

# Handout

## Developing Profit Objectives - Weighted Guidelines Method



### References:

- DCMA Pricing and Negotiation Instruction, April 2010
- FAR Subpart 15.4 – Contract Pricing
- FAR 15.404-4 – Profit
- DFARS 215.404-4 – Profit
- DFARS PGI 215.404-70, -71, -71-4 and -76.
- DFARS 253.215-70
- DFARS PGI 253.215.70

### Statutory Limitations - FAR 15.404-4(c)(4):

The contracting officer shall not negotiate a price or fee that exceeds the following statutory limitations, imposed by 10 U.S.C. 2306(d) and 41 U.S.C. 254(b):

(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. 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.



### Undefinitized Contract Actions (UCAs)

#### DFARS 217.7404-6 Allowable profit.

When the final price of a UCA is negotiated after a substantial portion of the required performance has been completed, the head of the contracting activity shall ensure the profit allowed reflects—

- (a) Any reduced cost risk to the contractor for costs incurred during contract performance before negotiation of the final price;
- (b) The contractor's reduced cost risk for costs incurred during performance of the remainder of the contract; and
- (c) The requirements at 215.404-71-3(d)(2). The risk assessment shall be documented in the contract file.



### Documentation

**FAR 15.406-3 (a)** The contracting officer shall document in the contract file the principal elements of the negotiated agreement. The documentation (e.g., price negotiation memorandum (PNM)) shall include the following:

- (10) The basis for the profit or fee prenegotiation objective and the profit or fee negotiated.

**DFARS 215.404-4(c)(2)(E): Contracting Officer Responsibilities:** Shall document the profit analysis in the contract file.

**DFARS 215.404-71-1(b):** In the price negotiation documentation, the contracting officer need not explain assignment of the normal value, but should address conditions that justify assignment of other than the normal value.

**DFARS PGI 215.406-3** Documenting the negotiation.

(a)(7) Include the principal factors related to the disposition of findings and recommendations contained in preaward and postaward contract audit and other advisory reports.

- (10) The documentation—

- (A) Must address significant deviations from the prenegotiation profit objective;
- (B) Should include the DD Form 1547, Record of Weighted Guidelines Application (see DFARS 215.404-70), if used, with supporting rationale; and
- (C) Must address the rationale for not using the weighted guidelines method when its use would otherwise be required by DFARS 215.404-70.



## DFARS 215.404-71-2 Performance Risk

*Description.* This profit factor addresses the contractor's degree of risk in fulfilling the contract requirements. The factor consists of two parts:

- (1) Technical--the technical uncertainties of performance.
- (2) Management/cost control--the degree of management effort necessary to ensure that contract requirements are met and
  - (ii) To reduce and control costs.

Standard. The standard designated range should apply to most contracts.

Technology incentive. For the technical factor only, contracting officers may use the technology incentive range for acquisitions that include development, production, or application of innovative new technologies.

The technology incentive range does not apply to efforts restricted to studies, analyses, or demonstrations that have a technical report as their primary deliverable. Refer to DFARS 215.404-71-2(d)(4).

Weighted Guidelines Values		
	Normal Value	Designated Range
<b>Standard</b>	<b>5%</b>	<b>3% to 7%</b>
<b>Technology Incentive</b>	<b>9%</b>	<b>7% to 11%</b>



### Evaluation criteria for technical.

Review the contract requirements and focus on the critical performance elements in the statement of work or specifications. Factors to consider include—

- Technology being applied or developed by the contractor;
- Technical complexity;
- Program maturity;
- Performance specifications and tolerances;
- Delivery schedule; and
- Extent of a warranty or guarantee.

Above normal conditions. The contracting officer may assign a higher than normal value in those cases where there is a substantial technical risk. Indicators are—

- Items are being manufactured using specifications with stringent tolerance limits;
- The efforts require highly skilled personnel or require the use of state-of-the-art machinery;
- The services and analytical efforts are extremely important to the Government and must be performed to exacting standards;
- The contractor's independent development and investment has reduced the Government's risk or cost;
- The contractor has accepted an accelerated delivery schedule to meet DoD requirements; or
- The contractor has assumed additional risk through warranty provisions. Extremely complex, vital efforts to overcome difficult technical obstacles that require personnel with exceptional abilities, experience, and professional credentials may justify a value significantly above normal. The following may justify a maximum value—
- Development or initial production of a new item, particularly if performance or quality specifications are tight; or
- A high degree of development or production concurrency.

