

Profit on government contracts, yes it is allowed

It appears as though many of us are forgetting one of the primary purposes for establishing and operating a business — **to earn a profit**. During the 1990's, Government contractors have seen their ability to realize a profit from operations become more and more difficult. Basically, two factors have created this situation; price competition and the contracting officer's negotiation objectives.

Most competitively awarded contracts begin with a Request for Proposal (RFP) that provides the proposal evaluation criteria under Section M of the RFP. Most RFP's provide for a "Best Value" contract award. The "Best Value" award criterion allows the government to award the contract to the responsive bidder that offers the Government the best overall proposal, but not necessarily the lowest price. One might conclude that this evaluation criterion would allow responsive bidders the opportunity to earn greater profits for providing high quality products and services. Unfortunately, this is not the norm.

Usually, the best value criteria have the phrase "when all other factors are essentially equal (technical, management and past performance), price becomes the deciding factor." This situation dictates that the bidding strategy focus on the multiplier (indirect cost rate factors) plus profit.

When conducting contract negotiations with a contracting officer it is critical to follow the requirements of the Federal Acquisition Regulations (FAR) 15.404-4 Profit. This FAR section actually works for the bidder. We have found that the government often overlooks the following two key paragraphs of this FAR section:

- ♦ FAR 15.404-4(2) It is in the Government's interest to offer efficient contractors opportunities for financial rewards sufficient to stimulate contract performance, attract the best capabilities of qualified large and small business concerns to Government contracts, and maintain a viable industrial base.
- ♦ FAR 15.404-4(3) Both the Government and the contractors should be concerned with profit as a motivator of efficient and effective contract performance. Negotiations, aimed merely at reducing prices by reducing profit, without proper recognition of the function of profit, are not in the Government's interest. Negotiations of extremely low profits use of historical averages, or automatic application of predetermined percentages to total estimated costs do not provide proper motivation for optimum contract performance.

Unfortunately, we must report what we hope is a rare occurrence, that is when the Government negotiator(s) attempt to equate General & Administrative (G&A) to profit. Over the last five years we have encountered two incidents where the Government attempted this. Once in a recent contract negotiation, when unfortunately, a reference was made to a Government sponsored training class where G&A was described as being an equivalent to profit because the G&A pool contained the owner's salary. The other, when a member of Congress actually suggested that the Government not reimburse contractors for G&A expense.

These two events indicate that there is still a misunderstanding in some Government circles as to what exactly G&A is. We hate to dwell on what we consider to be a very basic premise, but nevertheless, we feel we must define it, once again. General and administrative expense represents the cost of the activities required to manage and operate a company/organization. Some of the specific activities in question are executive management, human resources, accounting and finance, contract administration, business development and management information systems. If Government officials would stop and think about it, they too, have most of these activities and the related costs contained in their respective government agencies.

Prior to leaving this topic it is important to remember the specific FAR profit ceilings for negotiated contracts:

- ♦ For experimental, developmental, or research work performed under a cost-plus-fixed-fee contract, the fee shall not exceed 15 percent of the contract's estimated cost, excluding fees.
- ♦ For architect-engineer services for public works or utilities, the contract price or the estimated cost and fee for production and delivery of designs, plans, drawings, and specifications shall not exceed 6 percent of the estimated cost of construction of the public work or utility, excluding fees.
- ♦ For other cost-plus-fixed-fee contracts, the fee shall not exceed 10 percent of the contract's estimated cost, excluding fees.

Finally, it is important to develop a comprehensive pricing strategy prior to preparing your cost proposal. Your pricing strategy should not only include your indirect cost rate factors and direct cost parameters, but a reasonable profit objective as well. The primary drivers in computing your acceptable profit objective will be the financial risk the company is assuming e.g., contract performance, work statement requirements, deliverables, degree of difficulty, and contract type, e.g., cost reimbursable, time and material, or fixed price.