CHAPTER 1. INTRODUCTION

1-1. PURPOSE. The purpose of this handbook is to provide HUD grantees with the cost principles applicable to contracts which the grantee awards to commercial (i.e., for-profit) organizations. These cost principles are a reprint of Subpart 31.2 of the Federal Acquisition Regulation (FAR; 48 CFR Chapter 1), and are prescribed by HUD's regulations at 24 CFR Part 85, Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments (specifically, section 85.22, Allowable Costs). They are to be used in determining the allowability of costs when the HUD grantee is pricing contracts, including modifications to contracts, with a commercial organization. However, should these cost principles be inconsistent with any program statute, the program statute shall govern.

These cost principles DO NOT APPLY to contracts between a HUD grantee and a non-commercial organization. The universe of organization types and the cost principles to be applied are identified below:

State, local or tribal government	OMB Circular A-87
Private nonprofit organization other than an institution of higher education or hospital	OMB Circular A-122
Educational institution	OMB Circular A-21

Because the cost principles in this Appendix 1 of this handbook are a reprint of the FAR, whenever the following terms appear, be advised that they are referring to you, the HUD grantee: "Government"; "agency"; "ACO" (which means "Administrative Contracting Officer"); or, "contracting officer". The term "contractor" refers to your contractor.

The cost principles are provided as Appendix 1.

A glossary of terms is provided as Appendix 2.

1-2. APPLICABILITY. As specified in 24 CFR 85.36(f), you must perform a cost analysis or price analysis for every procurement action, including

contract modifications (e.g., "change orders"). The degree of detail required varies with the procurement method and contracting circumstances. These are addressed below.

A. Price Analysis is a review and evaluation of a proposed price without evaluating separate cost elements. It must be used in all cases where a cost analysis is not performed. Application of the cost principles in Appendix 1 is not required to conduct a price analysis.

B. Cost Analysis is a review and evaluation of the separate elements of cost which make up the contractor's cost proposal. It requires that the cost principles in Appendix 1 be used to determine the allowability and reasonability of costs. A cost analysis is required when:

1. The competitive proposal method of contracting is used (see 24 CFR 85.36(d)(3)), e.g., acquisition of professional, consulting, architect/engineering (A/E) services. For procurement of these services, offerors are required to submit cost proposals breaking down the elements of their proposed costs;

2. You are negotiating a contract with a sole source, as justified under 24 CFR 85.36(d)(4). You must request a complete cost breakdown and use these cost principles to establish a fair and reasonable price or established cost;

3. After soliciting sealed bids, you receive only one bid in response which differs substantially from your independent estimate. If you find that bid unreasonable and you elect not to seek further competition, then you may cancel the solicitation and negotiate a contract price with the sole bidder. If so, you must request a cost breakdown of his/her price and use the cost principles in Appendix 1 to determine price reasonableness; or,

4. You are negotiating a modification (including change orders) to any contract which changes the work previously authorized and impacts the price or estimated cost, upwards or downwards. You must request a cost breakdown of the contractor's proposed cost. NOTE: Modifications which change the work beyond the scope

of the contract must be justified as a noncompetitive action per 24 CFR 85.36(d)(4). If none of those conditions apply, the work must be procured competitively.

The only circumstances under which you do not need to conduct a cost analysis when adequate price competition is lacking is if the price can be established on the basis of a catalog or market price of a commercial product sold in substantial quantities to the general public or the price is set by law or regulation. (An item is "sold in substantial quantity" when the quantities regularly sold are sufficient to constitute a real commercial market. For services to be sold in substantial quantities, they must be customarily provided by the contractor, using personnel regularly employed and equipment (if any is necessary) regularly maintained solely to provide the services).

C. Profit. Cost analysis also requires that you negotiate profit as a separate element of the price (see 24 CFR 85.36(f)(2)). In negotiating profit, you should consider the following:

1. The complexity of the work to be performed;

2. The risk borne by the contractor;

3. The contractor's investment;

4. The amount of subcontracting;

5. The quality of the contractor's record of past performance; and,

6. Industry profit rates in the surrounding geographical areas for similar work.

Be advised that cost-plus-a-percentage-of-cost and percentage-of-construction-cost type contracts are prohibited. (See 24 CFR 85.36(f)(4)).

D. How Cost/Price Analysis Applies to Different Procurement Methods

1. Small Purchases

When using the small purchase method of procurement (see 24 CFR 85.36(d)(1)), price analysis is conducted by obtaining price or rate quotes from an adequate number of qualified sources and comparing the quotes or rates to prior purchases of a similar nature. These situations are typical of many of your procurements and will not require application of these cost principles.

2. Sealed Bidding

Purchase of supplies, equipment, and construction are typically accomplished using sealed bidding (see 24 CFR 85.36(d)(2)). For Public Housing Agencies (PHAs) and Indian Housing Authorities (IHAs) which receive funding under the Comprehensive Improvement Assistance Program (CIAP), sealed bidding is mandatory for the procurement of construction or equipment over $25,000 (see 24 CFR 968.240(c), except for procurement under the Consolidated Supply Program, 24 CFR Part 965, Subpart G). The reasonableness of the price is established by a comparison of your independent cost estimate and the competitive bids received. No further price analysis is required. (However, see paragraph B3 above, which requires cost analysis in certain situations when only one bid is received).

