

Weighted Guidelines

**Guiding Principles:**

It is in the Government's interest to offer contractors opportunities for financial rewards sufficient to stimulate efficient contract performance.

Both the Government and contractors should be concerned with profit as a motivator of efficient and effective contract performance.

[References: FAR 15.4, DEAR 915.4]

Overview

This section provides guidance for applying the Department's structured approach in determining profit/fee.

Background

The FAR requires consideration of certain factors (described in 15.404-4 as "profit-analysis factors" or "common factors") in developing a structured profit/fee approach. DOE's structured approach for determining profit/fee objectives is used in those acquisitions when the contracting officer is required to perform a cost analysis. This system provides a comprehensive approach for determining a fair profit or fee. It ensures consistent consideration of the relative value of the factors and provides a basis for documenting the contracting officer's fee/profit objective.

The attached Weighted Guidelines Application establishes the factors to be considered, the normal ranges for the values of those factors, and the analysis required in determining the appropriate value for each factor.

Weighted Guidelines Application

A. General. This section discusses the DEAR 915.404-4-70-2 profit objective factors and provides guidance on how to evaluate them.

The factors or subfactors relating to Contractor Effort, as shown at DEAR 915.404-4-70-2, Item I, are: similar to cost elements in most pricing proposals; broad and basic; and sufficient to evaluate all items of cost generally found in proposals.

In making a judgment of the value of each factor, the contracting officer recognizes the definition, description, and purpose of the factors and evaluates them as set forth herein.

B. Contractor effort. This factor measures how much the contractor is expected to contribute to the overall effort necessary to meet the contract performance requirements efficiently. This factor, which is apart from the contractor's basic responsibility for contract performance, takes into account what resources are necessary and what the contractor must do. This factor recognizes that, within a given performance output or sales dollar figure, necessary efforts of individual contractors can vary widely in both value and quantity, and that the profit objective reflects the extent and nature of the contractor's contribution to total performance. Evaluating this factor requires analyzing the cost content of the proposed contract as discussed below. Not to be included as part of the cost base (for purposes of computing profit) is any amount calculated for the cost of money for facilities capital computed in accordance with Cost Accounting Standard 414.

The following comprise the base elements for measuring contractor effort:

1. *Material acquisition.* Analysis of material acquisition cost items includes an evaluation of the managerial and technical effort necessary to obtain the required purchased parts, subcontracted items or services, and other materials, including consideration of the number of orders and supplies and whether established sources are available or new sources must be developed. In reviewing this element the contracting officer:

(a) Determines whether the contractor will obtain the material and tooling by routine orders from readily available suppliers (particularly orders of substantial value in relation to the total contract cost) or by subcontracts, and considers the extent to which the contractor must develop complex specifications involving creative design or close tolerance manufacturing requirements.

(b) Considers the managerial and technical efforts necessary for the prime contractor to administer subcontracts and select subcontractors, including efforts to break out sole source subcontractors through the introduction of competition. These determinations and considerations are made for purchases of raw materials or basic commodities, purchases of processed material, including all types of components of standard or near standard characteristics, and purchases of pieces, assemblies, subassemblies, special tooling, and other products special to the end item. The contracting officer recognizes that the contribution of the prime contractor to his purchasing program may be substantial. This may apply in the management of subcontracting programs involving many sources, new complex components and instrumentation, incomplete specifications, and close surveillance by the prime contractor.

(c) Evaluates recognized costs proposed as direct material costs, or proposed as material overhead costs, such as scrap charges, as material costs.

(d) Evaluates intra-company transfers which are accepted at price, in accordance with FAR 31.205-26(e), as material and evaluates other intra-company transfers by individual components of cost, i.e., material, labor, and overhead.

2. *Labor (technical and managerial, manufacturing, and support services)*. Analyses of labor cost include evaluation of the comparative quality and level of the talents, skills, and experience of personnel employed for contract performance. In reviewing this element:

(a) Technical and managerial labor are evaluated by giving consideration to the amount of notable scientific, unusual or scarce engineering, and top management talent needed in contrast to journeyman engineering effort, professional staff, or closely related supporting personnel. The diversity, or lack thereof, of scientific, engineering and managerial specialties required for contract performance and the corresponding need for related supervision and coordination are evaluated. By way of definition, project management/administration labor falling within this category includes senior project management personnel who oversee and direct the work, and usually consists of the project managers, project engineers, and comparable management personnel who form the project management team that plans, directs, and takes responsibility for the execution of the program or project assignment. The cost element for project management/administration labor usually applies to architect-engineer (A-E) contracts. The weight assigned takes into consideration the dollar amount of the project supervised.

