

Chapter 5

Contract Pricing

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Chapter 5 Contract Pricing

SECTION 1 TYPES OF CONTRACTS

5.1.1 General

- 5.1.1.a The negotiation of contract type and price are closely related and must be considered together with the issues of risk, uncertainty, and responsibility for costs.
- 5.1.1.b The type of contract used should reflect the cost risk and responsibility assumed by the contractor. Full cost responsibility is assumed under a firm-fixed-price contract, while there is minimal cost responsibility under a cost-reimbursement contract. The profit or fee arrangement should also reflect the cost responsibility assumed.
- 5.1.1.c Any type of contract described in this section may be used, as appropriate to the procurement. When in the Postal Service's interest, the contracting officer may decide to use a type of contract not described in this section, subject to the approval of the manager of Headquarters Purchasing, Field Customer Support, Major Facilities Purchasing, or National Mail Transportation Purchasing.
- 5.1.1.d When a contract type other than firm-fixed-price is used, the contract file must include adequate documentation to support the choice.

5.1.2 Selection of Contract Type

- 5.1.2.a The contracting officer is responsible for negotiating the least costly contract type appropriate to the circumstances of the procurement.
- 5.1.2.b Although contract type is a matter for negotiation, competitive purchasing procedures require that the solicitation specify a particular type of contract (permitting alternatives, if appropriate) in order to provide a basis for comparing proposals. Provision 5-1, *Type of Contract*, must be included in all solicitations. Clause B-3, *Contract Type*, must be included in all contracts awarded without the issuance of a written solicitation. A cost-plus-a-percentage-of-cost contract may not be used.
- 5.1.2.c A firm-fixed-price contract is generally preferred because it makes the contractor fully responsible for cost control and minimizes the need for Postal Service monitoring of performance. But if no reasonable basis for firm pricing exists, requiring a firm-fixed-price contract may reduce competition and lead to higher prices because of allowances for contingencies added to protect contractors from perceived risks. Whenever the probable cost of contract performance cannot be realistically estimated, a firm-fixed-price contract should not be used.

- 5.1.2.d When a firm-fixed-price contract cannot be used, costs can still be controlled by using incentives. Efficient contract performance is promoted by relating the amount of profit or fee payable under the contract to the contractor's ability to manage costs effectively.
- 5.1.2.e Cost-reimbursement contracts are suitable for use when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract.
- 5.1.2.f Factors to be considered in deciding contract type include:
 1. Realism of cost estimate;
 2. Extent of competition;
 3. Performance risks and uncertainties;
 4. Complexity of the requirement;
 5. Adequacy and firmness of specifications;
 6. Likelihood of changes;
 7. Prior experience (pricing and production);
 8. Extent of subcontracting;
 9. Adequacy of contractor's cost estimating and accounting system; and
 10. Urgency of the requirement.

5.1.3 Fixed Price Contracts

5.1.3.a Firm-Fixed-Price Contract

1. *Description.* A firm-fixed-price contract establishes a price that is not subject to adjustment based on the cost of performance. It places upon the contractor full responsibility for all costs and the resulting profit and loss, maximizing the incentive to control costs and perform effectively. It is the least burdensome type of contract to administer if requirements are stable; if frequent changes are likely, administration will be difficult.
2. *Application.* A firm-fixed-price contract is suitable for purchasing standard or modified commercial products, or supplies or services having reasonably definitive specifications or statements of work, and whenever fair and reasonable prices can be established at the outset, such as when:
 - (a) There is adequate price competition (see 5.3.3.c);
 - (b) Price analysis (see 5.3.3.b) indicates price reasonableness;
 - (c) In noncompetitive situations, cost or pricing data are adequate to permit realistic estimates of the costs of performance; or
 - (d) The cost impact of performance uncertainties can be estimated closely enough to reach agreement on a reasonable price representing assumption of the risks involved.

5.1.3.b Fixed-Price Incentive Contract

1. *Description.* A fixed-price incentive contract is a fixed-price contract that provides for adjusting profit and establishing the final contract price by applying a formula based on the relationship of total final negotiated cost to total target cost. For each item subject to incentive price revision, the contract specifies a target cost, a target profit, a target price, a price ceiling, and a profit adjustment formula. The price ceiling is the maximum that may

be paid to the contractor, except for adjustments specially provided for under contract clauses. When contract performance is completed, the parties negotiate the final cost, and the final price is established by applying the formula. When the final cost is less than the target cost, application of the formula results in a final profit greater than the target profit; when final cost is more than target cost, application of the formula results in a final profit less than the target profit. If the final negotiated cost exceeds the price ceiling, the contractor absorbs the difference as a loss. Because the profit varies inversely with the cost, this contract type provides a positive, calculable profit incentive for the contractor to control costs. Billing prices are established as an interim basis for payment; the billing prices may be adjusted if it becomes apparent that the final negotiated cost will be substantially different from target cost.

2. *Application.* A fixed-price incentive contract is appropriate when the parties can negotiate at the outset an initial target cost, target profit, and profit adjustment formula that will provide a fair and reasonable incentive and a ceiling that provides for the contractor to assume appropriate share of the risk. When the contractor assumes a considerable or major share of the cost responsibility under the adjustment formula, the target profit should reflect this responsibility.
3. *Limitations.* This contract type may be used only when:
 - (a) A firm-fixed-price contract is not suitable;
 - (b) There is an adequate basis for establishing reasonable firm targets at the time of initial contract negotiations; and
 - (c) The contractor's accounting system is adequate for providing data to support negotiation of final cost and incentive price revision.

5.1.3.c *Fixed-Price Contract with Economic Price Adjustment*

1. *Description.* A fixed-price contract with economic price adjustment provides for the upward and downward revision of the stated contract price upon the occurrence of contingencies that are defined in the contract. Upward adjustments are limited by the establishment of a reasonable ceiling, and provisions are included for downward adjustments when prices or rates fall below the base levels provided in the contract. In establishing the base levels from which adjustments will be made, the contracting officer must ensure that the base does not include allowance for any of the defined contingencies. Economic price adjustments are of two types:
 - (a) *Adjustments Based on Actual Costs of Labor or Materials.* These price adjustments are based on increases or decreases in specified costs of labor or material that the contractor actually experiences during contract performance.
 - (b) *Adjustments Based on Cost Indexes of Labor or Materials.* These price adjustments are based on increases or decreases in labor or material cost standards or indexes specifically identified in the contract.
2. *Application*
 - (a) *General.* This type of contract is appropriate when there is serious doubt as to the stability of market and labor conditions that will exist during an extended period of performance, and when contingencies that would otherwise be included in a firm-fixed-price contract are identifiable and can be covered separately. Its usefulness is limited by the difficulties of its administration.

(b) *Adjustments Based on Actual Costs of Labor or Material*

- (1) A contract may provide for adjustments based on actual costs of labor or material when:
 - (i) The contract is over \$100,000 in amount and over six months in duration;
 - (ii) There is no major element of design, engineering, or developmental work involved;
 - (iii) One or more identifiable labor or material cost factors are subject to change; and
 - (iv) Adjustments will be limited to contingencies beyond the contractor's control.
- (2) The schedule must describe in detail the types of labor and material subject to escalation, the labor rates (including fringe benefits) and unit prices of materials that may be increased or decreased, and the quantities of labor and specified materials allocable to each unit of supplies to be delivered under the contract. The percentage figure used in subparagraph c.6 of the clause may not exceed ten percent. In negotiating adjustments under the clause, the contracting officer must consider work in process and materials on hand at the time of changes in labor rates or materials prices, since these elements may have a significant impact on equitable price adjustments.

(c) *Adjustments Based on Cost Indexes of Labor or Material*

- (1) A contract may provide for adjustments based on cost indexes of labor or material when:
 - (i) The contract involves an extended period of performance with significant costs to be incurred beyond one year after performance begins;
 - (ii) The contract amount subject to adjustment is substantial; and
 - (iii) The economic variables for labor and materials are too unstable to permit a reasonable division of risk between the Postal Service and the contractor without providing for such adjustments.
- (2) The contracting officer must develop a clause tailored to the circumstances of the procurement, with the assistance of assigned counsel.

