

TRUTH IN NEGOTIATIONS

MR. H. F. HESSE
Deputy Director
Procurement Services Office

On September 10, 1962, the 87th Congress enacted Public Law 87-653, which provided, in part, that a prime contractor or any subcontractor shall be required to submit cost or pricing under the circumstances listed below, and shall be required to certify that, to the best of his knowledge and belief, the cost or pricing data submitted was accurate, complete and current.

- (1) Prior to the award of any negotiated prime contract where the price is expected to exceed \$100,000;
- (2) Prior to the pricing of any contract change or modification for which the price adjustment is expected to exceed \$100,000, or such lesser amount as may be prescribed by the head of the agency;
- (3) Prior to the award of a subcontract any any tier, where the prime contractor and each higher tier subcontractor have been required to furnish such a certificate, if the price of such subcontract is expected to exceed \$100,000; or
- (4) Prior to the pricing of a contract change or modification to a subcontract covered by (3) above, for which the price adjustment is expected to exceed \$100,000, or such lesser amount as may be prescribed by the head of the agency.

Any prime contract or change or modification thereto under which such certificate is required shall contain a provision that the price to the Government, including profit or fee, shall be adjusted to exclude any significant sums by which it may be determined by the head of the agency that such price was increased because the contractor or any subcontractor required to furnish such a certificate, furnished cost or pricing data which, as of a date agreed upon between the parties (which date shall be as close to the date of agreement on the negotiated price as is practicable), was inaccurate, incomplete or noncurrent:

Provided, that these requirements need not be applied to contracts or subcontracts where the price negotiated is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, prices set by law or regulation or, in exceptional cases where the head of the agency determines that the requirements of this subsection may be waived and states in writing his reasons for such determination:

In substance then, PL 87-653 required the Government negotiator, on negotiated procurements, whether new procurements or modification to an existing contract, over \$100,000 that did not fall within the exceptions stated under the law, to obtain from the contractor at the start of negotiations a certification that the cost or pricing data forming the basis for the negotiations was accurate, complete and current.

Thus, PL 87-653 has become more commonly termed the "Truth in Negotiation" Law.

Subsequent to passage of 87-653 the Armed Services Procurement Regulation was revised to cover the requirements for compliance with the law. This revision also provided a clause to obtain an audit to determine the accuracy, currentness and completeness of the cost or pricing data which formed the basis of the contractor's proposal.

Since the passage of the law, there has been a moot question as to how well the Department of Defense is complying with the law. In a recent report to the Congress the General Accounting Office indicated that the Department of Defense has recognized the desirability

of obtaining certified cost or pricing data for obtaining fair and reasonable prices and for effecting price adjustment under the defective pricing data provisions of the contracts. However, the GAO review revealed that agency procurement officials and prime contractors, in awarding a substantial number of prime contracts and subcontracts, failed to obtain factual or verifiable cost or pricing data in support of cost estimates. The GAO report went on to say that although contracting officers and prime contractors generally obtained cost-breakdowns and certificates of current cost or pricing data, the offerors were not required to submit a written identification of the source documents or other bases for significant cost elements included in the estimates. The crux of the GAO report was inadequate documentation and failure to enforce compliance with the instructions covering preparation of DD Form 633.

Mr. Bannerman, Assistant Secretary of the Navy (Installations and Logistics), in a recent address at an American Bar Association convention on Public Law 87-653 and the ASPR, disagreed with the Congress and the General Accounting Office on the Navy's performance to date but did allow that there was room for improvement. As the Secretary saw it the real questions are two:

First, what is a realistic and practical application of the law's requirement that cost or pricing data be "complete, current and accurate"—in other words, how much detail and timeliness do we really need to make it work?

Secondly: Whether the contractors and Government negotiators are describing the certified data well enough in their proposals and file memoranda to identify it if and when a question of price adjustment comes up in the future.

