This clause is the basis for cost analysis performed by EPA.

15.805-1-General-No real changes from the FPR merely a restatement of the FPR.

15.805-2 and -3-Price Analysis and Cost Analysis-No changes. Merely a restatement of the FPR.

15.805-4-Technical Analysis-This clause is new. FPR's only reference to technical analysis was for the auditor to incorporate the technical report

into the audit report. FAR prescribes the minimum factors the technical analysis should cover. These items include the need for the number and kinds of labor and labor mix, quantities and kinds of materials, etc.

15.805-5-Field Pricing Support-This clause replaces FPR 1-3.809-Contract Audit as a Pricing Aid. There have been significant changes to the audit requirement. The term audit has been replaced by field pricing support. As we understand the term, field pricing support means anyone but the Contracting Officer.

Under FPR there was a requirement that all fixed price contracts and modifications over \$100,000 and cost type contracts and modifications over \$500,000 shall be audited. Under FAR, the only requirement is any contract or modification requiring certified cost or pricing data (over \$500,000), the Contracting Officer shall request a review by field pricing support. FAR does state that this may include an audit by the cognizant audit office. There is no audit threshold in the FAR. This is a significant change.

Audits can still be requested. FAR addresses audits in 15.805-5 (d)-(f). FAR in 15.805-5(d) states that only auditors shall have general access to contractor's books and records. But, this does not preclude the Contracting Officer or his representative access to records. This clause is an addition from the FPR. We still have access to contractor's books and records.

Clauses (e) and (f) remain the same as in FPR.

FAR 15.805-5(g) is a new clause. The clause states that whenever field pricing support was requested, the ACO upon completion of the field

pricing report shall send to the auditor a copy of the field pricing report, without the audit report or the technical analysis report. This clause does not seem to be applicable to EPA because we do not use the ACO system. However this may become a requirement in the future.

FAR 15.805-5(i) is the clause that gives us the authority to review subcontract proposals. This clause states that the prime contractor is responsible for the cost analysis before awarding any subcontract. However, the Contracting Officer may request a separate cost analysis to ensure reasonableness of the price.

#### 15.806-Subcontract Pricing Considerations-FPR 1-3.807

Basically this clause represents a restatement of the certified cost or pricing data requirements in 15.804.

#### 15.807-Prenegotiation Objectives-New Clause

This clause requires the Contracting Officer to establish a prenegotiation position before negotiating a contract.

#### 15.808-Price Negotiation Memorandum-1-3.811

This clause establishes the information, as a minimum, that should be included in a summary of negotiation. The Contracting Officer is still required to provide to the auditor a summary of negotiation whenever an audit report is issued.

#### 15.809-Forward Pricing Agreements-1-3.701

This clause establishes the basic requirements for forward pricing agreements. The requirements include when a forward pricing agreement should be negotiated and how the forward pricing agreement should be used.

#### 15.810-Should Cost Analysis-New Clause

Should cost analysis as defined in this clause means a review of the contractor's entire operation. This includes both technical and cost areas.

Should cost as EPA uses it generally means the contractor's proposal is priced reflective of current cost or pricing data, i.e., the contractor is not buying in. As defined in FAR should cost represents an operations audit rather than a cost audit.

#### 15.811-Estimating Systems-1-3.809

Basically this clause is the same as FPR and states that estimating system reviews should be performed on certain contractor's in order to reduce the effort spent in reviewing those contractor proposals.

COMPENSATION FOR PERSONAL SERVICES  
AN ANALYSIS OF THE RECENT COST PRINCIPLE CHANGES  
(March 6, 1985)

Prepared by  
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## EXECUTIVE SUMMARY

The Federal Acquisition Regulation (FAR) compensation cost principle for contracts with commercial contractors (31.205-6) is an almost verbatim transcription of the Defense Acquisition Regulation (DAR) and the Federal Procurement Regulation (FPR) compensation cost principles. However, the DAR and FPR versions of the principle underwent significant revision just prior to the issuance of the FAR.

The revised DAR and FPR evolved from the old FPR and DAR, and numerous Board of Contract Appeals decisions. The revised version contained five general criteria for determining allowability of compensation for personal services:

- 1) a current year criterion - a change to the FPR which evolved from the DAR;
- 2) an established plan or practice criterion - a change to the FPR and the DAR;
- 3) no presumption of allowability for non-notified changes - a new requirement for both the FPR and the DAR;
- 4) an other cost principles criterion - no change from the FPR or DAR and,
- 5) a reasonableness criterion - contained in both the FPR and DAR but the revised principle has significant changes which (a) shifts the burden of proof to the contractor, (b) changes the reasonableness-of-total-compensation concept to one of reasonableness-of-elements-of-compensation, and (c) eliminates the use of Internal Revenue Code deductible amounts as a maximum of allowable compensation in almost all cases.

Compensation for Personal Services  
An Analysis of Recent Changes

The cost principles on compensaation in the Defense Acquisition Regulation (DAR) and the Federal Procurement Regulation (FPR) were revised in March, 1983, and December, 1983, respectively. The principles in both were almost the same, with no substantive differences. The Federal Acquisition Regulation (FAR), which was effective April 1, 1984, contained an almost verbatim version of the DAR and FPR principles. Because the issuance of the FAR followed so closely to the DAR and FPR changes to the compensation cost principle, there was very little opportunity to work with and become familiar with the revision. This paper discusses the FAR compensation cost principle and the changes made to the principle in the DAR and FPR.

