

Ch 11 - Analyzing Profit or Fee

- 11.0 - [Chapter Introduction](#)
- 11.1 - [The Factors Affecting Profit/Fee Analysis](#)
 - 11.1.1 - [Identifying The Need For An Agency Structured Approach](#)
 - 11.1.2 - [Considering Contractor Profit Motivation](#)
 - 11.1.3 - [Identifying Factors To Consider](#)
- 11.2 - [Developing An Objective Using The DoD Weighted Guidelines](#)
 - 11.2.1 - [Applying The DoD Weighted Guidelines](#)
 - 11.2.2 - [Identifying Exempted Contract Actions](#)

11.0 Chapter Introduction

This chapter identifies points that you should consider as you analyze contract profit/fee.

Requirement for Profit/Fee Analysis ([FAR 15.404-4\(b\)](#)). Profit/fee is the dollar amount over and above allowable costs that is paid to the firm for contract performance.

Most contract prices include either profit or fee, but contract profit/fee analysis is not required unless cost analysis is required to determine contract price reasonableness. When cost or pricing data are required, you must use profit/fee analysis to determine the reasonableness of any profit/fee included in the contract price. When cost information other than cost or pricing data are required, you may need to use profit/fee analysis to determine the reasonableness of any profit/fee included in the contract price.

Actual Profit/Fee May Vary ([FAR 15.404-4\(a\)\(1\)](#)). As you perform your profit/fee analysis, remember that (just as actual costs may vary from estimated costs) the contractor's actual realized profit/fee may vary from negotiated profit/fee, because of such factors as:

- Contract performance efficiency;
 - Incurrence of unallowable costs; and
 - Contract type.
-

11.1 Factors Affecting Profit/Fee Analysis

This section presents the general factors that you must consider when analyzing profit/fee as part of a contract cost analysis.

- 11.1.1 - [Identifying The Need For An Agency Structured Approach](#)
 - 11.1.2 - [Considering Contractor Profit Motivation](#)
 - 11.1.3 - [Identifying Factors To Consider](#)
-

11.1.1 Identifying The Need For An Agency Structured Approach

Each Agency Must Use a Structured Approach ([FAR 15.404-4\(b\)](#)). FAR only prescribes the factors that must be considered in establishing the profit/fee objective. It does not prescribe specific Government-wide procedures for profit/fee analysis.

Each agency making noncompetitive contract awards over \$100,000 that total \$50 million or more each year, must use a structured approach for determining the profit/fee prenegotiation objectives in those acquisitions that require cost analysis. An agency may develop its own structured approach, or use another agency's structured approach if that approach will meet its needs.

Exemptions May Be Authorized Where Approach Is Inappropriate ([FAR 15.404-4\(b\)](#) and [15.404-4\(c\)](#)). Agencies may exempt certain types of contract actions from the application of the agency's structured approach to profit/fee analysis. However, even in situations exempted from application of your agency's structured approach, you must follow the general FAR requirements for profit/fee objective development.

Examine your agency's guidelines to determine what specific exemptions apply.

11.1.2 Considering Contractor Profit Motivation

Underlying Assumption ([FAR 15.404-4\(a\)](#)). The underlying assumption behind Government structured approaches to profit/fee analysis is the belief that contractors are motivated by profit/fee. Structured approaches provide a discipline for ensuring that all relevant factors are considered in developing Government profit/fee negotiation objectives.

Profit/Fee Analysis Goals ([FAR 15.404-4\(a\)\(2\)](#)). It is in the Government's best interest to offer contractor's 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 to meet public needs.

Inconsistent Practices Regarding Profit/Fee Reward ([FAR 15.404-4\(a\)\(3\)](#)). If the Government is to use profit/fee to motivate contractor performance and achieve the above goals, practices primarily intended to reduce profit/fee or diminish the impact of profit/fee analysis are not in the Government's best interest. The following are practices that are inconsistent with Government profit/fee goals:

- Negotiations aimed at reducing prices by reducing profit/fee without proper consideration of the profit function.
- Negotiation of extremely low profits/fees.
- Use of historical average profit/fee rates without regard to the unique circumstances of the immediate negotiation.
- Automatically applying predetermined profit/fee percentages without regard to the unique circumstances of the immediate negotiation.

Profit/Fee Ceiling ([FAR 15.404-4\(a\)\(3\)](#) and [15.404-4\(c\)\(4\)](#)). Profit/fee calculations must consider the unique circumstances of the immediate negotiation. However, contract fee cannot exceed statutory limits that apply to cost-plus-fixed-fee contracts as identified in the following table:

Statutory Limits On Contract Fee	
Type of Contract	Statutory Fee Limitation

Experimental, developmental, or research work performed under a cost-plus-fixed-fee contract	15% of estimated contract cost
All other cost-plus-fixed-fee contracts	10% of estimated contract cost

11.1.3 Identifying Factors To Consider

Factors That Must Be Considered ([FAR 15.404-4\(d\)](#)). While each agency is responsible for developing its own structured approach, the FAR stipulates factors that must be considered unless they are clearly inappropriate or not applicable.

