AMS/FAST CHANGE REQUEST (CR) COVERSHEET

Change Request Number: 23-134

Date Received: September 19, 2023

Title: T3.2.4A6c.(2) Five-Year Approval for LH & TM Clarification

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Policy and Guidance: (Please check only one box)

- ☐ Policy
- ☒ Guidance
- ☐ Procurement Samples
- ☐ Procurement Templates
- ☐ Procurement Forms
- ☐ Procurement Checklists
- ☐ Procurement Tools and Resources
- ☐ Real Property Templates and Samples
- ☐ Procurement Clauses
- ☐ Real Property Clauses
- ☐ Other Tools and Resources

Summary of Change:
T3.2.4A6c.(2)-Changed FROM: "The Chief of the Contracting Office must approve any T&M or LH contract with a total performance period of more than five years (base period plus options, or contracts extended by modification)." TO: "The Chief of the Contracting Office (COCO) must approve any T&M or LH contract with a total period of performance of more than 5 years in duration. This does not include contracts where a 5-year period is extended by exercise of AMS Clause 3.2.4-34, “Option to Extend Services.” In that instance, approval is not needed and the contract’s duration must not exceed 5 years and 6 months (66 months)."

Reason for Change:
AAQ requested a change to clarify when COCO approval is required for Long Term T&M or Labor Hour Contracts greater than five years in T3.2.4.A.6c.(2).

Development, Review, and Concurrence: AAQ, AAP, AGC

Target Audience: FAA Acquisition Workforce

Briefing Planned: No.

ASAG Responsibilities: None.

Section / Text Location: Procurement Guidance T3.2.4A6c.(2)

The redline version must be a comparison with the current published FAST version.

- (●) I confirm I used the latest published version to create this change / redline

or

- ( ) This is new content

Links: https://fast.faa.gov/docs/procurementGuidance/guidanceT3.2.4.pdf

Attachments:
GuidanceT3.2.4 final
GuidanceT3.2.4 redline

Other Files: N/A.

Redline(s): See below.

Section Revised: T3.2.4 – Types of Contracts

Procurement Guidance - (~~7/2023~~10/2023)

T3.2.4 - Types of Contracts Revised 7/2009
- A Types of Contracts Revised 7/2007
  - 1 General Considerations Revised 10/2021
  - 2 Fixed-Price Revised 9/2020
  - 3 Cost-Reimbursement Revised 9/2021
  - 4 Incentive Contracts Revised 4/2022
  - 5 Indefinite Delivery Revised 10/2021
  - 6 Time-and-Materials / Labor-Hour Revised ~~10/2021~~10/2023
  - 7 Letter and Ceiling Priced Contracts Revised 9/2021
  - 8 Multi-year Contracting Revised 7/2007
  - 9 Options Revised 9/2021
  - 10 Basic Agreement Revised 7/2007
  - 11 Basic Ordering Agreement Revised 7/2007
- B Clauses
- C Procurement Forms Revised 9/2021
- D Procurement Samples Revised 9/2021
- E Procurement Templates Added 9/2021
- F Procurement Tools and Resources Added 9/2021
- G Appendices Revised 9/2021
  - 1 Appendix – Award Fee Revised 9/2021
  - 2 Appendix – Incentive Contracts Guide Revised 4/2022

T3.2.4 - Types of Contracts Revised 7/2009

A Types of Contracts Revised 7/2007

1 General Considerations Revised 10/2021

a. The Contracting Officer (CO) determines the type of contract. A variety of factors influence the CO's decision, such as nature and complexity of the requirement, degree to which requirements can be described, performance period, need for incentives, urgency, market conditions, industry practices, or procurement history.

b. Circumstances may change during implementation of a large program, a series of contracts, or a single long-term contract, and a different contract type may be appropriate in later periods than that used at the outset. Also, a combination of contract types may be appropriate for different aspects of a requirement under one contract award.

c. The CO uses sound judgment when selecting a contract type. Depending on the circumstances, it may be a matter for communication with vendors because contract price is closely related to contract type. The CO's objective should be to choose a contract type and price that will result in reasonable contractor risk and ensure efficient and economical contractor performance.

d. Performance requirements must be realistic, manageable, and within the control of the parties to the contract. The procurement team (CO, program official, legal counsel, and other staff) should, to the extent possible, assess and discuss contract performance risks and ensure contract requirements and terms are clear. Contract terms must be reasonable to both FAA and the contractor.

e. The CO determination of contract type dictates the method of procurement coding within the Procurement System. The procurement coding is specified by a single character in the procurement instrument identifier code within the contract number. (See AMS T3.13.1.A.1 – Numbering System for Procurement Instruments for more information on all digit alphabetic codes for various procurement instruments). For example, a letter "C" contract would be used for all types of contracts (i.e. Fixed Price, Cost Reimbursement, Time and Material/Labor Hour, Letter Contracts etc.) when initial requirements are more definite and there is an established price and requirements schedule. In contrast, a letter "D" contract indicates an Indefinite Delivery contract, and is commonly used when the exact quantity, services, or delivery schedule are not known up front.