FAR Part 31.205-6, "Compensation for Personal Services", is the longest and most detailed of the forty-eight commercial cost principles. The definition contained in the principle is so broad that it includes all types and forms of payments to employees: "Compensation for personal services includes all remuneration paid currently or accrued, in whatever form and whether paid immediatly or deferred, for services rendered by employees to the contractor during the period of performance."

Because compensation can take so many forms, the cost principle contains more guidance on determining allowability

then any other. Allowability under the principle is determined by five general criteria applicable to all forms of personal services compensation and ten additional special requirements for particular types of compensation.

#### General Criteria

Compensation is allowable subject to the following general criteria:

(1) Compensation must be for work performed by the employee in the current year,

(2) The compensation in total must be reasonable for the work performed,

(3) The compensation must conform to the contractor's established compensation plan or practice followed so consistently as to imply, in effect, an agreement to make the payment,

(4) No presumption of allowability exists where the contractor introduces major revisions of existing compensation plans or new plans and does not notify the Government, and

(5) A cost unallowable under another cost principle is not allowable solely on the basis that it constitutes compensation.

#### Additional Requirements

Additional requirements for certain forms of compensation are also contained in the cost principle for:

1. Labor-management agreement compensation.

2. Salaries and wages.
3. Domestic and foreign differential pay.
4. Bonuses and incentive compensation.
5. Severance pay.
6. Backpay.
7. Stock options, stock appreciation rights, and phantom stock plans.
8. Pensions.
9. Deferred compensation.
10. Fringe benefits.

Changes in the additional requirements are covered in other papers in this series. This paper will deal with the five general criteria for determining allowable personal compensation costs.

#### Current Year Criterion

"Compensation must be for work performed by the employee in the current year and must not represent a retroactive adjustment of prior years' salaries or wages".

The FPR requirement prior to the December, 1983, change was simply stated as "services rendered during the period of contract performance". The FAR requirement for a current year test evolved from the DAR which limited allowability to services performed in the current year and expressly disallowed retroactive adjustments of prior year salaries.

The only exceptions in the FAR to the current year general rule are (1) severance pay, (2) back pay for certain violations of Federal laws, (3) pension plan prior and past service costs, (4) deferred compensation accounted for in compliance with CAS 415, and (5) certain fringe benefit costs.

Severance pay in the FPR was covered in its own paragraph (15.205-39), not in the compensation cost principle. This change evolved from the DAR.

The FAR requires deferred compensation to be accounted for in accordance with CAS 415 and pension costs to be accounted for in accordance with CAS 412 and 413. The FPR did not have these requirements.

#### Established Plan or Practice Criterion

"Compensation must be based upon and conform to the terms and conditions of the contractor's established compensation plan or practice followed so consistently as to imply, in effect, an agreement to make payment."

Prior to the December, 1983, change the FPR requirement was simply, "compensation (must be) paid under the contractor's established policy". The DAR had similar language before it was changed in June, 1983.

#### No Presumption of Allowability Criterion

"No presumption of allowability will exist where the

contractor introduces major revisions of existing compensation plans or new plans and the contractor:

1) has not notified the cognizant ACO either before implementation or a reasonable period after implementation; and

2) has not provided the Government, either before implementation or within a reasonable period after it, an opportunity to review the allowability of the changes."

Prior to the December, 1983, change, the FPR had no language requiring advance notification of changes to established compensation plans. The FPR language limited compensation determinations to an after the fact, incurred cost review of salaries and wages paid to individuals. Since there was no notification requirements, very few advance agreements on compensation levels were executed. Without advance agreements, compensation levels were being negotiated after costs were incurred and paid, a very difficult position to negotiate from.

#### Other Cost Principles Criterion

"Costs that are unallowable under other paragraphs of this Subpart 31.2 shall not be allowable... solely on the basis that they constitute compensation for personal services."

Although the wording is different, both the FPR and the DAR compensation cost principles contained a similar prohibition against reclassifying otherwise unallowable costs as compensation to make the costs allowable.

## Reasonableness Criterion

"The compensation in total must be reasonable for the work performed; however, specific instructions on individual compensation elements must be observed where they are prescribed."

The compensation cost principle is unique in that it is the only cost principle with specific language for determining reasonableness. In fact, the FAR devotes an entire paragraph to guidance on when and how reasonableness determinations should be made. Both the FPR and the DAR had language on reasonableness but the recent revisions to both changed how it is to be determined. The FAR provides the same guidance as the FPR and DAR as to when reasonableness tests should be applied. "The tests (for reasonableness) need be applied only when a general review reveals amounts or types of compensation that appear unreasonable or unjustified." All compensation need not be subjected to the reasonableness tests, however, "compensation costs under certain conditions give rise to the need for special consideration". The conditions are in instances where:

- 1) Compensation is to owners of closely held corporations, partners, sole proprietors, members of immediate families or persons who are contractually committed to acquire a substantial financial interest in the contractor's enterprise.

- 2) Changes in compensation policy result in substantial increases coincident with an increase in the ratio

of government contracts to other business.

3) The contractor's business is such that it is not subject to the normal restraints of competitive business.

4) Compensation costs are in excess of amounts deductible under the Internal Revenue Code.

Remember these are situations when compensation should be given special consideration and the tests for reasonableness should be applied. It does not mean that the existence of any of the above situations makes some part of compensation unallowable.

The FAR overall test remains somewhat the same as the FPR and DAR. "Compensation for personal services will be considered reasonable if the total compensation conforms generally to compensation paid by other firms of the same size in the same industry, or in the same geographic area for similar services or work performed". Although this is difficult to determine, in appeals cases, the boards of contract appeals have held that surveys of compensation levels in the same industry or in the same geographic area for similar services provide the best measure for comparison.