Profit/Fee Factor	Provide greater profit/fee opportunity to contractors who:	As you develop your profit/fee objective consider:
Contractor Effort (i.e. complexity of the work and resources required for contract performance)	Undertake contracts requiring a high degree of professional and managerial skill and whose skills, facilities, and technical assets can be expected to lead to efficient contract performance.	Material acquisition -- managerial and technical effort necessary to obtain materials, given the: <ul style="list-style-type: none"> • Complexity of items required; • Number of purchase orders/subcontracts awarded and administered; • Need for source development; and • Complexity of purchase orders/subcontracts.
		Conversion Direct Labor contribution to contract performance, given the: <ul style="list-style-type: none"> • Diversity of labor

		<p>types required; and</p> <ul style="list-style-type: none"> • Amount and quality of supervision and coordination needed.
		<p>Conversion-Related Indirect Cost contribution to contract performance:</p> <ul style="list-style-type: none"> • Give indirect labor the same profit/fee consideration as direct labor. • Evaluate other indirect costs on complexity and contribution to contract performance.
		<p>General Management composition and contribution to contract performance:</p> <ul style="list-style-type: none"> • Give indirect labor the same profit/fee weight as comparable direct labor. • Evaluate management effort on complexity and involvement required. • Evaluate other cost elements on contribution to contract performance.
Cost Risk	Assume a proportionately	Contractor cost responsibility and

	greater degree of cost responsibility and associated risk.	associated risk as a result of: <ul style="list-style-type: none"> • Contract type; and • Reliability of the cost estimate in relation to the complexity and duration of the contract task.
Federal Socioeconomic Programs	Have displayed unusual initiative in support of socioeconomic programs.	Contractor support of programs for: <ul style="list-style-type: none"> • Small businesses; • Small businesses owned and controlled by socially and economically disadvantaged individuals; • Woman-owned small businesses; • Handicapped sheltered workshops; and • Energy conservation.
Capital Investments	Have made investments that will facilitate efficient and economical contract performance.	<ul style="list-style-type: none"> • Contractor investment amount; and • Effect of investment on efficient and economical contract performance.
Cost Control and Other Past Accomplishments	Have demonstrated an ability to perform similar tasks effectively and economically.	Contractor has: <ul style="list-style-type: none"> • Demonstrated ability to perform similar tasks effectively and economically;

		<ul style="list-style-type: none"> • Adopted measures to improve productivity; and • Other cost-reduction accomplishments that will benefit the Government in follow-on contracts.
Independent Development	Have undertaken relevant independent development without Government assistance.	<ul style="list-style-type: none"> • Independent development efforts relevant to the contract end item; and • Contractor's direct or indirect cost recovery from the Government.
Additional Factors	Actively support agency program objectives.	Any additional factors prescribed by your agency for this purpose.

Other Profit/Fee Considerations ([FAR 15.404-4\(c\)](#)). The factors identified above form the basis for agency structured approaches to profit/fee analysis. There are two other elements that you must consider when developing Government profit/fee objectives.

- **Eliminate Facilities Capital Cost of Money from the Profit/ Fee Base.** FAR requires that you base profit/fee prenegotiation objectives on the prenegotiation cost objectives. However, you must exclude any dollar amount for facilities cost of capital before applying profit/fee factors.
- **Consider Basic Contract Profit/Fee for Contract Modifications.** FAR requires that you consider profit/fee objectives based exclusively on the contract action being negotiated. The only exception is the negotiation of contract change or modification.
 - When you negotiate contract modifications, you may use the basic-contract profit/fee rate as

your negotiation objective rate if both of the following conditions are met:

- The contract modification is for the **same type and mix of work** as the basic contract.
 - The modification is of **relatively small dollar value** compared to the total contract.
- If the contract modification does not meet both of the above conditions, perform a profit/fee analysis to establish the appropriate profit/fee objective.

11.2 Developing An Objective Using The DoD Weighted Guidelines

This section covers the DoD structured approach to profit/fee analysis -- the Weighted Guidelines.

- 11.2.1 - [Applying The DoD Weighted Guidelines](#)
- 11.2.2 - [Identifying Exempted Contract Actions](#)

11.2.1 Applying The DoD Weighted Guidelines

Different Approaches for Different Products ([DFARS 215.404-4\(b\)](#), [215.404-71-2\(c\)](#), and [215.404-71-4\(c\)](#)). DoD contracting officers must use the weighted guidelines method for profit/fee analysis unless use of the modified weighted guidelines method or an alternate structured method is appropriate. The weighted guidelines define a structure for profit/fee analysis that includes designated ranges for objective values as well as norm values that you may tailor to fit the circumstances of your specific acquisition.

Examining the Weighted Guidelines Form The DD Form 1547 (available in [Adobe Acrobat \(PDF\) format](#)), Record of Weighted Guidelines Application, depicted below, provides the structure for DoD profit/fee analysis and reporting.

