15.404-4 Profit.

(a) *General*. This subsection prescribes policies for establishing the profit or fee portion of the Government prenegotiation objective in *price* negotiations based on cost analysis.

(1) Profit or fee prenegotiation objectives do not necessarily represent net income to contractors. Rather, they represent that element of the potential total remuneration that contractors *may* receive for contract performance over and above allowable costs. This potential remuneration element and the Government's estimate of allowable costs to be incurred in contract performance together equal the Government's total prenegotiation objective. Just as actual costs *may* vary from estimated costs, the contractor's actual realized profit or fee *may* vary from negotiated profit or fee, because of such factors as efficiency of performance, incurrence of costs the Government does not recognize as allowable, and the contract type.

(2) It is in the Government's interest to *offer* contractors opportunities for financial rewards sufficient to stimulate efficient contract performance, attract the best capabilities of qualified large and small business concerns to Government contracts, and maintain a viable industrial base.

(3) Both the Government and contractors *should* be concerned with profit as a motivator of efficient and effective contract performance. Negotiations aimed merely at reducing *prices* by reducing profit, without proper recognition of the function of profit, are not in the Government's interest. Negotiation of extremely low profits, use of historical averages, or automatic application of predetermined percentages to total estimated costs do not provide proper motivation for optimum contract performance.

(b) Policy.

(1) Structured approaches (see paragraph (d) of this subsection) for determining profit or fee prenegotiation objectives provide a discipline for ensuring that all relevant factors are considered. Subject to the authorities in 1.301(c), agencies making noncompetitive contract awards over $100,000 totaling $50 million or more ayear-

(i) *Shall* use a structured approach for determining the profit or fee objective in those *acquisitions* that require cost analysis; and

(ii) *May* prescribe specific exemptions for situations in which mandatory use of a structured approach would be clearly inappropriate.

(2) Agencies *may* use another agency's structured approach.

(c) *Contracting officer* responsibilities.

(1) When the *price* negotiation is not based on cost analysis, *contracting officers* are not required to analyze profit.

(2) When the *price* negotiation is based on cost analysis, *contracting officers* in agencies that have a structured approach *shall* use it to analyze profit. When not using a structured approach, *contracting officers shall* comply with paragraph (d)(1) of this subsection in developing profit or fee prenegotiation objectives.

(3) *Contracting officers shall* use the Government prenegotiation cost objective amounts as the basis for calculating the profit or fee prenegotiation objective. Before applying profit or fee factors, the *contracting officer shall* exclude from the pre-negotiation cost objective amounts the purchase cost of contractor-acquired property that is categorized as equipment, as defined in FAR 45.101, and where such equipment is to be charged directly to the contract. Before applying profit or fee factors, the *contracting officer shall* exclude any *facilities capital cost of money* included in the cost objective amounts. If the prospective contractor fails to identify or propose *facilities capital cost of money* in a proposal for a contract that will be subject to the cost principles for contracts with commercial organizations (see subpart 31.2), *facilities capital cost of money* will not be an allowable cost in any resulting contract (see 15.408(i)).

(4)

(i) The *contracting officer shall* not negotiate a *price* or fee that exceeds the following statutory limitations, imposed by 10 U.S.C. 3322(b) and 41 U.S.C. 3905:

(A) For experimental, developmental, or research work performed under a cost-plus-fixed-fee contract, the fee *shall* not exceed 15 percent of the contract's estimated cost, excluding fee.

(B) For *architect-engineer services* for public works or utilities, the contract *price* or the estimated cost and fee for production and delivery of designs, plans, drawings, and specifications *shall* not exceed 6 percent of the estimated cost of *construction* of the public work or utility, excluding fees.

(C) For other cost-plus-fixed-fee contracts, the fee *shall* not exceed 10 percent of the contract's estimated cost, excluding fee.

(ii) The *contracting officer*'s *signature* on the *price* negotiation memorandum or other documentation supporting determination of fair and reasonable *price* documents the *contracting officer*'s determination that the statutory *price* or fee limitations have not been exceeded.

(5) The *contracting officer shall* not require any prospective contractor to submit breakouts or supporting rationale for its profit or fee objective but *may* consider it, if it is submitted voluntarily.

(6) If a change or modification calls for essentially the same type and mix of work as the basic contract and is of relatively small dollar value compared to the total contract value, the *contracting officer may* use the basic contract's profit or fee rate as the prenegotiation objective for that change or modification.

(d) Profit-analysis factors-

(1) *Common factors*. Unless it is clearly inappropriate or not applicable, each factor outlined in paragraphs (d)(1)(i) through (vi) of this subsection *shall* be considered by agencies in developing their structured approaches and by *contracting officers* in analyzing profit, whether or not using a structured approach.