Because the contracts appeals boards interpreted FPR and DAR as placing the burden of proof on the Government to show that compensation is unreasonable, the responsibility for gathering survey information was also placed with the Government. The FAR, however, has added new language which changes this:

"in questionable cases the contractor has the responsibility to support the reasonableness of compensation in relation to the effort performed". We will have to wait to see how the boards handle the shift in the burden of proof responsibility.

A second significant change to the reasonableness test occurs in the total-compensation concept. Despite the FAR wording that, "Compensation will be considered reasonable if the total compensation (emphasis added) conforms generally to compensation paid by other firms..." the principle later adds a caveat that states, "this does not prevent the Government from challenging the reasonableness of an individual element of compensation...". This language is new and gives the Government the opportunity to challenge such items as bonuses, management incentive awards, cash awards, etc., on an individual basis, without regard to total compensation. Again, we will have to wait to see how the boards interpret the "total compensation" requirement of the first reasonableness test in relation to challenging an individual element.

Another change to the reasonableness test in the new principle is not one that was added, but rather one that wasn't included. Under the FPR and DAR, compensation of individual employees was considered reasonable if it was not in excess of costs deductible under the Internal Revenue Code. Use of the Code was a general test of reasonableness. For all individual

compensation, cost in excess of the amount deductible was generally unallowable. Under the new principle, costs in excess of those deductible under the Internal Revenue Code are unallowable only for closely held corporations.

### Epilogue

Despite all of the recent changes to the reasonableness criteria of the compensation cost principle, in a recent Comptroller General Report (GAO/NSIAD-85-1, October 12, 1984), General Accounting Office was unable to reach a conclusion on the reasonableness of compensation paid by twelve aerospace contractors. The report said the definition of reasonableness embodied in the DAR (which is the same as the FAR) lacks quantitative criteria and there is no generally accepted pay survey to which contractors can be compared. The publicly available surveys - prepared by the Bureau of Labor Statistics and the American Management Association - and the surveys the contractor participates in, have doubtful utility because the scope is usually too general or too limited. The report states that this fundamental problem of acceptable surveys led the Air Force to conclude that the current cost principle, for all practical purposes is, unenforceable and should be changed. The Air Force, in coordination with the other services, submitted proposals to the DAR council - the DOD body responsible for administering the DAR - to change the regulation in March, 1984. As of the date of this paper, the DAR Council is continuing its efforts to revise the criteria.

FACILITIES CAPITAL COST OF MONEY (FCCM)  
AN ANALYSIS OF THE FPR AND FAR PROVISIONS

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## EXECUTIVE SUMMARY

Prior to 1976, there was no provision for reimbursing contractors for Facilities Capital Cost of Money (FCCM) associated with the use of their assets. Contractors were expected to recover such costs out of their profit/fee. CAS 414, issued in 1976, provided a formula for FCCM computation. However, Temporary Regulation 40 gave agencies discretion to either allow FCCM as a cost and change their fee policies or disallow FCCM and retain their fee policies intact. Pursuant to Office of Federal Procurement Policy Letter 80-7, the Federal Procurement Regulation (FPR) was amended in 1981 to allow FCCM provided that a profit/fee offset was made. Where FCCM was not proposed as an element of cost, a waiver clause was inserted into the contract. The changes brought about by the Federal Acquisition Regulations are:

1. No requirement for fee offset although EPA's FAR Supplement does require this adjustment.
2. FCCM is not prohibited in cost reimbursable and cost share contracts.
3. The language in the waiver clause is different.

Facilities Capital Cost of Money  
An Analysis of the FPR and FAR Provisions

I. CAS 414 and FPR Temporary Regulation 40

The concept of creating a regulatory provision to allow government contractors to recover costs of capital has existed for years. While pure interest expense was and continues to be unallowable, it was recognized that all contractors experienced a cost in connection with the use of their assets. Since there was no provision in the cost principles of the Defense Acquisition Regulations (DAR), NASA Procurement Regulations (NASAPR) or Federal Procurement Regulations (FPR) for allowance of costs of capital, the government's policy was that such costs were financed out of profit or fee. The government's profit/fee treatment varied agency by agency. EPA's fee policies, contained in the EPAPR's (41 CFR 15-3.808-50) were practically verbatim to those of NASA. The fee weights considered, among other factors, the contractor's "investment in facilities capital". Theoretically, a contractor's incentive for modernizing its facilities would be the government's consideration of this investment when making fee determination. Contractors were not particularly pleased with this approach. However, everyone recognized that there was no simple method agreeable to all parties by which to measure cost of facilities capital.

The first effort towards allowing cost of capital came not in the form of a cost principle, but a Cost Accounting Standard (CAS) emanating from the CAS Board. Standard No. 414 was issued with an effective date of October 1, 1976, and provided a complicated computation leading to a Facilities Capital Cost of Money (FCCM) factor. Without going into detail, the basic components used in deriving FCCM were:

- (1) the net book value of a contractor's fixed assets,
- (2) the official government interest rate, determined semi-annually by the Treasury Department and used for certain claims and renegotiation settlements, and
- (3) the contractor's indirect cost allocation pools and bases.

Basically, the FCCM factor(s) consisted of identifying the fixed assets by indirect cost center, multiplying their net book values by the appropriate interest rate(s), and dividing the result by the allocation base(s). The resulting rate(s) was to be used in a manner similar to the indirect cost rate(s). It would be applied to the applicable base in each contract to enable the contractor to recover FCCM costs on a contract-by-contract basis.