(b) Manufacturing labor is evaluated by giving consideration to the variety and range of required manufacturing labor skills (i.e., department heads, supervisors, skilled and unskilled labor) and the contractor's manpower resources for meeting these requirements.

(c) Support services labor is evaluated in a manner similar to the above by assigning higher weights to professional-type skills and lower weights to semi-professional or other type skills required. Support services labor represents those classifications of direct labor whose efforts are not identifiable with the above descriptions of labor and may include labor classifications assigned exclusively for contract performance, such as on-site A-E firm employees performing project activities related to accounting, contract administration (including reporting), cost engineering, secretarial, clerical and the like. Direct charges of this nature are appropriately classified as direct rather than indirect, and like activities are not be allocated indirectly either to this contract or to the contractor's other work assignments. A weighting in excess of 9 percent for support service contract labor normally will be made only when the quality, skill, and experience of the support labor warrants a weighting corresponding to category (a) above.

3. *General management (overhead and general and administrative (G&A) but exclusive of IR&D costs)*.

(a) Analyzing overhead and G&A expenses includes evaluating their makeup and contribution to contract performance and a determination of the amount of labor within the expense pools and how it would be treated if it were considered as direct labor. The allocable labor elements are given the same profit consideration that they would receive if they were treated as direct labor. The other elements of these expense pools are evaluated to determine whether they are routine expenses (such as utilities, supplies, and maintenance) and hence given lesser profit consideration, or whether they contribute significantly to contract performance. Depreciation on facilities capital is excluded since the profit reward for facilities capital investment is separately weighted as discussed in paragraph D. below. The composite of the individual determinations in relation to the elements of the expense pools is the profit consideration given the pools as a whole. The procedure here differs from that used in the direct labor. The upper and lower limits assignable to the direct labor are absolute. For overhead expenses, individual expenses may be assigned values outside the range as long as the composite ratio is within the range.

(b) The contractor whose accounting system only reflects one overhead rate on all direct labor need not make changes to reflect more detail data (if CAS exempt) to correspond with the above classifications. The contracting officer can break out the applicable sections of the composite rate which can be classified as technical, managerial, or engineering overhead, manufacturing overhead, and general and administrative expenses and follow the appropriate evaluation technique.

(c) Management problems surface in various degrees and the management expertise exercised to solve them is considered as an element of profit. For example, a new program for an item that is on the cutting edge of the state of the art will cause more problems and require more managerial time and abilities of a higher order than a follow-on contract. If new contracts create more problems and require a higher profit consideration, follow-ons are adjusted downward as many of the problems may have been solved. An evaluation is made of the underlying managerial effort involved on a case-by-case basis.

(d) Where an analysis of the profit weight to be assigned to the overhead pool has been made, the weight to be assigned may be used for future contracts with the same contractor until there is a change in the cost composition of the overhead pool or the contract circumstances, or until the factors discussed in paragraph (3) above are relevant.

4. *Other direct costs (exclusive of CAS 414, Facilities Capital Cost of Money).* In evaluating this element:

(a) Proposals, particularly for research and development, often list as direct costs the kinds of expenses usually treated as indirect for other contracts. Examples are travel and subsistence, consultants, telephone, computer costs and reports reproduction. The accounting treatment of a cost category does not change the weight appropriate to the cost being evaluated.

(b) The weight ranges in the format cover the broad categories of direct material, labor, and G&A expenses. Although cost submissions may vary from the way shown in the format, all cost categories contained in submissions will fall under one of the broad groupings shown in the format. Because other direct costs are not direct material or direct labor, it follows that they will be considered as indirect costs for weighting purposes.

C. *Contract risk.* This factor reflects DOE policy that contractors bear an equitable share of cost risk and are compensated for it. Risk associated with costs to perform under a Government contract is usually minimal under cost-reimbursement-type contracts. In developing a prenegotiation profit or fee objective, the negotiating official considers the type of contract to be negotiated and the anticipated contractor cost risk.

