





Financial Implications of Contracting for Acquisition Programs

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Discussion Topics

- **Basic Contracting Information**
 - Contract Families/Types
 - Elements of Contracts
- **Budgeting for Contracts**
- **Applicable Funding Policies**
- **Acquisition Phases and Contract Types**
- **Planning for Contract Awards**
- **Unique Contract Provisions**
- **Pertinent Contract Clauses**
- **Managing On-going Contracts**
- **Summary**





Broad Policies Relative to Contract Types

- **Contracting Officers have relatively broad discretion**
- **Contract type should be determined on basis of appropriate risk allocation**
- **“Cost-Plus-Percentage-of-Cost” contracts are not authorized**
- **Fixed Price development (R & D) contracts > \$25 M must be approved by USD (AT&L)**



Contract Families

- **Fixed Price Contracts**
 - Provides for firm price or, in appropriate cases, an adjustable price
 - Contractor's profit built into price
 - Use when specific requirements known before award
- **Cost Reimbursement Contracts**
 - Provides for payment of allowable incurred costs
 - Contractor's profit = fee
 - Use when uncertainties in contract performance prevent sufficiently accurate estimate of costs for fixed-price contract





Contract Types

Fixed-Price Family

Firm Fixed Price (FFP)

Fixed Price (EPA)

Fixed Price Incentive (FPI)

Cost-Reimbursement Family

Cost Plus Fixed Fee (CPFF)

Cost Plus Incentive Fee (CPIF)

Cost Plus Award Fee (CPAF)





Elements of Contract Types

- **Firm Fixed Price (FFP)**
 - Negotiated Price (Includes cost and profit)
- **Fixed Price Economic Price Adjustment (FP-EPA)**
 - Negotiated Price (Includes cost and profit)
 - Price Adjustment (+ or - based on stated economic conditions)
- **Fixed Price Incentive (FPI)**
 - Target Cost
 - Target Profit
 - Share Ratio (Government / Contractor)
 - Ceiling Price





Elements of Contract Types

(Continued)

- **Cost Plus Fixed Fee (CPFF)**
 - Estimated Cost
 - Fixed Fee
- **Cost Plus Award Fee (CPAF)**
 - Estimated Cost
 - Base Fee ($\leq 3\%$ of estimated cost)
 - Award Fee
- **Cost Plus Incentive Fee (CPIF)**
 - Target Cost
 - Target Fee
 - Share Ratio (Government / Contractor)
 - Minimum Fee
 - Maximum Fee