RECORD OF WEIGHTED GUIDELINES APPLICATION		REPORT CONTROL SYMBOL DD-A&T(Q)1751	
1. REPORT	2. BASIC PROCUREMENT INSTRUMENT IDENTIFICATION NO.	3. SPIIN	4. DATE OF ACTION

NO.	a. PURCHASING OFFICE	b. FY	c. TYPE PROC INST CODE	d. PRISN		a. YEAR	b. MONTH
5.	CONTRACTING OFFICE CODE		ITEM	COST CATEGORY		OBJECTIVE	
6.	NAME OF CONTRACTOR		13.	MATERIAL			
			14.	SUBCONTRACTS			
7.	DUNS NUMBER	8. FEDERAL SUPPLY CODE		15.	DIRECT LABOR		
				16.	INDIRECT EXPENSES		
9.	DOD CLAIMANT PROGRAM	10. CONTRACT TYPE CODE		17.	OTHER DIRECT CHARGES		
				18.	SUBTOTAL COSTS (13 thru 17)		
11.	TYPE EFFORT	12. USE CODE		19.	GENERAL AND ADMINISTRATIVE		
				20.	TOTAL COSTS (18+19)		
			WEIGHTED GUIDELINES PROFIT FACTORS				
ITEM	CONTRACTOR RISK FACTORS	ASSIGNED WEIGHTING	ASSIGNED VALUE	BASE (ITEM 20)		PROFIT OBJECTIVE	
21.	TECHNICAL	%					
22.	MANAGEMENT/COST CONTROL	%					
23.	PERFORMANCE RISK (COMPOSITE)						
24.	CONTRACT TYPE RISK						
25.	WORKING CAPITAL	Costs Financed	Length Factor	Interest Rate			
				%			
	CONTRACTOR FACILITIES CAPITAL EMPLOYED		ASSIGNED VALUE	AMOUNT EMPLOYED			
26.	LAND						
27.	BUILDINGS						
28.	EQUIPMENT						
29.	COST EFFICIENCY FACTOR		ASSIGNED VALUE	BASE (Item 20)			
30.	TOTAL PROFIT OBJECTIVE						
			NEGOTIATED SUMMARY				
			PROPOSED	OBJECTIVE		NEGOTIATED	
31.	TOTAL COSTS						
32.	FACILITIES CAPITAL COST OF MONEY (DD FORM 1861)						

33.	PROFIT			
34.	TOTAL PRICE (Line 31 + 32 + 33)			
35.	MARKUP RATE (Line 32 + 33 divided by 31)		%	%
		CONTRACTING OFFICER APPROVAL		
36.	TYPED/PRINTED NAME OF CONTRACTING OFFICER (Last, First, Middle Initial)	37.	SIGNATURE OF CONTRACTING OFFICER	38. TELEPHONE NO.
				39. DATE SUBMITTED (YYYYMMDD)
		OPTIONAL USE		
96.	97.	98.	99.	

DD FORM 1547, JUL 2002
IS OBSOLETE.

PREVIOUS EDITION

The DD Form 1547 provides an excellent guide for review of the DoD weighted guidelines approach to profit/fee analysis. For the review, we will divide the DD Form 1547 into the 10 parts identified in the table below:

Dividing the DD Form 1547 for Analysis		
Part	Description	DD Form 1547 Item Numbers
1	Acquisition Identification Information	1 - 12
2	Cost Objective by Cost Category	13 - 20
3	Performance Risk	21 - 23
4	Contract Type Risk	24
5	Working Capital Adjustment	25
6	Facilities Capital Employed	26 - 28
7	Cost Efficiency Factor	29
8	Total Profit/Fee Objective	30
9	Negotiation Summary	31 - 35
10	Contracting Officer Approval	36 - 39

Acquisition Identification Information. Items 1-12 of the form define DoD requirements for basic acquisition information related to the profit/fee analysis including information about: the contractor, the contracting office, and the contract itself. The form requirements in this area are not considered in this chapter.

Cost Objective by Cost Category. Items 13-20 of the form detail the Government's prenegotiation objectives (less any facilities capital cost of money) by cost category. This information serves as the base for several of the profit/fee calculations made during analysis.

- Be sure to exclude any facilities capital cost of money included in your cost objective from this portion of the DD Form 1547.
- Item 19 must include General and Administrative (G&A) expenses and all Independent Research and Development (IR&D)/Bid and Proposal (B&P) expenses.

The cost information in the table below is taken from the DD Form 1861 in Chapter 10.

Cost Objective Information by Cost Category		
DD Form 1547 Item Numbers	Cost Category	Objective
13	Material	\$90,000
14	Subcontracts	-0-
15	Direct Labor	\$224,000
16	Indirect Expenses	\$364,000
17	Other Direct Charges	\$22,000
18	Subtotal Costs (13 thru 17)	\$700,000
19	General and Administrative	\$42,000
20	Total Costs (18 + 19)	\$742,000

Performance Risk Profit/Fee Analysis ([DFARS 215.404-71-2](#)). Items 21-23 of the form are designed to reward contractors who undertake contracts with more performance risk. To analyze performance risk, you must evaluate risk associated with fulfilling contract requirements. For profit/fee analysis, performance risk is subdivided into two types: technical and management/cost-control. The following table

outlines factors that you should consider as you analyze each type of risk.