Profit/Fee allowances for contractor assumption of cost risk require a determination of the degree of cost responsibility the contractor assumes and the reliability of cost estimates. This factor is specifically limited to the risk of costs of contract performance, including unallowable cost elements. It does not include contractor risks regarding reputation, losing a commercial market, losing potential profits in other fields, or any risk on the part of the contracting activity, such as the risk of not acquiring an effective product or service.

The first and basic determination of the degree of cost responsibility assumed by the contractor is related to the sharing of total cost risk by the Government and the contractor through the selection of contract type. The extremes are a cost-plus-fixed fee contract and a firm-fixed-price contract.

The second determination is that of the reliability of the cost estimates.

Contractors are likely to assume greater cost risk when contracting officers compensate them for it. Generally, a cost-plus-fixed-fee contract will not justify a reward for risk in excess of 0.5 percent, nor will a firm-fixed price contract justify a reward of less than the minimum on the following weighted guidelines. The reward for risk, by contract type, will usually fall into the following percentage ranges which are applied to total recognized contract costs, exclusive of facilities capital cost of money:

1. Type of contract and percentage ranges for profit objectives developed for equipment and supply contracts:

Cost-Plus-Fixed-Fee-0 to 0.5%

Cost-Plus-Incentive-Fee:

With Cost Incentives Only-1 to 2%

With Multiple Incentives-1.5 to 3%

Fixed-Price-Incentive:

With Cost Incentives Only-3 to 5%

With Multiple Incentives-4 to 6%

Prospective-Price-Redeterminable-4 to 6%

Firm-Fixed-Price-6 to 8%

2. Type of contract and percentage ranges for profit objectives developed for research and development contracts:

Cost-Plus-Fixed-Fee-0 to 0.5%

Cost-Plus-Incentive-Fee:

With Cost Incentives Only-1 to 2%

With Multiple Incentives-1.5 to 3%

Fixed-Price-Incentive:

With Cost Incentives Only-2 to 4%

With Multiple Incentives-3 to 5%

Prospective-Price-Redeterminable-3 to 5%

Firm-Fixed-Price-5 to 7%

3. Type of contract and percentage ranges for profit objectives developed for contracts for services:

Cost-Plus-Fixed-Fee-0 to 0.5%

Cost-Plus-Incentive-Fee-1 to 2%

Fixed-Price-Incentive-2 to 3%

Firm-Fixed-Price-3 to 4%

In selecting a weighting factor, the contracting officer considers that:

1. These ranges may not be appropriate for all acquisitions. For instance, a fixed-price-incentive contract that is closely priced with a low ceiling price and high incentive share may be tantamount to a firm fixed price contract. The converse is also true. A fixed-price incentive contract with a high ceiling and low share ratio can be very similar to a cost-

plus-incentive-fee contract. There are many permutations of this theme. A term in a cost-plus-incentive-fee contract that places unlimited negative fee adjustment risk on the contractor would create a contract similar to a fixed-price incentive contract.

2. The acquisition may not obviously fit a specific category shown. For example, effort under a particular A-E contract may better fall into the category of R&D, rather than services. Judgment is required, therefore, in establishing the category and weights to be applied in each case.

3. The contractor's subcontracting program may have a significant impact on the contractor's acceptance of risk under a contract form. It can cause risk to increase or decrease in terms of both cost and performance. This consideration is a part of the contracting officer's overall evaluation in selecting a factor to apply for cost risk. Subcontractors sometimes accept significant cost risk usually borne by the prime contractor. When this occurs, it may be appropriate to assign a percentage for contract risk below the low end of the range specified for the contract type. An example would be where a follow-on production contract has a substantial part of its costs falling on a subcontractor that accepts most of the incentive and penalty for cost performance. The mere presence of large subcontracts, however, does not imply the contract risk percentage should be lower than normal. The determinative factor is substantial transfer of the prime contractor's risk. The Department does not want to discourage appropriate subcontracting.

4. In evaluating cost risk in definitizing a letter contract, an unpriced change order, or an unpriced order under a basic ordering agreement, the effect on total contract cost risk as a result of partial performance is considered, but it can not be assumed that partial performance results in the contractor's cost risk being substantially reduced. The contract risk factor is applied to all costs, both incurred and estimated to be incurred, so determining the appropriate percentage for the factor entails considering all of the circumstances related to the total costs, not a portion of them.