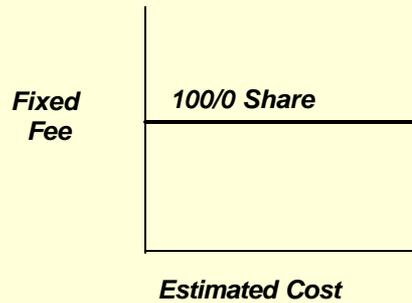




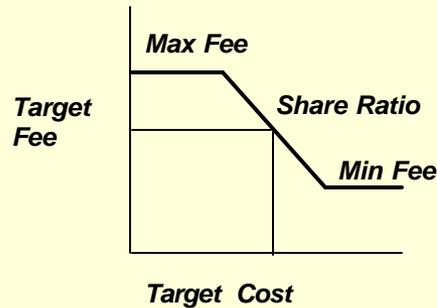
Contract Types

Schematics

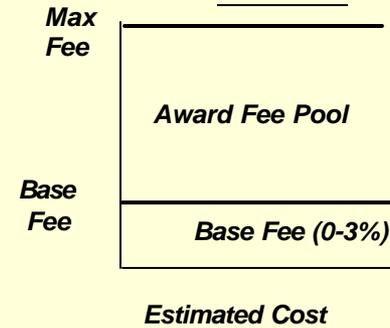
CPFF



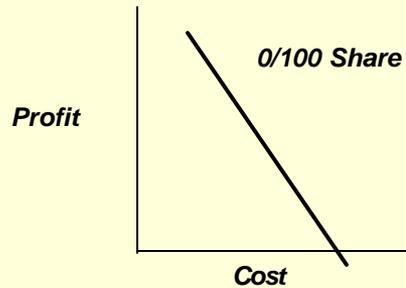
CPIF



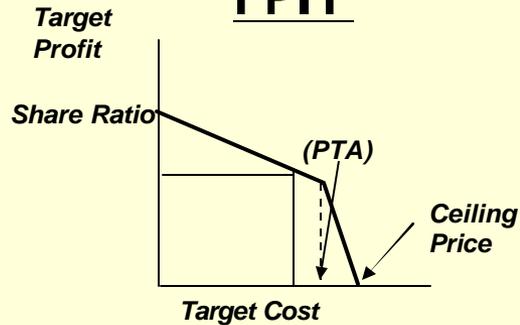
CPAF



FFP



FPIF



Multiple Incentives





Contract Types

Award Fees

- **Establish separate award fee consisting of:**
 - **Base Fee (0 - 3%)**
 - **Award Fee Pool which contractor may earn for superior performance**
- **Amount of fee to be paid is a judgment decision**
 - **Decision is made in accordance with criteria in Award Fee Plan**
- **Fee determination is a unilateral government decision; generally, decision is not subject to “Disputes” clause**





Contract Types

Award Fee Periods

- Frequency
- Time based periods
- Milestone or event-based periods
- Both time-based & milestone/event-based periods
- Award Fee period criteria & changes
- Unearned Award Fee – How can it be used?





Contract Types

Application of Award Fees

- **Elements of Award Fee**

- Award Fee Base (0 – 3 %)
- Award Fee Pool
- Evaluation Periods
- Total Award Fee available at contract award

(Periods)

	Award Fee Pool				
1	2	3	4	5	
Base Fee (0-3%)					

- **Financial Actions re Award Fee**

- Commitment made before start of award period
- Obligation made after end of award period





Characteristics of Contract Families

	<u>Cost Reimbursement</u>	<u>Fixed Price</u>
Contractor's Promise	Best Effort	Deliver
Financial Risk to Contractor	Low	High
Financial Risk to Government	High	?
Cash Flow to Contractor	As Cost Incurred	On Delivery
Progress Payments	-----	Yes
Performance Based Payments	-----	Preferred
Government Administration	High	Low
Fee / Profit	Periodic	On Delivery





Cost and Pricing

- **Government policy is to pay a “fair and reasonable” price for goods and services for which contract is awarded**
- **One responsibility of the contracting officer is to determine the “fair and reasonable” price**
- **Key Question: What is a “fair and reasonable” price and how is it determined?**





Price Analysis vs. Cost Analysis

Price Analysis

- Fast and “cheap” to perform
- Used to analyze sealed bids, small purchases and competitive proposals

Used when Purchasing:

- Standard, off-the-shelf items
- Repeat buys of other items
- Purchases < \$500,000

Cost Analysis

- Slow and costly to perform
- Used to analyze sole source and, occasionally, competitive proposals

Used when Purchasing:

- Research and Development efforts
- Unique sole source items
- Purchases > \$500,000





Budgeting for Different Contract Types

General Rule: Budget to Most Likely Price

Contract Type

Budgeted Amount



FFP

Negotiated Price

FP-EPA

Negotiated Price (but not EPA)

FPI

Target Cost + Target Profit

CPFF

Estimated Cost + Fixed Fee

CPAF

Estimated Cost + Base Fee
+ Maximum Award Fee

CPIF

Target Cost + Target Fee





Funding Policies for Acquisition-Related Contracts

- **For Research and Development Efforts**
 - RDT&E Appropriation
 - Incremental Funding Policy: Budget on basis of cost expected to be incurred during given fiscal year
- **For Production**
 - Procurement Appropriation
 - Full Funding Policy: Budget on basis of all cost for specific quantity of militarily usable end items expected to be put on contract during given fiscal year





Incremental Funding Policy

Simple Application – RDT&E Appropriation

Cost Incurred by Contract by Fiscal Year

Task Cost	FY 1	FY 2	FY 3	FY 4
TASK 1 \$ 300 K	\$ 50 K	\$ 100 K	\$ 100 K	\$ 50 K
TASK 2 \$ 150 K		\$ 25 K	\$ 100 K	\$ 25 K
TASK 3 \$ 100 K		\$ 10 K	\$ 50 K	\$ 40 K
Budget Request	\$ 50 K	\$135 K	\$250 K	\$115 K

