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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

OFFICE OF GENERAL COUNSEL

B-192944

OCT 20 1978

Dale R. Babione
Director, Contracts &
System Acquisition
Office of the Under
Secretary of Defense
Department of Defense

Dear Mr. Babione:

By letter dated September 5, 1978 you transmitted for our comment proposed changes to DAR 3-808.2(b) and 3-808.6(b)(5) regarding the profit policy set forth in Defense Procurement Circular (DPC) 76-3.

The first change involves the determination of the profit rate to be applied when an exception to the weighted guidelines is used. You indicate that the intent was to keep the level of profit the same whether it was developed under an exception to the old or new weighted guidelines. You also report that DOD intended that the profit objectives for non-capital intensive contracts, whether developed under the new weighted guidelines or an exception, would be lower than those developed for capital intensive contracts developed under the new weighted guidelines.

In contrast to that intent, you indicate that there were many negotiations conducted during the first year's implementation with profit rates higher than if either the old or the new weighted guidelines were applied. To assure results more consistent with the intent of DOD policy regarding exceptions, the revision of DAR 3-808.2 (b) is being considered.

This revised DAR coverage provides additional guidance regarding the exception to the weighted guidelines for service contracts with an insignificant amount of facilities required for efficient contract performance. An alternate weighted guidelines method is provided to develop profit objectives on these contracts. Under this method, the profit weights for engineering will normally be assigned at the low end of the range in recognition of the types of skills used on these service contracts. Use of the alternate weighted guidelines method will in your view result in profit levels very similar to those obtained on comparable contracts negotiated prior to DPC 76-3.

The second change affects the application of profit weights for cost risk on cost-plus-fixed-fee, cost-plus-incentive-fee, fixed-price-incentive and prospective price redetermination contracts. It is reported that the average profit for cost-plus-fixed-fee contracts increased during the first year's implementation of the new policy when the Cost Accounting Standard (CAS) 414 cost of money was included for comparison purposes. As this increase was not attributable to the level of facilities investment, DOD is considering a reduction in the maximum allowable cost risk from one percent to one-half percent for cost-plus-fixed-fee contracts.

DOD's review of the first year's implementation disclosed many contracts with cost incentives only that utilized the maximum profit weight for cost risk. Although the guidance to differentiate between cost and multiple incentives when establishing an objective for cost risk was inadvertently omitted from DPC 76-3, you indicate that it was DOD's intention that the maximum profit weight would only be applied to multiple incentive contracts. Therefore, DOD is considering the establishment of subranges for cost and multiple incentive contracts within the upper and lower limits of the cost risk ranges established in DPC 76-3.

We support DOD's attempt in the second change to reduce the profit negotiated for the cited types of contracts. Whether the action taken will be sufficient is uncertain. In addition, we suggest that consideration be given to extending the action to firm fixed-price contracts. Our recent review of the implementation of DOD's new profit policy showed that the average profit negotiated under the new policy for this type of contract also exceeded that anticipated by DOD.

We have no objection to the proposed coverage regarding service contracts.

Sincerely yours,

MILTON SOCOLAR

For Paul G. Dembling
General Counsel