5. Time and material, labor hour, and overhaul contracts priced on a time and material basis are considered to be cost-plus-fixed-fee contracts for the purpose of establishing a profit weight in the evaluation of the contractor's assumption of contract cost risk.

D. Capital investment (facilities). This element recognizes the investment risk associated with the facilities employed by the contractor. Measurement of the amount of facilities capital employed is discussed in FAR 30.414. Five to twenty percent of the net book value of facilities capital allocated to the contract is the normal range. The key factors that the contracting officer considers are:

1. The overall cost effectiveness of the facilities employed.
2. Whether the facilities are general purpose or special purpose items.
3. The age of the facilities.

4. The relationship of the remaining write-off life of the investment and the length of the program(s) or contract(s) on which the facilities are employed.

5. Special contract provisions that reduce the contractor's risk of recovery of facilities capital investment (termination-protection clauses, multi year cancellation ceilings, etc.).

The contracting officer requests the contractor to submit reasonable evidence that the new facilities are part of an approved investment plan and that benefits to the Government will result. New industrial facilities and equipment receive maximum weight when they:

1. Are to be acquired primarily for Government and energy related business and effort.
2. Have a long service life.
3. Have a limited economic life due to limited alternative uses.
4. Reduce the total life cycle cost of the products produced for, or services to, the Department of Energy.

If the new investment represents routine replacement of existing assets, a lesser weight is assigned.

E. *Independent research and development.* This factor rewards contractors in two ways:

1. As a reward for the contractor's investment in a viable independent research and development program, considering, among other things, the program's quality, scope, and resources employed. The normal weight range for this factor is from 5 to 7 percent of allowable IR&D costs allocable to the prospective contract.
2. As a reward for contractors who assume the extra risk of developing items with energy program applications on their own initiative with no direct Government assistance and little or no indirect Government assistance. Profit weights in the range of 0 to 20 percent of the basic profit dollars (total of profit dollars for DEAR 915.404-4-70-2, items I.A. through I.E.) are normal for this factor. The weight selection is based on the amount of assistance provided by the Government through independent research and/or development expense allowance under previous Government contracts and the extent the contractor already has been compensated for independent development through prior sales of the identical item to the Government.

F. *Participation in special programs.* A composite percentage weight within the range of -5 percent to +5 percent of the basic profit objective (total of profit dollars for DEAR 915.404-4-70-2, items I.A. through I.E.) is assigned. This profit factor, which applies to special circumstances as well as a particular acquisition, relates to rewards of outstanding achievement in contractor participation in the Government's small business, small disadvantaged business, women-owned small business concerns, labor surplus, energy conservation and other special programs. Participation that is rated as merely satisfactory is assigned a weight of zero, generally. Evidence of effective support may justify a plus weight and poor support a negative weight.

The contracting officer:

1. Gives favorable consideration to the contractor's policies and procedures that effectively support Government small business and small disadvantaged business subcontracting programs. Any unusual effort that the contractor displays in subcontracting with these concerns, particularly for development-type work likely to result in later production opportunities, and the overall effectiveness of the contractor in subcontracting with, and furnishing assistance to, such concerns is considered. Conversely, failure or unwillingness on the part of the contractor to support these Government policies is viewed as evidence of poor performance.
2. Makes a similar review and evaluation of the contractor's policies and procedures supporting the Government's labor surplus area program. In particular, favorable consideration is given to a contractor who: makes a significant effort to help find jobs and provide training for the hardcore unemployed; or promotes maximum subcontractor utilization of certified eligible concerns.

Gives favorable consideration to the contractor's initiatives and accomplishments in the conservation of energy and in carrying out any other special Government programs.

G. Other considerations. Particular situations may justify consideration of a profit allowance in addition to those specifically identified elsewhere in the guidelines. These situations are identified and the reason(s) for their use documented in the price negotiation memorandum. An assigned weight of -5 to +5 percent of the basic profit objective is the normal range for this profit factor. A zero weight designates a satisfactory or average effort.

Examples of "other considerations" are described in the following subparagraphs.

