

field pricing support by documenting the file to indicate what information will be used instead of the audit report and the field pricing report.

(3) When initiating audit and field pricing support, the Contracting Officer shall do so by sending a request to the cognizant Administrative Contracting Officer, with an information copy to the cognizant audit office. When field pricing support is not available, the Contracting Officer shall initiate an audit by sending, in accordance with agency procedures, two (2) copies of the request to the OIG Office of Audit Services, Regional Inspector General. In both cases, the Contracting Officer shall, in the request—

(i) Prescribe the extent of the support needed;

(ii) State the specific areas for which input is required;

(iii) Include the information necessary to perform the review, such as the offeror's proposal and the applicable portions of the solicitation, particularly those describing requirements and delivery schedules;

(iv) Provide the complete address of the location of the offeror's financial records that support the proposal;

(v) Identify the office having audit responsibility, if other than the HHS Regional Audit Office; and

(vi) Specify a due date for receipt of a verbal report and the written audit report. If the time available is not adequate to permit satisfactory coverage of the proposal, the auditor shall so advise the Contracting Officer and indicate the additional time needed. The Contracting Officer shall submit one copy of the audit request letter provided to the Office of Audit Services, Regional Inspector General and a complete copy of the contract price proposal to OIG Office of Audit Services. Whenever the Office of Audit Services has conducted an audit review, the Contracting Officer shall forward two (2) copies of the memorandum of negotiation to OIG Office of Audit Services.

#### 315.404-4 Profit.

(b) *Policy.* (1) The structured approach for determining profit provides a technique for establishing a profit objective for negotiation. A profit objective is that part of the estimated con-

tract price objective or value which, in the judgment of the Contracting Officer, constitutes an appropriate amount of profit for the acquisition being considered. This technique allows for consideration of the profit factors described in paragraph (d) of this section. The Contracting Officer's analysis of these factors shall be based on available information, such as proposals, audit data, assessment reports, and pre-award surveys. The structured approach provides a basis for documenting the profit objective. The Contracting Officer shall explain any significant departure from this objective. The amount of documentation depends on the dollar value and complexity of the proposed acquisition. The profit objective is a part of the overall negotiation objective and is directly related to the cost objective and any proposed sharing arrangement. The profit objective shall exclude factors considered inapplicable to the acquisition.

(ii) The Contracting Officer shall negotiate the profit objective at the same time as the other cost items and as a whole rather than as individual profit factors. The profit factor breakdown shall be part of the documentation. The Contracting Officer shall use the profit analysis factors in *FAR 15.404-4(d)* in lieu of the structured approach in the following circumstances:

(A) Contracts not expected to exceed \$100,000.

(B) A & E contracts.

(C) Management contracts for operations or maintenance of Government facilities.

(D) Construction contracts.

(E) Contracts primarily requiring delivery of material supplies by subcontractors

(F) Termination settlements.

(G) Cost-plus-award-fee contracts.

However, the Contracting Officer may perform a structured profit analysis as an aid in arriving at an appropriate fee arrangement. The Contracting Officer may make other exceptions in the negotiation of contracts having unusual pricing situations, but shall justify in writing those situations where the structured approach is determined to be unsuitable.

(c) *Contracting Officer responsibilities.* The Contracting Officer shall develop

## Health and Human Services

315.404-4

the profit objective, which shall realistically reflect the total overall effort of the contractor. The Contracting Officer shall not begin to develop the profit objective until he or she has completed a thorough review of the proposed contract work; conducted a review of all available knowledge regarding the contractor pursuant to  *FAR subpart 9.1*, including audit data, pre-award survey reports and financial statements, as appropriate; and completed an analysis of the contractor's cost estimate and comparison with the Government's estimate or projection of cost.

(d) *Profit-analysis factors*—(1) *Common factors*. The Contracting Officer shall consider the following factors in all cases in which profit is negotiated and shall use the weight ranges listed after each factor in all instances where the structured approach is used.

Profit factors	Weight ranges (%)
Contractor Effort:	
Material acquisition .....	1 to 5.
Direct labor .....	4 to 15.
Overhead .....	4 to 9.
General & Administrative (G & A) .....	4 to 8.
Other costs .....	1 to 5.
Other Factors:	
Cost risk .....	0 to 7.
Investment .....	-2 to +2.
Performance .....	-1 to +1.
Socioeconomic programs .....	-.5 to +.5.
Special situations	

(i) The Contracting Officer shall measure "Contractor Effort" by assigning a profit percentage within the designated weight range to each element of contract cost. The categories listed are for reference purposes only, but are broad and basic enough to provide guidance for other elements of cost. The Contracting Officer shall not include facilities capital cost of money. "Contractor Effort" shall include a computed total dollar profit.