As a result of the Congressional and General Accounting Office criticism, the ASPR subcommittee was given the task of trying to improve our operating regulations on this statute and their work and the work of the full committee recently crystallized into Defense Procurement Circular No. 55, dated 28 September 1967. For those of you who may not know it, a DPC has the same force and effect as an ASPR revision. Since the item contained in DPC No. 55 on contractor submission of cost or pricing data is effective on receipt it has really shaken up Industry as well as Government representatives. We have received many calls from contractors and Government auditors on its implementation. Where could I find a more captive audience than you to indicate what is required in terms of written submission or identification of supporting cost or pricing data?

First, we require a DD Form 633 properly filled out and certified. The proper DD Form 633 bears a date of Dec 1964, Figure 233. It contains instructions and guidance on the reverse side of the form, Figure 234, which are essential to sound pricing and which are not contained elsewhere in the ASPR. The information was placed on the form itself because it relates specifically to the contractor's cost breakdown and submission. Consequently, it is essential that the approved DD Form 633 be used. A reproduction of the front side only or a contractor form which does not contain the instructions, footnotes, and other data is unacceptable. Let me emphasize this point because I have seen a large number of 633's recently that are unacceptable as not complying with DPC No. 55. The instructions and footnotes to the 633 are the most important part of the form. Let's look at the instructions:

(1) The purpose of the form is to provide a standard format by which the offeror submits to the Government a summary of incurred and estimated costs suitable for detailed review and analysis. Prior to the award of a contract resulting from this proposal the offeror shall, under the conditions stated in ASPR 3-807.3, be required to submit a certificate of current cost or Pricing Data.

(2) In addition to the specific information required by the form, the offeror is expected, in good faith, to incorporate in and submit with this form any additional data, supporting schedules, or substantiation which are reasonably required for the conduct of an appropriate review and analysis in the light of the specific facts of this procurement. For

effective negotiations, it is essential that there be a clear understanding of

(a) the existing verifiable data

and (b) the judgmental factors applied in projecting from known data to the estimate,

(c) the contingencies used by the offeror in his proposed price, in short, the offeror's estimating process itself needs to be disclosed.

(3) When attachment of supporting cost or pricing data to this form is impracticable, the data will be described and made available to the Contracting Officer or his representative upon request.

(4) The format and the prescribed cost breakdown are not intended as rigid requirements. With the approval of the Contracting Officer the data may be presented in another form if required for a more effective and efficient presentation of cost or pricing data.

Notwithstanding this exception, and the substitution of another form, it is not intended that the balance of the Form 633 should be ignored. The ASPR will be revised to require a certified 633 in all instances, even though the contractor's format is substituted for the cost elements and proposed contract estimate portion of the standard form.

(5) By submission of this proposal the offeror grants to the Contracting Officer, or his authorized representative, the right to examine, for the purpose of verifying the cost or pricing data submitted, those books, records, documents and other supporting data which will permit adequate evaluation of such cost or pricing data, along with the computations and projections used therein. This right may be exercised in connection with any negotiations prior to contract award.

Let's look at the face side of the 633, Figure 233, and in particular the "Reference" column. This column or "locator" as I prefer to call it, provides specific identification of the detail supporting the estimated cost element. This data must be presented in such a manner that the factual data can be identified apart from the judgmental factors and estimates. It is suggested that you identify your material cost elements as Schedule A with further subdivision as follows:

Purchased Parts - Schedule A1

Eng. Overhead - Schedule C2

Subcontracted Items - Schedule A2

Mfg. Overhead - Schedule C3

Raw Material - Schedule A3

Service Overhead - Schedule C4

Standard Commercial Items - Schedule A4

General & Administrative Expense -
Schedule C5

Interdivisional Transfers - Schedule A5

Direct Eng. Labor - Schedule B1

Inter-Divisional Transfers at Cost -
Schedule D1

Direct Mfg. Labor - Schedule B2

Other Costs - Schedule D2

Direct Service Labor - Schedule B3

Royalties - Schedule D3

Material Overhead - Schedule C1

Federal Excise Tax - Schedule D4

29 January 1965, Rev. 9

F131

DEPARTMENT OF DEFENSE FORMS

F-200.633 DD Form 633: Contract Pricing Proposal

DEPARTMENT OF DEFENSE CONTRACT PRICING PROPOSAL		Form Approved Budget Bureau No. 12-R100	
This form is for use when submission of cost or pricing data (see AFSPR 3-907.3) is required.		Page No. 1 of 5 Pages	
NAME OF OFFEROR	SUPPLIES AND/OR SERVICES TO BE FURNISHED		
HOME OFFICE ADDRESS	QUANTITY	TOTAL AMOUNT OF PROPOSAL \$	
DIVISION(S) AND LOCATION(S) WHERE WORK IS TO BE PERFORMED	GOVT SOLICITATION NO.		
COST ELEMENTS		PROPOSED CONTRACT ESTIMATE	
	TOTAL COST ¹	UNIT COST ²	REFERENCE ³
1. DIRECT MATERIALS			
a. PURCHASED PARTS ⁴			
b. SUBCONTRACTED ITEMS ⁴			
c. OTHER MATERIALS			
(1) RAW MATERIALS ⁴			
(2) STANDARD COMMERCIAL ITEMS ⁴			
(3) INTERDIVISIONAL TRANSFERS (not other than cost) ⁴			
d. MATERIAL OVERHEAD ⁴			
e. INTERDIVISIONAL TRANSFERS AT COST ⁴			
2. DIRECT ENGINEERING LABOR ⁴			
3. ENGINEERING OVERHEAD ⁴			
4. DIRECT MANUFACTURING LABOR ⁴			
5. MANUFACTURING OVERHEAD ⁴			
6. OTHER COST ⁴			
7. SUBTOTAL			
10. GENERAL AND ADMINISTRATIVE EXPENSES ⁴			
11. ROYALTIES ⁴			
12. FEDERAL EXCISE TAXES			
13. SUBTOTAL			
14. PROFIT OR FEE			
15. TOTAL PRICE (AMOUNT)			
1. HAVE THE DEPARTMENT OF DEFENSE, NATIONAL AERONAUTICS AND SPACE ADMINISTRATION, OR THE ATOMIC ENERGY COMMISSION PERFORMED ANY REVIEW OF YOUR ACCOUNTS OR RECORDS IN CONNECTION WITH ANY OTHER GOVERNMENT PRIME CONTRACT OR SUBCONTRACT WITHIN THE PAST TWELVE MONTHS?			
<input type="checkbox"/> YES <input type="checkbox"/> NO <i>IF YES, IDENTIFY.</i> NAME AND ADDRESS OF REVIEWING OFFICE TELEPHONE NUMBER			
2. WILL YOU REQUIRE THE USE OF ANY GOVERNMENT PROPERTY IN THE PERFORMANCE OF THIS PROPOSED CONTRACT?			
<input type="checkbox"/> YES <input type="checkbox"/> NO <i>IF YES, IDENTIFY ON A SEPARATE PAGE.</i> 3. WILL THE AMOUNTS SHOWN ON THIS FORM INCLUDE (i) ANY CHARGE FOR PROPERTY OWNED, BORROWED, OR LEASED, ANY CHARGE AGAINST ANY OTHER PRIME OR CURRENT GOVERNMENT CONTRACT OR SUBCONTRACT OR (ii) ANY RENTAL OR USE CHARGE ON GOVERNMENT PROPERTY?			
<input type="checkbox"/> YES <input type="checkbox"/> NO <i>IF YES, JUSTIFY ON SEPARATE PAGE.</i> 4. DO YOU REQUIRE GOVERNMENT CONTRACT FINANCING TO PERFORM THIS PROPOSED CONTRACT?			
<input type="checkbox"/> YES <input type="checkbox"/> NO <i>IF YES, IDENTIFY. <input type="checkbox"/> ADVANCE PAYMENTS <input type="checkbox"/> PROGRESS PAYMENTS OR <input type="checkbox"/> GUARANTEED LOANS</i> 5. HAVE YOU BEEN AWARDED ANY CONTRACTS OR SUBCONTRACTS FOR SIMILAR ITEMS WITHIN THE PAST THREE YEARS?			
<input type="checkbox"/> YES <input type="checkbox"/> NO <i>IF YES, SHOW CUSTOMERS) AND CONTRACT NUMBER(S) BELOW OR ON A SEPARATE PAGE.</i>			
6. DO THE AMOUNTS SHOWN ON THIS FORM INCLUDE ANY CHARGE FOR OVERTIME PREMIUMS OTHER THAN OVERTIME OF THE TYPES DESCRIBED IN AFSPR 12-104?			
<input type="checkbox"/> YES <input type="checkbox"/> NO <i>IF YES, EXPLAIN ON A SEPARATE PAGE.</i> 7. DOES THIS COST SUMMARY CONFORM WITH THE COST PRINCIPLES SET FORTH IN AFSPR 3-907.3(a)(2)?			
<input type="checkbox"/> YES <input type="checkbox"/> NO <i>IF NO, EXPLAIN ON A SEPARATE PAGE.</i>			
This proposal is submitted for use in connection with and in response to _____			
* and reflects our best estimates as of this date, in accordance with the instructions to Offerors and the Footnotes which follow.			
*DESCRIBE RPP, ETC. TYPE NAME AND TITLE		SIGNATURE	
NAME OF FIRM		DATE OF SUBMISSION	