36 month effort

18 month effort

24 month effort

Planned Period of Performance (i.e., planning for costs to be incurred)





Full Funding Policy

Simple Application - Procurement Appropriation

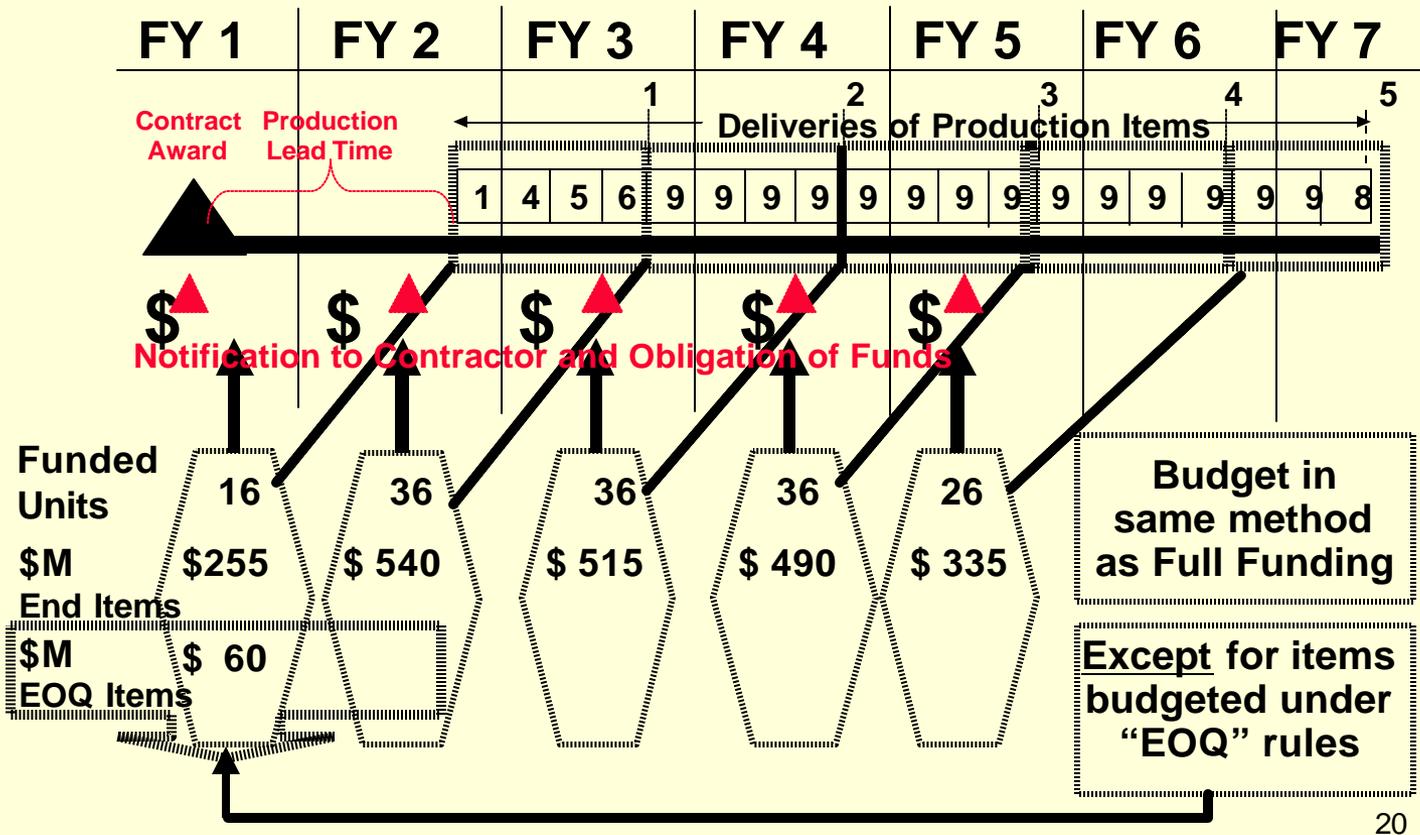
Lot Cost	FY 1	FY 2	FY 3	FY 4
\$ 400 K LOT 1 10 ITEMS	Contract Action 	<div style="border: 1px solid black; display: inline-block; padding: 2px;">2</div> <div style="border: 1px solid black; display: inline-block; padding: 2px;">2</div> <div style="border: 1px solid black; display: inline-block; padding: 2px;">3</div> <div style="border: 1px solid black; display: inline-block; padding: 2px;">3</div> = 10		
\$ 600 K LOT 2 20 ITEMS		Contract Action 	<div style="border: 1px solid black; display: inline-block; padding: 2px;">5</div> <div style="border: 1px solid black; display: inline-block; padding: 2px;">5</div> <div style="border: 1px solid black; display: inline-block; padding: 2px;">5</div> <div style="border: 1px solid black; display: inline-block; padding: 2px;">5</div> = 20	
\$ 900 K LOT 3 40 ITEMS			Contract Action 	<div style="border: 1px solid black; display: inline-block; padding: 2px;">8</div> <div style="border: 1px solid black; display: inline-block; padding: 2px;">10</div> = 18 + 22
Budget Request	\$ 400 K	\$ 600 K	\$ 900 K	- 0 - 19