Factors for Performance Risk Analysis	
Risk Type	Examples of Factors To Be Considered
Technical	<ul style="list-style-type: none"> • Technology being applied or developed by the contractor • Technical complexity • Program maturity • Performance specifications and tolerances • Delivery schedule • Extent of warranty or guarantee
Management/Cost Control	<ul style="list-style-type: none"> • Contractor's management and internal control systems • Management involvement expected under the contract • Resources applied and value added by the contractor • Contractor support for Federal socioeconomic programs • Expected reliability of cost estimates • Adequacy of management's approach to controlling cost and schedule • Other factors affecting contractor's ability to meet cost targets

- **Performance Risk Importance Weight.** In the "Assigned Weighting" column of the DD Form 1547, weight the two elements of performance risk, considering each element's relative importance to proposed contract performance. The total of the weights must always equal 100 percent.

Example 1: For a development contract, you might assign the following weights:

Technical	65 %
Management/Cost Control	35 %
	100 %

Example 2: For a production contract, you might assign the following weights:

Technical	20 %
Management/Cost Control	80 %
	100 %

Performance Risk Profit/Fee Value. The column marked "Assigned Value" permits you to assign a profit/fee value based on the level of risk associated with the elements of performance risk. The range of values that you can assign depends on the acquisition situation.

- **Standard Value Range:** The standard designated range applies to most contracts and is used for both technical risk and management/cost control risk. The designated value range is 3% to 7% with a normal value of 5%. Evaluation criteria for technical risk appear in [Table 11-1](#) below. Evaluation criteria for management/cost control risk appear in [Table 11-3](#) below.
- **Technology Incentive Range:** Contracting officers may apply this range **to the technical factor only** when an acquisition includes development, production, or application of innovative new technologies. This range may not be used for acquisitions restricted to studies, analyses, or demonstrations that have a technical report as their primary deliverable. Evaluation criteria for the technology incentive range appear in [Table 11-2](#) below.

Table 11-1. Assigning a Profit/Fee Value for Technical

Risk	
Consider .	When .
Maximum Value	<ul style="list-style-type: none"> • Contract effort requires development or initial production of a new item, particularly if performance or quality specifications are tight; or • Contract effort requires a high degree of development or production concurrency.
Significantly Above Normal Value	<ul style="list-style-type: none"> • Contract effort involves extremely complex, vital efforts to overcome difficult technical obstacles which require personnel with exceptional abilities, experience, and professional credentials.
Above Normal Value	<ul style="list-style-type: none"> • The contractor is either developing or applying advanced technologies; • Items are being manufactured using specifications with stringent tolerance limits; • Contract effort requires highly skilled personnel or the use of state-of-the-art machinery; • 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 and accelerated delivery schedule to meet DoD requirements; or • The contractor has assumed additional risk through warranty provisions.
Below Normal Value	<ul style="list-style-type: none"> • Contract is for off-the-shelf items; • Requirements are relatively simple; • Technology is not complex; • Contract efforts do not require highly skilled personnel; • Contract efforts are routine; • Programs are mature; or • Contract is a follow-on effort or

	repetitive-type acquisition.
Significantly Below Normal Weight	<ul style="list-style-type: none"> • Contract is for routine services; • Contract is for production of simple items; • Contract is for rote entry of Government furnished information; or • Contract is for simple operations with GFP.

Table 11-2. Assigning a Profit/Fee Value for Technical Risk Using the Technology Incentive Range	
The contracting officer should use the technology incentive range only for the most innovative contract efforts.	
Innovation may be in the form of	<ul style="list-style-type: none"> • Development or application of new technology that fundamentally changes the characteristics of an existing product or system and that results in increased technical performance, improved reliability, or reduced costs; or • New products or systems that contain significant technological advances over the products or systems they are replacing.
After deciding that use of the technology incentive range is appropriate, the contracting officer should consider the relative value of the proposed innovation to the acquisition as a whole. Generally use the normal value of 9%. However	
Consider using values less than the norm when:	The innovation represents a minor benefit.
Consider using values above the norm when:	The innovation will have a major positive impact on the product or program.

Table 11-3. Assigning a Profit/Fee Value for Management/Cost Control Risk

Consider .	When .
Maximum Weight	<ul style="list-style-type: none"> • Contract effort requires large scale integration of the most complex nature; • Contract effort involves major international activities with significant management coordination (e.g., offsets with foreign vendors); or • Contract effort has critically important milestones.
Above Normal Weight	<ul style="list-style-type: none"> • The contractor's value-added is both considerable and reasonably difficult; • Contract 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.
Below Normal Weight	<ul style="list-style-type: none"> • The program is mature and many end item deliveries have been made; • The contractor adds minimum value to an item; • Contract effort is routine and requires minimal supervision; • The contractor provides poor quality, untimely proposals; • The contractor fails to provide an adequate analysis of subcontractor costs; or • The contractor does not cooperate in the evaluation and negotiation of the proposal; • The contractor's cost estimating

	<p>system is marginal;</p> <ul style="list-style-type: none"> • 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 other indication of unreliable cost estimates and lack of cost control; or • The contractor has a poor record of past performance.
Significantly Below Normal Weight	<ul style="list-style-type: none"> • Reviews performed by the field contract administration offices disclose unsatisfactory management and internal control systems (e.g., quality assurance, property control, safety, security); or • Contract effort requires an unusually low degree of management involvement.