DD FORM 633

PREVIOUS EDITIONS ARE OBSOLETE

ARMED SERVICES PROCUREMENT REGULATION

F-200.633

Figure 233. DD Form 633—Contract Pricing Proposal

F132

29 January 1965, Rev. 9

ILLUSTRATIONS OF STANDARD AND DEPARTMENT OF DEFENSE FORMS
REFERENCED IN ASPR

F-200.633 DD Form 633: Contract Pricing Proposal—Continued

INSTRUCTIONS TO OFFERORS

1. The purpose of this form is to provide a standard format by which the offeror submits to the Government a summary of incurred and estimated costs (and attached supporting information) suitable for detailed review and analysis. Prior to the award of a contract resulting from this proposal the offeror shall, under the conditions stated in ASPR 3-807.3, be required to submit a Certificate of Current Cost or Pricing Data (see ASPR 3-807.3(e) and 3-807.4).

2. In addition to the specific information required by this form, the offeror is expected, if good faith, to incorporate in and submit with this form any additional data, supporting schedules, or substantiation which are reasonably required for the conduct of an appropriate review and analysis in the light of the specific facts of this procurement. For effective negotiations, it is essential that there be a clear understanding of:

- The existing, verifiable data
- The judgmental factors applied in projecting from known data to the estimate, and
- The contingencies used by the offeror in his proposed price.

In short, the offeror's estimating process itself needs to be disclosed.

3. When attachment of supporting cost or pricing data to this form is impracticable, the data will be described (with schedules as appropriate), and made available to the contracting officer or his representative upon request.

4. The format and the prescribed cost breakdown are not intended as rigid requirements. With the approval of the contracting officer the data may be presented in another form if required for a more effective and efficient presentation of cost or pricing data.

5. By submission of this proposal the offeror grants to the Contracting Officer, or his authorized representative, the right to examine, for the purpose of verifying the cost or pricing data submitted, those books, records, documents and other supporting data which will permit adequate evaluation of such cost or pricing data, along with the computations and projections used therein. This right may be exercised in connection with any negotiations prior to contract award.

NOTE 1. Enter in this column those necessary and reasonable costs which in the judgment of the offeror will properly be incurred in the efficient performance of the contract. When any of the costs in this column have already been incurred (e.g., on a letter contract or change order), describe them on an attached supporting schedule. When "pre-production" or "start-up" costs are significant or when specifically requested in detail by the contracting officer, provide a full identification and explanation of same. Identify all sales and transfers between your plants, divisions, or organizations under a common control, which are included in other than the lower of cost to the original transferor or current market price.

NOTE 2. The use of this column is optional for multiple line item proposals, except where the contracting officer determines that a separate DD Form 633 is required for selected line items.

NOTE 3. Attach separate pages as necessary and identify in this column the attachment in which the information supporting the specific cost element may be found. No standard formats prescribed; however, the cost or pricing data must be accurate, complete and current, and the judgment factors used in projecting from the data to the estimates must be stated in sufficient detail to enable the Contracting Officer to evaluate the proposal. For example, provide the basis used for pricing the bulk of materials such as vendor quotations, shop estimates, or invoice prices; the reason for use of overhead rates which depart significantly from experienced rates (reduced volume, a planned major rearrangement, etc.); or justification for an increase in labor rates (anticipated wage and salary increases, etc.). Identify and explain any contingencies which are included in the proposed price, such as anticipated costs of rejects and defective work, anticipated costs of engineering redesign and retesting, or anticipated technical difficulties in designing high-risk components.