2 Fixed-Price Revised 9/2020

a. *General*. Fixed-price types of contracts provide for a firm price or, in appropriate cases, an adjustable price. Fixed-price contracts providing for an adjustable price may include a ceiling price, a target price (including target cost), or both. Unless otherwise specified in the contract, the ceiling price or target price is subject to adjustment only by operation of contract clauses providing for equitable adjustment or other revision of the contract price under stated circumstances.

b. *Firm Fixed-Price*.

(1) Description:

(a) Provides for a price that is not subject to change regardless of the actual costs incurred by the contractor after award.

(b) Places maximum risk upon the contractor and full responsibility for all costs and resulting profit or loss with maximum incentive to control costs and perform effectively.

(c) Imposes minimum administrative burden upon the contracting parties.

(2) Use When:

(a) Performance risk can be reasonably predicted or where risk is minimal.

(b) For commercial items or commercial-type products or other supplies or services on the basis of reasonably definite functional or detailed specifications.

(c) Available cost or pricing information permits realistic evaluation of probable costs of performance or the CO can establish fair and reasonable prices at the outset.

(d) The contractor is willing to accept a firm fixed price representing assumption of the risks involved.

(e) For real property transactions where the vendor is willing to accept a fixed rate over the entire contract term representing the rental value for the land or space. (See also T3.8.8.B.5 for Rent Payment Structure)

(3) Considerations:

(a) Contractor is responsible for cost control and associated risks.

(b) Careful evaluation of project requirements and the Offeror's price proposal must be made to ensure a meeting of the minds and ensure price does not include excessive allowance for risk.

c. *Fixed-Price with Economic Price Adjustment.*

(1) Description:

Same as fixed price, except provides for an upward or downward revision of the stated contract price based on the occurrence of specific conditions specified in the contract. Adjustments are of three general types:

(a) Established prices. Increases or decreases from an agreed upon level in published or otherwise established prices of specific items or the contract end items. Normally restricted to industry-wide contingencies.

(b) Actual costs of labor or material. Increases or decreases in specified costs of labor or material that the contractor actually experiences during contract performance. Should be limited to contingencies beyond the contractor's control.

(c) Cost indexes of labor or material. Increases or decreases in specified costs of labor or material cost standards or indexes that are specifically identified in the contract.

(d) Actual costs of taxes. Increases or decreases in specified costs associated with state or local taxes during the term of any real property contract.

(2) Use When:

There is considerable doubt concerning the stability of the market or labor conditions that will exist during an extended contract period (i.e., during periods of high or significant fluctuations in inflation), and where the performance period is greater than one year.

(3) Considerations:

(a) Risk for contractor reduced.

(b) Important to ensure that the contingency (typically an index published by the Bureau of Labor Statistics) is a reliable indicator of the contractor's probable changes in cost. For example, the Employment Cost Index (ECI) is generally preferable to the Consumer Price Index (CPI-U) if labor costs are the primary component of the contractor's price. For real property contracts, the Cost of Living Index found in the U.S. Department of Labor Revised Consumer Price Index for Urban Wage Earners and Clerical Workers, will be incorporated into the fixed price amount and paid in accordance with the terms of the contract.

(c) Should not be used unless it is necessary either to protect the contractor and the FAA against significant fluctuations in labor or material costs, or market conditions.

(d) In contracts that do not require submission of cost or pricing data, the CO should obtain adequate information to establish the base level from which an adjustment may be made and may require verification of data submitted.

d. *Firm Fixed-Price, Level-of-Effort.*

(1) Description:

(a) Requires a contractor to provide a specified level of effort, over a stated period of time, for work that can be stated only in general terms, and the FAA pays the contractor

a fixed dollar amount.

(b) Suitable for investigation or study in a specific research and development area. The output of the contract is usually a report showing the results achieved through application of the required level of effort.

(2) Use When:

(a) The work required cannot otherwise be clearly defined.

(b) The required level of effort is identified and agreed upon in advance.

(3) Considerations:

(a) There is reasonable assurance that the intended result cannot be achieved by expending less than the stipulated effort.

(b) Payment is based on the effort expended rather than the results achieved.

e. *Fixed-Price Incentive.*

(1) Description:

(a) Provides for adjusting profit and establishing the final contract price by application of a formula based on the relationship of total final negotiated cost to total target cost.

(b) The final price is subject to a price ceiling, negotiated at the outset. The two forms of fixed-price incentive contracts are firm target and successive targets.

(2) Use When:

(a) A firm-fixed price is not suitable.