At the time CAS 414 was promulgated, the exemptions and special provisions pertaining to CAS were much more limited than now. The two most significant exemptions which would later affect EPA were not yet in existence: (1) the concept of modified coverage and (2) the exemption of small businesses from all CAS requirements. It thus appeared that most profit-making government contractors were to be reimbursed for FCCM. Up to this point, the General Services Administration (GSA) had always amended the FPR to fully incorporate each new CAS.

This pattern was broken in the case of CAS 414. FPR Temporary Regulation (TR) 40 was issued effective October 1, 1976. The base thrust of this regulation was to give agencies the option over whether to allow FCCM computed under CAS 414 or not. Keeping in mind that FCCM was supposedly covered in determining profit/fee, the government's concern was that unconditional allowability of FCCM under CAS 414 would result in increased costs to the government and duplication of FCCM recovery by contractors (as both an element of cost and fee/profit). Accordingly, TR 40 provided that: (1) agencies could retain their fee policies intact and treat FCCM generated by CAS 414 as unallowable costs, or (2) agencies could allow CAS 414-generated FCCM but would have to change their profit/fee policies to ensure that "on an overall basis,... aggregate prices will not increase". EPA chose the former approach.

Consequently, PIN No. 76-64, issued effective October 1, 1976, provided that CAS 414 was withdrawn from applicability to EPA contracts.

## II. Amendments to the FPR

TR 40 remained in effect for over 4 years. During this time, CAS regulations were issued providing more exemptions, such as small business, modified coverage, and a raising of the initial CAS-covered contract threshold amount from \$100,000 to \$500,000. It thus appeared that allowance of FCCM strictly within the CAS framework would exclude a broad segment of government contractors from coverage. The next move came from the Office of Federal Procurement Policy (OFPP) in the form of Policy Letter 80-7. The major features of this Policy Letter were the following:

A. TR 40 should be abolished.

B. All contractors, regardless of CAS status, would be allowed FCCM, computed using the methodology contained in CAS 414.

C. Since prevailing policy held that FCCM was previously covered in profit/fee, agencies must insure that FCCM was not reimbursed as both an element of cost and fee. Therefore, if FCCM was proposed and negotiated as a cost on a given contract, the profit/fee shall be correspondingly reduced (offset).

D. It was presumed that an offeror who did not propose FCCM as an element of cost intended to recover it in profit. Therefore, the resulting contract would contain a waiver clause in which the offeror would waive his rights to recover FCCM as an element of cost.

At the time of this Policy Letter, OFPP strictly speaking had no regulatory authority; their pronouncements were solely advisory. Both DOD and GSA did amend their procurement regulations. GSA's took the form of incorporating the Policy Letter in its entirety in Temporary Regulation 61, effective June 15, 1981. TR 61 abolished TR 40 and established the Policy Letter as official FPR policy regarding (1) determination of profit and fee and (2) allowability of FCCM.

The final FPR-era policy action occurred November 29, 1982, when TR 61 was codified into the relevant portions of the FPR. Amendment No. 225 to the FPR changed the following subparts:

1. Subpart 1-3.808 - Price Negotiation Policies and Techniques - This subpart dealt with profit/fee policy.

The major facets included in this subpart were:

a. Profit/Fee Offset - 1-3.808-3(b)(2) stated that if FCCM were to be allowed as a cost, the profit/fee must be correspondingly reduced.

b. Waiver Clause - 1-3.808-4(c) stated that if FCCM was not proposed as an element of cost a waiver clause reading as follows would be inserted into the contract:

"The contractor is aware that facilities capital cost of money is an allowable cost but waives the right to claim it under this contract."

2. Subpart 1-3.13 - Cost of Money for Capital Employed in Facilities in Use and Capital Assets Under Construction - This was a new subpart which basically covered the details associated with computing FCCM. CAS 414 was invoked as the means for computations. The method of recovering FCCM (through negotiation similar to overhead rates) was also discussed.

3. Part 1-7 - Contract Clauses - The standard contract clauses for cost reimbursement-type contracts were augmented by the FCCM waiver clause.

4. Subpart 15.205-5 - A new cost principle was added to cover FCCM. The key provisions:

a. FCCM must be measured in accordance with CAS 414 and FPR 1-3.13.

b. Adequate records (memorandum entries acceptable for FCCM itself) must be maintained by contractor.

c. FCCM is not allowable in cost-reimbursable or cost sharing contracts.

d. FCCM must be "specifically identified or proposed in cost proposals relating to the contract under which it is to be claimed. Although this was a reference to the waiver provision, no cross reference to Subpart 1-3.8 was made.

Since the profit/fee offset requirement gave agencies the option as to which offset method could be used, EPA amended the EPAPR (15-3.808-50(b) to provide that where FCCM was proposed as an element of cost, the profit/fee would be reduced by an identical dollar amount (dollar-for-dollar offset).

### III. FAR Policy

When FAR was first enacted, the FCCM provisions followed the DAR more so than the FPR. The differences, most of which exist as of the date of this paper, were as follows:

A. The most significant difference is that FAR does not require a profit/fee offset or reduction when FCCM is proposed as an element of cost. Since there is no prohibition against such an offset, EPA's FAR Supplement, EPAAP 1515.970-2(a)(3) required a dollar-for-dollar offset.

B. At the time of enactment, FAR did not contain a section comparable to FPR 1-3.13, the subpart containing the details behind computing FCCM. FAR has been recently amended

with the addition of a new subpart, 30.5, which essentially replaced FPR 1-13.3.

C. Unlike FPR, FAR does not prohibit FCCM in cost reimbursable or cost sharing contracts.

D. The language of the waiver clause is different. FAR 52.215-31 states the following:

"If the Contractor did not include facilities capital cost of money as a proposed allowable cost, it shall be deemed that the Contractor waived the right to claim it under this contract."