Below normal conditions. The contracting officer may assign a lower than normal value in those cases where the technical risk is low. Indicators are—

- Requirements are relatively simple;
- Technology is not complex;
- Efforts do not require highly skilled personnel;
- Efforts are routine;
- Programs are mature; or
- Acquisition is a follow-on effort or a repetitive type acquisition. The contracting officer may assign a value significantly below normal for—
- Routine services;
- Production of simple items;
- Rote entry or routine integration of Government-furnished information; or
- Simple operations with Government-furnished property.

Evaluation criteria for management/cost control. The contracting officer should evaluate--

- The contractor's management and internal control systems using contracting office information and reviews made by field contract administration offices or other DoD field offices;
- The management involvement expected on the prospective contract action;
- The degree of cost mix as an indication of the types of resources applied and value added by the contractor;
- The contractor's support of Federal socioeconomic programs;
- The expected reliability of the contractor's cost estimates (including the contractor's cost estimating system);
- The adequacy of the contractor's management approach to controlling cost and schedule; and
- Any other factors that affect the contractor's ability to meet the cost targets (e.g., foreign currency exchange rates and inflation rates).

Above normal conditions. The contracting officer may assign a higher than normal value when there is a high degree of management effort. Indicators of this are—

- The contractor's value added is both considerable and reasonably difficult;
- The effort involves a high degree of integration or coordination;
- The contractor has a good record of past performance;
- The contractor has a substantial record of active participation in Federal socioeconomic programs;
- The contractor provides fully documented and reliable cost estimates;
- The contractor makes appropriate make-or-buy decisions; or
- The contractor has a proven record of cost tracking and control. The contracting officer may justify a maximum value when the effort—
- Requires large scale integration of the most complex nature;
- Involves major international activities with significant management coordination (e.g., offsets with foreign vendors); or
- Has critically important milestones.

Below normal conditions. The contracting officer may assign a lower than normal value when the management effort is minimal. Indicators of this are—

- The program is mature and many end item deliveries have been made;
- The contractor adds minimal value to an item;
- The efforts are routine and require minimal supervision;
- The contractor provides poor quality, untimely proposals;
- The contractor fails to provide an adequate analysis of subcontractor costs;
- The contractor does not cooperate in the evaluation and negotiation of the proposal;
- The contractor's cost estimating system is marginal;
- The contractor has made minimal effort to initiate cost reduction programs;
- The contractor's cost proposal is inadequate;
- The contractor has a record of cost overruns or another indication of unreliable cost estimates and lack of cost control; or
- The contractor has a poor record of past performance. The following may justify a value significantly below normal—
- Reviews performed by the field contract administration offices disclose unsatisfactory management and internal control systems (e.g., quality assurance, property control, safety, security); or
- The effort requires an unusually low degree of management involvement.

## DFARS 215.404-71-3 Contract type risk and working capital adjustment.

*Description.* The contract type risk factor focuses on the degree of cost risk accepted by the contractor under varying contract types. The working capital adjustment is an adjustment added to the profit objective for contract type risk. **It only applies to fixed-price contracts that provide for progress payments.** Though it uses a formula approach, it is not intended to be an exact calculation of the cost of working capital. Its purpose is to give general recognition to the contractor's cost of working capital under varying contract circumstances, financing policies, and the economic environment.