- **Calculate Composite Performance Risk Value.** The "Performance Risk (Composite) Assigned Value" (Item 23), is the weighted average -- calculated using the weight assigned and the value assigned to the two types of performance risk. For example, the following calculations depict weighted value calculation:

	Weight Assigned	Value Assigned	Weighted Value
Technical	40%	4.5%	1.8%
Management/Cost Control	60%	4.0%	<u>2.4%</u>
Composite Value			4.2%

- **Identify Performance Risk Profit/Fee Base.** Enter the value from Item 20 as the "Performance Risk (Composite) Base," Item 23. Remember that the value in Item 20 is the total contract cost excluding facilities capital cost of money.
- **Calculate Performance Risk Profit/Fee Objective.** To calculate the "Performance Risk (Composite) Profit Objective," Item 23, multiply the "Performance Risk

(Composite) Assigned Value," by the "Performance Risk (Composite) Base" as shown in the example below:

Item	Contractor Risk Factors	Assigned Weighing	Assigned Value	Base (Item 20)	Profit Objective
21.	Technical	40%	4.5		
22.	Management/Cost Control	60%	4.0		
24.	Performance Risk (Composite)		4.2	\$742,000	\$31,164

Contract-Type Risk Profit/Fee Analysis ([DFARS 215.404-71-3](#)). Item 24 of the form focuses on the degree of cost risk accepted by the contractor under various types of contracts.

- **Select the Appropriate Profit/Fee Range.** The designated profit/fee ranges and the normal values for major contract types are described in the following table:

Profit/Fee Values for Contract-Type Risk			
Contract Type	Notes	Normal Value	Designated Range
Firm Fixed-Price			
No Financing	(1)	5.0%	4.0% to 6.0%
With Performance-Based Payments	(6)	4.0%	2.5% to 5.5%
With Progress Payments	(2)	3.0%	2.0% to 4.0%
Fixed-Price Incentive			
No Financing	(1)	3.0%	2.0% to 4.0%
With Performance-Based Payments	(6)	2.0%	0.5% to 3.5%
With Financing	(2)	1.0%	

			0.0% to 2.0%
Fixed-Price Redeterminable			
No Financing	<u>(3)</u>	2.5%	2.0% to 3.0%
With Financing	<u>(3)</u>	0.5%	0.0% to 1.0%
Cost-Plus-Incentive-Fee	<u>(4)</u>	1.0%	0.0% to 2.0%
Cost-Plus-Fixed-Fee	<u>(4)</u>	0.5%	0.0% to 1.0%
Time and Material	<u>(5)</u>	0.5%	0.0% to 1.0%
Labor-Hour	<u>(5)</u>	0.5%	0.0% to 1.0%
Firm fixed-price-level-of-effort-term	<u>(5)</u>	0.5%	0.0% to 1.0%

(1) "No Financing" means either that the contract does not provide progress payments or performance-based payments or provides them only on a limited basis (e.g., financing of first articles). Do not compute a working capital adjustment in Item 25.

(2) When the contract contains provisions for progress payments, compute a working capital adjustment in Item 25.

(3) For the purpose of assigning profit values, treat a fixed-price contract with redeterminable provisions as if it were a fixed-price-incentive contract with below normal conditions.

(4) Cost-reimbursement contracts shall not receive the working capital adjustment.

(5) These types of contracts are considered cost-plus-fixed-fee contracts for the purpose of assigning profit/fee values. They shall not receive the working capital adjustment in Item 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.

Note that fixed-price contracts with financing have lower profit/fee ranges and normal values than fixed-price contracts with no financing. The lower values consider the fact that the contractor assumes less financial risk when the Government provides financing.

- **Assign Appropriate Profit/Fee Value.** Use the normal value for each contract type unless you can justify a higher or lower value.
 - The elements that you should consider include:
 - Length of contract,
 - Adequacy of cost data projections,
 - Economic environment,
 - Nature and extent of subcontracted activity,
 - Contractor protection under contract provisions (e.g., economic price adjustment clauses),
 - Ceilings and share lines contained in incentive provisions, and
 - Risks associated with contracts for foreign military sales (FMS) which are not funded by U.S. appropriations.
 - 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.
 - In determining the appropriate value to assign, **assess the extent to which costs have been incurred prior to definitization of the contract action.** Your assessment must consider 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 at the low end of the designated range. If a substantial portion of the costs have been incurred prior to definitization, you may assign a value as low as 0 percent, regardless of contract type.
 - Within the range prescribed for a particular contract type, the assigned profit/fee value

should be consistent with the value for performance risk. It would be incongruous to assign a high value for contract type risk and a low value for performance risk, or vice versa.

Assigning a Profit/Fee Value for Contract-Type Risk	
Consider	When
Above Normal Weight	<ul style="list-style-type: none"> • 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) place a high degree of risk on the contractor; or • Contract is for FMS sales (other than those under DoD cooperative logistics support arrangement 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. • An aggressive performance-based payment schedule that increases risk.
Below Normal Weight	<ul style="list-style-type: none"> • Contract is for a very mature product line with extensive cost history; • Contract is for a relatively short term; • Contractual provisions substantially reduce the contractor's risk; • Incentive provisions 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.