While FAR is not supposed to result in major policy changes, the mere change in language may produce real changes, perhaps through a body of case law.

Contract Closeout Action at EPA Headquarters and  
Final Audit of EPA's Cost Reimbursement Contracts

When does contract closeout begin? The closeout process begins when the contract final delivery date expires. P&CMD then requests a certification from the Project Officer that the item has been delivered. EPA's Contract Administrator receives the contractor's Completion Voucher, or its Cumulative Claim. The Contract Administrator asks the Washington Cost Advisory Operations (WCAO) to request a final audit and furnish a closing statement, and provide comments which will assist in the final closeout of the physically completed cost-reimbursement (CR) type contract.

Contractor Submissions

The Contractor's Completion Voucher is discussed on page 3, paragraph 8 of the instructions for completing Public Vouchers and reads in part:

The contractor shall submit its Completion Voucher in the number of copies shown in paragraph three to the servicing finance office and a copy to the Contracting Officer, when the following has been accomplished:

- (a) Physical completion of all performance provisions of the contract and acceptance of the final report.
- (b) All direct costs have been incurred and booked. Indirect costs may be claimed at the provisional rate(s) if final rate(s) are not yet available. The contractor shall identify the Completion Voucher by typing Completion Voucher in the upper right corner of the SF 1034 beside the voucher number.

The Completion voucher may be submitted to EPA's C.O. promptly on completion of required work, but no later than one year from the contract completion date. Upon approval of that invoice or completion voucher, and after the Contractor's compliance with all terms of the contract, the Government shall promptly pay any balance of allowable

cost and that part of the fee (if any) not previously paid to the contractor, but shall be limited to 85% of the Fixed Fee. The withheld fee (15%) is payable upon submission of appropriate closing documents, after final audit of the contract has been completed, and all audit exceptions have been resolved. Page 4, of the Guide for Preparing Standard Form, SF1035, Continuation Sheet of the Public Voucher instructs the Contractor on the following:

- A - Contractor's Claim for the Reimbursement of the Purchased Material and Subcontracted Items.
- B - Costs Requiring Prior Authorization and Approval (Subcontracts under General Provisions).
- C - Withholding and Release of Contract Reserves
- D - Contractor's Completion Voucher and Cumulative Claim and Reconciliation - To the Contracting Officer
  - 1 - When physical completion of performance provisions of the contract is done and EPA has accepted the Final Report if required.
  - 2 - When all costs applicable to the contract have been incurred. Contractor is to type Completion Voucher in number block. This will notify the C.O. that the contract is ready for final audit.
- E - Contractor's Final Voucher and Closing Documents - The contractor submits his final Voucher to the EPA Contracting Officer after the following has been accomplished:
  - 1 - Completion of the final audit of the contract
  - 2 - Audit exceptions or questioned costs have been resolved. There is a mutual agreement between the Contractor and the C.O. on the final (total) allowable costs and the fixed fee of the contract.
  - 3 - Acceptable final fixed overhead (indirect cost) rates for all fiscal periods involved under the contract have been approved by the C.O. or his authorized representative.
  - 4 - Final Voucher shall be identified as such and should include the remaining reserves, and any adjustments to vouchered

costs necessitated by the final settlement of the contract price. The Contractor's Release and the Contractor's Assignment of Refunds, Rebates, Credits and Other Amounts shall be submitted with the Contractor's FINAL VOUCHER.

#### WCAO Steps

The Contractor's Completion Voucher and the Contractor's Cumulative Claim and Reconciliation, when available, are enclosed with the request memo to WCAO. At this point, WCAO (1) examines the Official Contract File; (2) determines the total dollars obligated by review of the Basic Contract and all Modifications for the following:

Total Estimated Cost	\$xxxxx
Fixed Fee	xxx
Cost Plus Fixed Fee (CPFF)	<u>\$xxxxx</u>
	=====

(3) determines the contract period. i.e., the effective date of contract through last date of performance in the Basic Contract or the last Modification issued showing an extension of the contract period; (4) determines whether the contract's Negotiated Indirect Cost Rates (FPR contracts) or Indirect Cost (FAR contracts) clause established ceiling indirect cost rate(s); (5) determines whether the contract has a level of effort clause, and (6) checks whether the contract contains any ceiling amounts for travel or other types of direct costs.

Once the contract has been reviewed, the WCAO prepares a letter requesting a final audit. This letter is generally addressed to the cognizant branch office of the Defense Contract Audit Agency, the organization

which performs the great majority of contract audits for EPA. Based on the Contract Audit Closing Statement, which includes the results of the final audit and other information, the cost advisory office makes its recommendations for close-out of the particular contract.

#### Final Audit

Why is final audit of Cost Reimbursement Type Contracts a requirement prior to contract closeout? The Contracting Officer (Contract Administrator) needs an official document recommending the total allowable cost and the total amount of fee (if any) payable to the Contractor for satisfactory completion of all work required under the specific contract. The contractor must agree with the recommended amounts of cost and fee, prior to closeout and retirement of EPA's Official Contract File.

How was the government's right to audit the contractor's accounting records incorporated into the CR type contracts? EPA's "General Provisions for Cost-Reimbursement Type Research and Development Contracts (With Fixed Fee)", contain forty three (43) approved clauses, designated EPA Form 1900-17. Prior to April 1, 1984, these clauses were incorporated into EPA contracts by reference.