Multiyear Procurement (MYP) Contract

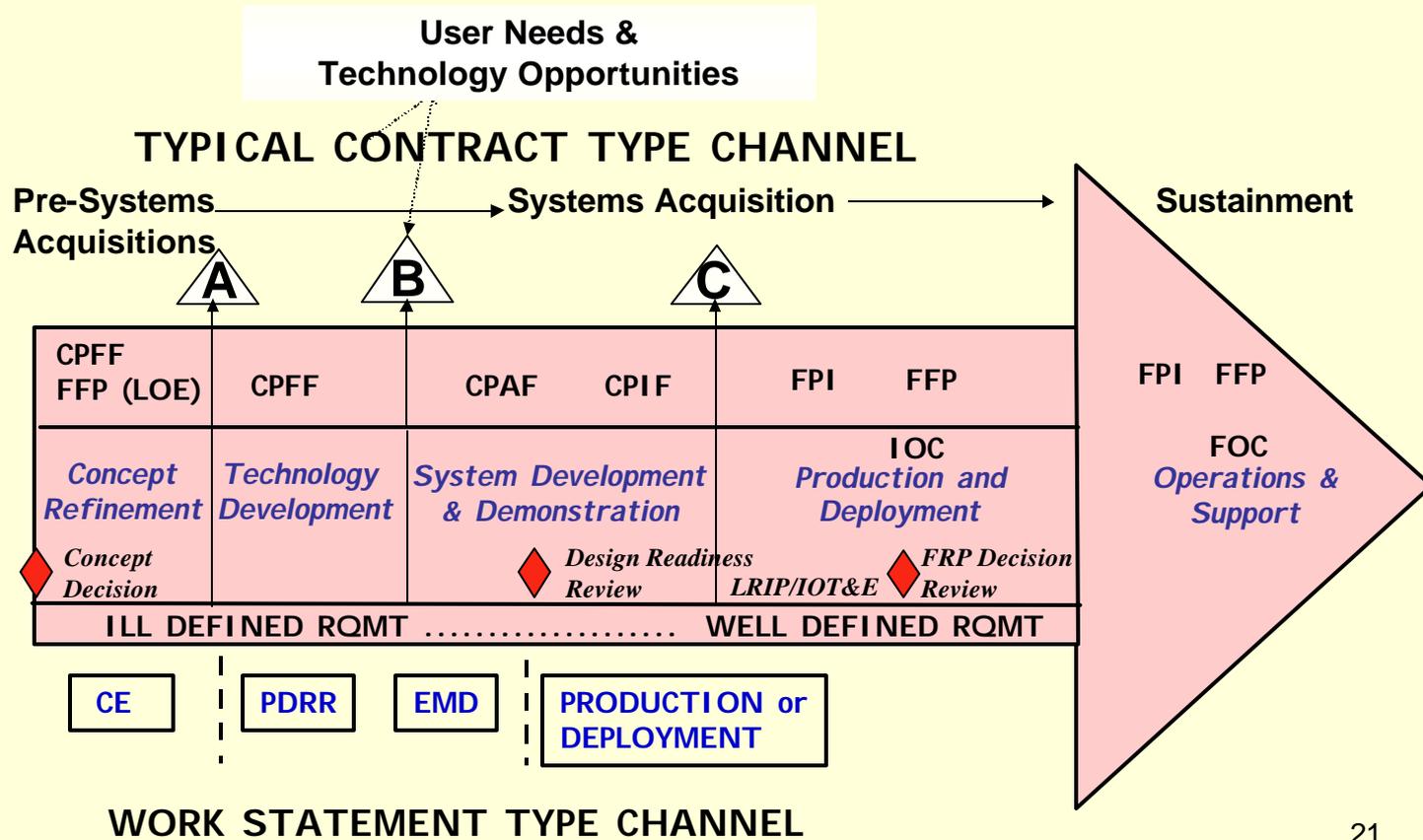
(Example of Budget Preparation for a MYP Contract)