NOTE 4. Provide a list of principal items within each category of material indicating known or anticipated sources, quantity, unit price, competition obtained, and basis of establishing source and reasonableness of cost.

NOTE 5. Include material for the proposed contract other than material described in the other footnotes under the cost element entitled "Direct Material."

NOTE 6. Include parts, components, assemblies, and services to be produced or performed by other than you in accordance with your designs, specifications, or directions and applicable only to the prime contract.

NOTE 7. Include raw and processed material for the proposed contract in a form or state which requires further processing.

NOTE 8. Include standard commercial items normally fabricated in whole or in part by you which are generally stocked in inventory. Provide explanation for inclusion at other than the lower of cost or current market price.

NOTE 9. Include all materials sold or transferred between your plants, divisions or organizations under a common control at other than cost to the original transferor and provide explanation of pricing method used.

NOTE 10. Provide the method of computation and application of your overhead expense, including cost breakdown, and showing trends and budgetary data as necessary to provide a basis for evaluation of the reasonableness of proposed rates.

NOTE 11. Include separate breakdown of costs.

NOTE 12. Provide a separate breakdown of labor by job category and furnish basis for cost estimates.

NOTE 13. Include all other estimated costs (e.g., special tooling, facilities, special test equipment, special plant rearrangement, preservation, packaging and packing, spoilage and rework, and warranty) which are not otherwise included. Identify separately each category of cost and provide supporting details. If the proposal is based on a P.O.B. destination price, indicate separately all outbound transportation costs included in total amount.

NOTE 14. If the total cost entered here is in excess of \$250, provide on a separate page for an DD Form 733, Royalty Report, the following information on each separate item of royalty or license fee: name and address of licensor; date of license agreement; patent numbers, patent application serial numbers, or other basis on which the royalty is payable; brief description, including any part or model numbers of each contract item or component on which the royalty is payable; percentage or dollar rate of royalty per unit; unit price of contract item; number of units; and total dollar amount of royalties. In addition, if specifically requested by the contracting officer, a copy of the current license agreement and identification of applicable claims of specific patents shall be provided.

NOTE 15. Selling price must include any applicable Federal excise tax on finished articles.

F-200.633

ARMED SERVICES PROCUREMENT REGULATION

Figure 234. DD Form 633—Instructions to Offerors

The numbers after the cost elements are explained under the footnotes.

Now we come to the certification of the current cost or Pricing Data Form. The certificate must be identical to the one set forth under ASPR 3-807.4. You must be particularly precise in identifying your proposal and date thereof. Heretofore you had to certify when you initially submitted your proposal, later when negotiations were underway and perhaps yet again after negotiations were completed and before the contract was signed. Under the proposed ASPR revision the requirement for submitting "current" data is met "when all accurate cost or pricing data reasonably available to the contractor at the time of agreement on price is submitted in writing to the Contracting Officer." Thus, the data would be considered "current" for that contract, if it was current, at the time the parties shook hands on the price, even though the contract is written or executed a month later. If new developments affecting price come up between the handshake on price, and the final execution of the contract, the Contractor is not required to disclose it to the Government. Those responsibilities would end with the handshake unless, for any reason, the parties chose to completely reopen negotiations.

Now let's look at the requirements for cost or pricing data as it applies to subcontractors. If a prime contractor agrees on a subcontract price before coming to agreement with the Government, the subcontractor's cost or pricing data becomes a part of the prime's data submission and subjects the prime contract to price adjustment should the subcontractor's data later be found defective.

Ordinarily, though, the Government and the prime contractor will agree on their price before the prime comes to terms with his sub. In those cases the prime contractor will be expected to support his subcontract cost estimates with whatever data is appropriate under the circumstances. If this data is simply passed on from the subcontractor, the prime is not held responsible for its accuracy. If the prime knew it was defective though, or if it came from another source such that it was actually the prime's data, then it would subject the prime contract to adjustment. And under any cost reimbursement or incentive or re-determinable contract, an increased payment to a subcontractor because his data was defective will be grounds for disallowing costs. There the Government's interests are not limited by the initial agreement on prime contract price.