One of the problems with final audit is the length of time it takes from our request for final audit to when we actually receive the final audit report. The DCAA auditors advised me that their first priority is to audit initial pricing proposals, and furnish reports to the requesting

Contracting Officer (CO) or his representative. The DCAA auditor's prompt issuance of initial pricing reports to CO helps speed up the negotiation of a contractor's proposal and award of the contract. With the award of a contract, the contract work may begin as soon as possible. My point is that the length of time it takes to receive the final audit report from DCAA is not due to the duration of the actual final audit, but rather due to the priorities of DCAA.

Another reason for the delay in the receipt of final audit reports on completed cost-type contracts is the contractor's failure to furnish the proposed final indirect cost rate(s) to the Contracting Officer with a copy to the cognizant audit activity, within ninety (90) days after the end of the contractor's fiscal year. This contractual requirement is found in paragraph (b) of the Negotiated Overhead Rates clause in EPA's General Provisions for FPR covered cost-Reimbursement type contracts and the Allowable Cost and Payment clause, which is incorporated by reference in FAR covered cost-type contracts.

If a contractor does not submit its indirect cost rate proposal within the ninety (90) day period, EPA's Cost Policy and Rate Negotiation Section sends the contractor a letter requesting its indirect cost proposal for EPA cost-reimbursable contracts active during the contractor's specific Fiscal Year. The referenced letter reads in part as follows:

The negotiated overhead rate clause in your cost reimbursement type contracts with the Environmental Protection Agency requires that you provide a final indirect cost rate proposal within 90

days after the end of your fiscal year. We have not received your proposed final rates for the fiscal year(s) ended \_\_\_\_\_.

Please submit your proposal (or notification that you have submitted your proposal to a Federal audit agency) as soon as possible addressed as follows:

Mr. John J. Zabretsky  
Chief, Cost Policy and Rate Negotiation Section  
Planning and Cost Advisory Branch (PM-214-F)  
Environmental Protection Agency  
Washington, D.C. 20460

Why is the Reconciliation of Indirect Cost Claimed so important prior to completion of contract closeout? The indirect cost rates, used by the contractor and applied to the appropriate base(s), on EPA Form 1900-34 Cumulative Claim and Reconciliation should not exceed any maximum ceiling rate(s) incorporated in the contract.

The Negotiated Indirect Cost Rates clause in Cost Plus Fixed Fee (CPFF) cost reimbursement contracts reads in part as follows:

"Final rates shall not exceed those listed below; provided however, that in the event rates developed by the cognizant audit activity on the basis of actual allowable costs are less than the maximum rate agreed to herein, then the rate established by such cognizant auditor and accepted by the Contracting Officer shall apply. The Government will not be obligated to pay any additional amounts on account of rates above the maximum ceiling rates set forth below."

FAR has set time limits on when contracts should be closed out. Physically completed contracts should be closed-out within six months for fixed-price contracts, thirty-six months for contracts involving indirect rate settlements and twenty months for all other contracts (FAR 4.804-1).

For Final Audit of a Level of Effort (L.O.E.) term type CR Contract:

The Audit Report requested by the cost advisory office must furnish a statement on the total Direct Labor Hours expended by the Contractor. This statement is required for the Contracting Officer, as the L.O.E contract clause establishes the Government's best estimate of the total number of Direct Labor Hours required for the contract, for example, 30 - 40 - or 60,000 man-hours. The same L.O.E. clause also provides that an equitable downward adjustment of the fee will be made, if the contractor does not expend 90% of the Direct Labor Hours established in the contract.

Quick Closeout Procedures

Unit Two of the Acquisition Handbook discusses Quick Closeout Procedures as authorized in FAR 42.708, and includes Attachment 1 entitled Final Audits - Desk Review Procedures to be followed by the Contract Administrator. The procedures basically allow the quick close out of a contract if most of the costs have been audited and we have final indirect cost rates for all but one of the fiscal years involved.

### Direct Labor on Fixed Rate Contracts

In recent years, EPA had increased the number of fixed rate contracts it has awarded. In these contracts, there are fixed hourly rates which include direct labor, indirect expenses and profit. These contracts may provide EPA contractors with opportunities to increase their profits beyond the amounts negotiated.

Included below, are actual examples of how contractors can increase their profits on EPA's fixed rate contracts.

The RFP requests nineteen (19) professional disciplines with levels 1 thru 4 in each discipline.

#### Example A

The contractor proposed four rates. One rate for each level, P1 thru P4. The proposed rates are weighted average rates of the contractor's labor categories. The contractor's categories and proposed rates are as follows:

<u>Proposed Unloaded Rates</u>	<u>EPA Category Level</u>	<u>Contractor's Labor Category</u>	<u>Current Unloaded Hourly Rate</u>
\$36.12/Hour	P-4	Principal Project Manager	\$39.06 25.41

A 55.9% difference between the rates.

\$28.88/Hour	P-3	Principal Project Manager Senior Associate	\$39.06 25.41 20.52
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A 90% difference between the low and high rates.

<u>Proposed Unloaded Rates</u>	<u>EPA Category Level</u>	<u>Contractor's Labor Category</u>	<u>Current Unloaded Hourly Rate</u>
\$21.65/Hour	P-2	Project Manager	\$25.41
		Senior Associate	20.52
		Associate	16.00

A 59% difference between the low and high rates.

\$12.52/Hour	P-1	Associate	\$16.00
		Analyst	12.01
		Research Assistant	9.72

A 65% difference between the low and high rates.

How much can this contractor increase his profits?

P-4

Loaded Proposed Rate	\$ 99.16/Hour
Loaded Principal Rate	\$107.28/Hour
Loaded Project Manager Rate	\$ 69.79/Hour

If the contract is awarded at the proposed loaded rate, the contractor loses \$8.12/hour whenever he uses the principal and reaps an additional profit of \$29.37 whenever he uses a project manager.