(i) *Contractor effort*. This factor measures the complexity of the work and the resources required of the prospective contractor for contract performance. Greater profit opportunity *should* be provided under contracts requiring a high degree of professional and managerial skill and to prospective contractors whose skills, facilities, and technical assets can be expected to lead to efficient and economical contract performance. The subfactors in paragraphs (d)(1)(i)(A) through (D) of this subsection *shall* be considered in determining contractor effort, but they *may* be modified in specific situations to accommodate differences in the categories used by prospective contractors for listing costs-

(A) *Material acquisition*. This subfactor measures the managerial and technical effort needed to obtain the required purchased parts and material, subcontracted items, and *special tooling*. Considerations include the complexity of the items required, the number of *purchase orders* and *subcontracts* to be awarded and administered, whether established sources are available or new or second sources *must* be developed, and whether material will be obtained through routine *purchase orders* or through complex *subcontracts* requiring detailed specifications. Profit consideration *should* correspond to the managerial and technical effort involved.

(B) *Conversion direct labor*. This subfactor measures the contribution of direct engineering, manufacturing, and other labor to converting the raw materials, data, and subcontracted items into the contract items. Considerations include the diversity of engineering, scientific, and manufacturing labor skills required and the amount and quality of supervision and coordination needed to perform the contract task.

(C) *Conversion-related indirect costs*. This subfactor measures how much the *indirect costs* contribute to contract performance. The labor elements in the allocable *indirect costs should* be given the profit consideration they would receive if treated as direct labor. The other elements of *indirect costs should* be evaluated to determine whether they merit only limited profit consideration because of their routine nature, or are elements that contribute significantly to the proposed contract.

(D) *General management*. This subfactor measures the prospective contractor's other *indirect costs* and *general and administrative (G&A) expense*, their composition, and how much they contribute to contract performance. Considerations include how labor in the overhead pools would be treated if it were direct labor, whether elements within the pools are routine expenses or instead are elements that contribute significantly to the proposed contract, and whether the elements require routine as opposed to unusual managerial effort and attention.

(ii) Contract cost risk.

(A) This factor measures the degree of cost responsibility and associated risk that the prospective contractor will assume as a result of the contract type contemplated and considering the reliability of the cost estimate in relation to the complexity and duration of the contract task. Determination of contract type *should* be closely related to the risks involved in timely, cost-effective, and efficient performance. This factor *should* compensate contractors proportionately for assuming greater cost risks.

(B) The contractor assumes the greatest cost risk in a closely priced firm-fixed-*price* contract under which it agrees to perform a complex undertaking on time and at a predetermined *price*. Some firm-fixed-*price* contracts *may* entail substantially less cost risk than others because, for example, the contract task is less complex or many of the contractor's costs are known at the time of *price* agreement, in which case the risk factor *should* be reduced accordingly. The contractor assumes the least cost risk in a cost-plus-fixed-fee level-of-effort contract, under which it is reimbursed those costs determined to be allocable and allowable, plus the fixed fee.

(C) In evaluating assumption of cost risk, *contracting officers shall*, except in unusual circumstances, treat time-and-materials, labor-hour, and firm-fixed-*price*, level-of-effort term contracts as cost-plus-fixed-fee contracts.

(iii) *Federal socioeconomic programs*. This factor measures the degree of support given by the prospective contractor to Federal socioeconomic programs, such as those involving small business concerns, small business concerns owned and controlled by socially and economically disadvantaged individuals, *women-owned small business concerns*, veteran-owned, *HUBZone*, service-disabled veteran-owned small business concerns, sheltered workshops for workers with disabilities, and energy conservation. Greater profit opportunity *should* be provided contractors that have displayed unusual initiative in these programs.

(iv) *Capital investments*. This factor takes into account the contribution of contractor investments to efficient and economical contract performance.

(v) *Cost-control and other past accomplishments*. This factor allows additional profit opportunities to a prospective contractor that has previously demonstrated its ability to perform similar tasks effectively and economically. In addition, consideration *should* be given to measures taken by the prospective contractor that result in productivity improvements, and other cost-reduction accomplishments that will benefit the Government in follow-on contracts.

(vi) *Independent development*. Under this factor, the contractor *may* be provided additional profit opportunities in recognition of independent development efforts relevant to the contract end item without Government assistance. The *contracting officer should* consider whether the development cost was recovered directly or indirectly from Government sources.

(2) *Additional factors*. In order to foster achievement of program objectives, each agency *may* include additional factors in its structured approach or take them into account in the profit analysis of individual contract actions.

Parent topic: 15.404 Proposal analysis.