1. *Cost-control and other past accomplishments.* This factor benefits a prospective contractor that has previously performed similar tasks effectively and economically. In addition, consideration is given to: measures taken by the prospective contractor that result in productivity improvements; and other cost-reduction accomplishments that will benefit Government contracts. Among other things, consideration is given to the contractor's efforts to explore additional production opportunities or to improve or develop new product, manufacturing, or performance technologies to reduce production cost.

2. *Complexity of R&D or services assignment.* This factor applies when a contract, such as an A-E contract, relates to a DOE project facility. The following complexity categories are used to establish the appropriate fee weight:

(a) *Class A*-Manufacturing plants involving continuous closed processes or other complicated operations requiring a high degree of design layout or process control, nuclear reactors, atomic particle accelerators; complex laboratories or industrial units especially designed for processing, testing or handling highly radioactive materials; facilities to be used for research, development, experimental or demonstration purposes which involve advance or unique design considerations that are peculiar to the purposes for which the facility is built.

(b) *Class B*-Normal manufacturing processes and assembly operations such as ore dressing, metal working plants and simple processing plants; power plants and accessory switching and transformer stations; water treatment plants; sewage disposal plants; hospitals and ordinary laboratories.

(c) *Class C*-Permanent administrative and general service buildings, permanent housing, roads, railroads, grading, sewers, storm drains and water and power distribution systems.

(d) *Class D*-Construction camps and facilities and other construction of a temporary nature.

3. *Operating capital.* This factor includes consideration of the level of the contractor's operating or working capital investment required for effective contract performance. This level will vary, depending on such circumstances as: the nature of the work and duration of the contract; contract type and dollar magnitude; the reimbursement or progress payment rate; the contractor's financial management practices; and the frequency of and

time lag between billings and Government payments. When the contractor will invest relatively few dollars for operating capital purposes (because of cost reimbursement and progress payment rates, or when an advance payment method (such as a letter of credit) is used to finance the contractor), a negative adjustment may be appropriate.

H. *Productivity/Performance adjustment for follow-on contracts.* One objective of DOE profit policy is to reduce costs needed to achieve national energy goals by encouraging contractor investment in modern cost-reducing facilities and other improvements in efficiency and performance. If costs serve as the basis for pricing (both cost and profit), success in reducing costs can reduce profit dollars on follow-on contracts. For example, a cost-plus-award-fee contract may be awarded as the first of two or more contracts. The incentive to increase productivity or performance and reduce cost under the first contract works against the contractor on any follow-on contracts because the reduced level of costs becomes a part of the basis for pricing subsequent contracts. In order to mitigate the relative loss of prospective profit dollars on a follow-on contract that occurs when costs are reduced under the predecessor contract or contracts due to productivity or performance gains, a special "Productivity/Performance Reward" may be included in the prenegotiation profit objective of a pending follow-on acquisition under certain circumstances.

The "Productivity/Performance Reward" may be applied when all of the following criteria are met:

1. The pending acquisition is for a follow-on contract.
2. Reliable actual cost data relating to the predecessor contract or contracts is available.

Changes made in the configuration of the item being acquired or in the technical aspects of the services being performed are not likely to invalidate price comparability.

The amount of productivity or performance reward for a given follow-on contract is based on the estimated cost reduction on the predecessor contract or contracts that can be attributed to productivity or performance gains. Set forth below are principles and procedures that apply to estimating cost reductions and calculating the productivity or performance reward:

1. The contractor prepares and supports the cost reduction estimate.
2. The overall contract cost decrease is based on estimated decreases measured at the unit cost level, or equivalent.
3. The lowest average unit cost or its equivalent (exclusive of profit) for a preceding performance period or production run serves as the unit cost baseline.

4. A technique is employed to determine that portion of the cost decrease attributable to productivity or performance gains as opposed to other factors such as the effects of quality differences between the base contract and the pending acquisition.
5. When the parties agree that the estimated overall contract cost decrease is materially affected by price level differences between the base period and the current point in time, an economic price adjustment may be applied to the estimate.
6. The reward is calculated by multiplying the contract cost decrease due to productivity/performance gains by the base profit objective rate.
7. The degree of review and validation of the data supporting the reward calculation is commensurate with the materiality of this profit element in relation to the overall price objective.

There may be several methods advanced, by both contracting officers and contractors, to quantify productivity/performance gains. Any technique may be acceptable, provided it equitably takes into account the principles and procedures listed above.