(b) The nature of the supplies or services being acquired and other circumstances of the acquisition are such that the contractor's assumption of a degree of cost responsibility will provide a positive profit incentive for effective cost control and performance.

(c) The performance requirements provide a reasonable opportunity for the incentives to have a meaningful impact on the contractor's management of the work, if the contract also includes incentives on technical performance and/or delivery.

(d) Billing prices are established as an interim basis for payment. These billing prices may be adjusted, within the ceiling limits, upon request of either party to the contract, when it becomes apparent that the final negotiated cost will be substantially

different from the target cost.

(3) Considerations:

(a) Places maximum risk upon the contractor and full responsibility for all costs and resulting profit or loss with maximum incentive to control costs and perform effectively.

(b) The final price is subject to a price ceiling, negotiated at the outset. See guidance on Firm Target and Successive Target contracts for additional considerations.

f. *Fixed-Price Incentive (Firm Target).*

(1) Description:

(a) Specifies a target cost, a target profit, a price ceiling (but not a profit ceiling or floor), and a profit adjustment formula. These elements are negotiated at the outset.

(b) Price ceiling is the maximum that may be paid to the contractor, except for any adjustment under other contract clauses.

(c) When performance is completed, the parties negotiate the final cost, and the final price is established by applying the formula.

(2) Use When:

(a) The contractor's accounting system is adequate for providing data to support negotiation of final cost and incentive price revision.

(b) Adequate cost or pricing information for establishing reasonable firm targets is available at the time of initial contract negotiation.

(3) Considerations:

(a) Profit varies inversely with the cost; therefore this contract type provides a positive, calculable profit incentive for the contractor to control costs.

(b) If the final negotiated cost exceeds the price ceiling, the contractor absorbs the difference as a loss.

(c) The CO should specify in the contract schedule the target cost, target profit, and target price for each item subject to incentive price revision.

g. *Fixed-Price Incentive (Successive Targets).*

(1) Description:

(a) Specifies the following elements, all of which are negotiated at the outset:

(i) Initial target cost;

(ii) Initial target profit;

(iii) Initial profit adjustment formula;

(iv) The production point; and

(v) A ceiling price.

(b) The profit adjustment formula to be used for establishing the firm target profit includes a ceiling and floor for the firm target profit.

(2) Use When:

(a) Available cost or pricing information is not sufficient to permit the negotiation of a realistic firm target cost and profit before award.

(b) Sufficient information is available to permit negotiation of initial targets.

(c) There is reasonable assurance that additional reliable information will be available at an early point in the contract performance so as to permit negotiation of either a firm-fixed price or firm targets and a formula for establishing final profit and price that will provide a fair and reasonable incentive.

(d) The contractor's accounting system is adequate for providing data for negotiating firm targets and a realistic profit adjustment formula, and negotiation of final costs.

(e) Cost or pricing information adequate for establishing a reasonable firm target cost is reasonably expected to be available at an early point in contract performance.

(3) Considerations:

(a) Initial profit adjustment formula normally provides for a lesser degree of contractor cost responsibility than would a formula for establishing final profit and price.

(b) A ceiling price is the maximum that may be paid to the contractor, except for any adjustment under other contract clauses.

(c) When the specified production point is reached, the parties negotiate the firm target cost giving consideration to cost experience under the contract and other pertinent factors. The firm target profit is established by the stated formula. The parties may then negotiate a firm-fixed price, using the firm target cost plus the firm target profit as a guide; **OR** negotiate a formula for establishing the final price using the firm target cost and firm target profit. The final cost is then negotiated at completion, and the final profit is established by the formula, as under the fixed-price (firm target) contract.

h. *Fixed-Price Award Fee.*

(1) Description:

(a) Provides for a price not subject to any adjustment on the basis of the contractor's actual costs in performing the contract and for a fee consisting of an award amount that the contractor may earn in whole, in part, or not at all during performance.

(b) Award fee is sufficient to provide motivation for excellence in such areas as quality, timeliness, etc.

(c) The amount of the award fee to be paid is determined by the FAA's judgmental evaluation of the contractor's performance in terms of the discriminators stated in the contract. This determination is made unilaterally by the FAA and is not subject to the "Disputes" clause.

(2) Use When:

(a) The work can be sufficiently defined to permit the use of a fixed-price contract and the CO believes the FAA can benefit by providing added incentives to encourage the contractor to perform beyond the minimum contract requirements.

(b) The additional administrative effort and cost required to monitor and evaluate performance are justified by the expected benefits.

(c) Multiple offices or functions may be support by the contract.

(3) Considerations

(a) Probable profit included in the fixed price when establishing the award fee.

(b) Contract contains an award fee determination plan which discusses the method the FAA will use to determine how much of the award fee may be paid to the contractor. The following topics are recommended:

(i) Performance discriminators (describes the specific areas of

performance to be evaluated, and the weighting given to each area).

