1515.404-471 EPA structured approach for developing profit or fee objectives.

(a) *General.* To properly reflect differences among contracts, and to select an appropriate relative profit/fee in consideration of these differences, weightings have been developed for application by the contracting officer to standard measurement bases representative of the prescribed profit factors cited in FAR 15.404(d) and EPAAR 1515.404-471(b)(1). Each profit factor or subfactor, or its components, has been assigned weights relative to their value to the contract's overall effort, and the range of weights to be applied to each profit factor.

(b)

(1) *Profit/fee factors.* The factors set forth in this paragraph, and the weighted ranges listed after each factor, shall be used in all instances where the profit/fee is negotiated.

Contractor's Input to Total Performance

	Weight Range (Percent)
Direct material	1 to 4.
Professional/technical labor	8 to 15.
Professional/technical overhead	6 to 9.
General labor	5 to 9.
General overhead	4 to 7.
Subcontractors	1 to 4.
Other direct costs	1 to 3.
General and administrative expenses	5 to 8.
Contractor's assumption of contract cost risk	0 to 6.

(2) The contracting officer shall first measure the “Contractor's Input to Total Performance” by the assignment of a profit percentage within the designated weight ranges to each element of contract cost. Such costs are multiplied by the specific percentages to arrive at a specific dollar profit or fee.

(3) The amount calculated for facilities capital cost of money (FCCM) shall not be included as part of the cost base for computation of profit or fee. The profit or fee objective shall be reduced by an

amount equal to the amount of facilities capital cost of money allowed. A complete discussion of the determination of facilities capital cost of money and its application and administration is set forth in FAR 31.205-10, and the appendix to the FAR (see 48 CFR 9904.414).

(4) After computing a total dollar profit or fee for the Contractor's Input to Total Performance, the contracting officer shall calculate the specific profit dollars assigned for cost risk and performance. This is accomplished by multiplying the total Government cost objective, exclusive of any FCCM, by the specific weight assigned to cost risk and performance. The contracting officer shall then determine the profit or fee objective by adding the total profit dollars for the Contractor's Input to Total Performance to the specific dollar profits assigned to cost risk and performance. The contracting officer shall use EPA Form 1900-2 in hardcopy or electronic copy equivalent to facilitate the calculation of the profit or fee objective.

(5) The weight factors discussed in this section are designed for arriving at profit or fee objectives for other than nonprofit and not-for-profit organizations. Nonprofit and not-for-profit organizations are addressed as follows:

(i) Nonprofit and not-for-profit organizations are defined as those business entities organized and operated:

(A) Exclusively for charitable, scientific, or educational purposes;

(B) Where no part of the net earnings inure to the benefit of any private shareholder or individual;

(C) Where no substantial part of the activities is for propaganda or otherwise attempting to influence legislation or participating in any political campaign on behalf of any candidate for public office; and

(D) Which are exempt from Federal income taxation under Section 51 of the Internal Revenue Code. (26 U.S.C.)

(ii) For contracts with nonprofit and not-for-profit organizations where fees are involved, special factor of −3 percent shall be assigned in all cases.

(c) *Assignment of values to specific factors—*

(1) *General.* In making a judgment on the value of each factor, the contracting officer should be governed by the definition, description, and purpose of the factors, together with considerations for evaluation set forth in this paragraph.

(2) *Contractor's input to total performance.* This factor is a measure of how much the contractor is expected to contribute to the overall effort necessary to meet the contract performance requirements in an efficient manner. This factor, which is separate from the contractor's responsibility for contract performance, takes into account what resources are necessary, and the creativity and ingenuity needed for the contractor to perform the statement of work successfully. This is a recognition that within a given performance output, or within a given sales dollar figure, necessary efforts on the part of individual contractors can vary widely in both value, quantity, and quality, and that the profit or fee objective should reflect the extent and nature of the contractor's contribution to total performance. Greater profit opportunity should be provided under contracts requiring a high degree of professional and managerial skill and to prospective contractors whose skills, facilities, and technical assets can be expected to lead to efficient and economical contract performance. The evaluation of this factor requires an analysis of the cost content of the proposed contract as follows:

(i) *Direct material (purchased parts and other material).* (A) Analysis of these cost items shall include an evaluation of the managerial and technical effort necessary to obtain the required material. This evaluation shall include consideration of the number of orders and suppliers, and whether established sources are available or new sources must be developed. The contracting officer shall also determine whether the contractor will, for example, obtain the materials by routine orders or readily available supplies (particularly those of substantial value in relation to the total contract costs), or by detailed subcontracts for which the prime contractor will be required to develop complex specifications involving creative design.

(B) Consideration should be given to the managerial and technical efforts necessary for the prime contractor to administer subcontracts, and to select subcontractors, including efforts to break out subcontracts from sole sources, through the introduction of competition.

(C) Recognized costs proposed as direct material costs such as scrap charges shall be treated as material for profit evaluation.

(D) If intracompany transfers are accepted at price, in accordance with FAR 31.205-26(e), they should be excluded from the profit or fee computation. Other intracompany transfers shall be evaluated by individual components of cost, i.e., material, labor, and overhead.

