

GEORGIA INSTITUTE OF TECHNOLOGY
SUGGESTED METHODS TO DETERMINE PRICE REASONABLENESS
AS PRESENTED BY ONR FEDERAL AUDITORS

1. **INTRODUCTION:** University purchasing agents or buyers are the primary personnel who make decisions on behalf of the university with respect to the purchase of goods and services needed by the university community. Frequently, these purchases involve the expenditure of federal and state provided funds and sponsored 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 ensure that both the university and government funds are utilized in a cost effective manner and to conserve funding where resources are limited.

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 which 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.

Equally important is that performing and documenting that prices to be paid are fair and reasonable is a requirement when expending or using federal funds for the purchase of required goods and services.

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. 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 and delivery and other factors. The basis for reaching that 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:** First, a cost analysis is different from 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 which collectively comprise the seller's price.

A cost analysis, on the other hand, actually examines the individual cost elements which comprise the total proposed price. Depending on the purchase, these elements may vary but generally include such things as labor rates, material cost, expenses (G&A) 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 purchases. 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 offeror can be concluded to be fair and reasonable. It is noted that generally where the difference in prices between the two offers ranges up 15%, the price competition is said to exist. A price which is very low must be checked to assure that the seller understands what he is selling and has made no errors. Example: Seller A proposes a price of \$2,592.00; Seller B, a price of \$2,550.00 and Seller C, a price of \$1,400.00. Seller C is proposing the same item and has made no errors in his/her pricing. If selection is made to other than the low, acceptable offer, the price must be determined to be fair and reasonable by other means.

- b. **CATALOG OR ESTABLISHED PRICE LIST:** Where only one offer is received and the seller has a published or established price list or catalog 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). It is a good idea to obtain a name of another recent purchaser and confirm that this was the price paid. 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 in substantial quantities.
- c. **GSA CONTRACTS OR PRICING AGREEMENTS:** The federal government often enters into contracts with various companies as to the prices of items which will be sold to the government. These are presumed to be fair and reasonable. If a seller cites a GSA contract price, that is adequate 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.
- d. **PRICE BASED ON PRIOR COMPETITION:** It may be that only one seller will propose. If this is the case and the item was previously purchased on competition, this may be acceptable. In such cases, you want to cite the price of the prior purchase and note if it was competitive or based on catalog price or other means. An increase in price, with no current catalog or competition, should be about the current rate of inflation, 4% to 6%.
- e. **COMPARISON TO A SUBSTANTIALLY SIMILAR ITEM:** Often an item is very similar to a commercial one but has added features which are required. If the seller can provide the price of the base item, by a catalog, and then state cost of the additional features, the buyer can then find the price reasonable based on these two factors. The reasonableness of the extra cost can be checked from other purchases that had the extras or some of them or based on an evaluation of the extra cost by technical personnel.
- f. **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 and date of confirmation.
- g. **COMPARISON TO PRICES WITH OTHER SIMILAR ITEMS:** If an item is generic, there may be a number of similar made products, such as computers. If the low

price for a computer is \$1,800.00, then a call to another firm asking for a price on a similarly configured machine can be used. Say the other is \$1,925.00, that can be used.

- h. **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.
 - i. **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.
 - j. **INDEPENDENT UNIVERISTY ESTIMATE:** If an independent estimate of the item has been prepared and other methods 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.
 - k. **COST ANALYSIS:** A cost analysis looks at the individual elements of the price 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 folks. 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.
6. **DOCUMENTATION:** Each price analysis or cost analysis must be documented in writing by the buyer.