3. Competitive Proposals

For the most part, you will use competitive proposals when you have a need to acquire professional, consulting, and architect/engineering (A/E) services (see 24 CFR 85.36(d)(3)). In order to determine the reasonableness of costs under these types of contracts, you will need to ask the offerors to submit the elements of their costs, i.e., a cost breakdown. As such, you will be required to perform a cost analysis and will need to apply the cost principles in Appendix 1.

While a fixed-price contract (i.e., a contract that

provides for a price that is not subject to any adjustment as a result of the contractor's cost experience in performing the contract) may be the result of the competitive proposal method of procurement, you will still be required to apply the cost principles to determine cost reasonableness. However, the application of the cost principles to fixed-price contracts does not require you to negotiate on individual elements of cost in arriving at an agreement on total price. The final price negotiated by you and the contractor on a fixed-price contract reflects agreement only on the total price. Although use of these cost principles is mandatory, the objective is to negotiate prices that are fair and reasonable, cost and other factors considered.

4. Noncompetitive Proposals

If you have justified procurement by noncompetitive proposals under one of the circumstances in 24 CFR 85.36(d)(4)(i), you must request a breakdown of the proposed costs and use cost analysis (i.e., verifying the proposed cost data, the projections of the data, and the evaluation of the specific elements of cost and profit). This is because, in noncompetitive situations, there is no price competition upon which to base the reasonableness of the cost.

5. Contract Modifications

If you are negotiating a modification (including change orders) to any contract (even if the basic contract was awarded competitively) which changes the scope of work previously authorized (see the NOTE on page 2, paragraph II B.4) and impacts the price or estimated cost, you must use cost analysis and the principles in Appendix 1 to arrive at a reasonable cost. The only exception to this rule is contract modifications which are based on pricing terms established in the contract document. Keep in mind that changes in scope do not always result in increased costs. A reduction in the work requirements may result in a decrease in the contract price. Regardless of the direction of the price change, such modifications require the use of cost analysis and of the cost principles in Appendix 1.

6. Contract Terminations

   If you are terminating either a fixed-price or cost-reimbursement contract for convenience, or a cost-reimbursement contract for cause (default), you must use cost analysis and the cost principles in Appendix 1 to arrive at a termination settlement. The cost principle at FAR 31.205-42 deals specifically with termination costs.

7. Cost-reimbursement Contracts

   In determining reasonable costs under any cost-reimbursement contract, you must perform a cost analysis and use the principles in Appendix 1.

8. Special Circumstances Regarding Construction and Architect/Engineer (A/E) Contracts

   a. This category includes all contracts and contract modifications negotiated on the basis of cost for construction management or construction, alteration or repair of buildings, bridges, roads, or other kinds of real property. It also includes A/E contracts related to construction projects. It does not include contracts for equipment, or other kinds of personal property.

   b. The cost principles and procedures in Appendix 1 shall be used in the pricing of contracts and contract modifications in this category if cost analysis is performed (i.e., for all A/E contracts and for those rare occasions where construction may be procured using other than sealed bidding).

   c. Although most construction contracts will be awarded using sealed bidding, modifications to such contracts will require application of these cost principles. Because of widely varying

factors in construction work such as the nature, size, duration, and location of the construction project, advance agreements as discussed in Appendix 3 (for such items as home office overhead, partners' compensation, employment of consultants, and equipment usage costs) can be particularly important in construction and A/E contracts. When appropriate, they serve to express the parties' understanding prior to the start of work and cost incurrence to avoid possible subsequent disputes or disallowances.

d. If a schedule of predetermined use rates for construction equipment (e.g., industry or Government-sponsored construction equipment cost guides; or, commercially published schedules of construction equipment usage costs) is used to determine direct costs, all costs of equipment that are included in the cost allowances provided by the schedule shall be identified and eliminated from the contractor's other direct and indirect costs charged to the contract.

1-3. COST AND PRICE ANALYSIS TECHNIQUES

A. Price analysis techniques. One or more of the following techniques may be used to perform price analysis:

1. Compare proposed prices received in response to the solicitation.

2. Compare prior proposed prices and contract prices with current proposed prices for the same or similar items/services.

3. Apply rough yardsticks (such as dollars per pound, per square foot, or other units) to highlight significant inconsistencies that warrant additional pricing inquiry.

4. Compare competitive price lists (such as the Consolidated Supply Contract Catalog), published market prices of commodities, similar indices and discount or rebate arrangements.

5. Compare proposed prices with your independent cost estimates.

B. Cost Analysis Techniques. You should, as appropriate, use the techniques discussed below to perform cost analysis:

1. Verify cost and pricing data and evaluate cost estimates, including:

a. Necessity for and reasonableness of proposed costs, including allowances for contingencies;

b. Projection of offeror's cost trends;

c. Technical appraisal (e.g., by an engineer) of proposed direct cost elements; and,

d. Application of audited or pre-negotiated (e.g., by the Federal Government) indirect cost rates, labor rates, or other factors.

2. Evaluate the effect of the offeror's current practices on future costs.

3. Compare costs proposed by the offeror with:

   a. Actual costs previously incurred by the same offeror;

   b. Previous cost estimates from the offeror or other offerors for the same or similar items;

   c. The methodology to be used by the offeror with the requirements of the solicitation (i.e., do the costs reflect the technical approach proposed?); and,

   d. Your independent cost estimate (or that of an independent architect, engineer, appraiser, etc.).

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4. Verify that the offeror's cost submissions comply with the cost principles in Appendix 1.