P-3

Loaded Proposed Rate	\$ 79.39/Hour
Loaded Principal Rate	\$107.28/Hour
Loaded Project Manager Rate	\$ 69.79/Hour
Loaded Senior Associate Rate	56.41/Hour

If the contract is awarded at the proposed loaded rate, the contractor loses \$27.89/hour whenever he uses the principal. He reaps an additional \$9.60/hour and \$22.98/hour whenever he uses a project manager and senior associate, respectively.

P-2

Loaded Proposed Rate	\$59.51/Hour
Loaded Project Manager Rate	\$69.79/Hour
Loaded Senior Associate Rate	\$56.41/Hour
Loaded Associate Rate	\$43.98/Hour

If the contract is awarded at the proposed loaded rate, the contractor loses \$10.28/hour if a project manager is used. He reaps an additional \$3.10/hour and \$15.53/hour whenever he uses a senior associate or associate, respectively.

P-1

Loaded Proposed Rate	\$34.39
Loaded Associate Rate	\$43.94
Loaded Analyst Rate	\$32.99
Loaded Research Assistant Rate	\$26.70

If the contract is awarded at the proposed loaded rate, the following occurs for each of his proposed categories.

Associate	-	He loses \$9.56/hour
Analyst	-	He reaps an additional \$1.40/hour
Research Assistant	-	He reaps an additional \$7.69/hour

### Example B

The contractor is a small business with less than 20 employees.

The contractor proposes the average rates of the individuals expected to work in each discipline and level.

#### Environmental Engineer P-4

Employee A	\$33.42/Hour
Employee B	28.93/Hour
Employee C	22.95/Hour
Average Rate	27.06/Hour

Loaded Average Rate	\$67.57/Hour
Loaded A Rate	83.45/Hour
Loaded B Rate	72.24/Hour
Loaded C Rate	57.31/Hour

If the contract is awarded at the proposed rate, the contractor loses \$15.88/hour on employee A, \$4.67/hour on employee B and reaps an additional profit on employee C of \$10.26/hour.

#### Civil Engineer P-2

Employee A	\$14.78/Hour
Employee B	10.17/Hour
Average Rate	12.47/Hour

Loaded Average Rate	\$31.14/Hour
Loaded A Rate	36.91/Hour
Loaded B Rate	25.91/Hour

If the contract is awarded at the proposed rate, the contractor loses \$5.77/hour on employee A and reaps an additional \$5.75/hour on employee B.

### Example C

The contractor is a large business and has a salary structure of levels 1 thru 30. The contractor's policy is to midpoint each level for proposal purposes. He also combines the average or midpoint rate for several levels to compute a rate for one of EPA's levels.

Examples of his levels and unloaded rate ranges are as follows:

	<u>Minimum Rate</u>	<u>Midpoint Rate</u>	<u>Maximum Rate</u>
Level 1	\$ 4.55	\$ 5.36	\$ 6.16
Level 16	11.66	15.10	18.55
Level 22	18.63	24.84	31.05
Level 25	23.55	31.40	39.25
Level 26	25.52	34.03	42.54
Level 28	33.23	44.31	55.38
Level 30	56.85	75.80	94.75

For one level four discipline the contractor combines levels 25, 26, and 28. Therefore the range of rates for the level four discipline is \$23.55/hour to \$55.38/hour (a 135% difference between low and high rate).

Assume level 22 is the proposed rate.

Loaded Midpoint Rate (Proposed Rate)	\$57.13/Hour
Minimum Loaded Rate	42.85/Hour
Maximum Loaded Rate	71.42/Hour

The contractor makes an additional profit of \$14.28/hour if an employee making the minimum rate is used and loses \$14.29/hour if an employee making the maximum rate is used.

Now suppose the contractor combines several of his levels to get the proposed unloaded rate.

Level 25	\$31.40/Hour
Level 26	34.03/Hour
Level 28	<u>44.30/Hour</u>
Average Rate	\$36.58/Hour
Loaded Rate	\$84.13/Hour

The minimum loaded rate for level 25 is \$54.17/hour. The maximum loaded rate for level 28 is \$127.37/hour.

If an employee at the minimum rate for level 25 is used, the contractor makes an additional profit of \$29.96/hour.

If an employee at the maximum rate for level 28 is used, the contractor loses \$43.24/hour.

Remember! The employees at the minimum rate for level 25 meet the RFP educational and experience requirements.

Example D

The contractor is a medium size firm with serveral divisions. Average rate for specific individuals were proposed for each discipline and level.

	<u>Labor Rate</u>	<u>Loaded Rate</u>
Employee A	\$22.72/Hour	\$ 70.44/Hour
Employee B	25.00/Hour	77.51/Hour
Employee C	22.36/Hour	69.33/Hour
Employee D	32.69/Hour	101.35/Hour
Average Rate	<u>\$25.69/Hour</u>	<u>\$ 79.65/Hour</u>

If the contract is awarded at the proposed rate, the following occurs:

Contractor reaps an additional \$9.21/hour on employee A. Contractor reaps an additonal \$2.14/hour on employee B. Contractor reaps an additional \$10.32/hour on employee C. Contractor loses \$21.70/hour on employee D.

### Example E

The contractor is a large company. For proposal purposes company wide average rates are used. The rates of over 800 employees are used to develop the rates.

