Lunch and Learn: Cost/Price Realism

Defense Acquisition University

Foundational Learning

Workflow Learning

Performance Learning

31 August 2016
DAU Midwest Region, Kettering, OH 45420
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Cost/Price Realism

One of the cost/price analysis techniques addressed in the Federal Acquisition Regulation (FAR), Cost/Price realism analysis may or may not be required, and/or may manifest itself differently depending upon the circumstances of your acquisition. These circumstances and requirements will be covered as a means of introducing Cost/Price Realism in this Lunch and Learn. Scenario driven interactive illustrations will follow to explore specific analysis techniques, obtaining necessary data, and/or potential solicitation/contract provisions to mitigate risk in evaluating indirect cost and employee compensation, including uncompensated overtime.

Outline

- Setting the stage:
  - Contractor Costs and Contact Cost/Price Composition
    - Contract Direct Cost, and Indirect Cost
    - Calculation of Indirect Rates, Typical Expenses, and Type (Fixed or Variable)
  - The Regulatory Backdrop
    - Kinds/types of Government Proposal Analysis Techniques and Contractor Supporting Data
    - Cost/Price Realism Analysis (what, when, how) FAR 15.404-1(d)

- Analytical Aspects: Indirect Cost Rates
  - Government Contract Types and Indirect Cost Rate Cycle
  - Contractor operating leverage; rate risk and opportunities
  - Scenarios; potentially unrealistic, or not?

- Analytical Aspects: Direct Labor Cost
  - (Executive) Compensation Ceilings
  - Professional Compensation Disclosures
  - Uncompensated Overtime (UCOT) Provisions
  - Illustrated Scenario

Assume company only has two (2) contracts. Prototype R&D contract (A) requires $13,875 in direct material and subcontracts, $96,000 in engineering direct labor and $20,000 in manufacturing direct labor. A production contract (B) requires $55,500 in direct material and subcontracts, $24,000 in engineering direct labor and $60,000 in manufacturing direct labor. The company's plant-wide indirect cost rates were calculated for the budget year, and applied in pricing these two contracts, as follows: Mat. O/H (12%), Eng. O/H (98%), Mfg. O/H (210%), and G&A (10%).

	Contract A R&D Prototype		Contract B Production		Total Cost Allocated
Material	$13,875		$55,500		$69,375
Mat O/H @ 12%	$1,665		$6,660	4X	$8,325
Engineering Labor	$96,000		$24,000		$120,000
Eng. O/H @ 98%	$94,080	4X	$23,520		$117,600
Manufacturing Labor	$20,000		$60,000		$80,000
Mfg. O/H @ 210%	$42,000		$126,000	3X	$168,000
Sub-total Production	$267,620		$295,680		$563,300
G&A @ 10%	$26,762		$29,568		$56,330
Total Cost	$294,382		$325,248		$619,630

Some Interesting Observations – Composition of Direct and Indirect Contract Costs

- All the <u>direct cost</u> were uniquely estimated with respect to the particular contract requirements. Identify the names of XYZ's direct costs?

- All the <u>indirect costs</u> were estimated by applying the same (identical) plant-wide rates to both contracts. So . . . .
  - Why did the production contract receive four (4) times the Mat. OH cost, and three (3) times the Mfg. OH cost?
  - Why did the R&D contract receive four (4) times the Eng. OH cost?

- Rounding to the whole percentage point, what percentage of XYZ's total operating cost are:
  - Direct Cost?
  - Indirect Cost?

Some Interesting Observations – Calculation of Indirect Rates, Typical Expenses, and Type (Fixed or Variable)

- Consider a typical contractor’s summary of accounts in submitting a plant-wide Mfg. OH Rate forward pricing rate (FPR) proposal for pricing all contracts in 2016 (next page).
  - What is the contractor reporting as their actual rates already experienced for the years 2013, 2014, and 2015?
  - What rate is the contractor proposing to price 2016 contracts? How is this rate calculated?
  - How much is the contractor projecting in total direct manufacturing labor costs to complete all potential business for all customers in 2016? How does this compare to the prior years’ actual business?
  - Had the projected total pool expenses for 2016, when compared to the prior year actual expenses, not also increased; the proposed 2016 rate would have been even (higher or lower)? Why?
  - How much of the pool expenses has the contractor already characterized as “Fixed Charges”? Could additional charges be “fixed”?
- An illustration of typical pool expenses found in a G&A Rate proposal is provided on the page following (but without the base information).

	Account Title	Actual 2013	Actual 2014	Actual 2015	Projected 2016
	Manufacturing Overhead Rate History and Projection				
Pool	**Salaries & Wages**				
	Indirect Labor	$1,338,330	$1,236,259	$1,395,245	$1,443,095
	Additional Compensation	$80,302	$75,490	$83,950	$88,000
	Overtime Premium	$13,214	$15,744	$11,296	$14,500
	Sick Leave	$65,575	$64,717	$67,742	$72,130
	Holidays	$79,164	$82,041	$83,006	$86,080
	Suggestion Awards	$310	$450	$423	$500
	Vacations	$140,272	$130,223	$147,891	$153,300
	Personnel Expenses				
	Compensation Insurance	$25,545	$24,544	$26,304	$28,500
	SUTA/FUTA	50,135	$46,762	$52,692	$51,500
	FICA/Medicare	$70,493	$65,990	$73,907	$77,850
	Group Insurance	$153,755	$143,670	$161,401	$169,130
	Travel Expense	$11,393	$9,636	$12,725	$13,900
	Dues & Subscriptions	$175	$175	$175	$175
	Recruiting & Hiring	$897	$431	$574	$250
	Employee Relocation	$4,290	$3,891	$3,562	$4,400
	Employee Pension Fund Salaried Hourly	$25,174 $62,321	$25,062 $58,132	$26,350 $65,497	$28,500 $68,700
	Training, Conferences, Tech Meetings	$418	$407	$539	$457
	Educational Loans & Scholarships	$400	$400	$400	$400
	General Operating	$495,059	$475,564	$509,839	$525,000
	Maintenance: Building	$9,102	$8,640	$12,318	$15,700
	Stationary, Printing, Office Supplies	$23,052	$21,530	$24,125	$25,500
	Material O/H on Supplies	$56,566	$49,305	$62,071	$62,500
	Maintenance: Office Equipment	$9,063	6,673	$10,875	$12,000
	Rearranging	$418	$2,128	$3,523	$3,600
	Other	$3,314	$3,198	$2,635	$2,500
	Heat, Light, & Power	$470,946	$446,971	$489,123	$507,200
	Telephone	$32,382	$30,414	$33,874	$35,000
	Fixed Charges				
	Depreciation	$187,118	$178,625	$175,641	$181,850
	Equipment Rental	$7,633	$7,633	$7,633	$7,633
	Total Pool	**$3,416,816**	**$3,214,705**	**$3,545,336**	**$3,679,850**
Base	**Manufacturing Direct Labor Cost**				
	Assembly Labor	$934,444	$898,780	$950,432	$999,700
	Fabrication Labor	$233,071	$225,950	$253,999	$258,100
	Inspection Labor	$173,372	$180,928	$203,500	$209,400
	Total Base	**$1,340,887**	**$1,305,658**	**$1,407,931**	**$1,467,200**
Rate	**Manufacturing Overhead Rate**	**254.8%**	**246.2%**	**251.8%**	**250.8%**