5.1.3.d *Clauses*

1. All fixed-price contracts must include Clause 5-1, *Payment — Fixed-Price*.
2. All fixed-price incentive contracts must also include Clause 5-2, *Incentive Price Revision*, properly filled in.
3. Fixed-price contracts providing for economic price adjustment based on actual costs of labor or material (see c.2(b) above) must include Clause 5-3, *Economic Price Adjustment — Labor and Materials*.

5.1.4 **Cost-Reimbursement Contracts**

- 5.1.4.a *General.* Cost-reimbursement contracts provide for payment of allowable incurred costs as prescribed in the contract. They establish an estimate of total cost for the purpose of committing funds and establishing a ceiling that the contractor may not exceed (except at its own risk) without the approval of the contracting

officer. Cost-reimbursement contracts are suitable for use only when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use a fixed-price contract.

- 5.1.4.b *Limitations.* A cost-reimbursement contract may be used only when:
1. The contractor's accounting system is adequate for determining costs applicable to the contract; and
 2. Appropriate Postal Service monitoring during performance will provide reasonable assurance that efficient methods and effective cost controls are used.
- 5.1.4.c *Cost Contract.* A cost contract is a cost-reimbursement contract under which the contractor receives no fee. A cost contract may be appropriate for research and development work, particularly with nonprofit educational institutions or other nonprofit organizations.
- 5.1.4.d *Cost-Sharing Contract.* A cost-sharing contract is a cost-reimbursement contract under which the contractor receives no fee and is reimbursed only an agreed upon portion of its allowable costs. It is suitable for use where there is a high probability that the contractor will receive substantial commercial benefits as a result of contract performance.
- 5.1.4.e *Cost-Plus-Incentive-Fee Contract*
1. *Description.* A cost-plus-incentive-fee contract is a cost-reimbursement contract that provides for the initially negotiated fee to be adjusted later by a formula based on the relationship of total allowable costs to target cost. This contract type specifies a target cost, a target fee, minimum and maximum fees, and a fee adjustment formula. After contract performance, the fee payable to the contractor is determined in accordance with the formula. The formula provides, within limits, for increases in fee above target fee when total allowable costs are less than target cost, and decreases in fee below target fee when total allowable costs exceed target cost. This increase or decrease is intended to provide an incentive for the contractor to manage the contract effectively. When total allowable costs are greater than or less than the range of costs within which the fee-adjustment formula operates, the contractor is paid total allowable costs, plus the minimum or maximum fee.
 2. *Application.* A cost-plus-incentive-fee contract is suitable when a cost-reimbursement contract is appropriate and a target cost and fee adjustment formula likely to motivate the contractor to manage the contract effectively can be negotiated. The fee adjustment formula should provide an incentive effective over the full range of reasonably foreseeable variations from target cost. If a high maximum fee is negotiated, the contract must provide for a low minimum fee, or even a zero or negative fee.
- 5.1.4.f *Cost-Plus-Fixed-Fee Contract*
1. *Description.* A cost-plus-fixed-fee contract is a cost-reimbursement contract that provides for payment to the contractor of a negotiated fee in a fixed amount. The fixed fee does not vary with actual cost, but may be adjusted as a result of changes made in contract requirements. This contract type gives the contractor only a minimum incentive to control costs.
 2. *Application.* A cost-plus-fixed-fee contract is suitable when a cost-reimbursement contract is necessary but the uncertainties and risks for the contractor are too great to permit negotiation of a reasonable cost-plus-incentive-fee arrangement.

3. *Completion or Level-of-Effort Form.* A cost-plus-fixed-fee contract must be in one of two basic forms — the completion form or the level-of-effort form.
 - (a) *Completion Form.* The completion form describes the scope of work by stating a definite goal or target and specifying an end product. This form of contract normally requires the contractor to complete and deliver the specified end product within the estimated cost, if possible, as a condition for payment of the entire fixed fee. If the work cannot be completed within the estimated cost, the Postal Service may require more effort without increase in fee, but the estimated cost must be increased.
 - (b) *Level-of-Effort Form.* The level-of-effort form describes the scope of work in general terms and obligates the contractor to devote a specified level of effort for a stated time period. Under this form, if performance is satisfactory, the fixed fee is payable at the expiration of the agreed upon period, upon contractor certification that the level of effort specified in the contract has been expended in performing the contract work. Renewal for further periods of performance requires new cost and fee arrangements, and is treated as a new purchase.
 - (c) *Preference.* Because of the greater obligation assumed by the contractor, the completion form is preferred over the level-of-effort form whenever the work can be defined well enough to permit a reasonable cost estimate within which the contractor can be expected to complete the work.

5.1.4.g *Clauses*

1. All cost-reimbursement contracts must include the following clauses:
 - (a) Clause 5-4, *Allowable Cost and Payment.*
 - (b) Either Clause 5-5, *Limitation of Cost*, (if the contract is fully funded) or Clause 5-6, *Limitation of Funds*, (if the contract is incrementally funded).
2. Cost contracts must include Clause 5-7, *Cost Contract — No Fee.*
3. Cost-sharing contracts must include Clause 5-8, *Cost-Sharing Contract — No Fee.*
4. Cost-plus-incentive-fee contracts must include Clause 5-9, *Incentive Fee.*
5. Cost-plus-fixed-fee contracts must include Clause 5-10, *Fixed Fee.*

5.1.5 **Indefinite-Delivery Contracts**

- 5.1.5.a *General.* An indefinite-delivery contract may be used when it is known or anticipated that there will be requirements for supplies or services over a period of time, but quantities, times, or places of deliveries are not known at the time of contract award. The contracts establish firm fixed prices, with orders to be placed directly by using activities or by specified purchasing offices with deliveries made directly to using activities.
- 5.1.5.b *Ordering.* The period for placing orders and the activities authorized to place orders must be identified in the contract Schedule. Ordinarily, orders should be placed in writing or by written communication; when necessary, oral orders may be made if they are promptly confirmed in writing. Orders must contain:
 1. Date of order, contract number, and order number;
 2. Item number and description, and unit price;

3. Place and date of delivery or performance;
 4. Packaging, packing, and shipping instructions, if any;
 5. Accounting and fiscal data; and
 6. Any other pertinent information.
- 5.1.5.c *Definite-Quantity Contract.* A definite-quantity contract provides for a definite quantity of specific supplies or services during the contract period, with deliveries to designated locations when ordered.
- 5.1.5.d *Indefinite-Quantity Contract.* An indefinite-quantity contract provides for an indefinite quantity of specific supplies or services, within stated minimum and maximum limits, to be delivered during the contract period to designated locations when ordered. It is for use when precise requirements for supplies or services during the contract period, above known minimum requirements, cannot be determined before contract award.
1. The contract must require the Postal Service to order, and the contractor to deliver, at least a stated minimum quantity of supplies or services as ordered during the contract period, and requires the contractor to deliver any additional quantities ordered, not to exceed a stated maximum.
 2. The minimum quantity must not exceed known requirements, and the maximum quantity must be realistic. The contract may specify minimum or maximum quantities for individual delivery orders, and a maximum that may be ordered during a specified time.
- 5.1.5.e *Requirements Contract.* A requirements contract provides for filling all actual purchase requirements of designated activities for specific supplies and services to be delivered as ordered during the contract period. It is for use when recurring requirements are anticipated during the contract period, but precise quantities that designated activities will need cannot be determined before contract award. It may also be used to obtain supplies and services that may be required in excess of the quantities that the activities themselves can furnish within their own capabilities.
1. The solicitation and contract must state an estimated total quantity, and, if feasible, the maximum limit of the contractor's obligation to deliver and the Postal Service's obligation to order. The total quantity estimate must be as realistic as possible, based on records of previous requirements and current information. The contract may specify minimum or maximum quantities for individual delivery orders, and a maximum that may be ordered during a specified time.
 2. When a requirements contract is for repair, modification, or overhaul of items of Postal Service property, the solicitation must state that failure of the Postal Service to furnish such items in the amounts described as "estimated" or "maximum" will not entitle the contractor to any price adjustment under the *Postal Service Property* clause of the contract.
- 5.1.5.f *Clauses*
1. All indefinite-delivery contracts must include the following clauses:
 - (a) Clause 5-11, *Ordering*.
 - (b) Clause 5-12, *Delivery-Order Limitations*.
 2. All definite-quantity contracts must include Clause 5-13, *Definite Quantity*.
 3. All indefinite-quantity contracts must include Clause 5-14, *Indefinite-Quantity*.