A significant point to recognize is the distinction between factual data and judgment. Factual data is the kind of information that can be verified for accuracy. While this includes the information upon which pricing judgments are based, the ASPR makes it clear that it does not include the judgments themselves. The distinction between a judgment and a fact helps to clarify what is meant by "Accuracy." But what about the words "complete" and "current." In this regard, ASPR states that the contractor's submission is complete if it includes all factual information that significantly affects price negotiations. Putting this another way, it means contractor submission of all facts that could contribute to sound estimates of future costs. ASPR further tells us that "current" means all such facts as are reasonably available to the contractor up to the time of agreement on price. In effect, what we want to know is how you arrived at your price and we want you to certify to the collection of facts forming the basis for your price. We are not asking you to certify as to the accuracy of what you think your costs are going to be under the contract.

Another significant point to recognize is that DPC No. 55 makes no change in the policy to negotiate contracts on a "total price" basis rather than trying to reach separate agreements on each individual cost element and then totaling them up. It is our experience that negotiations conducted on a total price basis generally serve the Government's interests far better. Within the give-and-take of the negotiation process, the total price technique is best designed to arrive at final prices which are fair and reasonable to both parties.

There is no question that failure by Industry to comply with appropriate submission of data under 87-653 is going to extend the procurement cycles. We are going to expand our

requests for proposal to provide appropriate guidance in submission of data. We are also going to include it as a discussion area during the bid conferences.

In closing, I would like to pass along the thought that if you in Industry exercise sound judgment in submitting requisite 633's and supporting exhibits and identification, and if our Government representatives also exercise sound judgment in evaluating such data, we will have all the data needed to negotiate fair and reasonable prices as well as complying fully with 87-653.

THE NEGOTIATION PROCESS

MR. S. M. SEEDS
Contract Counsel, Marine Systems Center
Honeywell, Inc.

I would like to introduce this topic, "The Negotiation Process," by presenting an analogy. Let's borrow the rope, or in nautical terms, a line, from the Navy emblem. As a rope is made up of many fibers spun into strands which are woven into the end product, so does the process leading to a negotiation contain many intertwined parts. We have (1) the synopsis, (2) the RFQ, (3) the Specification, the contractors' design concept, (4) the technical proposal, (5) cost proposal, (6) DCAA's and DCASR's evaluation and comments, (7) the pre-negotiation clearance, (8) its endorsement and approval, just to mention a few.

Likewise, the performance of the contract after award is composed of many vital intertwined strands: (1) the design, (2) the hardware, (3) handbooks, (4) drawings, (5) reports, (6) billings, and (7) payments, are just a few.

Now, how do we bring these two sections together? We tie a knot, which is the negotiation process and agreement on an award.

This truly is an amazing phenomenon. Perhaps hundreds of people have been involved from both Government and Industry in the development of the procurement prior to award, as there are hundreds of strands in the rope. After award, hundreds and maybe thousands of people will be involved, again representing both parties to the agreement. Yet the knot will be tied, the agreement reached by negotiation between just a few individuals; maybe as few as four—generally not more than a dozen. Truly on their shoulders falls an important responsibility and a challenge.

If our rope is to remain intact and not untwine or break, the knot must carefully weave and tie in each and every strand securely and permanently—the negotiations conference members must also discuss and agree on all aspects of the potential contract. Not only must cost and profit be considered, but also (1) technical compliance with the specification, (2) schedule, (3) reporting requirements, (4) documentation, its content and format, (5) payment provisions, and a whole host of other factors, each must be discussed, agreed to, and tied down. I would like to state here and now that we at Honeywell, and I believe Industry in general, believe that the negotiation process is a proper and necessary part of military contracting, further that it has, and no doubt will continue, to provide a sound basis of reaching agreement on a new contract, or change to an existing contract. When competition is not present, I know of no other means to achieve the result that the negotiation process does.

Like most things, however, the world keeps turning and tomorrow there may be room