	Account Title	Actual 2013	Actual 2014	Actual 2015	Projected 2016
	General & Administrative Expense Rate History and Projection				
Pool	**Salaries & Wages**				
	Indirect Labor	$1,407,100	$1,426,042	$1,458,724	$1,460,500
	Additional Compensation	$125,431	$120,410	$152,691	$155,000
	Overtime Premium	$4,883	-0-	$5,069	$5,000
	Sick Leave	$34,875	$33,262	$32,937	$32,500
	Holidays	$49,962	$49,260	$50,013	$49,500
	Suggestion Awards	$240	$402	$225	$250
	Vacations	$80,637	$79,260	$81,398	$82,525
	Personnel Expenses				
	Compensation Insurance	$1,025	$902	$1,103	$1,200
	SUTA/FUTA	$22,465	$21,526	$23,591	$23,600
	FICA	$31,419	$28,620	$31,519	$32,000
	Group Insurance	$29,008	$28,942	$29,226	$29,300
	Travel Expense	$62,513	$70,001	$64,987	$67,000
	Dues & Subscriptions	$2,375	$2,210	$2,119	$2,500
	Recruiting	$1,378	$902	$1,075	$1,250
	Employee Relocation	$566	$2,125	$1,974	$1,500
	Employee Pension Fund Salaried	$33,097	$31,625	$34,123	$35,000
	Hourly	$17,632	$15,260	$17,956	$18,500
	Training, Conferences, Tech Meetings	$7,003	$8,102	$7,536	$7,500
	Courtesy Meal Expense	$6,238	$6,124	$5,436	$7,000
	Educational Loans & Scholarships	$1,392	$624	$1,525	$1,500
	Supplies				
	Operating	$2,010	$1,862	$1,724	$2,000
	Maintenance - Building	$411	$4,262	$856	$750
	Stationary, Printing, Office Supplies	$32,515	$27,640	$33,209	$33,500
	Postage	$1,651	$2,316	$2,056	$2,100
	Material O/H on Supplies	$1,732	$1,710	$1,634	$1,980
	Maintenance - Equipment	$938	$950	$983	$1,000
	Other	$15,829	$18,216	$16,982	$17,500
	Public Utilities				
	Telephone	$59,105	$63,142	$61,372	$65,000
	Heat, Light, & Power	$237,512	$211,403	$241,298	$245,000
	Miscellaneous Income & Expense				
	Legal & Auditing	$16,714	$18,260	$10,945	$15,000
	Professional Services	$21,197	$24,000	$23,791	$22,500
	Patent Expense	$18,466	$17,620	$9,084	$10,000
	Public Relations	$12,155	$14,670	$14,172	$15,000
	Interdivisional Transfers				
	At Cost	($48,243)	-0-	-0-	-0-
	Corporate Expense				
	Headquarters	$1,556,956	$1,467,024	$1,673,824	$1,700,000
	Fixed Charges				
	Insurance Property	$9,820	$9,926	$10,930	$11,000
	Insurance Inventories	$4,024	$4,862	$4,543	$4,500
	Franchise Tax	$268,495	$260,126	$246,624	$265,000
	Rent – Equip	$1,426	$1,426	$1,426	$1,426
	Total Pool	**$4,131,952**	**$4,075,014**	**$4,358,680**	**$4,426,381**

The Regulatory Backdrop: Kinds/types of Government Proposal Analysis and Contractor Supporting Data (FAR 15.404, summarized with some interpretation)

- Fair and "reasonable" prices is the overarching regulatory objective; GAO protest decisions, however, interpret regulations, and further differentiate reasonableness (cost/price not too high), from realism (cost/price not too low).
- Price Analysis: comparing current and/or recent historical bottom line total prices when certified cost or pricing data are not required with these statutory exceptions . . .
  - Sealed bidding (lowest price award with NO discussion – pure price competition)
  - Under $750,000 and/or Simplified Acquisition Threshold (SAT)
  - Commercial Item (commercial market establishing price reasonableness)
  - Head of Contracting Activity exceptional cases with written waiver/determination
  - Price Competition (adequate for price reasonableness in best value competitions)
- Cost Analysis: analysis of all contractor cost elements (typically) when certified data are required; and/or selected elements of cost (typically) when certified data are not required (e.g. commercial items, waiver) going to reasonableness determination.
- Cost Realism Analysis: used in supporting contract award decisions in competitive acquisitions with selected data requested as outlined in solicitation, but also for ensuring sufficient funding is available for the work to be performed.
- Technical analysis: required in making commercial item determinations (CIDs) and/or supporting price analysis, cost analysis, and cost realism determinations and analysis.

(d) *Cost realism analysis*. (1) Cost realism analysis is the process of independently reviewing and evaluating specific elements of each offeror's proposed cost estimate to determine whether the estimated proposed cost elements are realistic for the work to be performed; reflect a clear understanding of the requirements; and are consistent with the unique methods of performance and materials described in the offeror's technical proposal.

(2) Cost realism analyses shall be performed on cost-reimbursement contracts to determine the probable cost of performance for each offeror.

(i) The probable cost may differ from the proposed cost and should reflect the Government's best estimate of the cost of any contract that is most likely to result from the offeror's proposal. The probable cost shall be used for purposes of evaluation to determine the best value.

(ii) The probable cost is determined by adjusting each offeror's proposed cost, and fee when appropriate, to reflect any additions or reductions in cost elements to realistic levels based on the results of the cost realism analysis.

(3) Cost realism analyses may also be used on competitive fixed-price incentive contracts or, in exceptional cases, on other competitive fixed-price-type contracts when new requirements may not be fully understood by competing offerors, there are quality concerns, or past experience indicates that contractors' proposed costs have resulted in quality or service shortfalls. Results of the analysis may be used in performance risk assessments and responsibility determinations. However, proposals shall be evaluated using the criteria in the solicitation, and the offered prices shall not be adjusted as a result of the analysis.

FAR 15.404-1(d) *Cost realism analysis*

- One of the proposal analysis techniques found at FAR 15.404-1.
- Used in competitive source selections – "evaluating . . . each offeror's proposed"
- For Cost Reimbursement Contracts
  - No choice, mandated – "shall"
  - Probable cost determination
    - "Most Likely" (aka MPC)
    - Adjustments (+ or -) of proposed "to realistic levels"
    - Determines winner
  - Reasoning (GAO Protest Decisions) – proposal estimates not controlling in cost contracts.
- For Fixed Price Contracts
  - Permissive, "may", on incentive contracts
  - "exceptional" case on other fixed price
    - MPC adjustments prohibited
    - Performance risk and/or responsibility assessments only
  - So called "price realism" legal principle constructed in GAO protest decisions
  - Explicit "reserve the right "language required in solicitation
  - Loose solicitation language can obligate one be done even if not intended
  - Can present difficulties in sustaining government award decision before GAO.

Purpose and Conduct of Cost Realism

When an agency evaluates proposals for the award of a cost reimbursement contract, an <u>offeror's proposed estimated costs of contract performance are not considered controlling</u>, since an offeror's estimated costs may not provide valid indications of the final actual costs that the government is required, within certain limits, to pay. Consequently, a cost realism analysis must be performed by the agency to determine the extent to which an offeror's proposed costs represent what the contract should cost, assuming reasonable economy and efficiency. Because the contracting agency is in the best position to make this cost realism determination, our review is limited to determining whether the agency's cost realism analysis is reasonably based and not arbitrary.

General Research Corp., B-241569, Feb. 19, 1991, 91-1 CPD ¶ 183 at 5.

- Proposed cost of contract performance on cost reimbursable contracts are not controlling; and may not be a valid indication of final actual costs the Government is required to pay.

- Comptroller (GAO) review authority on deciding bid protests is limited to determining whether the cost realism analysis is reasonably based and not arbitrary; because the contracting agency is in the best position to make the cost realism determination.

Cost/Price Realism Actions

- Cost Reimbursable Contracts (adjusted values used for award decision)

	Contractor A	Contractor B	Contractor C
Proposed	$1,000,000	$1,400,000	$1,600,000
Realism Adjusted	$1,450,000	NA	$1,500,000

  – And the winner is ____________________ at $_____________________.
  – How/why does Government have such audacity (besides mandate of the regulation)?

    Cost reimbursable; what’s bid is not what’s paid.

    Consider Contractor B’s contention, if the adjustment weren’t made.

- Fixed Price Contracts
  – Results may NOT be used to adjust for award decision.

    Why not? Its fixed price, what’s bid is what’s paid.

  – May be used to investigate for performance risk (yellow)
  – Reevaluate responsibility determination (can they financially absorb the loss to still deliver)

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- Analytical Aspects: Indirect Cost Rates
  - Government Contract Types and Indirect Cost Rate Cycle
  - Contractor operating leverage; rate risk and opportunities
  - Scenarios; potentially unrealistic, or not?

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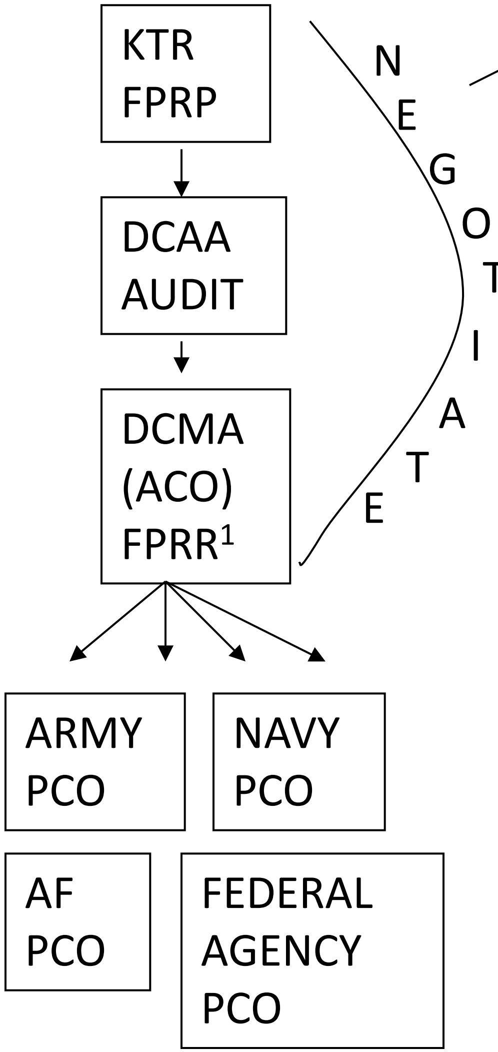
Contract Types and Rate Types

- Firm-Fixed-Price
  - Forward Pricing Rates only are used, both up front and for final price paid; price bid, or negotiated, is the final price paid.
  - If contract financing authorized with progress payments, Interim Billing Rates may be used to calculate loan disbursements which will be liquidated at delivery.