4. All requirements contracts must include Clause 5-15, *Requirements*. When obtaining requirements in excess of the quantities that the activities can furnish within their own capabilities (see paragraph e above), use the clause with its alternate paragraph c.

5.1.6 Time-and-Materials and Labor-Hour Contracts

5.1.6.a Time-and-Materials Contract

1. *Description*. A time-and-materials contract provides for the purchase of supplies or services on the basis of:
 - (a) Direct labor hours at specified, fixed hourly rates (which include wages, overhead, general and administrative expense, and profit); and
 - (b) Material at cost, and when appropriate, material-handling costs as a part of material costs. Material-handling costs may include all indirect costs, including general and administrative expense, allocated to direct materials in accordance with the contractor's usual accounting practices. Such material-handling costs may include only costs clearly excluded from the labor-hour rate.
2. *Application*. A time-and-materials contract is for use only when it is not possible to estimate in advance the extent or duration of the work or to anticipate costs with any reasonable degree of confidence. Because it does not encourage effective management control by the contractor, it may be used only when provision is made for adequate monitoring by Postal Service personnel during performance, to give reasonable assurance that inefficient or wasteful methods are not being used. Examples of situations in which this type of contract might be appropriate are:
 - (a) Repair, maintenance, and overhaul work;
 - (b) Work to be done in emergency situations; and
 - (c) Engineering and design services in connection with the production of supplies.
3. *Limitation*. This type of contract may be used only if no other type of contract will meet the Postal Service's needs. The contract must establish a ceiling price which the contractor exceeds at its own risk. The contracting officer must document the contract file to show the basis for any change in the ceiling.
4. *Optional Method of Pricing Material*. When the work to be performed requires the contractor to furnish material that is regularly sold to the general public in the normal course of business by the contractor, the contract may provide for charging material on a basis other than at cost if:
 - (a) The total estimated contract price does not exceed \$50,000 or the estimated price of material so charged does not exceed 20 percent of the estimated contract price;
 - (b) The material to be so charged is identified in the contract;
 - (c) No element of profit on material so charged is included in the profit in the fixed hourly labor rates; and
 - (d) The contract provides that the price to be paid for such material must be on the basis of an established catalog or list price, in effect when material is furnished, less all applicable discounts, and not exceeding

the contractor's sales price to its most favored customer for the same item in like quantity, or the current market price, whichever is lower.

- 5.1.6.b *Labor-Hour Contract.* A labor-hour contract is a variant of the time-and-materials contract, differing only in that materials are not supplied by the contractor. All the requirements of paragraph a above, except those dealing with materials are applicable to labor-hour contracts.
- 5.1.6.c *Clause.* Time-and-materials and labor-hour contracts must include Clause 5-16, *Payment (Time-and-Materials and Labor-Hour Contracts)*.

5.1.7 Letter Contracts

- 5.1.7.a *Description.* A letter contract is a written preliminary contractual instrument that authorizes the contractor to begin work immediately, before negotiation of a definitive contract.
- 5.1.7.b *Application*
1. A letter contract is for use when:
 - (a) The requirement demands that the contractor be given a binding commitment so that work can be commenced immediately; and
 - (b) Negotiation of a definitive contract in sufficient time to meet the requirement is not possible.
 2. Each letter contract must be as complete and definitive as possible under the circumstances. When award is based on price competition, an overall price ceiling must be included in the letter.
 3. Each letter contract must contain a negotiated definitization schedule including:
 - (a) A date for submission of the contractor's price proposal;
 - (b) A date for the start of negotiation; and
 - (c) A target date for definitization, which must be the earliest practicable date.
 4. Each letter contract must state the maximum liability of the Postal Service. This is the amount estimated to be needed to cover performance prior to definitization; it may not exceed 50 percent of the total estimated cost of the contract.
 5. The definitization schedule must provide for definitization of the contract within 180 days after the date of the letter contract or before completion of 40 percent of the work to be performed, whichever occurs first. However, the contracting officer may in extreme cases authorize an additional period. If, after exhausting all reasonable efforts, the contracting officer and the contractor cannot negotiate a definitive contract because of failure to reach agreement on price or fee, Clause 5-19, *Contract Definitization* (see paragraph d below) requires the contractor to proceed with the work and provides that the contracting officer may determine a reasonable price or fee subject to appeal as provided in Clause B-9, *Claims and Disputes*.
- 5.1.7.c *Limitations*
1. A letter contract may be used only if no other type of contract is suitable, and its use must be approved by the manager of Headquarters Purchasing, Field Customer Support, National Mail Transportation Purchasing, or Major Facilities Purchasing.

2. A letter contract may not commit the Postal Service to a definitive contract in excess of the funds available at the time the letter contract is executed.
3. A letter contract may not be modified to add new work unless the work added is inseparable from the work being performed under the letter contract.

5.1.7.d *Clauses*

1. A letter contract must include clauses required for the type of definitive contract contemplated, and any additional clauses known to be appropriate.
2. All letter contracts must include the following clauses:
 - (a) Clause 5-17, *Execution and Commencement of Work*.
 - (b) Clause 5-18, *Limitation of Postal Service Liability*. Insert in the clause as the maximum liability, the amount necessary to cover the contractor's performance before definitization. The maximum liability amount may not exceed 50 percent of the estimated cost of the definitive contract unless approved by the manager of Headquarters Purchasing, Field Customer Support, National Mail Transportation Purchasing, or Major Facilities Purchasing.
 - (c) Clause 5-19, *Contract Definitization*, with the definitization schedule established in accordance with subparagraphs b.3 and b.5 above. If the contract is not awarded on the basis of price competition, omit paragraph d of the clause.
 - (d) If a cost-reimbursement definitive contract is contemplated, Clause 5-20, *Payment of Allowable Costs before Definitization*.

5.1.8 **Ordering Agreements**

5.1.8.a *General*

1. An ordering agreement is not itself a contract. It is a written agreement negotiated between a purchasing activity and a contractor that contains terms and conditions applying to future contracts (orders) between the parties.
2. An ordering agreement is useful to expedite contracting for uncertain requirements for supplies or services when specific quantities and prices are not known at the time the agreement is signed, but substantial quantities of the supplies or services covered by the agreement are expected to be purchased from the contractor. The use of ordering agreements reduces administrative lead time and inventory investment.

5.1.8.b *Limitations*

1. An ordering agreement may not state or imply any obligation or agreement by the Postal Service to place future contracts or orders with the contractor.
2. An ordering agreement may be changed only by modifying the agreement itself and not by individual orders issued under it. Modifying an ordering agreement does not retroactively affect orders previously issued under it.
3. An ordering agreement extending for more than one year must be reviewed annually to determine whether it should be continued.

