Profit and Fee Guideline - 3.3.G (09/08/04)

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This guideline was extensively revised to address administrative changes throughout the document.

Methods to Determine Profit or Fee - 3.3.G.1

There are different methods of determining the appropriate amount for profit or fee. The Sandia Contracting Representative (SCR) shall use the method or the combination of methods that will most likely result in a fair and reasonable profit or fee. Some methods that may be used are listed as follows.

- Where adequate price competition exists, contracts should be awarded to the responsible company which offers the best-value to Sandia without regard to the amount of profit.
- If the price is adequately justified by other price analysis methods, award may be made without regard to the amount of profit.

- If the price is adequately justified by an established catalog or market price of, or based on, commercial items sold in substantial quantities to the general public, award may be made without regard to the amount of profit.

- If the price is set by law or regulation, award may be made without regard to the amount of profit.

For contracts where the elements making up the price are analyzed, the SCR should develop a profit or fee objective. In developing the profit or fee objective, the SCR should take into consideration the risk involved and contribution of the Contractor to the effort. The SCR may choose to determine a reasonable profit or fee by comparing similar types of procurement for like items or services or conduct a market analysis to determine that the profit is reasonable for work to be performed taking into consideration the amount of risk assumed by the Offeror.

Where cost analysis is required, the SCR may justify fee by considering the following factors and documenting the analysis and the importance the SCR attaches to each.

- Contractor effort the complexity of the work, and the resources required by the Contractor for performance;

- material acquisition the complexity of the items to be acquired; the amount and type of Contractor effort required to obtain the material; whether procurement consists of routine Purchase Orders (POs) or complex subcontracts, etc.;

- type of engineering, scientific, manufacturing, or other labor required to perform the contract;

- how the Contractor's indirect costs and general and administrative expense contribute to contract performance;

- contract cost risk contract type and reliability of cost estimate;

- compliance with federal socioeconomic programs;

- capital investments the types of equipment and facilities owned by the Contractor;

- Contractor facility and equipment (age, undepreciated value, cost effectiveness, etc.); reliance on government-owned facilities; availability of operating capital, financial management practices, etc.;

- independent development by Contractor of specialized processes, services or technology that will benefit the contract work;

- profit or fee paid on previous contracts where an analysis has been done that documents the actual similarities and differences between the contracts and contract efforts used for comparison;

- profit and fee rates for similar work under similar economic conditions in industry; and

- any other relevant factor(s).

Whatever the means used to determine profit or fee, the rationale for determining profit must be well documented in the contract file, reflect the best professional judgment of the SCR, and shall not exceed the maximum allowable profit or fees as specified in the Section 3.3.G.2 of this guideline.

Note: Any documents describing the Sandia rationale for profit and fee are proprietary to Sandia and are not to be released to the public.

The SCR may use the Weighted Guidelines Analysis Method described in Section 3.3.G.4 in this guideline to determine an "acceptable profit" objective.

Maximum Allowable Profit/Fee - 3.3.G.2

Use the following table to determine the maximum allowable profit/fee for each contract type.

Contract Type	Maximum Profit/Fee
Cost-Plus-Fixed-Fee (CPFF) (for experimental, developmental or research)	15 percent of contract's estimated cost (not including the fee)
CPFF (all others)	10 percent of contract's estimated cost (not including the fee)
Time and Material (T&M) and Labor-Hour (LH) (experimental, developmental or research)	15 percent of the hourly/labor rate (not including the profit)
T&M and LH (all others)	10 percent of the hourly/labor rate (not including the profit)

These represent limitations on fee and profit on contracts involving the expenditure of public funds. The Contractor's proposed effort and risk must support any amount of profit or fee negotiated. Regardless of fee or profit levels proposed by the Contractor, the Contractor's proposal will be reviewed and analyzed by Sandia to determine the amount of fee or profit appropriate for the contract effort.

There is no maximum allowable profit on a Firm-Fixed Price (FFP) contract.

Profit or Fee for Educational Institutions or Other Nonprofit Institutions - 3.3.G.3

It is Sandia policy not to pay profit or fees in contracts with educational institutions or nonprofit institutions. However, some institutions include a management fee in their proposals which is a predetermined allowable charge approved by a government agency for such things as replacement of equipment and facilities, acquisitions of new or improved equipment, performance of independent research and development, etc.

Weighted Guidelines Analysis Method - 3.3.G.4

The Weighted Guidelines Analysis Method is one method that may be utilized in determining a profit objective. This method provides a vehicle for performing the analysis to develop a profit/fee objective and provides a format for summarizing profit amounts, subsequently negotiated as part of the contract price.

The profit objective should be determined prior to negotiations regardless of method used.

In cases where contract changes or modifications call for a substantial change in price or specifications or risk, then the basic contract profit and the Contractor's effort may be radically changed and a detailed analysis of the profit factors would be a necessity.

For contract changes, the addition of new work should not affect the fee or profit for the existing work unless the overall nature of the work has been significantly changed.

The following are factors and weight ranges used when the Weighted Guidelines (SF 6432-WG) are applied.