- Cost Reimbursable Contracts
  - Forward Pricing Rates used only to establish contract targets and funding requirements.
  - Interim Billing Rates, updated (e.g. monthly) as pool expenses and/or business base changes, used to provisionally pay actual cost invoices during the year with a true-up adjustment near the end of the year.
  - Final Rates, calculated when all pool expenses and business actually performed have been accounted for during the year, used to close contracts performed.

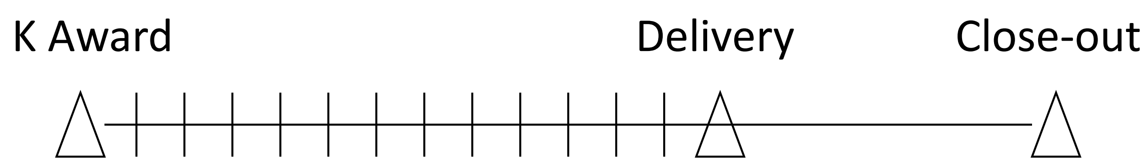
Rate Cycle

CPRG Vol. 4, Chapter 2 (Tab D-11) https://acc.dau.mil/CommunityBrowser.aspx?id=379604#2.3.1



FPRA (FAR 15.407-3 and 42.17)

- Must be used by all PCO's
- Either Ktr. or Govt. may bail-out at any time
- Only used in K formation (only "paid" if FFP K)



Billing Rates (FAR 42.704)

- Made during performance
- For public vouchers (CR) (or PP financing on FP)
- ↑Rates → ↑ Billings
- ↓Rates → ↓ Billings
- Billings provisional in nature (subject to final rates)

Final Rates (FAR 42.705)

- Annual year-end
- Makes "final" payment
- Closes flexibly priced Ks (CR & FPI)
- Audit/Approval can be lengthy if many acctng "issues" crossing years

1- FAR 42.1701(a) FPRAs (FPRRs) for contractors with significant Government volume (at one time $200M). But check DCMA Policy 130 at http://www.dcma.mil/policy/130/DCMA-INST-130.pdf.

Consider the following: applying FPRs on change orders.

- You're negotiating a FFP change to an existing FFP annual lot buy contract for jet engines – should you go ahead and use the FPRs?
- If you were a sole-source prime contractor using predominantly FFP contracts, how much would you put in the base (remembering conservative base = higher rates).
  - Anything but existing contracts, firm known current requirements?
  - Anything in for new/unknown business such as change orders?
- If the answer to those questions above is NO – then wasn't the overhead already paid by the government's recent annual FFP lot buys applying that rate?
  - At least the fixed cost portion?

$R_{PROPOSED} = \frac{\text{Pool}}{\text{Base}}$

<u>Pool $$$$$</u>

- F100 (F15/F16)
- TF30 (F14)
- TF33 (KC135)

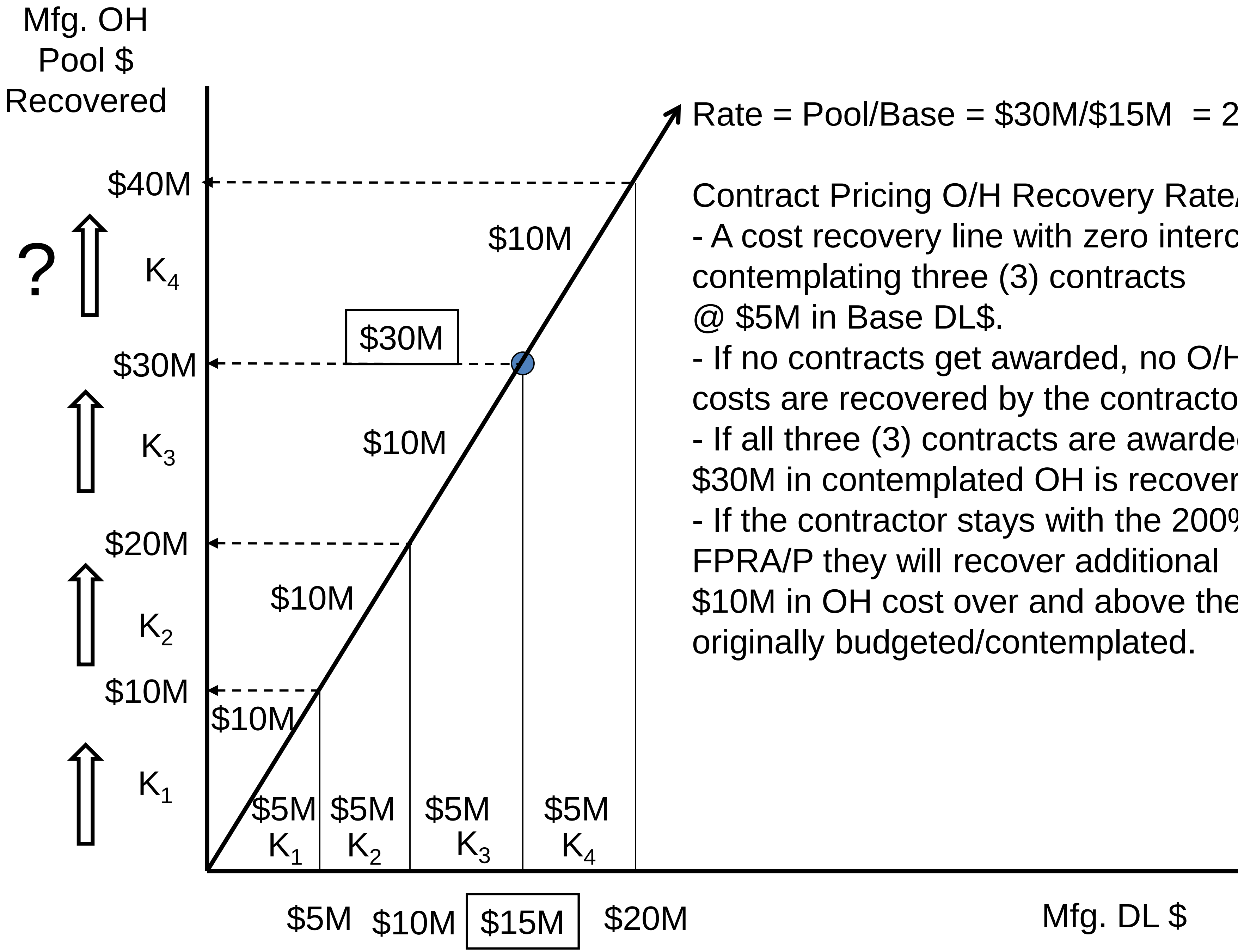
- ECPs/CCPs (????)

If the total overhead has been fully applied (paid) here, because that was all that was put in the conservative base when proposing the higher rate used here;

should I apply that rate again here?

