Methods to Determine Price Reasonableness (purchases greater than simplified acquisition threshold)

1. Overview:

It is important that all purchases are utilized in a cost-effective manner. To assist with this, cost or price analysis are need for all purchases greater than the simplified acquisition threshold of $250,000.

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 which is determined to be fair and reasonable is the fulfillment of this important objective.

3. WHAT IS A PRICE ANALYSIS:

In simple terms, a price analysis is a review, analysis or examination of the price proposed by a supplier and an assessment or evaluation as to whether it is fair and reasonable. A determination that a price is fair and reasonable is really a conclusion that the proposed price is fair to both parties, 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. This is what is called price analysis.

4. WHAT IS A COST ANALYSIS:

A cost analysis is different from 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 seller's total price.

A cost analysis 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 (G&A) and a profit or fee.

5. METHODS 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 offered can be concluded to be fair and reasonable.

b. COMPARABLE TO PRICE SOLD TO FED. GOV'T.:

The Federal Government often enters contracts with various companies to establish the prices of items that will be sold to the Government General Services Administration (GSA). These are presumed to be fair and reasonable. If a Seller cites a GSA contract price, it must also provide the GSA contract number. If the GSA price is available from a website, the buyer must provide a copy of the webpage. 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 (supplier should provide their price break structure for volume sales).

c. CATALOG OR ESTABLISHED PRICE LIST:

Where only one offer is received and the seller has a published or established price list or catalog, available to the public, which sets forth the price of a commercial item, this fact can be used to find the price fair and reasonable.

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, this information, considering inflation factors, can be used to determine a price fair and reasonable. The historical pricing summary must be supported by appropriate documentation (computer reports or copies of PO's).

f. PRICE BASED ON PRIOR COMPETITION:

It may be that only one Seller 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 current 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 prior to contacting suppliers, 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 Seller'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 Seller 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 Seller has no catalog but has sold the same item to others 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.

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 awarding agency, 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.