(ii) The Contracting Officer shall use the total dollar profit for the "Contractor Effort" to calculate specific profit dollars for "Other Factors"—cost risk, investment, performance, socioeconomic programs, and special situations. The Contracting Officer shall multiply the total dollar profit for the "Contractor Effort" by the weight assigned to each of the elements in the "Other Factors" category. Facilities

capital cost of money is not included. Form HHS 674, Structured Approach Profit/Fee Objective, shall be used.

(iii) In making a judgment of the value of each factor, the Contracting Officer shall consider the definition, description, and purpose of the factors together with considerations for evaluating them.

(iv) The structured approach was designed for arriving at profit objectives for other than nonprofit organizations. However, the Contracting Officer shall use the modified structured approach in paragraph (d)(1)(iv)(B) of this section to establish fee objectives for nonprofit organizations.

(A) For purposes of this section, nonprofit organizations are defined as those business entities organized and operated exclusively for charitable, scientific, or educational purposes, no part of the net earnings of which inure to the benefit of any private shareholder or individual, and which are exempt from Federal income taxation under Section 501(c)(3) of the Internal Revenue Code.

(B) For contracts with nonprofit organizations where fee is involved, the Contracting Officer shall subtract up to three percentage points from the total "profit" objective percentage. In determining the amount of this adjustment, the Contracting Officer shall consider the following factors:

(1) Tax position benefits.

(2) Granting of financing through advance payments.

(3) Other pertinent factors which may work to either the advantage or disadvantage of the contractor in its position as a nonprofit organization.

(2) *Contractor effort*. Contractor effort is a measure of how much the contractor is expected to contribute to the overall effort necessary to meet the contract performance requirement in an efficient manner. This factor, which is apart from the contractor's responsibility for contract performance, takes into account what resources are necessary and what steps the contractor must take to accomplish a conversion of ideas and material into the final service or product called for in the contract. 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 and quantity, and that the profit objective shall reflect the extent and nature of the contractor's contribution to total performance. A major consideration, particularly in connection with experimental or R & D work, is the difficulty or complexity of the work to be performed, and the unusual demands of the contract, such as whether the project involves a new approach unrelated to existing technology or equipment or only refinements to these items. The evaluation of this factor requires an analysis of the cost content of the proposed contract as follows:

(i) *Material acquisition* (subcontracted items, purchased parts, and other material). Analysis of these cost items shall include an evaluation of the managerial and technical effort necessary to obtain the required subcontracted items, purchased parts, material or services. The Contracting Officer shall determine whether the contractor will obtain the items or services by routine order from readily available sources or by detailed subcontracts for which the prime contractor must develop complex specifications. The Contracting Officer shall also consider the managerial and technical efforts necessary for the prime contractor to select subcontractors and to perform subcontract administration functions, which may be substantial. Normally, the lowest unadjusted weight for direct material is two percent. A weighting of less than two percent may be appropriate only in unusual circumstances when there is a minimal contribution by the contractor.

(ii) *Direct labor* (professional, service, manufacturing and other labor). Analysis of the various labor categories of the cost content of the contract shall include evaluation of the comparative quality and quantity of professional and semiprofessional talents, manufacturing and service skills, and experience to be employed. In evaluating professional and semiprofessional labor for the purpose of assigning profit dollars, the Contracting Officer shall consider the amount of notable scientific talent or unusual or scarce talent needed in contrast to nonprofessional effort, including the contribution this talent

will provide toward the achievement of contract objectives. Since nonprofessional labor is relatively plentiful and the contractor may easily obtain it, it is less critical to the successful performance of contract objectives. Therefore, the Contracting Officer cannot weight it nearly as high as professional or semiprofessional labor. The Contracting Officer shall evaluate service contract labor in a like manner by assigning higher weights to engineering or professional type skills required for contract performance and considering the variety of manufacturing and other categories of labor skills required and the contractor's personnel resources for meeting those requirements. For purposes of evaluation, the Contracting Officer may separately categorize, as appropriate, certain types of labor (e.g., quality control, receiving and inspection), that do not fall within the definition of professional, service or manufacturing labor; but shall apply the same evaluation considerations as outlined in this paragraph.