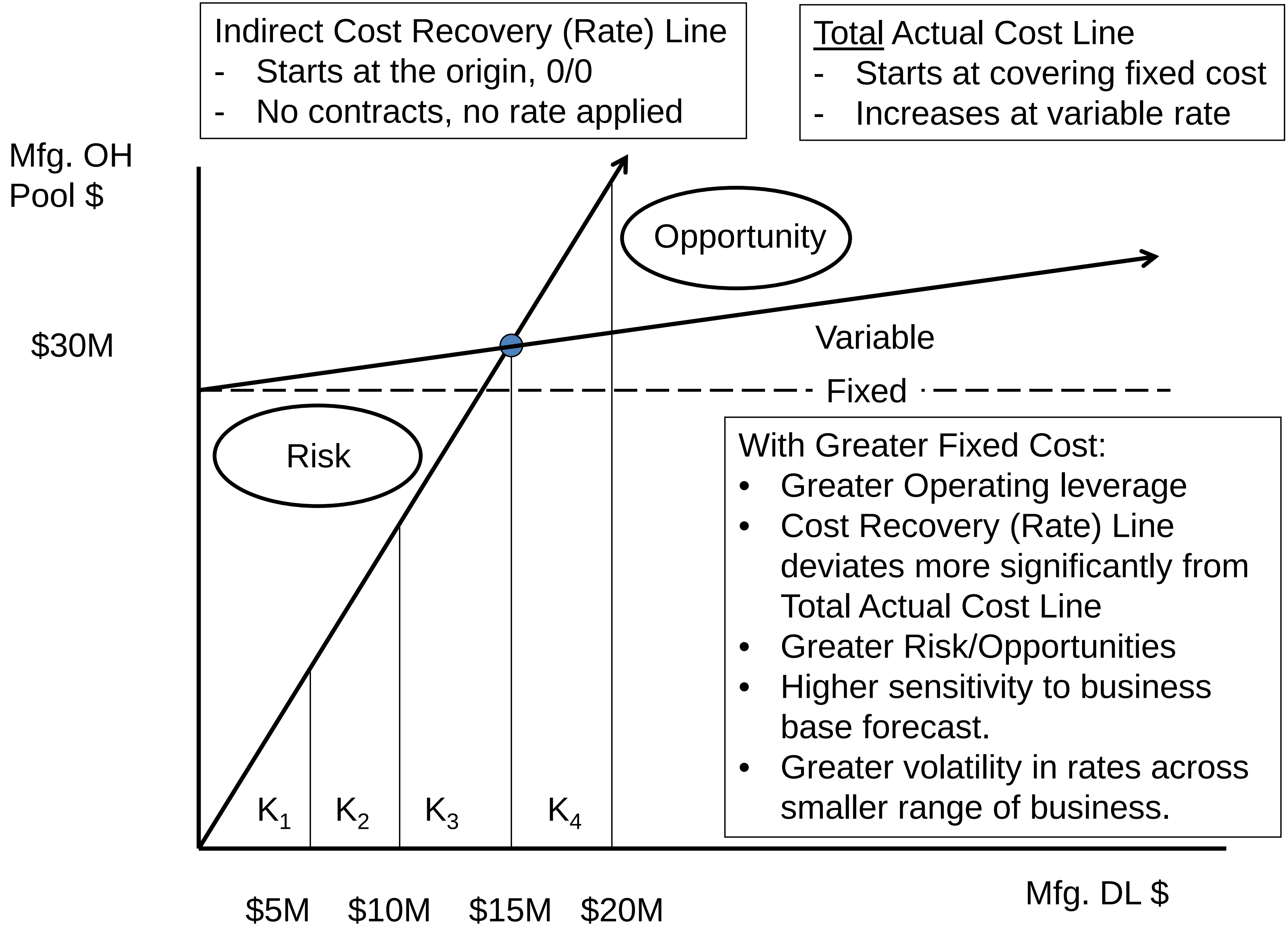
Impact of Leverage (fixed cost) in Rates; Risk and/or Opportunities

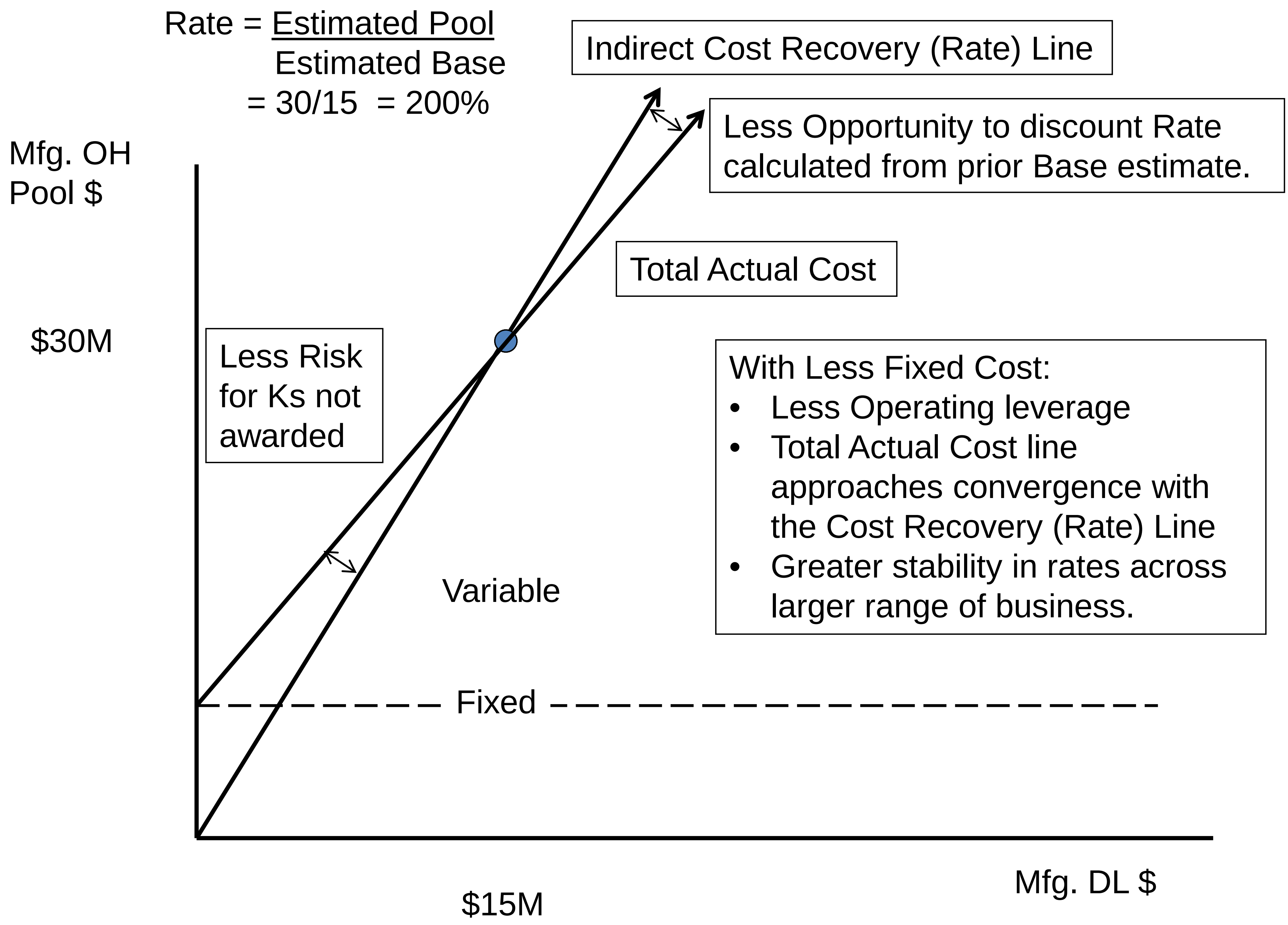
- Scenario:
  - Contractor proposed expense pool of $30M.
  - Proposed manufacturing labor base of $15M; assumes 3 contracts @ $5M in manufacturing direct labor.
  - ACO negotiates FRPRA at 200% ($30M pool / $15M base = 200%).
  - Early on all three (3) PCOs use the FPRA in forming contracts; <u>**all**</u> **FFP**.
- Along comes a fourth NEW contract (also with $5M in manufacturing labor).
  - If the FPRA is used, will the actual Mfg. O/H expense recovered exceed that considered by the ACO in the FPRA negotiations?
  - Since these are FFP contracts, is this a windfall profit for the contractor?
  - If the fourth potential contract is competitive FFP, should the contractor bid based on the full FPRA rate? Or do they have opportunity to rationally bid lower than the last FPRA rates in the interest of winning the new business?
  - In a competitive evaluation, should the government consider a proposal using less than the full FPRA rate an unrealistically low offer; calling into question either their financial responsibility, or rating performance risk as high for this contractor?



Rate = Pool/Base = $30M/$15M = 200%

Contract Pricing O/H Recovery Rate/Line
- A cost recovery line with zero intercept contemplating three (3) contracts @ $5M in Base DL$.
- If no contracts get awarded, no O/H costs are recovered by the contractor.
- If all three (3) contracts are awarded, all $30M in contemplated OH is recovered.
- If the contractor stays with the 200% FPRA/P they will recover additional $10M in OH cost over and above the $30 originally budgeted/contemplated.


