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Office of
General Counsel

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Mr. James D. Currie
Acting Administrator
Office of Federal Procurement Policy
Office of Management and Budget
Executive Office of the President

Dear Mr. Currie:

By letter dated December 28, 1979, your office requested our views on a draft segment of the Federal Acquisition Regulation (FAR) concerning the establishment of profit objectives for use in negotiating noncompetitive contracts. As we understand it, the draft is an "outgrowth of the Commission on Government Procurement recommendation that the Office of Federal Procurement Policy (OFPP) take the lead in development of uniform government-wide guidelines for determining profit objectives in negotiated contracts." For the following reasons we are opposed to the draft segment as proposed.

Initially, we note that the proposed regulation does not establish uniform government-wide guidelines for determining profit objectives, but rather requires each agency to develop a "structured approach" for determining prenegotiation profit objectives. We think this approach is undesirable because even under ideal circumstances each agency's structure might be significantly different and hence no uniform profit policy is likely to result. In any event, we believe the criteria contained in the proposed regulation and which are to be considered by an agency in establishing its "structured approach" are not sufficiently definite and that insufficient emphasis has been placed on contractor capital investment in facilities.

Section 15.806-1(b) states that: "In the long term, earned profit from Government contracts must be comparable with return from other investment opportunities involving similar risks." However, there is no guidance



concerning computing and comparing the contractor's return on investment. Throughout the proposed regulation the emphasis is on basing profit objectives as a percent of estimated cost elements. This has long been recognized as a disincentive for encouraging more productive effort which would help reduce costs. Although some attention was directed toward a special "productivity reward" in 15.806-4(b)(2), there is insufficient guidance to enable contracting personnel to uniformly determine "cost-control accomplishment" in a manner which would best serve the Government's interest.

The Commission on Government Procurement recommended that uniform guidelines emphasize consideration of contractor capital investment in facilities. Additionally, it has long been this Office's position that profit under Government contracts should be a function of a contractor's capital investment in facilities rather than costs. However, the proposed FAR merely states that an agency may include consideration of contractor facilities investment. The guidelines offered for this factor are inadequate to permit contracting personnel to effectively consider this important element. The guidance offered is even weaker than the guidance in DOD's Defense Procurement Circular 76-12, which we found inadequate in our March 8, 1979, report to the Congress (PSAD-79-38).

To summarize, we believe that insufficient emphasis has been given to the return on contractor investment, and inadequate guidance is offered to permit Government contracting officials to obtain relative uniform results. Accordingly, we suggest that OFPP withdraw the proposed regulation and develop more detailed approaches with more definitive criteria and procedures to enable contracting officers to determine appropriate profit allowances for contractor's facility capital investments, cost risk, productivity improvements subject to special profit rewards, and other significant elements related to prenegotiation profit objectives.

Sincerely yours,

Harry R. Van Cleave

for Milton J. Socolar
General Counsel