5.1.8.c *Content of Agreement*. An ordering agreement must:

1. Describe the supplies and services to be provided;

2. Describe the method for determining prices to be paid to the contractor for the supplies or services;
 3. Include delivery terms and conditions or specify how they will be determined;
 4. List the activities authorized to issue orders under the agreement;
 5. Specify the point at which each order becomes a binding contract (for example, issuance of the order, acceptance of the order in a specified manner, or failure to reject the order within a specified number of days);
 6. Provide that failure to reach agreement on price on any one order issued before its price is established (see paragraph e below) is a dispute under Clause B-9, *Claims and Disputes* included in the ordering agreement; and
 7. Contain the clauses prescribed for the type of contract represented by the orders to be placed. (For clauses prescribed according to contract dollar amount, the aggregate value of orders expected to be placed must be estimated.)
- 5.1.8.d *Ordering.* A contracting officer representing any activity listed in an ordering agreement may issue orders for supplies or services covered by that agreement. Except for orders under mandatory ordering agreements (see 3.1.4.b), competition must be obtained before placing an order, unless precluded by compelling urgency or other good reason in the Postal Service's interest. Competition may be by oral or written solicitation among firms holding ordering agreements for the same supplies or services, or on the open market. If an order is placed without obtaining competition, the file must be documented to show the reason.
- 5.1.8.e *Pricing.* The contracting officer may not authorize the contractor to begin work on an order under an ordering agreement until prices have been established, unless urgency precludes advance pricing and the order establishes a ceiling price limiting the Postal Service's obligation. Pricing must be accomplished as soon as possible after issuance of an unpriced order.

5.1.9 **Task Order Contracts**

Task order contracts are suitable for use when purchasing services that can only be described in general terms at the time of contract award, and must be ordered as specific requirements develop or can be defined. The contract describes the scope of the services to be provided, contains appropriate terms and conditions, and provides for the placement of task orders by the contracting officer. The contract must be for a specified period and must state the maximum liability of the Postal Service. Each task order describes and establishes a price for the task to be performed. If the price cannot be negotiated before issuance of the task order, the task order must have a ceiling price limiting the Postal Service's obligation.

5.1.10 **Multiyear Contracts**

When a multiyear contract is appropriate (see 2.2.9), any authorized type of contract may be used, but one of the following will be suitable for most situations:

- 5.1.10.a *Requirements.* A multiyear requirements contract commits the Postal Service to purchase all of its requirements for the specified supplies or services from the

contractor for the stated multiyear period. Offerors are required to propose a single unit price over the period of performance of the contract, but economic price adjustment provisions may be included in accordance with 5.1.3.c. The solicitation must include an estimate of the Postal Service requirements based on careful analysis of past purchases, current inventory, and projected need over the multiyear period. Because of the risk that requirements may not materialize, this type of contract is not appropriate if high start-up costs are involved.

- 5.1.10.b *Definite-Quantity.* A definite-quantity multiyear contract commits the Postal Service to buy specified quantities of supplies or services in each year covered by the contract. Offerors are required to propose level unit prices over all the years covered by the contract, and can be expected to spread start-up costs over all contract quantities. Options for additional quantities in each year (at prices not including start-up costs) may be included if it is expected that larger quantities may be needed. Economic price adjustment provisions may be included in accordance with 5.1.3.c. This type of multiyear contract is appropriate when high start-up costs are involved, since there will be an equitable adjustment for such costs under termination for convenience procedures (see 6.9.2) if the Postal Service does not purchase the entire multiyear quantity.

SECTION 2 COST PRINCIPLES

5.2.1 General

- 5.2.1.a This section contains the principles for determining or negotiating the allowability of costs under Postal Service contracts.
- 5.2.1.b These principles apply to:
1. The determination of allowable costs under cost-reimbursement contracts and subcontracts;
 2. The determination or negotiation of cost or price when required by a contract clause; and
 3. The pricing of contracts and subcontracts, and contract and subcontract modifications, when cost analysis is performed (see 5.3.3.d).
- 5.2.1.c Cost Accounting Standards Board standards and regulations (4 CFR 331 et seq.) do not apply to the Postal Service.

5.2.2 Contract Cost

- 5.2.2.a *Composition of Total Cost.* The total cost of a contract is the sum of the allowable direct and indirect costs allocable to the contract, incurred or to be incurred, less any allowable credits. Any generally accepted method of determining or estimating costs that is equitable under the circumstances and consistently applied may be used.
- 5.2.2.b *Direct Costs.* Any cost that can be specifically identified with a contract is a direct cost of the contract. Costs are considered to be identified specifically with a contract, and are therefore direct costs, if they are segregated from other costs and recorded in accounts identifying the costs with the particular contract.

5.2.2.c *Indirect Costs.* Indirect costs are those costs that, because of their incurrence for common or joint objectives, are neither readily segregable nor subject to treatment as direct costs. Indirect costs may be allocated to contracts on the basis of necessity to the overall operation of the contractor's business. Allocation on this basis is permissible even if a direct or indirect relationship to a particular cost objective cannot be shown.

5.2.2.d *Credits.* A credit is the applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor.

5.2.3 **Cost Allowability**

5.2.3.a *Determining Allowability.* To be allowable, costs must be:

1. Reasonable;
2. Allocable;
3. Consistent with generally accepted accounting principles;
4. Appropriate to the particular circumstances;
5. Consistent with the requirements and terms of the contract; and
6. Not unallowable (see 5.2.5).

5.2.3.b *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. In determining the reasonableness of a specific cost, matters to consider include:

1. Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or contract performance;
2. The restraints or requirements imposed by such factors as generally accepted sound business practices, arm's-length bargaining, and federal and state laws and regulations;
3. The action that a prudent business person, considering responsibilities to the owners of the business, employees, customers, the Postal Service, and the public at large, would take under the circumstances; and
4. Any deviations from the established practices of the contractor that may unjustifiably increase the contract costs.

5.2.3.c *Allocability.* A cost is allocable to a contract if it:

1. Is incurred specifically for the contract;
2. Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
3. Is necessary to the overall operation of the business, although a direct relationship to the contract cannot be shown.

5.2.4 **Advance Agreements**

5.2.4.a Because the reasonableness or allocability of costs may be hard to determine in some cases, the contracting parties should reach advance agreement on the treatment of special or unusual costs, to avoid later disputes and disallowances.

- 5.2.4.b Advance agreements may be negotiated either before or during a contract but should be negotiated before incurrence of the costs involved. The agreements must be in writing, signed by both parties, and incorporated into applicable current and future contracts. An advance agreement must contain a statement of its applicability and duration.
- 5.2.4.c Advance agreements may be negotiated with a particular contractor for a single contract, a group of contracts, or all the contracts of one or more purchasing activities.
- 5.2.4.d Advance agreements may not provide for treatment of costs inconsistent with this chapter.
- 5.2.4.e The absence of an advance agreement on any cost will not, in itself, affect the reasonableness or allocability of that cost.
- 5.2.4.f Examples of costs for which advance agreements may be particularly important are:
1. Compensation for personal service, including but not limited to allowances for off-site pay, incentive pay, location allowances, hardship pay, and cost-of-living differentials;
 2. Use charges for fully depreciated assets;
 3. Deferred maintenance costs;
 4. Precontract costs;
 5. Independent research and development and bid and proposal costs;
 6. Royalties and other costs for use of patents;
 7. Selling and distribution costs;
 8. Travel and relocation costs;
 9. Cost of idle facilities and idle capacity;
 10. Costs of automatic data processing equipment;
 11. Severance pay to employees on support services contracts;
 12. Plant reconversion;
 13. Professional services (for example, legal, accounting, and engineering);
 14. General administrative costs (such as corporate, division, or branch allocations attributable to the general management, supervision, and conduct of the contractor's business as a whole, particularly in construction, job-site, architect-engineer, and facilities contracts);
 15. Costs of construction plant and equipment; and
 16. Costs of public relations and advertising.