Indirect Cost Recovery (Rate) Line
- Starts at the origin, 0/0
- No contracts, no rate applied
Total Actual Cost Line
- Starts at covering fixed cost
- Increases at variable rate
Mfg. OH Pool $
Opportunity
$30M
Variable
Fixed
Risk
With Greater Fixed Cost:
• Greater Operating leverage
• Cost Recovery (Rate) Line deviates more significantly from Total Actual Cost Line
• Greater Risk/Opportunities
• Higher sensitivity to business base forecast.
• Greater volatility in rates across smaller range of business.
K_1
K_2
K_3
K_4
Mfg. DL $
$5M
$10M
$15M
$20M


Rate = Estimated Pool / Estimated Base
= 30/15 = 200%
Indirect Cost Recovery (Rate) Line
Less Opportunity to discount Rate calculated from prior Base estimate.
Mfg. OH Pool $
Total Actual Cost
$30M
Less Risk for Ks not awarded
With Less Fixed Cost:
• Less Operating leverage
• Total Actual Cost line approaches convergence with the Cost Recovery (Rate) Line
• Greater stability in rates across larger range of business.
Variable
Fixed
Mfg. DL $
$15M

Three Contracts and a Fourth Summary

- We ascertained the new, fourth contract had NOT been included in the base when calculating the forward pricing rate.
- We made note of how much operating leverage (fixed cost) actually exists in the pools.
  - More leverage, more flexibility to discount rates.
  - Less leverage, less variation in rates expected.
  - Pools with predominantly variable costs very stable across broader range.
- We made note the fourth contract to come along was fixed-price.
  - If flexibly priced contract (e.g. cost reimbursable), deep discounting in rates proposed will not materialize in billing rates recalculated after award.
  - Without a rate ceiling capping deeply discounted rates covering only variable cost, re-allocation of fixed cost will materialize within increased billing rates.
- We made note that the existing portfolio of three contracts were also fixed-price.
  - Rebates to existing fixed-price customers will NOT be made as a result of rates recalculated (lowered) resulting from the fourth contract increasing base.
  - Without having to rebate those fixed price contracts with lowered billing rates, the fixed cost has truly been absorbed and paid by those fixed-price contracts.
  - If flexibly priced (e.g. cost reimbursable) contracts are in the existing portfolio, lower billing rates recalculated after award will essentially rebate those contracts for a share of the fixed costs previously “priced” there.

Legitimate concern for Cost/Price Realism?

- The contractor explains they were able to use Overhead and G&A rates <u>significantly</u> below their recent rates by only having to include their variable cost – thus their low cost/price is, in fact, realistic.
- You have requested a copy of their recent FPRP. They do, in fact, have a significant amount of fixed cost in their expenses providing operating leverage and opportunity for rate variations. Your acquisition was also in the business base used for calculating the rates proposed in the FPRP.
- Should you be concerned regarding the realism of their proposal?

- ❑ **Your contract in the FPR base?**
- ❑ **Significant operating leverage in pools?**
- ❑ **Your contract FFP?**
- ❑ **Existing contracts mostly FFP?**

Legitimate concern for Cost/Price Realism?

- The contractor explains they were able to use Overhead and G&A rates <u>significantly</u> below their recent rates by only having to include their variable cost – thus their low cost/price is, in fact, realistic.
- The likely competitors are all established in the professional services sector who actively manage their businesses to reduce or eliminate fixed cost. Even the heavy manufacturers breaking into providing professional services have reorganized so their profit centers in this market have very little fixed cost, or leverage built into their indirect rates.
- Should you be concerned regarding the realism of their proposal?

- ❑ **Your contract in the FPR base?**
- ❑ **Significant operating leverage in pools?**
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Legitimate concern for Cost/Price Realism?

- The contractor explains they were able to use Overhead and G&A rates significantly below their recent rates by only having to include their variable cost – thus their low cost/price is, in fact, realistic.
- You had obtained information that there is indeed some degree of leverage (fixed cost) in the indirect rates. Furthermore, a survey of the contractor's portfolio of existing contracts find the vast majority to be Government flexibly priced contracts (cost plus, and fixed-price incentive).
- Should you be concerned regarding the realism of their proposal?

- ❑ **Your contract in the FPR base?**
- ❑ **Significant operating leverage in pools?**
- ❑ **Your contract FFP?**
- ❑ **Existing contracts mostly FFP?**

Legitimate concern for Cost/Price Realism?

- The contractor explains they were able to use Overhead and G&A rates <u>significantly</u> below their recent rates by only having to include their variable cost – thus their low cost/price is, in fact, realistic.

- You had obtained information that there is indeed some degree of leverage (fixed cost) in the indirect rates. Furthermore, a survey of the contractor's portfolio of existing contracts find they are practically all commercial (and/or Government) firm-fixed-price (FFP) contracts.

- Should you be concerned regarding the realism of their proposed FFP?

- ❑ **Your contract in the FPR base?**
- ❑ **Significant operating leverage in pools?**
- ❑ **Your contract FFP?**
- ❑ **Existing contracts mostly FFP?**

Legitimate concern for Cost/Price Realism?

- The contractor explains they were able to use Overhead and G&A rates <u>significantly</u> below their recent rates by only having to include their variable cost – thus their low cost/price is, in fact, realistic.
- You had obtained information that there is indeed some degree of leverage (fixed cost) in the indirect rates. Furthermore, a survey of the contractor's portfolio of existing contracts find they are practically all commercial (and/or Government) firm-fixed-price (FFP) contracts
- Should you be concerned regarding the realism of their proposed CPFF?

- ❑ **Your contract in the FPR base?**
- ❑ **Significant operating leverage in pools?**
- ❑ **Your contract FFP?**
- ❑ **Existing contracts mostly FFP?**

Rate Caps?

- No known prohibition – indeed, FAR 31.201-2(a) specifically provides that any otherwise allowable cost (such as overhead costs over the capped rate) can be made unallowable by mutual agreement of the parties through the provisions of the contract signed bilaterally.
- There could be difficulties adding a rate cap for an individual offeror after the solicitation goes out and individual offers have been received.
- If rate caps are to be used, consider putting the provision in the solicitation upfront.

OSD Level Peer Reviews

Best Practices, Lessons Learned, and Recommendations (as of December 20, 2013)

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Pricing	Competitive Multiple Award Services Contract	Regarding the manner in which the source selection team (SST) addressed one offeror that had been flagged by DCAA as proposing rates the offeror was likely to exceed in actual performance: noted that rates were approved by DCMA. In discussions, the SST secured assurance from this offeror that they would be willing to agree to ceiling amounts for their overhead rates. The peer review team suggested that, instead, this situation could be addressed with a cost realism adjustment to the offeror's evaluated/probable cost. The PRT recommended a more detailed legal analysis as to whether it would be appropriate to establish such a ceiling agreement for one offeror, particularly given the fact that some Contract Line Item Number (CLINs) will be cost reimbursable.	Phase 2	Recommendation

Outline

√ Setting the stage:
- Contractor Costs and Contact Cost/Price Composition
  - Contract Direct Cost, and Indirect Cost
  - Calculation of Indirect Rates, Typical Expenses, and Type (Fixed or Variable)
- The Regulatory Backdrop
  - Kinds/types of Government Proposal Analysis Techniques and Contractor Supporting Data
  - Cost/Price Realism Analysis (what, when, how) FAR 15.404-1(d)

√ Analytical Aspects: Indirect Cost Rates
- Government Contract Types and Indirect Cost Rate Cycle
- Contractor operating leverage; rate risk and opportunities
- Scenarios; potentially unrealistic, or not?

Analytical Aspects: Direct Labor Cost
- (Executive) Compensation Ceilings
- Professional Compensation Disclosures
- Uncompensated Overtime (UCOT) Provisions
- Illustrated Scenario

Compensation Ceilings - FAR 31.205-6(p)
(formerly known as executive compensation ceilings)

- One of the cost principles at FAR 31 used in cost-based pricing that limits reimbursement in cost type contracts and negotiating fixed price contracts using cost analysis.
- Dates back to 1995 for DoD (DFARS) set at $250,000; adopted into FAR effective 1997.
- Recent changes (see OFPP Memo March 16, 2016)
  - From "executives" (e.g. CEO, Top 5) to all employees (FY 2012 NDAA)
  - Statutory formula-adjusted caps for contracts awarded before June 24, 2014 (now up to $1,144,888) replaced for contracts awarded after June 24, 2014 by the Bipartisan Budget Act of 2013 (BBA) with new cap of $487,000.
- Contractors may still pay any employee any amount they choose to, these ceilings only limit what they will be reimbursed by the Government.
- Application in Cost Realism Analysis for Cost Type contracts: a MPC adjustment might lower a contractors proposed cost for evaluation to these ceilings if they were overlooked by the contractor.

Professional Employee Compensation Rates and Uncompensated Overtime (UCOT)

- Professional Employee Compensation - solicitation provision FAR 52.222-46
  - Professional employees exempt from Service Contract Act of 1965.
  - Disclosures required on negotiated contracts > $650,000 (FAR 22.1103).
  - Corporate “Plans” part of Internal Controls reviewed cyclically (2-4 years) by DCAA for large contractors (DCAM 5-800); can be rather “HR”ish in nature.
  - Disclosure should also include data (national/regional pay surveys).
  - Idea is to identify unrealistically low compensation (pay) being proposed; insufficient for securing/retaining the skills needed to do the job satisfactory.

- Uncompensated Overtime (UCOT) – solicitation provision FAR 52.237-10
  - Employees exempt from the Fair Labor Standards Act of 1938.
  - Use of uncompensated overtime is not encouraged.
  - Disclosure required when purchasing hours rather than tasks (FAR 37.115).
  - Disclosure is only with respect to UCOT planned on subject contract.
  - Government must conduct risk (?) assessment for unrealistically low rates.
  - When there is uncompensated overtime (acknowledged), the adjusted rate, rather than the hourly rate, shall be applied to all proposed hours (?).