Contract Type	Notes	Normal Value	Designated Range
Firm-fixed-price, no financing	(1)	5%	4% to 6%
Firm-fixed-price, with performance-based payments	(6)	4%	2.5% to 5.5%
Firm-fixed-price, with progress payments	(2)	3%	2% to 4%
Fixed-price incentive, no financing	(1)	3%	2% to 4%
Fixed-price incentive, with performance-based payments	(6)	2%	0.5% to 3.5%
Fixed-price with redetermination provision	(3)		
Fixed-price incentive, with progress payments	(2)	1%	0 to 2%
Cost-plus-incentive-fee	(4)	1%	0 to 2%
Cost-plus-fixed-fee	(4)	0.5%	0 to 1%
Time-and-materials (including overhaul contracts priced on time-and-materials basis)	(5)	0.5%	0 to 1%
Labor-hour	(5)	0.5%	0 to 1%
Firm-fixed-price, level-of-effort	(5)	0.5%	0 to 1%

- (1) "No financing" means either that the contract does not provide progress payments or performance-based payments, or that the contract provides them only on a limited basis, such as financing of first articles. Do not compute a working capital adjustment.
- (2) When the contract contains provisions for progress payments, compute a working capital adjustment (Block 25).
- (3) For the purposes of assigning profit values, treat a fixed-price contract with redetermination provisions as if it were a fixed-price incentive contract with below normal conditions.
- (4) Cost-plus contracts shall not receive the working capital adjustment.
- (5) These types of contracts are considered cost-plus-fixed-fee contracts for the purposes of assigning profit values. They shall not receive the working capital adjustment in Block 25. However, they may receive higher than normal values within the designated range to the extent that portions of cost are fixed.
- (6) When the contract contains provisions for performance-based payments, do not compute a working capital adjustment.

### Evaluation criteria.

General. The contracting officer should consider elements that affect contract type risk such as—

- Length of contract;
- Adequacy of cost data for projections;
- Economic environment;
- Nature and extent of subcontracted activity;
- Protection provided to the contractor under contract provisions (e.g., economic price adjustment clauses);
- The ceilings and share lines contained in incentive provisions;
- Risks associated with contracts for foreign military sales (FMS) that are not funded by U.S. appropriations; and
- When the contract contains provisions for performance-based payments—
  - The frequency of payments;
  - The total amount of payments compared to the maximum allowable amount specified at FAR 32.1004(b)(2); and
  - The risk of the payment schedule to the contractor.



**Mandatory. The contracting officer shall assess the extent to which costs have been incurred prior to definitization of the contract action (also see 217.7404-6(a)). The assessment shall include any reduced contractor risk on both the contract before definitization and the remaining portion of the contract. When costs have been incurred prior to definitization, generally regard the contract type risk to be in the low end of the designated range. If a substantial portion of the costs have been incurred prior to definitization, the contracting officer may assign a value as low as 0 percent, regardless of contract type.**

**Above normal conditions.** The contracting officer may assign a higher than normal value when there is substantial contract type risk. Indicators of this are—

- Efforts where there is minimal cost history;
- Long-term contracts without provisions protecting the contractor, particularly when there is considerable economic uncertainty;
- Incentive provisions (e.g., cost and performance incentives) that place a high degree of risk on the contractor;
- FMS sales (other than those under DoD cooperative logistics support arrangements or those made from U.S. Government inventories or stocks) where the contractor can demonstrate that there are substantial risks above those normally present in DoD contracts for similar items; or
- An aggressive performance-based payment schedule that increases risk.

**Below normal conditions.** The contracting officer may assign a lower than normal value when the contract type risk is low. Indicators of this are—

- Very mature product line with extensive cost history;
- Relatively short-term contracts;
- Contractual provisions that substantially reduce the contractor's risk;
- Incentive provisions that place a low degree of risk on the contractor;
- Performance-based payments totaling the maximum allowable amount(s) specified at FAR 32.1004(b)(2); or
- A performance-based payment schedule that is routine with minimal risk.

**DFARS 215.404-71-3 Contract type risk and working capital adjustment - Continued**

*Description.* The contract type risk factor focuses on the degree of cost risk accepted by the contractor under varying contract types. The working capital adjustment is an adjustment added to the profit objective for contract type risk. **It only applies to fixed-price contracts that provide for progress payments.** Though it uses a formula approach, it is not intended to be an exact calculation of the cost of working capital. Its purpose is to give general recognition to the contractor's cost of working capital under varying contract circumstances, financing policies, and the economic environment.

