Mastering the Art of Documenting Price Reasonableness in Sole-Source Procurement

Why Price Reasonableness Matters When You Have No Competition

I remember sitting across from a project manager who had just awarded a contract for a specialized piece of machinery. There was only one supplier in the world that made it. The PM looked at me and said, "How do I prove we didn't overpay?" That question is the heart of documenting price reasonableness when competition doesn't exist. Without a competitive bid, you need a defensible record that shows your price was fair even though you couldn't compare it to other offers.

When I first started in procurement, the idea of justifying a sole-source price felt like trying to prove a negative. You can't show that three other companies bid higher or lower because there are no other companies. Over time, I learned that the key is not to fake competition but to build a clear, logical case based on cost data, market research, and common sense. That case becomes your documentation. It's the difference between a contract file that passes audit scrutiny and one that draws red flags.

Start With the Cost Breakdown

The foundation of any good price reasonableness file is understanding what goes into the price. I've found that most suppliers are willing to share a cost breakdown if you ask early and explain why. You want to see direct material costs, direct labor, overhead, profit margin, and any special tooling or setup charges. One time, a supplier shared their bill of materials and labor hours with me, and I noticed they were charging for a component that had already been paid for in a previous contract. That kind of detail only surfaces when you dig into the breakdown.

When you have that data, you can compare it to industry averages. For example, if the supplier's labor rate is $85 an hour and the Bureau of Labor Statistics shows a median rate of $65 for that trade in your region, you have a red flag to investigate. Maybe they have specialized certifications or a remote location that justifies the difference. The point is, you can document that you checked. You can also look at publicly available financial reports for the supplier's industry. If their gross margin is typically 30 percent and they are asking for 50 percent on your contract, you need a good reason why.

Leveraging Cost Models and Independent Estimates

Another technique I have used is building a simple cost model in a spreadsheet. I take the supplier's breakdown and plug in my own estimates for material costs from index data or commodity exchanges. For labor, I use published wage surveys. I add typical overhead percentages from industry reports. The result is a "should cost" estimate. It is not perfect, but it gives you a benchmark. If the supplier's price is within 10 or 15 percent of your model, you have a solid basis for saying the price is reasonable. If it is way off, you have a question to ask.

Independent cost estimates from third-party engineers or cost consultants can also be gold. I have worked on projects where we paid a small firm to estimate the cost of manufacturing a custom part. Their estimate came in 20 percent lower than the sole-source supplier's quote. With that estimate in hand, we negotiated the price down. The final price was still above the estimate, but we had documented that the price was reasonable given the supplier's unique expertise and the small production run. That negotiation and the supporting estimate went into the file.

Market Research Beyond Competitors

When there is no direct competition, you have to get creative with market research. I look at analogous products or services. For instance, if you are buying a custom software module, you can look at the cost of similar modules built for other industries. If the supplier is the only one who can make a specific alloy bracket, you can research the cost of fabricating a similar bracket out of a different material and adjust for material cost differences. It is not a perfect apples-to-apples comparison, but it shows that you did your homework.

Published price lists or catalogs from the supplier can help too. If the supplier has a standard product that is similar to your custom item, you can use the standard price as a baseline and add a reasonable premium for customization. I once used a supplier's own online store price for a base model to justify that the custom model's price was only 15 percent higher, well within industry norms for add-ons. That comparison went right into the documentation.

Historical Prices and Escalation

Another approach is looking at what you paid for the same or similar item in the past. If you bought the same part three years ago for $1,000 and the supplier is now asking $1,200, you can check inflation indices for that commodity. If the index shows a 15 percent increase over three years, then $1,150 would be expected. The $1,200 price is close enough. You can document that you considered historical prices and adjusted for inflation. This is especially useful when you have a long relationship with a sole-source supplier. The key is to show that the price did not jump arbitrarily.

I also recommend checking whether the supplier publishes annual price escalation letters or has a posted pricing formula. Some suppliers tie their price increases to a published index like the Producer Price Index. If your contract price follows that formula, you can document that the price is reasonable because it is based on an objective, external measure. You just need to attach the formula and the index values to your file.

Putting It All Together in a Written Memo

After you have gathered your cost breakdown, market research, and any independent estimates, the next step is writing a clear memo that explains your reasoning. This is where documenting price reasonableness becomes an art. You want to tell a story: here is what we bought, here is why there was no competition, here is how we determined the price was fair. Include your sources, your calculations, and your judgment calls. A good memo does not just list facts; it explains why you chose the method you did and why you believe the conclusion is sound.

I always include a section on risks and uncertainties. For example, if my cost model had a wide error margin because material prices are volatile, I note that. If the supplier's quote is based on preliminary engineering and could change, I mention that too. Auditors appreciate honesty. They would rather see that you acknowledged a range of possible prices than that you pretended you had certainty. Acknowledging uncertainty actually strengthens your documentation because it shows you applied critical thinking.

Common Pitfalls to Avoid

One mistake I see often is relying solely on the supplier's own justification. If the supplier says "this is our standard price" and you accept that without any independent check, your documentation is weak. You need to verify. Another pitfall is waiting until the end of the contract to assemble the documentation. I have learned to start the file as soon as I know I am dealing with a sole-source situation. That way, I can ask for data while it is fresh and while the supplier is still motivated to cooperate. Last-minute documentation tends to be thin and rushed.

Another pitfall is over-relying on a single method. If you only use a cost model and the model has a flaw, your entire justification collapses. I always try to have at least two independent sources of evidence. That could be a cost model plus a historical price comparison, or a market analogy plus an independent estimate. Triangulating on a reasonable price makes your case much stronger.

The Role of Compliance in Your File

For many organizations, the documentation is not just good practice; it is a compliance requirement. Federal acquisition regulations, for example, require a written determination of price reasonableness for sole-source contracts above a certain threshold. Even if you are not in government contracting, your organization's audit team may have similar standards. SpendLogic's guidance emphasizes that the file should be self-explanatory to someone who was not involved in the procurement. That means avoiding jargon and explaining your thought process clearly.

I have seen compliance officers reject a file because the memo did not mention the specific regulation or policy that applied. So I always check the relevant policy first. If your organization requires a specific form or checklist for sole-source justifications, use it. Do not create your own format unless you have to. Following the prescribed format shows that you understand the compliance framework.

Final Thoughts on Building a Defensible File

At the end of the day, documenting price reasonableness is about showing your work. It is the same principle as solving a math problem in school: the teacher wanted to see the steps, not just the answer. An auditor wants to see that you asked the right questions, gathered relevant data, and made a reasonable judgment. If you can show that, your file will stand up to scrutiny.

I have used these methods on contracts ranging from custom machine parts to specialized consulting services. In every case, the effort I put into documenting the price upfront saved me headaches later. It gave me confidence when I defended the price to management and to auditors. And it built trust with my suppliers because they saw that I was thorough and fair. So next time you face a sole-source situation, remember that you have tools at your disposal. Use them, and write it all down. Your future self will thank you.