Cost Realism Analysis - Compensation & UCOT

- Consider the following:
  - Requirement for A&AS support in Government offices.
  - Expect regular 40hrs/week aligned with Government employees' work schedule.
  - Currently don't expect any "overtime" to be required; but you never know when mission happens.

- Three (3) contractors submit offers:
  - Contractors A, B, and C propose hourly rates of $25.00, $20.00, and $16.67, respectively [1].
  - All three submit their glossy HR Compensation Plans as required.
  - None of the competitors are contemplating any overtime to be worked <u>on your contract</u> (just as you've noted in your solicitation).
  - All three have accounting systems deemed adequate for determining costs applicable to the contract.
  - All three assert their proposed rates to be consistent with their cost accounting practices which will be used to accumulate and invoice costs.

[1] For simplicity assume no indirect (OH, G&A) cost.

Cost Realism Analysis - Compensation & UCOT

Contractor:	A	B	C
D.L. Rate/Hour in Proposal:	$ 25.00	$ 20.00	$ 16.67
Annualized @ 2080 hours/year:	$ 52,000.00	$ 41,600.00	$ 34,673.60

- Professional Employee Compensation Information (FAR 52.222-46)
  - Info about the Company's HR Plan; difficulty connecting it to proposal.
  - Market Based Pay Survey information from pre-solicitation market research, however, raises realism concern with Contractor C's pay sufficient for skills required.

- You turn to the Uncompensated Overtime (UCOT) disclosures (52.237-10)
  - No contractor has identified ANY hours in their proposal in excess of 40 hours per week as being planned for your contract (which is all the provision requires).
  - Each contractor affirms their proposed rates are 100% consistent with their cost accounting practice as also required by the provision.

- What will you do with/about Contractor C?

Cost Realism Analysis - Compensation & UCOT

Contractor:	A	B	C
D.L. Rate/Hour in Proposal:	$ 25.00	$ 20.00	$ 16.67
Annualized @ 2080 hours/year:	$ 52,000.00	$ 41,600.00	$ 34,673.60

Per 37.115-2(d), and as stated in the solicitation provisions at 52.237-10(d):

Will you consider Contract C a risk, and/or adjust their rate upward in a MPC?

- ***General Research Corp***. Comp. Gen. Dec. B-241569, Feb 19, 1991
  - Contracting office blindly relied on advice (DCAA) regarding GRC accounting practice.
  - GRC's proposed rates completely consistent with their accounting practice, which also happened to be the practice preferred by the DCAA Contract Audit Manual (DCAM).
  - MPC adjustment (upward) found inconsistent with acceptable accounting practice; protest sustained.
- ***SRS Technologies*** Comp. Gen. Dec. B-291618.2, Feb 24, 2003 (Contractor A – Sparta, Contractor B – SRS)
  - Neither offeror (Sparta or SRS) proposed hours beyond those solicited and there was <u>no requirement that the proposed personnel be dedicated</u> to the contract; both accounting methods "acceptable."
  - Proposed estimated cost are not controlling in cost reimbursable contracts, thus cost realism is required to assess final actual costs that will be required to actually pay (per the accounting system).
  - SRS rates pass UCOT savings on to Government with every hour billed (Sparta's does not, nor is there any contractual means to compel/require Sparta to perform the contract with uncompensated OT).
  - In its cost realism analysis agency required to accept SRS's rates based on UCOT; protest sustained.

UCOT – Two (2) Legal Accounting Treatments

Say - must work 60 hours/week to earn $1,000/week.

<u>40-Hour Accounting</u>

	Sun	Mon	Tue	Wed	Thu	Fri	Sat
7:00							
8:00		$25.00	$25.00	$25.00	$25.00	$25.00	$0
9:00		$25.00	$25.00	$25.00	$25.00	$25.00	$0
10:00		$25.00	$25.00	$25.00	$25.00	$25.00	$0
11:00		$25.00	$25.00	$25.00	$25.00	$25.00	$0
12:00							
1:00		$25.00	$25.00	$25.00	$25.00	$25.00	$0
2:00		$25.00	$25.00	$25.00	$25.00	$25.00	$0
3:00		$25.00	$25.00	$25.00	$25.00	$25.00	$0
4:00		$25.00	$25.00	$25.00	$25.00	$25.00	$0
5:00		$0	$0	$0	$0	$0	$0
6:00		$0	$0	$0	$0	$0	$0
7:00							

Only "regular" work hours charged to projects/contracts.

Say - must work 60 hours/week to earn $1,000/week.

<u>Total Time Accounting (TTA)</u>

	Sun	Mon	Tue	Wed	Thu	Fri	Sat
7:00							
8:00		$16.67	$16.67	$16.67	$16.67	$16.67	$16.67
9:00		$16.67	$16.67	$16.67	$16.67	$16.67	$16.67
10:00		$16.67	$16.67	$16.67	$16.67	$16.67	$16.67
11:00		$16.67	$16.67	$16.67	$16.67	$16.67	$16.67
12:00							
1:00		$16.67	$16.67	$16.67	$16.67	$16.67	$16.67
2:00		$16.67	$16.67	$16.67	$16.67	$16.67	$16.67
3:00		$16.67	$16.67	$16.67	$16.67	$16.67	$16.67
4:00		$16.67	$16.67	$16.67	$16.67	$16.67	$16.67
5:00		$16.67	$16.67	$16.67	$16.67	$16.67	$16.67
6:00		$16.67	$16.67	$16.67	$16.67	$16.67	$16.67
7:00							

All work hours charged to all contracts at same rate.

- 40-hour practice provides opportunity to “bill” only for the “regular” time (say to a Government CPFF contract to completely pay employee’s salary?), while the <u>remaining 20 hours required for employment worked “uncompensated”</u> for “free” on other projects (FFP contracts?) .
- Government concern for distortion in allocating direct and associated indirect cost for potential CAS 418 and/or FAR 31.201-4 violations.
- DCAA procedures for incurred cost (contract closeout) audits (DCAM 6-410) recognizes Total Time Accounting as an acceptable method (6-410.4), although “other possible accounting methods” (6-410.5) are recognized along with “materiality considerations (6-410.6). I.E. TTA still legal.

Cost Realism Analysis - Compensation & UCOT

Armed with a little legal and accounting practice insight; before immediately assessing risk, and/or doing an MPC adjustment (increase) on Contractor C evaluated cost rates – let's say we first seek "clarification" [1] regarding Contractor A, B, and C's; 1) terms of employment, 2) accounting practice for UCOT (whether contemplated on our contract, or not), and 3) the basis for their proposed rates.

Contractor:	A	B	C
Accounting Method:	40 Hour	Total Time	Total Time
Required Hours/Week:	60	50	60
Salary/Week:	$1,000	$1,000	$1,000
Rate/Hour:	$25.00	$20.00	$16.67

- If we had considered Contractor A's compensation of $52,000 ($25.00/Hr. @ 2080 hrs.) realistic for the market; can we any longer consider Contractor C, or B, not providing adequate compensation?
- If we had been inclined to believe Contractor A to present less risk, can we any longer come to that conclusion with Contractor B and C also providing equivalent monetary "compensation" to their employees for the same skill category/class?
- Previously suspecting Contractor C to be risky, if we had sought clarification only from Contractor C to find they have to work 60 hours/week, and were/are inclined to believe such an over-worked employee presents certain performance risk – is Contractor C really any riskier than Contractor A?

[1] *SRS Technologies* Comp. Gen. Dec. B-291618, 24 Feb 2003, footnote 4 found exchanges initially characterized by the agency to be "discussions" to instead be "clarifications" as they did not request, or result in, proposal revisions.

Compensation & UCOT Take-aways

- Compensation – leverage what information and/or other agency reviews you can (e.g. DCAA on large contractor Plans as part of Internal Controls reviews), but be prepared:
  - Having a corporate "Plan" and connecting that glossy plan to the nuts and bolts of any proposal are two totally different things.
  - Remember the solicitation provision also asks for supporting data in the form of national and regional salary surveys be submitted.
  - Independent Government Market Research to include market surveys for compensation levels commensurate for desired skill sets being solicited.

- UCOT – primarily understand limitations of the standard solicitation provisions and need for additional information to be obtained through solicitation and/or clarifications.
  - UCOT provision doesn't prohibit contractor employees working other projects; you must stipulate they must work exclusively on your contract if intent is for a 40-hour week,
  - Contractors to reveal terms of employment; <u>total hours employee is expected to work to earn their salary</u> regardless of contracts or customers, not just your requirement.
  - Contractors to identify accounting practice for UCOT (40 hour or Total Time) and specific accounting treatment(s) described in DCAM 6-410.4 and/or DCAM 6-410.5.
  - A contractor's 40-hour accounting practice may permit, on T&M contracts, billing the Government at the higher, unadjusted, rate for any extra hours desired even though the employee is not compensated (see GaN Corporation ASBCA No. 57834, 13 July 2012).
  - Depending upon whether their future business pans out, a contractor's TTA practice (that preferred by DCAA) may result in higher billings on cost reimbursable contracts, now preferred over T&M on A&AS efforts – may want to consider a ceiling provision.