**Working Capital Adjustment**

**Costs financed.**

- Costs financed equal total costs multiplied by the portion (percent) of costs financed by the contractor.
- Total costs equal Block 20 (i.e., all allowable costs excluding facilities capital cost of money), reduced as appropriate when—
  - The contractor has little cash investment (e.g., subcontractor progress payments liquidated late in period of performance);
  - Some costs are covered by special financing provisions, such as advance payments; or
  - The contract is multiyear and there are special funding arrangements.
- The portion that the contractor finances is generally the portion not covered by progress payments, i.e., 100 percent minus the customary progress payment rate (see FAR 32.501). For example, if a contractor receives progress payments at 80 percent, the portion that the contractor finances is 20 percent. On contracts that provide progress payments to small businesses, use the customary progress payment rate for large businesses.



**Contract length factor.**

- This is the period of time that the contractor has a working capital investment in the contract. It—
  - Is based on the time necessary for the contractor to complete the substantive portion of the work;
  - Is not necessarily the period of time between contract award and final delivery (or final payment), as periods of minimal effort should be excluded;
  - Should not include periods of performance contained in option provisions; and
  - Should not, for multiyear contracts, include periods of performance beyond that required to complete the initial program year's requirements.
- The contracting officer—
  - Should use the following table to select the contract length factor;
  - Should develop a weighted average contract length when the contract has multiple deliveries; and
  - May use sampling techniques provided they produce a representative result.

Example: A prospective contract has a performance period of 40 months with end items being delivered in the 34th, 36th, 38th, and 40th months of the contract. The average period is 37 months and the contract length factor is 1.15.

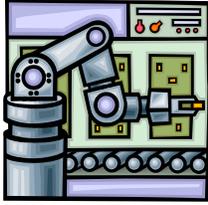
Period to Perform Substantive Portion (in months)	Contract Length Factor
21 or less	0.40
22 to 27	0.65
28 to 33	0.90
34 to 39	1.15
40 to 45	1.40
46 to 51	1.65
52 to 57	1.90
58 to 63	2.15
64 to 69	2.40
70 to 75	2.65
76 or more	2.90

**Interest Rate.**

Use the interest rate established by the Secretary of the Treasury (see [http://www.treasurydirect.gov/govt/rates/tcir/tcir\\_opdirsemi.htm](http://www.treasurydirect.gov/govt/rates/tcir/tcir_opdirsemi.htm)). Do not use any other interest rate. Although the Renegotiation Board is no longer in existence, other federal agencies are required to use interest rates computed under the criteria established by the Renegotiation Act of 1971 (P.L. 92-41). For example, the Contract Dispute Act of 1978 (P.L. 95-563) and the Prompt Payment Act (P.L. 97-177) provide for interest due on claims at a rate established by the Secretary of the Treasury pursuant to 31 U.S.C. § 3902(a). Note that the rate is issued semi-annually for the periods of January - June and July -December. Do not round published rate.

## DFARS 215.404-71-4 Facilities capital employed.

**Description.** This factor focuses on encouraging and rewarding capital investment in facilities that benefit DoD. It recognizes both the facilities capital that the contractor will employ in contract performance and the contractor's commitment to improving productivity.



Weighted Guidelines Values		
	Normal Value	Designated Range
Land	0%	N/A
Buildings	0%	N/A
Equipment	17.5%	10% to 25%



### Evaluation criteria.

In evaluating facilities capital employed, the contracting officer—

- Should relate the usefulness of the facilities capital to the goods or services being acquired under the prospective contract;
- Should analyze the productivity improvements and other anticipated industrial base enhancing benefits resulting from the facilities capital investment, including—
  - The economic value of the facilities capital, such as physical age, undepreciated value, idleness, and expected contribution to future defense needs; and
  - The contractor's level of investment in defense related facilities as compared with the portion of the contractor's total business that is derived from DoD; and
- Should consider any contractual provisions that reduce the contractor's risk of investment recovery, such as termination protection clauses and capital investment indemnification.