(iii) *Overhead and G & A expense.*

(A) Analysis of these overhead items of cost shall include the evaluation of the makeup of these expenses and how much they contribute to contract performance. To the extent practicable, analysis shall include a determination of the amount of labor within these overhead pools and how this labor would be treated if it were considered direct labor under the contract. The Contracting Officer shall give the allocable labor elements the same profit considerations that they would receive if they were treated as direct labor. The other elements of these overhead pools require analysis to determine whether they are routine expenses, such as utilities and maintenance, and hence given lesser profit consideration, or whether they are significant contributing elements. The composite of the individual determinations in relation to the elements of the overhead pools shall be the profit consideration given the pools as a whole. The procedure for assigning relative values to these overhead expenses differs from the method used in assigning values of the direct labor. The upper and lower limits assignable to the direct labor are absolute. In the case of overhead

expenses, individual expenses may be assigned values outside the range as long as the composite ratio is within the range.

(B) It is not necessary that the contractor's accounting system break down overhead expenses within the classifications of research overhead, other overhead pools, and general administrative expenses, unless dictated otherwise by Cost Accounting Standards (CAS). The contractor whose accounting system reflects only one overhead rate on all direct labor need not change its system, if CAS exempt, to correspond with these classifications. The Contracting Officer, in an evaluation of such a contractor's overhead rate, may break out the applicable sections of the composite rate which could be classified as research overhead, other overhead pools, and general and administrative expenses, and follow the appropriate evaluation technique.

(C) The Contracting Officer shall consider management problems that may surface in varying degrees and the management expertise exercised to solve them as an element of profit. For example, a contract for a new R & D program or an item which is on the cutting edge may 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 weight, the Contracting Officer shall adjust follow-ons downward because many of the problems should have been solved. In any event, the evaluation shall consider the underlying managerial effort involved on a case-by-case basis.

(D) It may not be necessary for the Contracting Officer to make a separate profit evaluation of overhead expenses, in connection with each acquisition action for substantially the same project with the same contractor. Where the Contracting Officer has made an analysis of the profit weight to be assigned to the overhead pool, the weight assigned may apply to future acquisitions with the same contractor unless there is a change in the cost composition of the overhead pool or contract circumstances, or unless the factors discussed in paragraph (d)(2)(iii)(C) of this section are involved.

(iv) *Other costs.* Analysis of this factor shall include all other direct costs associated with contractor performance (e.g., travel and relocation, direct support, and consultants). Analysis of these items of cost shall include the significance of the cost of contract performance, nature of the cost, and how much they contribute to contract performance. Normally, travel costs require minimal administrative effort by the contractor and, therefore, usually receive a weight no greater than one percent. Also, the contractor may designate individuals as "consultants," but in reality the contractor may obtain these individuals to supplement its workforce in the performance of routine duties required by contract. These costs would normally receive a minimum weight. However, there may be instances when contract performance may require the contractor to obtain the services of consultants having expertise in fields such as medicine or human services. In these instances, the contractor may expend greater managerial and technical effort to obtain these services and, consequently, the costs shall receive a much greater weight.

(3) *Other factors:*

(i) *Contract cost risk.* The contract type employed basically determines the degree of cost risk assumed by the contractor. For example, where a portion of the risk has been shifted to the Government through cost-reimbursement provisions, unusual contingency provisions, or other risk-reducing measures, the amount of profit shall be less than where the contractor assumes all the risk.

(A) In developing the prenegotiation profit objective, the Contracting Officer shall consider the type of contract anticipated and the contractor risk associated therewith, when selecting the position in the weight range for profit that is appropriate for the risk the contractor will bear. This factor is one of the most important in arriving at the prenegotiation profit objective. Evaluation of this risk requires a determination of: The degree of cost responsibility assumed by the contractor; the reliability of the cost estimates in relation to the tasks assumed by the contractor; and the complexity of the

tasks assumed by the contractor. This factor is specifically limited to the risk of contract costs. Risks associated with a contractor's reputation, a contractor's potential loss of a commercial market, or a contractor's loss of potential profits in other fields, are not within the scope of this factor.