#### Civil Engineer P-1

Low Rate	\$ 7.50/Hour
High Rate	<u>\$14.75/Hour</u>
Average Rate	<u>\$11.24/Hour</u>
Loaded Average Rate	\$32.10/Hour
Loaded Low Rate	<u>\$21.41/Hour</u>
Loaded High Rate	<u>\$42.12/Hour</u>

If the contract is awarded at the proposed rate, the contractor loses \$10.02/hour if the high rate employee is used and reaps an additional profit of \$10.69/hour if the low rate employee is used. There are 35 employees in this category and 19 have rates below \$11.24/hour.

#### Civil Engineer P-3

Low Rate	\$14.88/Hour
High Rate	<u>\$28.85/Hour</u>
Average Rate	<u>\$19.74/Hour</u>
Loaded Average Rate	\$56.36/Hour
Loaded Low Rate	<u>\$42.49/Hour</u>
Loaded High Rate	<u>\$82.38/Hour</u>

If the contract is awarded at the proposed rate, the contractor loses \$26.02/hour on the high rate employee and reaps an additional profit of \$13.87/hour on the low rate employee. There are 79 employees in this category and 40 are below \$19.74/hour.

Civil Engineer P-4

Low Rate	\$ 22.19/Hour
High Rate	\$ 56.73/Hour
Average Rate	\$ 28.82/Hour

Loaded Average Rate	\$ 82.30/Hour
Loaded Low Rate	\$ 63.37/Hour
Loaded High Rate	\$162.00/Hour

If the contract is awarded at the proposed rate, the contractor loses \$79.70/hour on the high rate employee and reaps an additional profit of \$18.93/hour on the low rate employee. There are 20 employees in this category and 12 employees are under \$28.82/hour.

In the above examples, I have shown that a contractor can gain or lose on a fixed rate contract. However, EPA contractors are not in business to lose money. Only in rare circumstances will a contractor give us anyone making more than the proposed rate.

The following example illustrates how EPA can be taken in by a contractor's explanation of his rates.

### Example F

The RFP required approximately twelve (12) rates. The contractor proposed four rates (PL, P2, P3, and P4). The proposed rates were average rates of the employees expected to work on the contract. A comparison of the technical and cost proposal disclosed individuals included in the technical proposal which were not in the cost proposal. The contractor was requested to submit rates for each of the RFP categories and to include all of the individuals in the technical proposal. There were twenty-five individuals in the technical proposal which were not included in the cost proposal. The contractor's response was that the individuals in the technical proposal not included in the cost proposal have higher hourly rates than other proposed individuals. Therefore, if we forced them to propose separate rates for each discipline and level, the hourly rates would increase.

The CO accepted the contractor's explanation and accepted the proposed four rates.

The rates of the additional 25 individuals are as follows:

#### P4

A	\$ 57.56	Proposed Average \$60.05
B	45.94	
C	42.86	
D	41.61	
E	64.68	
F	64.68	
G	145.53	
H	48.51	
Average	<u>\$ 63.92</u>	
	=====	

P3

A	\$ 50.90	Proposed Average \$33.72
B	32.10	
C	40.52	
D	120.02	
E	39.84	
F	129.36	
G	56.60	
H	36.52	
I	44.77	
J	45.43	
Average	<u>\$ 59.61</u>	
	=====	

P2

A	\$ 38.75	Proposed Average \$24.37
B	29.90	
C	72.36	
Average	<u>\$ 47.00</u>	
	=====	

P1

A	\$ 9.96	Proposed Average \$15.63
B	13.59	
C	11.65	
D	15.53	
Average	<u>\$ 12.68</u>	
	=====	

A review of the contract financial management report disclosed only 3 of the 25 additional individuals were used during the first ten months of the contract (5 or 6 these were supposed to be key personnel). Two were used in the P1 category and one in the P3 category. The hourly rates of all three were lower than the average rates proposed. In the P1 category A was used at \$9.96/hour. The average rate proposed was \$15.63. A was used for 1183 hours. This resulted in additional profit of \$6707.61 for the contractor.

In conclusion, our cost analyses as a minimum should include the following:

1. Determine the method the contractor is using for computing direct labor.
2. If rates for individuals are proposed - determine the actual rate and category of each individual proposed.
3. If weighted average rates are used - determine the weighting and rates of individuals or categories proposed.
4. If straight averages are used - determine the number of persons in each category, the rates of each one and the high and low range.
5. Compare names in the technical proposal with the cost proposal.
6. Compare the hours proposed with the hours available.  
(In Example E - Civil Engineer P1, the contractor has 35 employees in this category and 19 of them have an hourly rate less than the proposed average hourly rate. If EPA is only asking for 6,000 hours per year, the 19 lower than average rate employees could easily fill these hours).

7. Do not accept a no-cost questioned report from DCAA as meaning the rates are acceptable. You have to have information in your workpapers supporting why the rates are acceptable or nonacceptable.

There are numerous other ways a contractor can increase his profit on fixed rate contracts. Some of these are:

1. Hire new employees at lower than proposed rates.
2. Hire new consultants at lower than proposed rate.
3. Use lower paid consultants and charge EPA as if a regular employee was working.
4. Use personnel who do not meet the education and experience requirements of the contract and are paid at a lower rate.
5. Charge EPA for overtime hours, but do not pay the employees for overtime.
6. Hire temporary employees who do not receive fringe benefits.

EPA has several contractors whose entire business consists mostly of EPA work. In the past, we have awarded mostly cost reimbursable - level of effort contracts. Therefore, most of our contractor's contracts are cost-reimbursable. Then we award a few fixed rate contracts for the contractor to mix with their many cost reimbursable contracts. We have placed these contractors in

any excellent position to manipulate thier personnel in such a way to maximize their profits without violating the terms of the contract.



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