-
- **Contract-Type Risk Profit/Fee Base.** Enter the value from Item 20 as the "Contract Type Risk Base" (Item 24).
 - **Calculate Cost Risk Profit/Fee Objective.** To calculate the "Contract Type Risk Profit Objective" (Item 24),

multiply the "Contract Type Risk Assigned Value," by the "Contract Type Risk Base" (Item 20) as shown in the example below:

For example: A firm fixed-price contract with normal progress payments, normal risk, and the cost structure presented in earlier in this chapter would require the following calculations.

Item	Contractor Risk Factor	Assigned Value	Base (Item 20)	Profit Objective
24.	Contract Type Risk	3.0%	\$742,000	\$22,260

Working Capital Profit/ Fee Adjustment ([DFARS 215.404-71-3](#)). Item 25 of the form recognizes contractor working capital investment, the money required to finance contract expenses until contract payment is received. It only applies to fixed-priced contracts with Government financing.

- **Calculate the Costs Financed.**
 - Identify contract "Total Costs Objective" (excluding facilities capital cost of money) in Item 20.
 - Reduce the "Total Costs Objective" as appropriate when:
 - The contractor has little cash investment (e.g. subcontractor progress payments liquidate late in the period of performance).
 - Some costs are covered by special financing provisions such as advance payments.
 - The contract is multi-year and there are special funding arrangements.
 - Calculate the portion of contract cost financed by the contractor. Normally that is 100% minus the customary progress payment rate. On contracts that provide flexible progress payments or progress payments to small business, **use the customary rate for large businesses.**
 - Calculate the "Working Capital Costs Financed" by multiplying "Total Costs Objective" by the percentage of costs financed by the contractor.
- **Select the Appropriate Contract Length Factor.** The "Length Factor" (Item 25) is related to the period of

time that the contractor will have a working capital investment in the contract.

- o The period of substantive performance that you use to select the length factor:
 - Is based on the time necessary for the contractor to complete the substantive portion of the work.
 - Is not necessarily based on the entire period of time between contract award and final delivery (or final payment). It should exclude any periods of minimal contract performance.
 - Should not be based on periods of performance contained in option provisions
 - Should not, for multi-year contracts, include periods of performance beyond that required to complete the initial program year's requirements.
 - Should be based on a weighted average contract length when the contract has multiple deliveries.
 - May be estimated using sampling techniques provided the sampling techniques produce a representative result.
- o After you determine the period of substantive performance use the following table to select the appropriate contract length factor.

Period of Substantive Performance	Length Factor
21 months or less	.40
22 to 27 months	.65
28 to 33 months	.90
34 to 39 months	1.15
40 to 45 months	1.40
46 to 51 months	1.65
52 to 57 months	1.90
58 to 63 months	2.15
64 to 69 months	2.40
70 to 75 months	2.65
76 months or more	2.90

- **Identify the Interest Rate.** Identify the "Interest Rate" determined semi-annually by the Secretary of the Treasury under Public Law 92-41. This rate is also known as: Renegotiation Board Interest Rate; Prompt

Payment Act Interest Rate; Contract Dispute Act Interest Rate; and Facilities Capital Cost of Money Rate. The rate can be found on the Bureau of the Public Debt's [Prompt Payment Act Interest Rate webpage](#).

- **Calculate Working Capital Profit/Fee Objective.** To calculate the "Working Capital Profit Objective" (Item 25), multiply the "Costs Financed" by the "Length Factor" and then multiply the product from that calculation by the "Interest Rate" as shown in the example below. The adjustment must not exceed four percent of the "Total Costs" in Item 20 of the form.

For example: Using the above approach with a contract cost of \$742,000, progress payments of 80 percent, substantive period of performance of 25 months, and an interest rate of 5.25 percent, the calculation would be:

Step 1. Calculate the Costs Financed:

Total Costs Objective x (1.00 - Progress Payment Rate)

\$742,000 x (1.00 - .80)

\$742,000 x .20

\$148,400

Step 2. Select the Appropriate Contract Length Factor:

.65 is the length factor for a 25 month substantive period of performance.

Step 3. Identify the Interest Rate:

5.25 percent is the interest rate.

Step 4. Calculate Working Capital Profit/Fee Objective:

Costs Financed x Length Factor x Interest Rate

\$148,400 x .65 x .0525

\$5,064 (rounded down from \$5064.15)

The figures in Item 25 of the form would appear as follows:

Item	Contractor Risk Factor	Costs Financed	Length Factor	Interest Rate	Profit Objective
25	Working Capital	\$148,400	.65	5.25%	\$5,064

Facilities Capital Employed Profit/ Fee Analysis ([DFARS 215.404-71-4](#)). This section recognizes contractor investment in equipment.