(B) The first and basic 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 through the selection of contract type. The extremes are a cost-plus-fixed-fee contract requiring the contractor to use its best efforts to perform a task and a firm fixed-price contract for a service or a complex item. A cost-plus-fixed-fee contract would reflect a minimum assumption of cost responsibility, whereas a firm-fixed-price contract would reflect a complete assumption of cost responsibility. The determination of risk by contract type usually falls into the following percentage ranges:

	Percent
Cost-reimbursement type contracts .....	0-3
Fixed-price type contracts .....	2-7

(C) The second determination is that of the reliability of the cost estimates. Sound price negotiation requires well-defined contract objectives and reliable cost estimates. Prior experience assists the contractor in preparing reliable cost estimates on new acquisitions for similar efforts. An excessive cost estimate reduces the likelihood that the cost of performance will exceed the contract price, thereby reducing the contractor's assumption of contract cost risk.

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

(E) Contractors are likely to assume greater cost risk only if Contracting Officers objectively analyze the risk associated with proposed contracts and are willing to compensate contractors 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 re-

ward of less than the minimum in the structured approach. The reward for risk, by contract type, will usually fall into the following percentage ranges:

(1) Type of contract and percentage ranges for profit objectives based on structured approach for R & D and manufacturing contracts:

	Percent
Cost-plus-fixed-fee .....	0 to 0.5.
Cost-plus-incentive-fee: With cost incentive only.	1 to 2.
With multiple incentives .....	1.5 to 3.
Fixed-price-incentive: With cost incentive only.	2 to 4.
With multiple incentives .....	3 to 5.
Prospective price redetermination .....	3 to 5.
Firm-fixed-price .....	5 to 7.

(2) Type of contract and percentage ranges for profit objectives based on the structured approach for service contracts:

	Percent
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.

(F) These ranges may not be appropriate for all acquisitions. For instance, a fixed-price incentive contract with a low ceiling price and high incentive share may be tantamount to a firm fixed-price contract. In this situation, the Contracting Officer may 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. On the other hand, a contract with a high ceiling and low incentive formula can be considered to contain cost-plus-incentive-fee contract features. In this situation, the Contracting Officer may determine that the Government is retaining much of the contract cost responsibility and that the risk the contractor assumes is minimal. Similarly, if a cost-plus-incentive-fee contract includes an unlimited downward (negative) fee adjustment on cost control, it could be comparable to a fixed-price-incentive contract. In such a pricing environment, the Contracting Officer may determine that the Government has transferred a greater amount of cost responsibility to the contractor than is typical under

a normal cost-plus-incentive-fee contract.

(G) The contractor's subcontracting program may have a significant impact on the contractor's acceptance of risk. It could cause risk to increase or decrease in terms of both cost and performance. This consideration shall be a part of the Contracting Officer's overall evaluation in selecting a factor to apply to cost risk. The Contracting Officer may determine, for instance, that the prime contractor has effectively transferred real cost risk to a subcontractor and the contract cost risk evaluation may, as a result, be below the range which would otherwise apply for the contract type being proposed. However, without any substantial transfer of cost risk from the prime contractor to a subcontractor, the Contracting Officer shall not lower the contract cost risk evaluation merely because a substantial portion of the contract costs represents subcontracts.

(H) In making a contract cost risk evaluation for an acquisition that involves definitization of a letter contract, unpriced change orders, and unpriced orders under basic ordering agreements, the Contracting Officer shall consider the effect on total contract cost risk of partial performance before definitization. Under some circumstances, the total amount of cost risk may have been effectively reduced. Under other circumstances it may be apparent that the contractor's cost risk remains substantially unchanged. To be equitable, the Contracting Officer shall make the determination of profit weight for all recognized costs, both incurred and yet to be expended, considering all attendant circumstances—not merely the portion of costs incurred or percentage of work completed prior to definitization.

(I) The Contracting Officer shall consider time-and-materials and labor-hour contracts to be cost-plus-fixed-fee contracts for the purpose of establishing profit weights in the evaluation of the contractor's assumption of contract cost risk, unless otherwise exempt from use of the structured approach under paragraph (b)(1)(ii) of this section.