### Above normal conditions.

- The contracting officer may assign a higher than normal value if the facilities capital investment has direct, identifiable, and exceptional benefits. Indicators are—
  - New investments in state-of-the-art technology that reduce acquisition cost or yield other tangible benefits such as improved product quality or accelerated deliveries; or
  - Investments in new equipment for research and development applications.
- The contracting officer may assign a value significantly above normal when there are direct and measurable benefits in efficiency and significantly reduced acquisition costs on the effort being priced. Maximum values apply only to those cases where the benefits of the facilities capital investment are substantially above normal.

### Below normal conditions.

- The contracting officer may assign a lower than normal value if the facilities capital investment has little benefit to DoD. Indicators are—
  - Allocations of capital apply predominantly to commercial item lines;
  - Investments are for such things as furniture and fixtures, home or group level administrative offices, corporate aircraft and hangars, gymnasiums; or
  - Facilities are old or extensively idle.
- The contracting officer may assign a value significantly below normal when a significant portion of defense manufacturing is done in an environment characterized by outdated, inefficient, and labor-intensive capital equipment.

### Contract facilities capital estimates.

The contracting officer shall estimate the facilities capital cost of money and capital employed using—

- An analysis of the appropriate Forms CASB-CMF and cost of money factors (48 CFR 9904.414 and FAR 31.205-10); and
  - DD Form 1861, Contract Facilities Capital Cost of Money.
- Use the allocated facilities capital attributable to land, buildings, and equipment, as derived in DD Form 1861, Contract Facilities Capital Cost of Money.
- In addition to the net book value of facilities capital employed, consider facilities capital that is part of a formal investment plan if the contractor submits reasonable evidence that—
    - Achievable benefits to DoD will result from the investment; and
    - The benefits of the investment are included in the forward pricing structure.
  - If the value of intracompany transfers has been included in Block 20 at cost (i.e., excluding general and administrative (G&A) expenses and profit), add to the contractor's allocated facilities capital, the allocated facilities capital attributable to the buildings and equipment of those corporate divisions supplying the intracompany transfers. Do not make this addition if the value of intracompany transfers has been included in Block 20 at price (i.e., including G&A expenses and profit).

### **DFARS 215.404-71-5 Cost efficiency factor.**

This special factor provides an incentive for contractors to reduce costs. To the extent that the contractor can demonstrate cost reduction efforts that benefit the pending contract, the contracting officer may increase the prenegotiation profit objective by an amount not to exceed 4 percent of total objective cost (Block 20 of the DD Form 1547) to recognize these efforts (Block 29).

To determine if using this factor is appropriate, the contracting officer shall consider criteria, such as the following, to evaluate the benefit the contractor's cost reduction efforts will have on the pending contract:

- (1) The contractor's participation in Single Process Initiative improvements;
- (2) Actual cost reductions achieved on prior contracts;
- (3) Reduction or elimination of excess or idle facilities;
- (4) The contractor's cost reduction initiatives (e.g., competition advocacy programs, technical insertion programs, obsolete parts control programs, spare parts pricing reform, value engineering, outsourcing of functions such as information technology). Metrics developed by the contractor such as fully loaded labor hours (i.e., cost per labor hour, including all direct and indirect costs) or other productivity measures may provide the basis for assessing the effectiveness of the contractor's cost reduction initiatives over time;
- (5) The contractor's adoption of process improvements to reduce costs;
- (6) Subcontractor cost reduction efforts;
- (7) The contractor's effective incorporation of commercial items and processes; or
- (8) The contractor's investment in new facilities when such investments contribute to better asset utilization or improved productivity.

When selecting the percentage to use for this special factor, the contracting officer has maximum flexibility in determining the best way to evaluate the benefit the contractor's cost reduction efforts will have on the pending contract. However, the contracting officer shall consider the impact that quantity differences, learning, changes in scope, and economic factors such as inflation and deflation will have on cost reduction.



### **Reporting**

#### **PGI 215.404-76 Reporting profit and fee statistics.**

When the contracting officer delegates negotiation of a contract action that exceeds the cost or pricing data threshold to another agency (e.g., to an ACO), that agency must ensure that a copy of the DD Form 1547 is provided to the delegating office for reporting purposes within 30 days after negotiation of the contract action.