- **Determine the Facilities Capital Employed.** As you learned in [Chapter 10](#), total facilities capital employed is calculated by dividing the facilities capital cost of money allowed on the contract by the cost of money rate using the DD Form 1861, Contract Facilities Capital Cost of Money. The total facilities capital employed is then distributed into three components, land, buildings, and equipment, using Section 7 of the DD Form 1861. The facilities capital employed dollar figure for each component is then transferred to the appropriate "Amount Employed" column of DD Form 1547 -- Item 26 for land, Item 27 for buildings, or Item 28 for equipment.
- **Select the Appropriate Profit/Fee Value Range.** After transferring the facilities capital employed to the DD Form 1547, assign a profit/fee value to equipment capital employed. Facilities investments in land and buildings are not rewarded in profit/fee analysis because the Government does not appreciably benefit from investments in land and buildings. The following table shows the designated ranges and normal values for each:

Profit/Fee Values for Facilities Capital Employed			
Application	Asset Type	Designated Range	Normal Value
Standard --used for most contracts.	Land	N/A	0%
	Buildings	N/A	0%
	Equipment	10% to 25%	17.5%

- **Assign Appropriate Profit/Fee Value.**
 - As you assign a profit/fee objective value to equipment employed:

- Relate the usefulness of the equipment to the goods or services being acquired under the prospective contract.
- Analyze the productivity improvements and other anticipated industrial base enhancing benefits resulting from the investment in equipment, including:
 - The economic value of the equipment, such as physical age, undepreciated value, idleness, and expected contribution to future defense needs; and
 - The contractor's level of investment in defense related equipment as compared with the portion of the contractor's total business which is derived from the DoD.
- Consider any contractual provisions that reduce the contractor's risk of investment recovery (e.g., a termination protection clause, capital investment indemnification, and productivity saving rewards).
- You should assign the normal value unless you can justify a higher or lower value. Consider the following table:

Assigning a Profit/Fee Value for Facilities Capital Employed	
Consider .	When .
Significantly Above Normal Weight	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
Above Normal Weight	There are direct, identifiable, and exceptional benefits, such as: <ul style="list-style-type: none"> • New investments in state-of-the-art technology which reduce acquisition cost or yield other tangible benefits such as improved product quality or accelerated deliveries; • Investments in new equipment for research and development

	applications.
Below Normal Weight	The capital investment has little benefit to DoD, for example: <ul style="list-style-type: none"> • Allocations of capital apply predominately to commercial product lines; • Investments are for such things as furniture and fixtures, corporate aircraft, or gymnasiums; or • Facilities are old or extensively idle.
Significantly Below Normal Weight	A significant portion of defense manufacturing is done in an environment characterized by outdated, inefficient, and labor-intensive capital equipment

- **Calculate the Facilities Employed Capital Profit/Fee Objective.** Using the above approach, normal assigned values, and facilities capital employed figures from Chapter 10, Section 6 could look like this:

Item	Contractor Facilities Capital Employed	Assigned Value	Amount Employed	Profit Objective
26	Land		\$47,320	
27	Buildings		\$118,300	
28	Equipment	17.5%	\$70,980	\$12,422

The Cost Efficiency Factor. (DFARS 215.404-71-5) This is a special factor that encourages contractors to reduce costs. Contracting officers may use this factor to increase the prenegotiation profit objective by an amount not to exceed 4% of total objective costs (Block 20 of the DD Form 1547). Contracting officers may use this factor only when the contractor can demonstrate cost reduction efforts that **benefit the pending contract.**

The contracting officer shall consider criteria such as the following in evaluating whether or not to use the cost efficiency factor:

- The contractor's participation in Single Process Initiative (SPI) improvements;
- Actual cost reductions achieved on prior contracts;
- Reduction or elimination of excess or idle facilities;
- 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;
- The contractor's adoption of process improvements to reduce costs;
- Subcontractor cost reduction efforts;
- The contractor's effective incorporation of commercial items and processes; or
- 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.

Example: The contracting officer has evaluated the criteria listed above and decided that a cost efficiency factor of 1.5% is appropriate based on the contractor's adoption of process improvements and small cost reductions achieved on a prior contract. The entry on the DD Form 1547 would appear as follows:

		Assigned Value	Base (Item 20)	Profit Objective
29	Cost Efficiency Factor	1.5%	\$742,000	\$11,130

Total Profit/Fee Objective. The total profit/fee objective is the sum of all profit/fee objectives calculated in Parts

2 - 6 of the DD Form 1547. For the on-going example used throughout this section, the total profit/fee objective would be:

Item	Profit Factor	Profit Objective
23.	Performance Risk (Composite)	\$31,164
24.	Contract Type Risk	\$22,260
25.	Working Capital	\$5,064
28.	Equipment Facilities Capital Employed	\$12,422
29.	Cost Efficiency Factor	\$11,130
30.	Total Profit/Fee Objective	\$82,040

Negotiation Summary ([DFARS 215.404-76](#)). This part of the DD Form 1547 summarizes the proposed, objective, and negotiated cost and profit/fee positions. The section is primarily used for reporting to higher headquarters. Questions often arise regarding Line 35, "Markup Rate." The markup rate calculation includes both profit/fee and facilities capital cost of money as markup. As a result, offhand evaluations of the size of the markup can be misleading. The figures for on-going example would be:

NEGOTIATION SUMMARY					
Item	Summary Elements	Proposed	Objective	Negotiated	
31.	Total Costs		\$742,000		
32.	Facilities Capital Cost of Money		\$18,928		
33.	Profit		\$82,040		
34.	Total Price (Line 31 + 32 + 33)		\$842,968		
35.	Markup Rate (line 32 + 33 divided by 31)		13.6 %		

Contracting Officer Approval. After completion of the negotiation, the DD Form 1547 must be signed and dated by the contracting officer.

Completed Price/Fee Analysis The example below depicts a DD Form 1547, completed through Item 35 for the Government objective, using the figures from the on-going example used throughout this section.