5.2.5 Unallowable Costs

- 5.2.5.a *Categories of Unallowable Costs.* The following categories of costs, with the exceptions noted, are unallowable:
1. *Public Relations and Advertising.* Public relations and advertising costs, except for costs of:
 - (a) Responding to inquiries concerning company policies and activities;
 - (b) Essential communication with the public, press, stockholders, creditors, and customers, including communication on matters of public concern;

- (c) Participation in community service activities, such as blood bank drives, charity drives, and disaster assistance (but not contribution to civil defense funds and projects);
 - (d) Recruitment of personnel needed for contract performance;
 - (e) Acquiring scarce items for contract performance; and
 - (f) Disposing of scrap or surplus materials acquired for contract performance.
2. *Bad Debts.* Bad debts, including actual or estimated losses arising from uncollectible accounts receivable due from customers and other claims, and any directly associated costs such as collection costs and legal costs.
 3. *Contributions or Donations.* Contributions or donations, including cash, property, and services, except as provided in a.1(c) above.
 4. *Dividends.* Dividend provisions or payments, and distribution of profits.
 5. *Entertainment.* Costs of amusement, diversion, social activities, and directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities. Costs of membership in social, dining, or country clubs or other organizations having the same purposes, regardless of whether the cost is reported as taxable income to the employees.
 6. *Fines and Penalties.* Costs of fines and penalties resulting from violations of, or failure of the contractor to comply with, federal, state, local, or foreign laws and regulations, except when incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer.
 7. *Life Insurance.* Costs of insurance on the lives of officers, partners, or proprietors, unless the insurance represents additional compensation.
 8. *Interest and Other Financial Costs.* Interest on borrowings (however represented), bond discounts, costs of financing and refinancing capital, and the costs of preparing and issuing prospectuses and stock rights.
 9. *Lobbying*
 - (a) Costs associated with the following activities:
 - (1) Attempts to influence the outcome of any federal, state, or local election, referendum, initiative, or similar procedure through contributions, endorsements, publicity, or similar activities.
 - (2) Establishing, administering, contributing to, or paying the expenses of a political party, campaign, political action committee, or other organization established for the purpose of influencing the outcomes of elections.
 - (3) Any attempt to influence (i) the introduction of federal or state legislation, or (ii) the enactment or modification of any pending federal or state legislation through communication with any member or employee of the Congress or state legislature (including efforts to influence state or local officials to engage in similar lobbying activity), or with any government official or employee in connection with a decision to sign or veto enrolled legislation.
 - (4) Any attempt to influence (i) the introduction of federal or state legislation, or (ii) the enactment or modification of pending federal or state legislation by preparing, distributing, or using publicity or propaganda, or by urging members of the general public to

- contribute to or participate in any mass demonstration, march, rally, fund-raising drive, lobbying campaign, or letter-writing or telephone campaign.
- (5) Legislation liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effect of legislation, when such activities are carried on in support of or in knowing preparation for an effort to engage in unallowable activities.
- (b) The following activities are excepted from the coverage (a) above:
- (1) Providing a technical and factual presentation of information on a topic directly related to the performance of a contract through hearing testimony, statements, or letters to the Congress or state legislature, or subdivision, member, or cognizant staff member thereof, in response to a documented request (including a *Congressional Record* notice requesting testimony or statements for the record at a regularly scheduled hearing) made by the recipient member, legislative body or subdivision, or a cognizant staff member thereof; provided that costs under this subparagraph (1) for transportation, lodging or meals are unallowable unless incurred for the purpose of offering testimony at a regularly scheduled Congressional hearing in response to a written request for such presentation made by the Chair or Ranking Minority Member of the Committee or Subcommittee conducting such hearing.
 - (2) Any lobbying to influence state legislation in order to directly reduce contract cost, or to avoid material impairment of the contractor's authority to perform the contract.
 - (3) Any activity specifically authorized by statute to be undertaken with funds from the contract.
10. *Losses on Other Contracts.* An excess of costs over income under any other contract (including the contractor's contributed portion under cost-sharing contracts).
11. *Taxes*
- (a) Federal income and excess profits taxes.
 - (b) Taxes in connection with financing, refinancing, refunding operations, or reorganizations.
 - (c) Taxes from which exemptions are available to the contractor directly, or available to the contractor based on an exemption afforded the Postal Service, except when the contracting officer determines that the administrative burden incident to obtaining the exemption outweighs the corresponding benefits accruing to the Postal Service. The term "exemption" means freedom from taxation in whole or in part and includes a tax abatement or reduction resulting from mode of assessment, method of calculation, or otherwise.
 - (d) Special assessments on land that represent capital improvements.
 - (e) Taxes (including excises) on real or personal property, or on the value, use, possession or sale thereof, which is used solely in connection with work other than on Postal Service and other government contracts.
 - (f) Taxes on accumulated funding deficiencies of, or prohibited transactions involving, employee deferred compensation plans pursuant to section

4971 or section 4975 of the Internal Revenue Code of 1954, as amended.

- (g) Income tax accruals designed to account for the tax effect of differences between taxable income and pretax income as reflected by the books of account and financial statements.

12. *Defense of Fraud Proceedings*

- (a) Costs incurred in connection with defense of any:
 - (1) Criminal or civil investigation, grand jury proceeding, or prosecution;
 - (2) Civil litigation; or
 - (3) Administrative proceedings such as suspension or debarment, or any combination of the foregoing, brought by the government against a contractor, its agents or employees, are unallowable when the charges that are the subject of the investigation, proceedings, or prosecution involve fraud or similar criminal offenses (including filing of a false certification) on the part of the contractor, its agents or employees, and result in conviction (including conviction entered on a plea of nolo contendere), judgment against the contractor, its agents or employees, or decision to debar or suspend, or are resolved by consent or compromise.
- (b) When the charges of fraud are resolved by consent or compromise, the parties may agree on the extent of allowability of such costs as a part of such resolution.

5.2.5.b *Exclusion of Unallowable Costs.* Costs that are expressly unallowable or mutually agreed to be unallowable, including unallowable directly associated costs, must be identified and excluded from any billing, claim, or proposal applicable to a Postal Service contract. A directly associated cost is any cost which is generated solely as a result of incurring another cost, and which would not have been incurred had the other cost not been incurred. When an unallowable cost is incurred, its directly associated costs are also unallowable.

5.2.6 **Termination Costs**

- 5.2.6.a *General.* Contract terminations generally give rise to the incurrence of costs or the need for special treatment of costs that would not have arisen had the contract not been terminated. This part 5.2.6 describes the cost principles peculiar to termination situations, to be used in conjunction with the other cost principles in this section.
- 5.2.6.b *Common Items.* The costs of items reasonably usable on the contractor's other work are not allowable unless the contractor submits evidence that the items could not be retained at cost without sustaining a loss. The contracting officer should consider the contractor's plans and orders for current and planned production when determining if items can reasonably be used on other work of the contractor.
- 5.2.6.c *Costs Continuing After Termination.* Costs that cannot be discontinued immediately after the effective date of termination are generally allowable. However, any costs continuing after the effective date of the termination because of the negligent or willful failure of the contractor to discontinue them are unallowable.

- 5.2.6.d *Start-Up Costs.* Reasonable start-up and preparatory costs are generally allowable. When included in the settlement proposal as a direct charge, they must not also be included in overhead. Start-up costs for one contract must not be allocated to others.
- 5.2.6.e *Loss of Useful Value.* Loss of useful value of special tooling and special machinery and equipment is generally allowable, provided:
1. The special tooling or special machinery and equipment is not reasonably capable of use in the other work of the contractor;
 2. The Postal Service's interest is protected by transfer of title or by other means deemed appropriate by the contracting officer; and
 3. The loss of useful value for any one terminated contract is limited to that portion of the equipment cost which bears the same ratio to the total cost as the terminated portion of the contract bears to the entire terminated contract and other Postal Service contracts for which the special tooling or special machinery and equipment were acquired.
- 5.2.6.f *Rental Under Unexpired Leases.* Rental costs under unexpired leases, less the residual value of such leases, are generally allowable when shown to have been reasonably necessary for the performance of the terminated contract, if:
1. The amount of rental claimed does not exceed the reasonable use value of the property leased for the period of the contract and such further period as may be reasonable; and
 2. The contractor makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease.
- 5.2.6.g *Alterations of Leased Property.* The cost of alterations and reasonable restorations required by the lease may be allowed when the alterations are necessary for performing the contract.
- 5.2.6.h *Settlement Expenses*
1. Settlement expenses, including the following, are generally allowable:
 - (a) Accounting, legal, clerical, and similar costs reasonably necessary for:
 - (1) The preparation and presentation, including supporting data, of settlement claims to the contracting officer; and
 - (2) The termination and settlement of subcontracts.
 - (b) Reasonable costs for the storage, transportation, protection, and disposition of property acquired or produced for the contract.
 - (c) Indirect costs related to salary and wages incurred as settlement expenses under (a) and (b); normally, such indirect costs must be limited to payroll taxes, fringe benefits, occupancy costs, and immediate supervision costs.
 2. If settlement expenses are significant, a cost account or work order must be established to separately identify and accumulate them.
- 5.2.6.i *Subcontractor Claims.* Subcontractor claims, including the allocable portion of the claims common to the contract and to other work of the contractor, are generally allowable. An appropriate share of the contractor's indirect expenses may be allocated to the amount of settlements with subcontractors, provided that the amount allocated is reasonably proportionate to the relative benefits received and is otherwise consistent with the principles of this chapter. The indirect expense so

allocated must exclude the same and similar costs claimed directly or indirectly as settlement expenses.