Defense Acquisition Systems Continuum

Contract Type Selection





Planning for Contract Awards

- **Consider contract type and award timing early**
 - Factor this information into cost and budget estimates
 - Avoid execution issues probable from planning to award contracts in first or fourth quarter of year
- **Initial planning done as part of obligation plan**
- **Consult contracting officer when preparing obligation plans**
- **Proper planning usually results in better execution**





Multiyear Service Contracts

DoD may award Multi-year Service Contracts that satisfy following criteria:

- (1) There is a continuing requirement for the services;**
- (2) Furnishing of services will require a substantial initial investment in plant or equipment, or the incurrence of substantial contingent liabilities for assembly, training, or transportation of a specialized work force; and**
- (3) Use of such a contract will promote best interest of U.S. by encouraging effective competition and promoting economies on operation.**

Type Services for which such contracts may be awarded include:

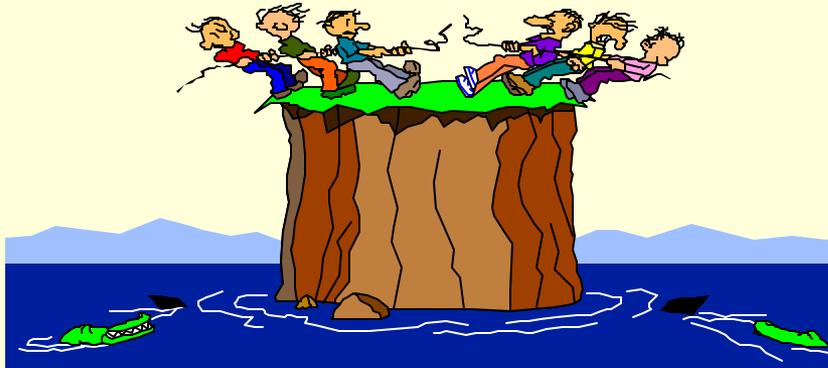
- (1) Operation, maintenance and support of facilities and installations;**
- (2) Maintenance or modification of aircraft, ships, vehicles, and other highly complex military equipment;**
- (3) Specialized training necessitating high quality instructor skills (eg. Pilot and aircrew members; foreign language training);**
- (4) Base services(eg. Ground maintenance; in plane refueling; bus transportation; refuse collection and disposal.)**

Chapter 137 of Title 10, United States Code, Sec 2306c, Multiyear Services Contracts.
(Originated in FY 2000 Authorization language).



Severable Services

- DoD may enter into a contract for severable services that begin one fiscal year and ends next fiscal year if the contract period does not exceed one year
- Funds made available for a given fiscal year may be obligated for total amount of that contract



References: (1) Title 10, U.S. Code, Section 2410a
(2) Comptroller General Decision B-259274 (22 May 96)





