



Methods Commonly Used to Determine Price Reasonableness

1. INTRODUCTION: The procurement of goods and services frequently involves the expenditure of federally provided funds. In all cases, a main consideration is to assure that the price to be paid for these goods and services is fair and reasonable. This is essential to insure that both University and federal funds are utilized in a cost effective manner and to conserve funding where resources are limited. Each price analysis or cost analysis **MUST** be documented in writing.

2. WHY PRICE OR COST ANALYSIS: The most basic reason for requiring that price or cost analyses be performed and documented is that it is a sound business practice. This, as noted above, ensures that funds are expended in the most cost effective manner and conserves limited resources. A price that is excessive or unreasonable fails completely to accomplish this important goal; a price that is determined to be fair and reasonable is the fulfillment of this objective. Equally important is that validating that prices to be paid are fair and reasonable is a requirement of public law when expending or using federal funds for the purchase of required goods and services that will equal or exceed \$10,000.

3. WHAT IS A PRICE ANALYSIS: In simple terms, a price analysis is a review, analysis or examination of the price proposed by a vendor and an assessment or evaluation as to whether or not it is fair and reasonable by considering the quality, delivery and other factors. The basis for reaching the conclusion is found in the facts and information considered and analyzed by the buyer.

4. WHAT IS A COST ANALYSIS: A cost analysis is different than a price analysis. The major difference is that a price analysis looks at the whole price. It does not involve an examination of the individual cost elements or components that collectively comprise the vendor's total price. A cost analysis actually examines the individual cost elements that comprise the total proposed price. Depending on the purchase, these elements may vary but generally include such things as labor rates, material costs, overhead or indirect rates, a cost of money factor, general and administrative expenses and a profit or fee.

5. MEANS COMMONLY USED IN PRICE ANALYSIS: In performing a price analysis, that is, determining a price to be fair and reasonable without examining the individual components of the price, a buyer has a wide selection of methods. Which method is used and its suitability depends on the facts or information of the individual purchase. What follows is a listing of the most common methods or criteria used to determine a price fair and reasonable by price analysis.

- a. **PRICE COMPETITION:** When two or more acceptable offers are received and the lowest price is selected, the price of the lowest vendor can be concluded to be fair and reasonable. It is noted that generally where the difference in prices between the two vendors differs by less than 15%, the price competition is said to exist. A price that is very low must be checked to assure that the vendor understands what is being asked for and has made no errors. Example: Vendor A proposes a price of \$2,592; Vendor B, a price of \$2,550 and Vendor C, a price of \$1,400. Vendor C is low but the difference is too great. This must be checked to see if Vendor C is proposing the same item(s) and has made no errors in the proposed pricing. If selection is made to other than the low, acceptable offer, the price must be determined to fair and reasonable by other means.
- b. **COMPARABLE TO PRICE SOLD TO FED. GOV'T.:** The Federal Government often enters into contracts with various companies to establish the prices of items that will be sold to the government. These are presumed to be fair and reasonable. If a vendor cites a GSA contract price, it must also provide the GSA contract number. This then is adequate rationale to determine the price fair and reasonable. The actual price may be lower than the GSA due to discounts, (if this is the case, it should be noted in the written analysis), or higher based upon volume sales discounts (vendor should provide their price break structure for volume sales).
- c. **CATALOG OR ESTABLISHED PRICE LIST:** Where only one offer is received and the vendor has a published or established price list or catalog, available to the general public, which sets forth the price of a commercial item,

this fact can be used to find the price fair and reasonable. The catalog should be current (within one year, generally). Provide a dated page from the catalog along with the page where pricing is identified (this could be a printout of a web page). Often, discounts off of the price list are offered. If this is the case, it should be noted in the written analysis. The item to be purchased should generally be a commercially produced one sold to the general public versus a custom good.

- d. **MARKET PRICES:** Where an item has an established market price, verification of an equal or lower price also establishes the price to be fair and reasonable. Example, the purchase of metals, such as lead, gold, silver, or commodities such as grains.
- e. **HISTORICAL PRICES:** If the buyer has a history of the purchase of the item over several years, use of this information, taking into account inflation factors, can be used to determine a price fair and reasonable. The historical pricing summary must be supported by appropriate documentation (copies of PO's).
- f. **PRICE BASED ON PRIOR COMPETITION:** It may be that only one vendor will make an offer. If this is the case, and the item was previously purchased based on competition, this may be acceptable. In such cases, cite the price of prior purchase and note if it was competitive or based on catalog price or other. An increase in price, with no current catalog or competition, should be about the rate of inflation between the time of the last competition and the commitment of the current order.
- g. **INDEPENDENT UNIVERSITY (In-house) ESTIMATE:** If an independent estimate of the item has been prepared and no other method or information is available, a price can be compared to the estimate and if it compares favorably, this can be a basis to find a price fair and reasonable. The estimate, however, must be independent. Use of a vendor's pricing to make an independent estimate is NOT independent.
- h. **COMPARISON TO A SUBSTANTIALLY SIMILAR ITEM:** Often an item is very similar to a commercial one, but has added features that are required. If the vendor can provide the price of the base item, by a catalog, and then state the costs of the additional features, the buyer can then find the price reasonable based on these two factors. Differences should be detailed and priced. The reasonableness of the extra cost can be a) checked against other purchases that had the extras, or some of them; or, b) based on an evaluation of the extra cost by technical personnel.
- i. **SALES OF THE SAME ITEM TO OTHER PURCHASERS:** If the vendor has no catalog, but has sold the same item to other similar institutions or universities in the recent past, the price can be determined to be fair and reasonable by verifying with those other purchasers what price they paid. This must be noted in the written documentation with name, telephone number, date of confirmation and price paid. A copy of another customer's invoice will suffice.
- j. **AWARD SPECIFICALLY IDENTIFIES ITEM/PERSON AND PRICE:** Under federally funded grant or cooperative agreement awards, if the award references a proposal that a) specifically identified the manufacturer, model and the price (only if a vendor quotation accompanied the proposal), or b) identified a specific person with an hourly rate for fixed price for that person, then the contracting officer has accepted that price as being deemed reasonable by the proposer and nothing else needs be done as long as the final price does not exceed the budgeted line item. If, however, the award is a federally funded contract or purchase order, then the proposer must formally provide rationale with the proposal (using one of the above methodologies in a) through i)) to determine price reasonableness at the time of the proposal before this method of price reasonableness is acceptable. Under FAR regulations, it is the responsibility of the proposer to determine price reasonableness, either at the time of proposal or at the time an acquisition is made. It is not the responsibility of the contracting officer. Documentation (copy of the award pages related to the acquisition and any supporting documents, i.e., copies of quotations, in-house estimates, other customer invoices, GSA pricing, etc.) supporting either of the above situations must be provided to Procurement Services.

6. COST ANALYSIS: A cost analysis looks at the individual elements of the price (labor rates, direct & indirect materials and overhead, G&A expenses, profit/fee) and analyzes these. Overhead or indirect rates may be verified and found reasonable by verifying such rates with the government, in many cases. The number of hours proposed, not the price, should be evaluated by the technical or scientific staff. The reasonableness of the percent of fee or profit is the responsibility of the buyer. It is negotiable in most cases. An asking price is not always a taking price.

7. DOCUMENTATION: Each price analysis or cost analysis MUST be documented in writing.