5.2.7 Construction and Architect-Engineer Contracts

- 5.2.7.a The cost principles of this section apply to contracts for construction (including alteration or repair) of buildings and other kinds of real property, and to architects-engineer contracts related to construction, except as provided in this part 5.2.7.
- 5.2.7.b Because of widely varying factors such as the nature, size, duration, and location of construction projects, advance agreements (see 5.2.4) for such items as home office overhead, partner's compensation, employment of consultants, and equipment use costs are particularly important in construction and architect-engineer contracts.
- 5.2.7.c Allowable ownership and operating costs of construction equipment must be determined as follows:
1. Actual cost data must be used when they can be determined for both ownership and operating costs from the contractor's accounting records. When such costs cannot be determined, the contract may specify the use of a schedule of predetermined rates to determine ownership and operating costs of construction equipment, such as the *Construction Ownership and Operating Expense Schedule* published by the U.S. Army Corps of Engineers.
 2. Predetermined schedules of construction equipment use rates provide average ownership and operating rates for construction equipment. The allowance for ownership costs should include the cost of depreciation and may include costs facilities capital cost of money. The allowance for operating costs may include costs for such items as fuel, filters, oil, and grease; servicing, repairs, and maintenance; and tire wear and repair. Costs of labor, mobilization, demobilization, overhead, and profit are generally not reflected in schedules, and separate consideration may be necessary.
 3. When a schedule of predetermined use rates for construction equipment is used to determine direct costs, all costs of equipment that are included in the cost allowances provided by the schedule must be identified and eliminated from the contractor's other direct and indirect costs charged to the contract. If the contractor's accounting system provides for site or home office overhead allocations, all costs included in the equipment allowances may need to be included in any cost input base before computing the contractor's overhead rate. In periods of work suspension pursuant to a contract clause, the allowance for equipment ownership may not exceed an amount for standby cost as determined by the schedule or contract provision.
- 5.2.7.d Reasonable costs of renting construction equipment are allowable as follows:
1. Minor repair and maintenance costs incident to operating such rented equipment not included in the rental rate are allowable.
 2. Costs incident to major repair and overhaul of rental equipment are unallowable.
 3. Charges for construction equipment rented from any division, subsidiary, or organization under common control are allowable if such rental is the contractor's established practice, and if no part of such costs duplicates any other allowed cost.

- 5.2.7.e Costs incurred at the job site incident to performing the work, such as the cost of superintendence, timekeeping and clerical work, engineering, utility costs, supplies, material handling, and restoration and cleanup are allowable as direct or indirect costs. provided the accounting practice used is in accordance with the contractor's established and consistently followed cost accounting practices for all work.
- 5.2.7.f Rental and other costs, less any applicable credits, incurred in acquiring the temporary use of land, structures, and facilities are allowable. Costs, less any applicable credits, incurred in constructing or fabricating structures and facilities of a temporary nature are allowable.

5.2.8 Facilities Contracts

- 5.2.8.a The cost principles of this section apply to facilities contracts (under which Postal Service facilities are provided to a contractor or subcontractor for use in performing one or more related contracts for supplies or services), except as provided in this part 5.2.8.
- 5.2.8.b Advance agreements (see 5.2.4) should be made between the contractor and the contracting officer as to indirect cost items to be applied to the facilities purchase. When necessary to produce an equitable result, the contractor's usual method allocating indirect cost may be varied and appropriate adjustment may be made to the pool of indirect cost and the bases of their distribution.
- 5.2.8.c Indirect manufacturing and plant overhead costs primarily incurred or generated by reason of direct labor or maintenance labor operations are not allocable to the purchase of existing facilities.
- 5.2.8.d Contracts providing for the installation of new facilities or the rehabilitation of existing facilities may involve the use of the contractor's plant maintenance labor, as distinguished from direct labor engaged in the production of the company's normal products. In such instances, only those types of indirect manufacturing and plant operating costs related to or incurred by reason of the expenditures of the classes of labor needed for the performance of the facilities work may be allocated to the facilities contract. Thus, a facilities contract involving the use of plant maintenance labor only would not be subject to an allocation of such cost items as direct productive labor supervision, depreciation, and maintenance expense applicable to productive machinery and equipment, or raw material and finished goods storage costs.
- 5.2.8.e When a facilities contract calls for the construction, production, or rehabilitation of equipment or other items involved in the regular course of the contractor's business by the use of the contractor's direct labor and manufacturing processes, the indirect costs normally allocated to all that work may be allocated to the facilities contract.
- 5.2.8.f If facilities constituting the contractor's usual commercial products (or only minor modifications thereof) are acquired by the Postal Service under the contract, the Postal Service must not pay more than the contractor's most-favored-customer price or the price of other suppliers for like quantities of the same or substantially the same items, whichever is lower.

5.2.9 Educational Institutions

In determining contract costs applicable to research and development, training, and other work performed by educational institutions, it is Postal Service policy to adopt the cost principles of Office of Management and Budget (OMB) Circular No. A-21, *Cost Principles for Educational Institutions*, as in effect on the date of the contract.

5.2.10 Nonprofit Organizations

5.2.10.a A nonprofit organization is a business:

1. Exempt from federal income taxation under section 502 of the Internal Revenue Code;
2. Organized and operated exclusively for charitable, scientific, or educational purposes;
3. No part of whose net earnings inure to the benefit of any private shareholder or individual; and
4. No substantial part of whose activities is carrying on propaganda or otherwise attempting to influence legislation or participating on any political campaign on behalf of any candidate for public office.

5.2.10.b In determining costs applicable to contracts performed by nonprofit organizations, it is Postal Service policy to adopt the cost principles of Office of Management and Budget (OMB) Circular No. A-122, *Cost Principles for Nonprofit Organizations*, as in effect on the date of the contract.

5.2.11 State, Local, and Indian Tribal Governments

In determining allowable costs under contracts with state, local, and federally recognized Indian tribal governments, it is Postal Service policy to adopt the cost principles of Office of Management and Budget (OMB) Circular No. A-87, *Cost Principles for State and Local Governments*, as in effect on the date of the contract.

5.2.12 Indirect Cost Rates

5.2.12.a *General.* This part describes procedures for establishing billing rates and final indirect cost rates for use in:

1. Reimbursing indirect costs under cost-reimbursement contracts;
2. Determining progress payments under fixed-price contracts; and
3. Negotiating the final price of fixed-price incentive contracts.

5.2.12.b *Definitions*

1. "Billing rate" means an indirect cost rate established temporarily for reimbursement of incurred indirect costs. It may be adjusted as necessary pending establishment of final indirect cost rates.
2. "Final indirect cost rate" means the indirect cost rate established and agreed upon by the Postal Service and the contractor as not subject to change. It is usually established after the close of the contractor's fiscal year (unless the parties decide upon a different period) to which it applies. In the case of

cost-reimbursement research and development contracts with educational institutions, it may be predetermined; that is, established for a future period on the basis of cost experience with similar contracts, together with supporting data.

3. "Indirect cost rate" means the percentage or dollar factor that expresses the ratio of indirect expense incurred in a given period to direct labor cost, manufacturing cost, or another appropriate base for the same period.