Budgeting for Termination Liability

On Incrementally Funded RDT&E Contracts

- Unliquidated obligation on incrementally funded contract must be sufficient to cover cost of terminating for convenience (if action required)
- Termination costs can not increase total budget needed
- If contract terminated, termination costs to be financed from unliquidated obligations without reprogramming
- Exceptions (expected to be rarely used):
 - Statutory Waivers: When exempted by Public Law (then budgeted on a pay-as-you-go basis)
 - Special Termination Cost Clause: Permitted by DFAR in fixed-price incentive and incrementally funded cost reimbursement contracts; approval requires notification of House and Senate Appropriations Committees





Contract Clauses that Provide Some Control over Unliquidated Obligations

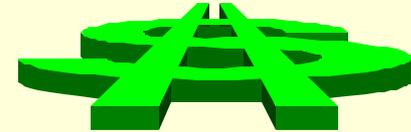
- Contractor required to notify government 60 days prior to incurring costs equal to 75% of amount obligated
 - Incrementally Funded Cost-Reimbursement Contracts
 - Called “Limitation of Funds Clause (LOF)”
 - Fully Funded Cost-Reimbursement Contracts
 - Called “Limitation of Cost Clause (LOC)”
- Contractor required to notify government 90 days prior to incurring costs equal to 85% of amount obligated
 - Incrementally Funded Fixed Price Contracts
 - Called “Limitation of Government Obligation Clause (LOGO)”
- Notification allows termination liability to be covered by unliquidated obligations on that specific contract





Cancellation Ceiling for Multiyear Procurement Contracts

- Cancellation Ceiling may cover:
 - Non-recurring Costs
 - Recurring Cost (with approval of Agency Head and USD (C))
- Cancellation Ceiling is:
 - Negotiated along with other provisions of the contract
 - A decreasing amount each year
 - Not an additional amount to be budgeted
- MYP contracts with Cancellation Ceiling > \$100M require 30 day written notice to Congressional Defense Committees prior to award





Managing On-Going Contracts From Resource Management Perspective

- As with other DoD entities, Acquisition Program Offices forecast obligations and expenditures in Obligation and Expenditure Plans
- Acquisition Program Offices are responsible for managing obligations and expenditures associated with contracts awarded for their programs
- Deviations from planned obligations and expenditures must be reported and justified to higher headquarters
- Vast majority of Program Office funding is obligated against contracts
- Proper management of fiscal aspect of contracts requires close coordination with contractors





Information Available to Improve Management of On-Going Contracts

- Many acquisition-related contracts require contractors to provide periodic reports reflecting status of contract work effort and costs
- Earned Value Management
 - For flexibility-priced contracts above specified cost criteria (stated in FY 2000 Constant \$) a Cost Performance Report (CPR) is required:
 - DoD Directives require use of formal Earned Value Management Systems standard guidelines (current guidelines developed by industry)
 - RDT&E contracts greater than \$73 Million
 - Procurement contracts greater than \$315 Million
 - The monthly CPR compares actual work or progress made on the contract and associated costs to planned work and associated costs
 - For flexibility-priced contracts below those cost criteria, a less rigorous Cost/Schedule Status Report (CSSR) is required
 - EVM related reports not required for firm fixed price, level of effort, or time and materials contracts





Information Available to Improve Management of On-Going Contracts

- **Contract Funds Status Report (CFSR)**
 - Applicable for contracts over six months in duration
 - Normally not required for firm fixed price contracts unless circumstances require specific funding visibility
 - Generally required quarterly unless contract states otherwise
 - Contractor-prepared report provides basic fiscal information:
 - Initial and adjusted contract price
 - Funds obligated to date
 - Accrued expenditures
 - Contract work authorized and forecast
 - Projected total price of contracted work
 - Forecast of billings to the government by period
 - Estimated termination costs by period





Summary

- Acquisition program offices must follow provisions of Financial Management Regulation (DoD 7000.14-R) for fiscal matters and FAR/DFAR for contracting matters
- Vast majority of budget authority provided defense acquisition programs is obligated against contracts
- Resource management in acquisition program offices requires active management of fiscal aspects of contracts
- Government requires some contractors – by terms of the contract – to periodically report on status of work actually accomplished and at what cost and projected data
- Government can and should make maximum use of data contained in those reports to better manage execution of the program, to include management of resources





Questions or Comments???

Can we stop now?
My brain is full!

I don't have a clue

I think I
know
this "stuff"





"That's all Folks!"