Profit Factors	Weighted Ranges (%)
1. Contractor Effort (weights applied to cost)	
a. Material Acquisitions	
(1.) Purchased Parts	1 to 3
(2.) Subcontract Items	1 to 4
(3.) Other Materials	1 to 3
b. Labor Skills	
(1.) Technical and Managerial	
(a.) Scientific	10 to 20
(b.) Project Management/Administration	8 to 20

(c.) Engineering	8 to 14
(2.) Manufacturing	4 to 8
(3.) Support Services	4 to 14
c. Overhead	
(1.) Technical and Managerial	5 to 8
(2.) Manufacturing	3 to 6
(3.) Support Services	3 to 7
d. Other Direct Costs	3 to 8
e. G&A (General Management Expenses)	5 to 7
2. Contract Risk (type of contract--weights applied to total cost of Items 1a through 1e)	0 to 8
3. Capital Investment (weights applied to the net book value of allocable facilities)	5 to 20
4. Independent Research and Development (IR&D)	
a. Investment in R&D Program (weights applied to allocable R&D costs)	5 to 7
b. Developed Items Employed (weights applied to total profit for Items 1a through 1e)	0 to 20
5. Special Program Participation (weights applied to total of profit for Items 1a through 1e)	-5 to +5
6. Other Considerations (weights applied to total of profit for Items 1a through 1e)	-5 to +5
7. Productivity/Performance (special computation)	(As computed)

Weighted Guidelines Application - 3.3.G.5

The table in the Weighted Guidelines Analysis Method lists those Sandia factors which are given consideration for profit/fee determination in all cases in which profit/fee is to be specifically negotiated and the Weighted Guidelines Analysis Method is utilized. This paragraph discusses these factors and provides guidance on how they should be evaluated.

The profit/fee elements (factors or subfactors) relating to Contractor effort are similar to those cost elements contained in most Contractor contract pricing proposals. Often, individual proposals will be in a different format, but, since these factors and subfactors are broad and basic, they provide sufficient guidance to evaluate all items of cost generally found in proposals.

In determining the value of each factor, the SCR should recognize the definition, description, and purpose of the factors, together with consideration for evaluating them as set forth herein.

Contractor Effort - 3.3.G.5.a

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 a part from the Contractor's basic responsibility for contract performance, takes into account what resources are necessary, and what the Contractor must do, to accomplish a conversion of ideas and materials into the final product or service called for in the contract. This factor recognizes that, within a given performance output or within a given sales dollar figure, necessary efforts on the part of the individual Contractors can vary widely in both value and quantity, and, that the profit objective should reflect the extent and nature of the Contractor's contribution to total performance. The evaluation of this factor requires an analysis of the cost content of the proposed contract, as discussed in this paragraph. Not to be included as part of the cost base (for purposes of computing profit) is any amount calculated for facilities capital cost of money.

The following comprise the base elements for measuring Contractor effort:

- **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.

- **Labor** (technical and managerial manufacturing and support services). Analysis of the labor cost content of the contract includes evaluation of the comparative quality and level of the talents, skills, and experience of those personnel to be employed for contract performance.

- **General management** (overhead and G&A but exclusive of Independent Research and Development (IR&D) cost). In reviewing this element:

  Analysis of overhead and G&A expenses includes evaluation of the makeup of these expenses and how much they contribute to the contract performance.

- **Other direct costs** (exclusive of facilities capital cost of money).

  In evaluating this element, the SCR should ensure that the ODC's proposed are necessary for the project.

Contract Risk - 3.3.G.5.b

This factor reflects the Sandia policy that Contractors bear an equitable share of cost risk, and to compensate them for the assumption of that risk. A Contractor's risk associated with costs to perform under a Sandia contract is usually minimal under Cost-Reimbursement-type contracts. In developing a prenegotiation profit or fee objective, the SCR may need to consider the type of contract to be negotiated and the anticipated Contractor cost risk. This consideration is one of the most important factors in arriving at a prenegotiation profit objective.

Profit/fee allowances for Contractor assumption of cost risk includes a determination of the degree of cost responsibility the Contractor assumes, and the reliability of the cost estimates in relation to the task assumed. This factor is specifically limited to the risk of cost of contract performance, including unallowable cost elements. Thus, such risks on the part of the Contractor as 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, are not within the scope of this factor.

The first and basic determination of the degree of cost responsibility assumed by the Contractor is related to the sharing of total risk of performance cost by Sandia and the Contractor through the selection of contract type. The extremes are a CPFF contract, requiring only that the Contractor use his best efforts to perform a task, and a FFP contract. A CPFF contract reflects a minimum assumption of cost responsibility, whereas a FFP contract reflects a complete assumption of cost responsibility.

The second determination is that of the reliability of the cost estimates. Sound price negotiation requires well-defined contract objectives and reliable cost estimates which, among other things, take the difficulty of the task into consideration. Prior production experience assists the Contractor in preparing reliable cost estimates on new contracts for similar items.

Generally, a CPFF contract will not justify a reward for risk in excess of 0.5 percent, nor will a FFP contract justify a reward of less than the minimum on the following Weighted Guidelines. For purposes of performing Weighted Guideline analysis, T&M/LH and Fixed-Rate contracts are to be considered as CPFF level of effort contracts. Where proper contract-type selection has been made, 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 (FCCM).