5.2.12.c *Billing Rates*

1. A billing rate is established on the basis of information resulting from recent review, previous audits or experience, or similar reliable data or experience. It should be as close as possible to the final indirect cost rate anticipated for the contractor's fiscal period, as adjusted for any unallowable costs. When the dollar value of contracts requiring use of a billing rate does not warrant submission of a detailed billing rate proposal, the billing rate may be established by making appropriate adjustments from the prior year's indirect cost experience to eliminate unallowable and nonrecurring costs and to reflect new or changed situations.
2. Once established, billing rates may be prospectively or retroactively revised by mutual agreement of the parties, at either party's request, to prevent substantial overpayment or underpayment.
3. The elements of indirect cost and the base or bases used in computing billing rates are determinative of the indirect costs to be distributed or of the bases of distribution to be used in the final settlement.

5.2.12.d *Determination Procedure*

1. In accordance with Clause 5-4, *Allowable Cost and Payment*, the contractor must submit to the contracting officer or the contracting officer's representative a final indirect cost rate proposal reflecting actual cost experience during the covered period, together with supporting cost or pricing data.
2. On the basis of analysis of the proposal, with audit assistance and advise if needed, the contracting officer or the contracting officer's representative will negotiate an indirect cost rate agreement and prepare a negotiation memorandum showing the basis for the agreement.
3. The indirect cost rate agreement, when signed by the contractor and contracting officer, is considered to be incorporated into the contract.

5.2.12.e *Educational Institutions*

1. Under cost-reimbursement contracts with educational institutions, the Postal Service uses indirect cost rates established in accordance with Office of Management and Budget (OMB) Circular No. A-88, *Indirect Cost Rates, Audit, and Audit Follow Up at Educational Institutions*, which assigns each educational institution to a single government agency for the negotiation of indirect cost rates. Cognizant government agencies and educational institutions are listed in the Directory of Federal Contract Audit Offices, available from:

ATTENTION OTD
DEFENSE CONTRACT AUDIT AGENCY
CAMERON STATION
ALEXANDRIA VA 22314-6178

2. Payment for reimbursable indirect costs may be made on the basis of predetermined final indirect cost rates, if predetermined rates have been

established by the cognizant agency. If predetermined rates are used, the rates and bases must be included in the contract's schedule, and the contract must include Clause 5-21, *Predetermined Indirect Cost Rates*.

- 5.2.12.f *Nonprofit Organizations*. See 5.2.10.
- 5.2.12.g *State, Local, and Indian Tribal Governments*. See 5.2.11.
- 5.2.12.h *Cost-Sharing Rates*. Cost-sharing contracts (see 5.1.4.d) may call for the contractor to participate in the costs of the contract by accepting indirect cost rates lower than the anticipated actual rates. In such cases, a negotiated indirect cost rate ceiling may be incorporated into the contract for prospective application.
- 5.2.12.i *Ceilings on Indirect Cost Rates*
 1. Some situations make it prudent to provide a final indirect cost rate ceiling in a contract. Examples of such circumstances are when the proposed contractor:
 - (a) Is a new or recently organized company, and there is no past or recent record of incurred indirect costs;
 - (b) Has a recent record of rapidly increasing indirect cost due to a declining volume of sales without a commensurate decline in indirect expenses;
 - (c) Seeks to enhance its competitive position in a particular circumstance by basing its proposal on indirect costs rates lower than those that may reasonably be expected to occur during contract performance, thereby causing a cost overrun.
 2. In such cases, a ceiling covering the final indirect cost rates may be negotiated and specified in the contract.
 3. When ceiling provisions are utilized, the contract must also provide that:
 - (a) The Postal Service will not be obligated to pay any additional amount if the final indirect cost rates exceed the negotiated ceiling rates; and
 - (b) If the final indirect cost rates are less than the negotiated ceiling rates, the negotiated rates will be reduced to conform with the lower rates.

SECTION 3 PRICE EVALUATION

5.3.1 General

- 5.3.1.a This section describes policies and procedures for evaluating initial contract prices and subcontract prices, and for pricing contract modifications.
- 5.3.1.b Contracting officers are responsible for ensuring that contract prices are fair and reasonable. To carry out this responsibility, contracting officers must:
 1. Evaluate proposed prices using the methods of price and cost analysis described in this section;
 2. Price each contract separately and independently, and not consider proposed price reductions under other contracts or losses or profits on other contracts; and

3. Not include in a contract any amount for a specified contingency if the contract provides for price adjustment based upon the occurrence of that contingency.

5.3.2 Definitions

- 5.3.2.a "Cost analysis" means the review and evaluation of the separate cost elements and proposed profit of an offeror's or contractor's cost or pricing data, and 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.
- 5.3.2.b "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 projection, 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:
1. Supplier quotations;
 2. Nonrecurring costs;
 3. Information on changes in production methods and in production or purchasing volume;
 4. Data supporting projections of business prospects and objectives and related operating costs;
 5. Unit-cost trends such as those associated with labor efficiency;
 6. Make-or-buy decisions;
 7. Estimated resources to attain business goals;
 8. Information on management decisions that could have a significant bearing on costs; and
 9. Historical actual costs for the same or similar items.
- 5.3.2.c "Price" means cost plus any fee or profit applicable to the contract type.
- 5.3.2.d "Price analysis" means the process of examining and evaluating a proposed price without evaluating its separate cost elements and proposed profit.
- 5.3.2.e "Technical analysis" means that examination and evaluation of a proposal by engineering, management, or other personnel having specialized knowledge in order to determine and report on the need for and reasonableness of the proposed resources.

5.3.3 Proposal Analysis

- 5.3.3.a *Contracting Officer's Responsibility.* The contracting officer, exercising sole responsibility for the final pricing decision, must obtain advice and assistance appropriate to the complexity and dollar value of the proposals to be analyzed. As circumstances warrant, the contracting officer must obtain and evaluate the advice of specialists in contracting, finance, law, contract audit, quality assurance, engineering, traffic management, and contract pricing, coordinating the team

effort involved. If assistance in analyzing cost or pricing data is not available within the contracting officer's organization, it may be obtained from the Inspection Service. 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; and
4. Conducting negotiations.

5.3.3.b *Price Analysis*

1. Price analysis is the preferred method of proposal analysis. Price analysis must always be performed, and should be relied on entirely in all but a few situations. Even when cost analysis is performed to evaluate individual cost elements of a contractor's proposal, some form of price analysis must always be performed to ensure that the overall price is fair and reasonable, and that there is no need for further evaluation.
2. 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 proposed prices received in response to the solicitation.
 - (b) Comparison of prior proposed prices and contract prices with current proposed prices for the same or similar end items in comparable quantities.
 - (c) Application of rough yardsticks (such as dollars per pound or per horsepower, or other units) to highlight significant inconsistencies that warrant additional pricing inquiry.
 - (d) Comparison with competitive published catalogs or lists, published market prices or commodities, similar indexes, and discount or rebate arrangements.
 - (e) Comparison of proposed prices with independent Postal Service cost estimates (see 2.1.5).
 - (f) Ascertaining that the price is set by law or regulation.
3. Whenever adequate price competition has been obtained, comparison of proposed prices and Postal Service estimates will ordinarily suffice to meet price analysis requirements.

5.3.3.c *Adequate Price Competition*

1. Price competition exists if:
 - (a) Proposals are solicited;
 - (b) Two or more independent and responsible offerors submit priced proposals meeting the solicitation's requirements; and
 - (c) The solicitation identifies price as a significant evaluation factor for contract award.
2. If price competition exists, it is presumed adequate, unless:
 - (a) The solicitation is made under conditions that unreasonably deny to one or more known and qualified offerors an opportunity to compete;

- (b) The low offeror has such a decided advantage that it is practically immune from competition; or
- (c) The contracting officer determines that the lowest price is not fair and reasonable.