(ii) *Professional/technical and general labor.* Analysis of labor should include evaluation of the comparative quality and level of the talents and experience to be employed. In evaluating labor for the purpose of assigning profit dollars, consideration should be given to the amount of notable scientific talent or unusual or scarce talent needed, in contrast to journeyman effort or supporting personnel. The diversity, or lack thereof, of scientific and engineering specialties required for contract performance, and the corresponding need for supervision and coordination, should also be evaluated.

(iii) *Overhead and general and administrative expenses.* (A) Where practicable, analysis of these overhead items of cost should include the evaluation of the individual elements of these expenses, and how much they contribute to contract performance. This analysis should include a determination of the amount of labor within these overhead pools, and how this labor would be treated if it were considered as direct labor under the contract. The allocable labor elements should be given the same profit consideration as if they were direct labor. The other elements of indirect cost pools should be evaluated to determine whether they are routine expenses such as utilities, depreciation, and maintenance, and therefore given less profit consideration.

(B) The contractor's accounting system need not break down its overhead expenses within the classification of professional/technical overhead, general overhead and general and administrative expenses.

(iv) *Subcontractors.* (A) Subcontract costs should be analyzed from the standpoint of the talents and skills of the subcontractors. The analysis should consider if the prime contractor normally should be expected to have people with comparable expertise employed as full-time staff, or if the contract requires skills not normally available in an employer-employee relationship. Where the prime contractor is using subcontractors to perform labor which would normally be expected to be done in-house, the rating factor should generally be at or near 1 percent. Where exceptional expertise is retained, or the prime contractor is participating in the mentor-protégé program, the assigned weight should be nearer to the high end of the range.

(v) *Other direct costs.* The analysis of these costs should be similar to the analysis of direct material.

(3) *Contractor's assumption of contract cost risk*. (i) The risk of contract costs should be shifted to the fullest extent practicable to contractors, and the Government should assign a rating that reflects the degree of risk assumption. Evaluation of this risk requires a determination of the degree of cost responsibility the contractor assumes, the reliability of the cost estimates in relation to the task assumed, and the chance of the contractor's success or failure. This factor is specifically limited to the risk of contract costs. Thus, such risks of losing potential profits in other fields are not within the scope of this factor.

(ii) The first determination of the degree of cost responsibility assumed by the contractor is related to the sharing of total risk of contract cost by the Government and the contractor, depending on selection of contract type. The extremes are a cost-plus-fixed-fee contract requiring only that the contractor use its best efforts to perform a task, and a firm-fixed-price contract for a complex item. A cost-plus-fixed-fee contract would reflect a minimum assumption of cost responsibility by the contractor, whereas a firm-fixed-price contract would reflect a complete assumption of cost responsibility by the contractor. Therefore, in the first step of determining the value given for the contractor's assumption of contract cost risk, a lower rating would be assigned to a proposed cost-plus-fixed-fee best efforts contract, and a higher rating would be assigned to a firm-fixed-price contract.

(iii) The second determination is that of the reliability of the cost estimates. Sound price negotiation requires well-defined contract objectives and reliable cost estimates. An excessive cost estimate reduces the possibility that the cost of performance will exceed the contract price, thereby reducing the contractor's assumption of contract cost risk.

(iv) The third determination is that of the difficulty of the contractor's task. The contractor's task may be difficult or easy, regardless of the type of contract.

(v) Contractors are likely to assume greater cost risks only if the contracting officer objectively analyzes the risk incident to the proposed contract, and is willing to compensate contractors for it. Generally, a cost-plus-fixed-fee contract would not justify a reward for risk in excess of 1 percent, nor would a firm-fixed-price contract normally justify a reward of less than 4 percent. Where proper contract type selection has been made, the reward for risk by contract type would usually fall into the following percentage ranges:

Type of contract	Percentage ranges
Cost-plus-fixed-fee	0 to 1.
Prospective price determination	4 to 5.
Firm-fixed-price	4 to 6.

(A) These ranges may not be appropriate for all acquisitions. The contracting officer might determine that a basis exists for high confidence in the reasonableness of the estimate, and that little opportunity exists for cost reduction without extraordinary efforts. The contractor's willingness to accept ceilings on their burden rates should be considered as a risk factor for cost-plus-fixed-fee contracts.

(B) In making a contract cost risk evaluation in an acquisition that involves definitization of a letter contract, consideration should be given to the effect on total contract cost risk as a result of partial performance under a letter contract. Under some circumstances, the total amount of cost risk may have been effectively reduced by the existence of a letter contract. Under other circumstances, it may be apparent that the contractor's cost risk remained substantially as great as though a letter contract had not been used. Where a contractor has begun work under an anticipatory cost letter, the risk assumed is greater than normal. To be equitable, the determination of a profit weight for application to the total of all recognized costs, both those incurred and those yet to be expended, must be made with consideration to all relevant circumstances, not just to the portion of costs incurred or percentage of work completed prior to definitization.

Parent topic: Subpart 1515.4—Contract Pricing