RECORD OF WEIGHTED GUIDELINES APPLICATION					REPORT CONTROL SYMBOL DD-A&T(Q)1751	
1. REPORT NO.	2. BASIC PROCUREMENT INSTRUMENT IDENTIFICATION NO.				3. SPIIN	4. DATE OF ACTION
	a. PURCHASING OFFICE	b. FY	c. TYPE PROC INST CODE	d. PRISM		a. YEAR
5. CONTRACTING OFFICE CODE			ITEM	COST CATEGORY		OBJECTIVE
6. NAME OF CONTRACTOR			13.	MATERIAL		\$90,000
			14.	SUBCONTRACTS		0
7. DUNS NUMBER	8. FEDERAL SUPPLY CODE		15.	DIRECT LABOR		\$224,000
			16.	INDIRECT EXPENSES		\$364,000
9. DOD CLAIMANT PROGRAM	10. CONTRACT TYPE CODE		17.	OTHER DIRECT CHARGES		\$22,000
			18.	SUBTOTAL COSTS (13 thru 17)		\$700,000
11. TYPE EFFORT	12. USE CODE		19.	GENERAL AND ADMINISTRATIVE		\$42,000
			20.	TOTAL COSTS (18+19)		\$742,000
WEIGHTED GUIDELINES PROFIT FACTORS						
ITEM	CONTRACTOR RISK FACTORS	ASSIGNED WEIGHTING	ASSIGNED VALUE	BASE (ITEM 20)		PROFIT OBJECTIVE
21.	TECHNICAL	40%	4.5%			
22.	MANAGEMENT/COST CONTROL	60%	4.0%			
23.	PERFORMANCE RISK (COMPOSITE)		4.2%	\$742,000	\$31,164	
24.	CONTRACT TYPE RISK		3.0%	\$742,000	\$22,260	
25.	WORKING CAPITAL	Costs Financed	Length Factor	Interest Rate		
		\$148,400	.65	5.25%		\$5,064
	CONTRACTOR FACILITIES CAPITAL EMPLOYED		ASSIGNED VALUE	AMOUNT EMPLOYED		
26.	LAND			\$47,320		

27.	BUILDINGS		\$118,300	
28.	EQUIPMENT	17.5%	\$70,980	\$12,422
29.	COST EFFICIENCY FACTOR	ASSIGNED VALUE	BASE (<i>Item 20</i>)	
		1.5%	\$742,000	\$11,130
30.	TOTAL PROFIT OBJECTIVE			\$82,040
NEGOTIATED SUMMARY				
		PROPOSED	OBJECTIVE	NEGOTIATED
31.	TOTAL COSTS		\$742,000	
32.	FACILITIES CAPITAL COST OF MONEY (<i>DD FORM 1861</i>)		\$18,928	
33.	PROFIT		\$82,040	
34.	TOTAL PRICE (<i>Line 31 + 32 + 33</i>)		\$842,968	
35.	MARKUP RATE (<i>Line 32 + 33 divided by 31</i>)	%	13.6%	%
CONTRACTING OFFICER APPROVAL				
36.	TYPED/PRINTED NAME OF CONTRACTING OFFICER (<i>Last, First, Middle Initial</i>)	37.	SIGNATURE OF CONTRACTING OFFICER	38. TELEPHONE NO.
				39. DATE SUBMITTED (<i>YYYYMMDD</i>)
OPTIONAL USE				
96.	97.	98.	99.	

11.2.2 Identifying Exempted Contract Actions

Exemptions From Required Weighted Guidelines Use ([DFARS 215.404-4\(c\)\(2\)](#), [215.404-72](#), and [DFARS 215.404-74](#)).

In the DoD, you generally must use the weighted guidelines approach for profit/fee analysis when you perform cost analysis of cost or pricing data to determine price reasonableness. However, you:

- May use an alternate structured approach for the following:
 - Contract actions under \$500,000;
 - Architect-engineering or construction contracts;
 - Contracts primarily requiring delivery of material from subcontractors;
 - Termination settlements; or
 - Contracts for which the weighted guidelines would not produce a reasonable overall profit/fee and

the head of the contracting activity approves use of an alternate approach in writing.

- Must use the modified weighted guidelines (described in [DFARS 215.404-72](#)) for contract actions with nonprofit organizations other than FFDRCs.
- Must not use weighted guidelines or an alternate approach for cost-plus-award-fee contracts. Instead follow the guidelines presented in [DFARS 215.404-74](#).

Using an Alternate Structured Approach ([DFARS 215.404-73](#)). When using an alternate structured approach, you may design your profit/fee analysis to meet the requirements of the acquisition situation. However, the alternate approach must:

- Consider the three basic components of profit-- performance risk, contract type risk (including working capital), and facilities capital employed.
- Include an offset for any facilities capital cost of money included in contract cost. To calculate the offset, reduce the overall prenegotiation profit objective by one percent of the total cost or the amount of facilities capital cost of money, whichever is less.

When you use an alternate approach, you must still complete a DD Form 1547, however, you are not required to complete Items 21 through 30. The profit amount in the negotiation summary of the DD Form 1547 must be the profit figure after the offset for facilities capital cost of money.