5.3.3.d *Cost Analysis*

1. Cost analysis is normally appropriate only when there is not adequate price competition and no method of price analysis will ensure a fair and reasonable price. Cost analysis should be limited to those cost elements that the contracting officer decides needs close analysis in the Postal Service's interest. When limited analysis of specific cost elements or factors will provide a reasonable pricing result, the contracting officer should obtain only the data needed to support the limited cost analysis required.
2. Cost analysis involves the following techniques and procedures, as appropriate:
 - (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 cost 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 and labor rates.
 - (b) Evaluating the effect of the offeror's current practices on future costs. In conducting this evaluation, the contracting officer must ensure that the effects of inefficient or uneconomical past practices are not projected into the future. In pricing production of recently developed, complex equipment, the contracting officer should make a trend analysis of basic labor and materials even in periods of relative price 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 cost estimates from the offeror or from other offerors for the same or similar items;
 - (3) Independent Postal Service cost estimates; and
 - (4) Forecasts or planned expenditures.
 - (d) Analysis of contractor make-or-buy decisions in evaluating subcontract costs.
 - (e) Verification that the offeror's cost submissions are in accordance with the cost principles in 5.2.
 - (f) 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 must attempt to obtain them. If they cannot be obtained, satisfactory allowance for the incomplete data must be made in negotiations.

5.3.3.e *Technical Analysis.* Technical analysis should be performed as necessary to assist in price analysis or cost analysis. Technical analysis of proposals may range from evaluating technical proposals in accordance with evaluation factors specified in the solicitation to extensive analysis of materials, labor hours and labor mix, special tooling and facilities, and other factors pertinent to a cost analysis effort.

5.3.3.f *Cost or Pricing Data*

1. Consistent with subparagraph d.1 above, cost or pricing data must be obtained before the award of any noncompetitive contract or contract modification when the contracting officer requires them for analysis to determine reasonableness of price. Only the data needed to make that determination should be obtained. Before agreement on price, the contracting officer must require the contractor to update the data as of the latest dates for which information is reasonably available. Data within the contractor's or a subcontractor's organization on matters significant to contractor management and to the Postal Service will be treated as reasonably available. What is significant depends upon the circumstances of each procurement.
2. The contracting officer must require offerors or contractors to obtain cost or pricing data for proposed subcontracts or subcontract modifications when necessary to determine the reasonableness of the proposed contract or subcontract price, including negotiated final pricing actions (such as termination settlements and total final price agreements for fixed-price incentive contracts). The offeror or contractor is responsible for performing price analysis or cost analysis on subcontract proposals, and including the results of subcontract reviews and analyses as part of its cost or pricing data. In unusual circumstances, to ensure that adequate analysis is performed, the contracting officer may require the offeror or contractor to submit to the Postal Service, along with its own cost or pricing data, the subcontract cost or pricing data obtained. This in no way diminishes the offeror's or contractor's responsibility to perform subcontract cost or price analysis and negotiate fair and reasonable subcontract prices.
3. If cost or pricing data are needed and the offeror or contractor refuses to provide necessary data in spite of a repeated request, the contracting officer must withhold the award or contract modification and refer the matter to the next higher lever of contracting authority. The ultimate disposition of the matter must be documented.

5.3.3.g *Profit*

1. Except for architect-engineer contracts (see 11.3.3), it is Postal Service policy that predetermined percentages or limitations on profit or fee not be used.
2. When adequate price competition is obtained, or price analysis techniques are sufficient to ensure a fair and reasonable price, analysis of profit is not appropriate.
3. When cost analysis is required for price negotiations, profit must be analyzed as well. Profit should be analyzed with the objective of rewarding contractors for financial and other risks they assume; resources they use; and organization, performance, and management capabilities they employ. Due consideration should be given to the complexity of materials requirements, the extent of subcontracting, the ratio of indirect costs to direct costs, and the contribution of capital investments to contract performance.

4. If the pricing action involves a contract change or modification that requires essentially the same type and mix of work as the basic contract, and is of relatively small dollar value compared to the total contract amount, the profit or fee may be established on the basis of the basic contract's profit or fee rate.

5.3.3.h *Defective Cost or Pricing Data*

1. If, before agreement in price, the contracting officer learns that any cost or pricing data required by paragraph f above are inaccurate, incomplete, or noncurrent, the contracting officer must immediately bring the matter to the attention of the offeror or contractor, whether the defective data increase or decrease the contract price. The contracting officer must then negotiate using any new data submitted or making allowance for the incorrect data, documenting the file accordingly.
2. If, after award, cost or pricing data are found to be inaccurate, incomplete, or noncurrent as of the date of final agreement on price, the Postal Service is entitled to a price adjustment, including profit or fee, of any significant amount by which the price was increased because of the defective data. This entitlement is ensured by including in the contract the appropriate clause prescribed in paragraph i below, which gives the Postal Service the right to a price adjustment for defects in cost or pricing data submitted by the contractor, a prospective contractor, or an actual subcontractor. In arriving at a price adjustment under the clause, the contracting officer must consider:
 - (a) The time by which the cost or pricing data became reasonably available to the contractor;
 - (b) The extent to which the Postal Service relied upon the defective data; and
 - (c) Any understated cost or pricing data submitted in support of price negotiations, up to the amount of the Postal Service's claim for overstated pricing data arising out of the same pricing action (the initial pricing of the same contract or the pricing of the same change order). Such offsets need not be in the same cost groupings (such as materials, direct labor, or indirect costs).
3. If, after award, the contracting officer learns or suspects that the data furnished were not accurate, complete, and current, the contracting officer must obtain an audit to evaluate the accuracy, completeness, and currency of the data. The contracting officer may not reprice the contract solely because the profit was greater than forecast or because some contingency specified in the submission failed to materialize.
4. For each advisory audit received based on a postaward review that indicates defective pricing, the contracting officer must determine if the data submitted were defective and relied upon. Before making such a determination, the contracting officer should give the contractor an opportunity to support the accuracy, completeness, and currency of data in question. The contracting officer must prepare a memorandum indicating the contracting officer's determination if the submitted data were accurate, complete, and current as of the date of final agreement on price, if the contracting officer relied on the data, and the results of any contractual action taken. The contracting officer must send one copy of this memorandum to the Inspection Service, one copy to the auditor if the audit was not performed by the Inspection Service, and one copy to the contractor.

5. If both contractor and subcontractor submitted cost or pricing data, the Postal Service has the right, under the clauses prescribed in paragraph i below, to reduce the prime contract price if it was significantly increased because a subcontractor submitted defective data. This right applies whether these data supported subcontract cost estimates or supported firm agreements between subcontractor and contractor.
 6. If audit discloses defective subcontractor cost or pricing data, the information necessary to support a reduction in prime contract and subcontract prices may be available only from within the Postal Service. To the extent necessary to secure a prime contract price reduction, the contracting officer should make this information available to the prime contractor or appropriate subcontractor upon request. If release of the information would compromise Postal Service security or disclose trade secrets or confidential business information, the contracting officer may release it only under the conditions that will protect it from improper disclosure. Information made available under this subparagraph h.6 must be limited to that used as the basis for the prime contract price reduction. In order to afford an opportunity for corrective action, the contracting officer should give the prime contractor reasonable advance notice before determining to reduce the prime contract price.
 - (a) When a prime contractor includes defective subcontract data in arriving at the price but later awards the subcontract to a lower priced subcontractor (or does not subcontract for the work), any adjustment in the prime contract price due to defective subcontract data is limited to the difference (plus applicable indirect cost and profit markups) between (1) the subcontract price used for pricing the prime contract and (2) either the actual subcontract price or the actual cost to the contractor, if not subcontracted, provided the data on which the actual subcontract price is based are not themselves defective.
 - (b) Under cost-reimbursement contracts and fixed-price incentive contracts, payments to subcontractors that are higher than they would be had there been no defective subcontractor cost or pricing data will be the basis for disallowance or nonrecognition of costs under the clauses prescribed in paragraph i below.
- 5.3.3.i *Clauses.* Whenever cost or pricing data may be required for the negotiation of a contract, or for the negotiation of a subsequent modification of a contract, the contract must include the following clauses:
1. Clause 5-22, *Price Reduction for Defective Cost or Pricing Data.*
 2. Clause 5-23, *Subcontractor Cost or Pricing Data.*