Cost/Price Realism and Indirect Cost, Rates, and Distortion

- This was an abbreviated treatment of a vast topic using just two (2) of many illustrated examples developed at DAU Midwest Kettering.

- A more complete treatment including all the illustrated examples and cases (there are many more), can be provided in a 1-2 day workshop as was done for the PEO CS&CSS.

- Just contact Bob, Chris, or Brad at:

robert.williams@dau.mil, 937-781-1057

christopher.merkel@dau.mil, 937-781-4029

bradley.riddle@dau.mil, 937-781-1079

- Even if you are not in our Midwest Region, we can partner with a DAU Professor in your region to conduct a joint workshop. (e.g. Professor Robert Gustavus is a provider partner at DAU Capital Northeast because of his association with courses from which this content was drawn.)

A 1-2 Day Rates Workshop for you.

- Are you overestimating your program cost by using overly-simplistic trend analysis of rates, direct and indirect?
- Do you have a realistic expectation of how high or low your rates should be, and whether or how much total cost will be affected?
- Do you have an objective method for evaluating how low a contractor's rates can go before being considered "unrealistic" in competitive acquisition environments?
- Do you have a way to objectively evaluate program funding impacts in the face of uncertain budgetary times for defense contractors?
- Do you know how to mitigate the risk of rate fluctuations in uncertain times using various contract provisions depending on differing acquisition environments?

-----Original Message-----
From: USARMY TACOM (US)
Sent: Wednesday, February 03, 2016 11:57 AM
To: Williams, Robert; Merkel, Christopher
Subject: RE: Understanding Defense Industry Cost/Price Rates
Workshop 20/21 January

Bob / Chris,

The workshop was excellent! Cost Analysts such as myself should be required to do more training in Contractor Rates. I looked at the BUS-CE certification standards, and there is only one online course (CLB 029) required for BUS-CE certification that deals with rates. In my opinion, there should be a requirement to take a resident course similar to the Cost/Price Rates Workshop in order to receive Level III certification in BUS-CE.

As soon as I got back to my office from the workshop, I contacted my DACO at BAE York (Pennsylvania) to get detailed information supporting their most recent FPRA. He provided the data that same day. For every single overhead pool, I was able to normalize the costs and to regress the base dollars versus the overhead dollars. Every linear regression yielded a good r-squared and a positive intercept (fixed costs).

Since BAE York's base is highly dependent on tracked vehicle programs that are managed at TACOM, there is a direct correlation between the planned expenditures on our programs (M88, AMPV, PIM, & Bradley) and the overhead rates at York. That correlation implies shared risk within and across our programs that definitely should impact how we do Cost Uncertainty & Risk Analysis...

Cost Analyst (PD MBTS)
US Army TACOM LCMC

Understanding Defense Industry and their Cost/Price Rates Workshop

A workshop using interactive scenarios and examples illustrating the dimensions of direct and indirect cost/pricing rates used by defense industry. Various rates will be covered; including overhead rates, general and administrative (G&A) rates, forward pricing rates, billing rates, final rates, offsite rates, field service rates, and wrap rates. How industry develops these rates throughout their business cycle serving their strategic interest in capturing contract awards will be illustrated. How Government personnel should then oversee and properly apply their rates will be also be examined. The preponderance of DoD's acquisition costs paid to contractors are for their legitimate indirect cost of doing business. But distortions in allocating these costs using apparently simple rates can result in program/project inequities.

In considering this workshop you might ask yourself the following questions:

- Are you familiar with differences in contractors' home office vs. offsite rates? How contractors use similar approaches to capture new business? And how Government negotiators can use similar strategies to avoid contractor windfalls negotiating ECPs?
- Are you overestimating your program cost by using overly-simplistic trend analysis of rates, both direct and indirect?
- Do you have a realistic expectation of how high or low your rates should be, and whether or how much total cost will be affected should alternative, yet permissible, accounting methods be used?
- Do you have an objective method for evaluating how low a contractor's rates can (really) go before being considered "unrealistic" in competitive acquisition environments?
- Do you have a way to objectively evaluate program funding impacts in the face of uncertain budgetary times for defense contractors?
- Do you know how to mitigate the risk of rate fluctuations in uncertain times using various contract provisions depending on differing acquisition environments?

This workshop is being presented by Professors Robert (Bob) Williams (robert.williams@dau.mil) and Christopher (Chris) Merkel (christopher.merkel@dau.mil) of the DAU, Midwest Region's main campus in Kettering, OH. Professor Williams possesses years of experience and expertise in cost, price, and finance, relative to Government contracting. Professor Merkel's years of experience and expertise comes from the business cost estimating and financial management (comptroller) career field. Together they provide a complete picture of the programmatic, budgeting/execution, and contracting implications of using defense contractors' rates in a workshop designed for a mixture of attendees from the contracting, contract pricing, finance, cost estimating and program management communities.

Backup References

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

March 16, 2016

MEMORANDUM FOR THE HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES

FROM: Anne E. Rung
Administrator
Office of Federal Procurement Policy

SUBJECT: Determination of the Statutory Formula Benchmark Compensation Amount for Fiscal Years 2013 and 2014 for Certain Executives and Contractor Employees, Pursuant to Section 39 of the Office of Federal Procurement Policy Act, as amended (41 U.S.C. § 1127)

This memorandum sets forth the benchmark compensation amount for certain employees of Federal Government contractors as required by Section 39 of the Office of Federal Procurement Policy (OFPP) Act, as amended (41 U.S.C. § 1127, otherwise known as the statutory formula cap) for the cost allowability purposes of section 4304(a)(16) of title 41 and section 2324(e)(1)(P) of title 10 for covered contracts awarded before June 24, 2014. For covered contracts awarded on or after June 24, 2014, a new cap applies pursuant to section 702 of the Bipartisan Budget Act of 2013 (BBA), Pub. L. 113-67, December 26, 2013.

For contracts awarded prior to June 24, 2014, section 1127 limits the reimbursement or allowability of compensation costs under Federal Government contracts as implemented at Federal Acquisition Regulation (FAR) 31.205-6(p). In less technical terms, the statutory formula cap places a ceiling on the total annual compensation costs the Federal Government will reimburse a contractor for the compensation package the contractor provides to certain of its employees for work done pursuant to certain Federal Government covered contracts. This statutory formula cap applies to limit the reimbursement of the compensation costs of certain contractor senior executives on covered contracts with civilian and defense agencies. Additionally, as a result of changes made by section 803 of the National Defense Authorization Act for FY 2012, Pub. L. 112-81, December 31, 2011, for covered contracts with defense agencies (i.e., DOD, NASA and Coast Guard), the statutory formula cap was expanded to cover all other contractor employees and applies to the compensation costs incurred after December 31, 2011. With both civilian and defense agencies, the statutory formula cap applies only when the contractor is performing covered contracts that are of either a cost-reimbursable nature or other cost-based nature.

Section 1127 sets out a formula for determining the cap amount. Specifically, the statutory formula cap amount is set at the median (50th percentile) amount of compensation provided, over the most recent year for which data is available, to the five most highly compensated employees in management positions at each home office and each segment of all publicly-owned U.S. companies with annual sales over $50 million. The determination is based on analysis of data made available by the Securities and Exchange Commission. Compensation means the total amount of wages, salaries, bonuses, restricted stock, deferred and performance incentive compensation, and other compensation for the year, whether paid, earned, or otherwise accruing, as recorded in the employer's cost accounting records for the year.

Since enactment of the statutory formula in 1998, the cap has increased more than 300%. In 2010, the President began calling on Congress to replace the current statutory formula cap with a lower, more sensible limit that is on par with what the Government pays its own executives and employees. In December 2013, with the Administration's strong support, Congress reformed the ceiling on the reimbursement of contractor employee compensation. Section 702 of the BBA replaced section 1127 with a new cap of $487,000 to be adjusted annually to reflect the change in the Employment Cost Index for all workers as calculated by the Bureau of Labor Statistics (otherwise known as the BBA cap). The new $487,000 BBA cap provides a reasonable level of compensation for high value Federal contractor employees while ensuring taxpayers are not saddled with paying excessive compensation costs. On June 24, 2014, the Federal Acquisition Regulatory Council issued an interim rule to amend the Federal Acquisition Regulation to reflect the new BBA cap and issuance of a final rule is pending. However, the new $487,000 BBA cap applies on a prospective basis only to contracts awarded on or after June 24, 2014. Because the statutory formula cap continues to apply to contracts awarded before June 24, 2014, the Administration is compelled by statute to determine the statutory formula cap amount for FYs 2013 and 2014 in accordance with the statutory formula set forth in section 1127 to address these pre-existing contracts.