(ii) *Investment.* HHS encourages its contractors to perform their contracts

with the minimum of financial, facilities, or other assistance from the Government. As such, it is the purpose of this factor to encourage the contractor to acquire and use its own resources to the maximum extent possible. The evaluation of this factor shall include an analysis of the following:

(A) *Facilities* (including equipment). Evaluating how this factor contributes to the profit objective requires knowledge of the level of facilities utilization needed for contract performance, the source and financing of the required facilities, and the overall cost-effectiveness of the facilities offered. The Contracting Officer shall provide contractors with additional profit, if they furnish their own facilities and such contractor-furnished facilities contribute significantly to lower total contract costs. On the other hand, contractors that rely on the Government to provide or finance needed facilities shall receive a corresponding reduction in profit. Between these extremes, the Contracting Officer shall evaluate cases on their merits and make positive or negative adjustments in profit, as appropriate. When applicable, the contractor's computation of facilities capital cost of money under CAS 414 can help the Contracting Officer identify the level of facilities investment the contractor will employ in contract performance.

(B) *Payments.* In analyzing this factor, the Contracting Officer shall consider the frequency of payments by the Government to the contractor. The key to this weighting is to give proper consideration to the impact the contract will have on the contractor's cash flow. Generally, negative consideration applies to advance payments and payments more frequent than monthly, with the Contracting Officer making a maximum reduction as the contractor's working capital approaches zero. The Contracting Officer shall generally give positive consideration for payments less frequent than monthly and for a capital turn-over rate on the contract less than the contractor's or the industry's normal capital turn-over rate.

(iii) *Performance* (cost control and other past accomplishments). The Contracting Officer shall evaluate the contractor's past performance in areas such as: quality of services or products, meeting performance schedules, efficiency in cost control (including need for and reasonableness of costs incurred), accuracy and reliability of previous cost estimates, degree of cooperation (both business and technical), compliance with previous contract requirements, and management of subcontract programs. Where a contractor has consistently achieved excellent results in these areas in comparison with other contractors in similar circumstances, this performance merits a proportionately greater opportunity for profit. Conversely, a poor record in this regard warrants less profit.

(iv) *Federal socioeconomic programs*. This factor, which may apply to special circumstances or particular acquisitions, relates to the extent of a contractor's successful participation in Government sponsored programs involving: Small businesses; HUBZone small businesses; service-disabled, veteran-owned small businesses; 8(a) small businesses; women-owned small businesses; small disadvantaged businesses; sheltered workshops for the disabled; mentor-protégé; energy conservation, *etc.* The Contracting Officer shall give positive consideration for the contractor's policies and practices that support Federal socioeconomic programs and contribute to successful results. Conversely, the Contracting Officer shall view failure or unwillingness on the part of the contractor to support Federal socioeconomic programs as evidence of poor performance for the purpose of establishing a profit objective.

(v) *Special situations*.

(A) *Inventive and developmental contributions*. The Contracting Officer shall consider the extent and nature of contractor-initiated and contractor-financed independent development in formulating the profit objective, provided that the Contracting Officer has made a determination that the effort will benefit the contract. Examples of profit weighting factors include contribution of the independent develop-

ment to health and human service-related missions; the initiative demonstrated by the contractor in pursuing the independent development; the extent of the contractor's cost risk; and whether the independent development cost was recovered directly or indirectly from Government sources.

(B) *Unusual pricing agreements*. Occasionally, unusual contract pricing arrangements are made with the contractor wherein it agrees to cost ceilings (e.g., a ceiling on overhead rates for conditions other than those discussed at FAR 42.707). In these circumstances, the Contracting Officer shall give the contractor favorable consideration in developing a profit objective.

(C) *Negative factors*. Special situations need not be limited to those which only increase profit levels. A negative consideration may be appropriate when the contractor is expected to obtain spin-off-benefits as a direct result of the contract (e.g., products or services with commercial application).

(4) *Facilities capital cost of money*. When facilities capital cost of money (cost of capital committed to facilities) is included as an item of cost in the contractor's proposal, the Contracting Officer shall reduce the profit objective in an amount equal to the amount of facilities capital cost of money allowed in accordance with the Facilities Capital Cost-of-Money cost principle. If the contractor does not propose this cost, the Contracting Officer shall insert a provision in the contract that makes facilities capital cost of money an unallowable cost.

### Subpart 315.6—Unsolicited Proposals

#### 315.605 Content of unsolicited proposals.

(d) *Certification by offeror*. To ensure against contacts between HHS personnel and prospective offerors that would exceed the limits of advance guidance set forth in FAR 15.604 and potentially result in an unfair advantage to an offeror, the Contracting Officer shall: Furnish the following certification template to any prospective offeror of an unsolicited proposal; and require that the executed certification be