

Contract Cost and Price

- ✓ **Perform a cost analysis or price analysis for every procurement:** Grantees must perform a cost or price analysis for every procurement, including changes to contracts or change orders. The method and degree of analysis depends on the situation. As a starting point, make independent estimates to determine a reasonable price before receiving bids or proposals. The independent estimate may be developed by grantee staff or by an independent expert.

- ✓ **Perform a cost analysis in the following circumstances:**
 - When the contractor is required to submit the components of the estimated total cost, such as labor, materials, overhead, and profit (e.g., for professional, consulting, and architectural engineering services contracts).
 - When adequate price competition is lacking, and for sole source procurements, including contract modifications or change orders, unless price reasonableness can be established on the basis of catalog or market prices of commercial products or services sold in substantial quantities to the general public or set by law or regulation.
 - For sole-source procurements, (e.g., noncompetitive proposal procurement method) and when negotiating a contract after a sealed bid procurement fails to produce more than one bidder, and it is determined rebidding would not produce additional bids.
 - For any contract modifications or [change orders](#), if the modification changes the work authorized under the contract and changes the price or total estimated cost, either upwards or downwards.

A [price analysis](#) is used to determine the reasonableness of the proposed price. The reasonableness of the proposed price can be established on the basis of the catalogue or market price. If the price is set by law or regulation, this analysis can be used to establish reasonableness.

A [cost analysis](#) verifies proposed cost data, projections of cost data changes, and the evaluation of the specific elements of costs and profits. It is used to determine whether the elements that make up the total estimated cost of a contract are allowable, allocable, and reasonable.

How do cost analysis and price analysis apply to the different procurement methods?

- **Small Purchases.** For routine, commercial type purchases, comparing price or rate quotes obtained from an adequate number of qualified vendors is sufficient price analysis. If the small purchase is for professional or technical services, or the grantee needs to evaluate other factors than price, then at least a limited cost analysis is appropriate. In either case, the grantee's analysis should include comparing the proposed prices to past prices it has paid for the same or similar items or services.
- **Sealed Bids.** This is the preferred method for contracting for supplies, equipment and construction. Normally, the competitive pricing forces of the marketplace determine the reasonableness of the low price obtained through sealed bidding. Nevertheless, the grantee should always compare its own independent cost estimate to the low competitive bid received. In the event they are significantly different, the grantee will need to examine each to verify that either its own estimate or the market price is valid. Otherwise, no further price or cost analysis is required under sealed bidding.
- **Competitive (Negotiated) Proposals.** To determine the reasonableness of proposed costs, cost breakdowns must be obtained from the potential contractors showing all the elements of their proposed total costs. A cost analysis must be performed for each proposal. All proposed costs contained in each potential contractor's price must be analyzed.
- **Noncompetitive Proposals.** No competition is intended, and usually, there is no market to help set the price or estimated cost. Since there is no price competition to tell the grantee if the price or estimated cost is reasonable, the grantee must obtain a breakdown of the proposed costs and perform a cost analysis.

- ✓ **Observe the requirements for when a cost analysis must be performed, and use a price analysis to determine the reasonableness of the proposed contract price in all cases where a cost analysis is not required.**

[\[34 CFR § 80.36 \(f\)\(1\)\]](#)

- ✓ **Negotiate profit as a separate element of the price for each contract in which there is no price competition and in all cases where cost analysis is performed.**

When establishing a fair and reasonable profit, the following should be considered:

- Complexity of the work to be performed;
- The risk borne by the contractor;
- The contractor's investment;
- The amount of subcontracting;
- The contractor's record of past performance; and
- Industry profit rates in the surrounding geographical area for similar work.

[\[34 CFR § 80.36 \(f\)\(2\)\]](#)

- ✓ **Ensure grant funds are only used for allowable costs under the appropriate set of federal cost principles**

Grant funds may only be used for the allowable contractors' costs of contractors. To be allowable, all costs including contractor fees and profit must be necessary, reasonable, and allocable to the federal program, and comply with applicable cost principles.

For each kind of organization, there is a set of federal cost principles for determining allowable costs. For contracts with:

- State, local, or Indian tribal governments use [White House Office of Management and Budget \(OMB\) Circular A-87](#).
- Private nonprofit organizations other than an institution of higher education, a hospital, or an organization named in OMB Circular A-122 as not subject to OMB Circular A-122 use [OMB Circular A-122](#).
- Educational institutions use [OMB Circular A-21](#).
- For-profit organizations, other than hospitals, use [48 CFR § 31.2, Contracts with Commercial Organizations](#).

[\[34 CFR § 80.36 \(f\)\(3\)\]](#), [\[34 CFR § 80.22\]](#)

- ✓ **Observe limitations on methods of contracting**

The [cost plus a percentage of cost method](#) and the [percentage of construction cost method](#) of contracting are prohibited. [\[34 CFR § 80.36\(f\)\(4\)\]](#)

How do I perform a price analysis?

Use as many of the following techniques as applicable and appropriate:

- Compare competitive prices received in response to the solicitation to one another. This assumes the grantee receives a large enough number of competitively priced offers from the current marketplace.
- Compare proposed prices with prices under existing contracts and with prices proposed in the past for the same or similar items/services. Factor in any market changes (e.g., commodity price changes) or other influences (e.g., inflation).
- Apply rough yardsticks (e.g., dollars per pound, per square foot, per hour, etc.) to compare prices and highlight significant inconsistencies that warrant additional pricing inquiry.
- Compare competitive price lists, published catalog or market prices of commodities and products, similar indices and discount or rebate arrangements.
- Compare proposed prices with your independent (in-house) cost estimates.

How do I perform a cost analysis?

Verify the accuracy of the cost and pricing information submitted, and evaluate:

- The reasonableness of the proposed costs, including allowances for contingencies. To be considered reasonable, proposed costs must meet three tests. The costs must be:
 - *Allowable*. The cost must be allowable under applicable cost principles. (See page 13)
 - *Allocable*. The costs are logically related to, or required in the performance of the contract.
 - *Reasonable*. This term is generally defined as what a prudent person would pay in a competitive marketplace. A cost can be allowable and allocable, and still not be what a prudent person would pay (e.g., first class airfare for a proposed contractor).
- The necessity for proposed cost items. Technical personnel (e.g., architect, information systems specialist, etc.) should review the proposed direct cost elements to determine their necessity to perform the contract and reasonableness (e.g., in comparison to market rates). A cost may be allowable under the cost principles and allocable to the type of work to be performed, but still not be necessary for the specific contract.
- Application of audited or pre-negotiated by indirect cost (e.g., overhead) rates, labor and fringe benefit rates, or other factors.
- Effect of the potential contractor's current practices on future costs. Does the contractor have a track record of completing contracts at or under cost? Does the contractor overrun costs?
- The projection of the potential contractor's cost trends. Is there any indication the contractor's costs are likely to increase or decrease over the life of the contract?

Compare costs proposed by the contractor with –

- Actual costs previously incurred by the same contractor for the same or similar work. If it is a repetitive type of work or service, how much has it cost in the past. Apply any appropriate inflation factors for past work.
- Actual costs of the same or similar work performed by other contractors.
- Previous cost estimates from the potential contractor or others for the same or similar items.
- The methods proposed by the potential contractor with the requirements of the solicitation. Do the costs reflect the technical approach proposed and the work required?
- The grantee's independent cost estimate either created by grantee staff or for the grantee by an independent architect, engineer, appraiser, etc.
- Verify the costs submitted by the potential contractor comply with the appropriate set of cost principles. (See page 13)