After consultation with the Director of the Defense Contract Audit Agency, OFPP has determined, pursuant to the requirements of section 1127, that the statutory formula cap amount for the ceiling on the compensation of a contractor employee covered by this provision is $980,796 for FY 2013, and $1,144,888 for FY 2014. Each of these statutory formula cap amounts applies to limit the reimbursement, by the Government to the contractor, of the costs of compensation for certain contractor employees for costs incurred on all covered contracts, at the beginning of the contractor FY that begins January 1 for the respective year (or pro-rated over that portion of the contractor FY that includes January 1 for the respective year). The statutory formula cap amount (i.e., $980,796) for FY 2013 is applicable to compensation costs incurred on all covered contracts during the period of January 1, 2013 through December 31, 2013 for the contractor's fiscal year. The statutory formula cap amount (i.e., $1,144,888) for FY 2014 is applicable on all covered contracts to compensation costs incurred as of January 1, 2014 continues in subsequent contractor FYs, unless and until revised by OFPP. As explained above, this statutory formula cap applies only to covered contracts awarded before June 24, 2014 for both defense and civilian procurement agencies to limit the reimbursement of the compensation costs for certain contractor employees.

Employers continue to have the discretion to compensate their employees at any level they deem appropriate. The statutory formula cap only limits how much the Government will reimburse the contractors for the services of those affected employees.

Questions concerning this memorandum may be addressed to Raymond Wong, OFPP, at 202-395-6805.

Subpart 22.11 -- Professional Employee Compensation

22.1101 -- Applicability.

The Service Contract Act of 1965, now codified at 41 U.S.C. chapter 67, Service Contract Labor Standards, was enacted to ensure that Government contractors compensate their blue-collar service workers and some white-collar service workers fairly, but it does not cover bona fide executive, administrative, or professional employees.

22.1102 -- Definition.

"Professional employee," as used in this subpart, means any person meeting the definition of "employee employed in a bona fide. . . professional capacity" given in 29 CFR 541. The term embraces members of those professions having a recognized status based upon acquiring professional knowledge through prolonged study. Examples of these professions include accountancy, actuarial computation, architecture, dentistry, engineering, law, medicine, nursing, pharmacy, the sciences (such as biology, chemistry, and physics, and teaching). To be a professional employee, a person must not only be a professional but must be involved essentially in discharging professional duties.

22.1103 -- Policy, Procedures, and Solicitation Provision.

All professional employees shall be compensated fairly and properly. Accordingly, the contracting officer shall insert the provision at 52.222-46, Evaluation of Compensation for Professional Employees, in solicitations for negotiated contracts when the contract amount is expected to exceed $650,000 and the services are to be provided which will require meaningful numbers of professional employees. This provision requires that offerors submit for evaluation a total compensation plan setting forth proposed salaries and fringe benefits for professional employees working on the contract. Supporting information will include data, such as recognized national and regional compensation surveys and studies of professional, public and private organizations, used in establishing the total compensation structure. Plans indicating unrealistically low professional employee compensation may be assessed adversely as one of the factors considered in making an award.

52.222-46 -- Evaluation of Compensation for Professional Employees.

As prescribed in 22.1103, insert the following provision:

Evaluation of Compensation for Professional Employees (Feb 1993)

(a) Recompetition of service contracts may in some cases result in lowering the compensation (salaries and fringe benefits) paid or furnished professional employees. This lowering can be detrimental in obtaining the quality of professional services needed for adequate contract performance. It is therefore in the Government's best interest that professional employees, as defined in 29 CFR 541, be properly and fairly compensated. As part of their proposals, offerors will submit a total compensation plan setting forth salaries and fringe benefits proposed for the professional employees who will work under the contract. The Government will evaluate the plan to assure that it reflects a sound management approach and understanding of the contract requirements. This evaluation will include an assessment of the offeror's ability to provide uninterrupted high-quality work. The professional compensation proposed will be considered in terms of its impact upon recruiting and retention, its realism, and its consistency with a total plan for compensation. Supporting information will include data, such as recognized national and regional compensation surveys and studies of professional, public and private organizations, used in establishing the total compensation structure.

(b) The compensation levels proposed should reflect a clear understanding of work to be performed and should indicate the capability of the proposed compensation structure to obtain and keep suitably qualified personnel to meet mission objectives. The salary rates or ranges must take into account differences in skills, the complexity of various disciplines, and professional job difficulty. Additionally, proposals envisioning compensation levels lower than those of predecessor contractors for the same work will be evaluated on the basis of maintaining program continuity, uninterrupted high-quality work, and availability of required competent professional service employees. Offerors are cautioned that lowered compensation for essentially the same professional work may indicate lack of sound management judgment and lack of understanding of the requirement.

(c) The Government is concerned with the quality and stability of the work force to be employed on this contract. Professional compensation that is unrealistically low or not in reasonable relationship to the various job categories, since it may impair the Contractor's ability to attract and retain competent professional service employees, may be viewed as evidence of failure to comprehend the complexity of the contract requirements.

(d) Failure to comply with these provisions may constitute sufficient cause to justify rejection of a proposal.

37.115 -- Uncompensated Overtime.

37.115-1 -- Scope.

The policies in this section are based on Section 834 of Public Law 101-510 (10 U.S.C. 2331).

37.115-2 -- General Policy.

(a) Use of uncompensated overtime is not encouraged.

(b) When professional or technical services are acquired on the basis of the number of hours to be provided, rather than on the task to be performed, the solicitation shall require offerors to identify uncompensated overtime hours and the uncompensated overtime rate for direct charge Fair Labor Standards Act -- exempt personnel included in their proposals and subcontractor proposals. This includes uncompensated overtime hours that are in indirect cost pools for personnel whose regular hours are normally charged direct.

(c) Contracting officers must ensure that the use of uncompensated overtime in contracts to acquire services on the basis of the number of hours provided will not degrade the level of technical expertise required to fulfill the Government's requirements (see 15.305 for competitive negotiations and 15.404-1(d) for cost realism analysis). When acquiring these services, contracting officers must conduct a risk assessment and evaluate, for award on that basis, any proposals received that reflect factors such as:

(1) Unrealistically low labor rates or other costs that may result in quality or service shortfalls; and

(2) Unbalanced distribution of uncompensated overtime among skill levels and its use in key technical positions.

(d) Whenever there is uncompensated overtime, the adjusted hourly rate (including uncompensated overtime) (see definition at 37.101), rather than the hourly rate, shall be applied to all proposed hours, whether regular or overtime hours. (added March 2015)

37.115-3 -- Solicitation Provision.

The contracting officer shall insert the provision at 52.237-10, Identification of Uncompensated Overtime, in all solicitations valued above the simplified acquisition threshold, for professional or technical services to be acquired on the basis of the number of hours to be provided.

52.237-10 -- Identification of Uncompensated Overtime.

As prescribed in 37.115-3, insert the following provision:

Identification of Uncompensated Overtime (Mar 2015)

(a) *Definitions*. As used in this provision --

“Adjusted hourly rate (including uncompensated overtime)” is the rate that results from multiplying the hourly rate for a 40-hour work week by 40, and then dividing by the proposed hours per week which includes uncompensated overtime hours over and above the standard 40-hour work week. For example, 45 hours proposed on a 40-hour work week basis at $20 per hour would be converted to an uncompensated overtime rate of $17.78 per hour ($20.00 x 40 divided by 45 = $17.78).

“Uncompensated overtime” means the hours worked without additional compensation in excess of an average of 40 hours per week by direct charge employees who are exempt from the Fair Labor Standards Act. Compensated personal absences such as holidays, vacations, and sick leave shall be included in the normal work week for purposes of computing uncompensated overtime hours.

(b) (1) Whenever there is uncompensated overtime, the adjusted hourly rate (including uncompensated overtime), rather than the hourly rate, shall be applied to all proposed hours, whether regular or overtime hours.

(2) All proposed labor hours subject to the adjusted hourly rate (including uncompensated overtime) shall be identified as either regular or overtime hours, by labor categories, and described at the same level of detail. This is applicable to all proposals whether the labor hours are at the prime or subcontract level. This includes uncompensated overtime hours that are in indirect cost pools for personnel whose regular hours are normally charged direct.

(c) The offeror’s accounting practices used to estimate uncompensated overtime must be consistent with its cost accounting practices used to accumulate and report uncompensated overtime hours.

(d) Proposals that include unrealistically low labor rates, or that do not otherwise demonstrate cost realism, will be considered in a risk assessment and will be evaluated for award in accordance with that assessment.

(e) The offeror shall include a copy of its policy addressing uncompensated overtime with its proposal.

(End of Provision)