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

Equipment and Supply Contracts	**Weighted Ranges (%)**
CPFF	0 to 0.5
Cost-Plus-Incentive-Fee (CPIF):	1 to 2
- With Cost Incentives Only	1.5 to 3
- With Multiple Incentives	
Fixed-Price-Incentive (FPI):	3 to 5
- With Cost Incentives Only	4 to 6
- With Multiple Incentives	
Prospective Price Redeterminable	4 to 6

FFP	6 to 8

Type of contract and percentage ranges for profit objectives developed for Research and Development (R&D) contracts:

Research and Development Contracts	Weighted Ranges (%)
CPFF:	0 to 0.5
CPIF:	
- With Cost Incentives Only	1 to 2
- with Multiple Incentives	1.5 to 3
FPI:	
- With Cost Incentives Only	2 to 4
- With Multiple Incentives	3 to 5
Prospective Price Redeterminable	3 to 5
FFP	5 to 7

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

Service Contracts	Weighted Ranges (%)
CPFF	0 to 0.5
CPIF	1 to 2
FPI	2 to 3
FFP	3 to 4

Capital Investment (Facilities) - 3.3.G.5.c

This element relates to the consideration to be given in the profit objective in recognition of the investment risk associated with the facilities employed by the Contractor. Five to twenty percent of the net book value of facilities capital allocated to the contract is the normal range of weight for this profit factor.

Independent Research and Development (IR&D) - 3.3.G.5.d

This factor rewards Contractors in two ways:

- As a reward for the Contractor's investment in a viable IR&D program for technology that directly benefits the specific contract effort--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.

- 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 or Sandia assistance and little or no indirect government or Sandia assistance. Profit weights in the range of 0 to 20 percent of the basic profit dollars are normal for this factor. The weight selection is to be based on the amount of assistance provided by the government or Sandia through independent research and/or development expense allowance under previous government or Sandia contracts and the extent the Contractor already has been compensated for independent development through prior sales of the identical item to the government or Sandia.

Special Program Participation - 3.3.G.5.e

A composite percentage weight within the range of -5 percent to +5 percent of the basic profit objective may be assigned for this profit objective. This profit factor, which may apply to special circumstances as well as a particular acquisition, relates to rewards of outstanding achievement in Contractor participation in the government's effort in subcontracting with small business, small disadvantaged business, energy conservation, and other special programs. Participation that is rated as merely satisfactory should be assigned a weight of zero, generally. Evidence of effective support may justify a plus weight and poor support a negative weight.

In assessing this factor, the SCR should give favorable consideration to the Contractor’s:

- history and record in effectively supporting government small business and small disadvantaged business subcontracting programs. Any unusual effort that the Contractor displays in subcontracting with small business or small disadvantaged business 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 should be considered. Conversely, failure or unwillingness on the part of the Contractor to support government small or small disadvantaged business policies shall be viewed as evidence of poor performance for the purpose of establishing a profit objective, and

- initiatives and accomplishments in the conservations of energy and in carrying out any other special government programs.

Other Considerations - 3.3.G.5.f

Particular situations may justify consideration of a profit allowance in addition to those specifically identified elsewhere in the guidelines. These situations shall be identified and the reason(s) for their use documented in the records of price negotiation. An assigned weight of -5 to +5 percent of the basic profit factor depending on the circumstances of the particular acquisition. A zero weight designates a satisfactory or average effort.

Complexity of R&D or Services Assignment. A weighting for the complexity of the R&D or services assignment may be considered when a contract, such as an A-E contract relates to a Sandia project facility. The following complexity categories are to be used for the purpose of establishing the appropriate fee weight:

- **Class A -** Manufacturing plants involving continuous closed processes or other complicated operations requiring a high degree of design control; nuclear reactors, power generation systems and facilities and 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 advanced or unique design considerations that are peculiar to the purposes for which the facility is built.
- **Class B -** Normal manufacturing processes and assembly operations such as: ore dressing, metal working plants and simple processing plants; power plants and simple processing plants; power plant and accessory switching and transformer stations; water treatment plants; sewage disposal plants; hospitals and ordinary laboratories.
- **Class C -** Permanent administrative and general service buildings, permanent housing roads, railroads, grading, sewers, storm drains and water and power distribution systems.
- **Class D –** Construction camps and facilities and other construction of a temporary nature.

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 Sandia's payments.

Such circumstances should be taken into account in determining what profit adjustment, if any, is appropriate under this subfactor. When the Contractor will invest relatively few dollars for operating capital purposes (because of milestone payment and progress payment rates, or when an advance payment method, is used to finance the Contractor), a negative adjustment may be appropriate.

Government-Furnished Property and Materials. If Sandia is furnishing property or materials, the SCR should evaluate the effect that use of that property will have in the overall Contractor’s risk. This evaluation may indicate that the profit should be adjusted downward, especially if the property or materials provided are items that most Contractors in that industry would be expected to provide.

Send feedback on ideas and information on this page to the Process Expert, Randy Shibata.

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