(ii) Frequency of evaluations, total award fee, and amount of fee allocated per performance evaluation period.

(iii) Process for making changes to the plan.

(iv) Termination (describes how the final period of evaluation will be treated should the contract be terminated).

3 Cost-Reimbursement **Revised 9/2021**

a. *General.* Cost-reimbursement type contracts provide for payment of allowable incurred costs, to the extent prescribed in the contract. These contracts establish an estimate of total cost for the required work and establish a ceiling that the contractor may not exceed (except at its own risk) without the CO's approval. Cost-reimbursement contracts are appropriate when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract.

The CO must notify FAA Cost/Price Analysis Services (AAP-500) when awarding all cost reimbursable contracts. This requirement includes task orders and contracts with reimbursable CLINs over 15% of the total contract value for the purposes of maintaining a list of contracts required by AMS Policy to be audited.

b. *Cost.*

(1) Description:

A cost-reimbursement contract in which the contractor receives no fee.

(2) Use When:

(a) Research and development work, particularly with nonprofit educational institutions or other nonprofit organizations, and for facilities contracts.

(b) The contractor's accounting system is adequate for determining costs applicable to the contract.

(c) The uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use a fixed price contract.

(d) The total value of the contract is high enough to justify the higher administrative costs when compared to other contract types.

(3) Considerations:

(a) Appropriate FAA surveillance during performance will provide reasonable assurance that efficient methods and effective cost controls are used.

(b) Verifiable cost information is available.

(c) A ceiling price which the contractor may not exceed without the CO's approval.

(d) Allowable costs are determined according to FAA Cost Principles.

c. *Cost-Sharing*.

(1) Description:

A cost-reimbursement contract in which the contractor receives no fee and is reimbursed only for an agreed-upon share of its allowable costs.

(2) Use When:

(a) The contractor agrees to absorb a portion of the costs with the expectation of compensating benefits.

(b) The contractor's accounting system is adequate for determining costs applicable to the contract.

(c) The uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use a fixed price contract.

(d) The total value of the contract is high enough to justify the higher administrative costs when compared to other contract types.

(3) Considerations:

(a) Appropriate FAA surveillance during performance will provide reasonable assurance that efficient methods and effective cost controls are used.

(b) Verifiable cost information is available.

(c) A ceiling price which the contractor may not exceed without the CO's approval.

(d) Allowable costs are determined according to FAA Cost Principles.

d. *Cost-Plus-Fixed Fee.*

(1) Description:

(a) Provides for payment to the contractor of a negotiated fee that is fixed at the inception of the contract. The fee is a fixed dollar amount.

(b) For CPFF LOE contract, the fee is determined by the level of effort performed. The fixed fee may vary by a pre-determined amount or percentage of the total fixed fee available based on the level of effort, but not cost incurred.

(c) The fixed fee does not vary with actual cost, but may be adjusted as a result of changes in the scope of work to be performed under the contract.

(d) If the contract is incrementally funded, the CO should identify in all awards and modifications the portion of funding allocated to the fee.

(e) Typically written in either completion form or term form.

(f) Permits contracting for efforts that might otherwise present too great a risk to contractors, but it provides the contractor only a minimum incentive to control costs.

(2) Use When:

(a) The uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use a fixed-price contract.

(b) The total value of the contract is high enough to justify the higher administrative costs when compared to another contract type.

(c) The contractor's accounting system is adequate for determining costs applicable to the contract.

(d) The level of effort required is unknown such as for the performance of research or preliminary exploration or study.

(e) The extra incentive of a cost plus award fee is not necessary, but payment of profit is still appropriate.

(3) Considerations:

(a) A contract ceiling price is established at award and the contractor may not exceed the ceiling without the CO's written approval.

(b) Costs are determined according to FAA Cost Principles.

(c) Contractor's accounting system is adequate for determining costs applicable to the contract.

(d) A Contractor may invoice the fee as a percentage of costs incurred, rather than a fixed dollar amount per invoice subject to the total Fixed Fee amount. If a Contractor invoices as a percentage of costs, the CO and COR must closely monitor the payment of fee and ensure compliance with AMS Clause 3.2.4-6 Fixed Fee and its require fee withholding. The Contractor fee may be released for payment once all deliverables have been received and accepted by the COR.

(e) Fixed fee payments may also be structured subject to contract terms and conditions such as milestone payments. A percentage or amount of the total fixed fee is paid upon completion of specified milestones.

(f) Cost plus fixed fee does not provide fee incentives for superior performance.

(g) Generally less costly to administer from an administrative standpoint than cost plus award fee.

(h) May be completion or term. Completion form is preferred because of the differences in obligation assumed by the contractor. This forms states a definite goal or target and specifies an end product. If the work cannot be completed within the estimated cost, FAA may require more effort and increase the estimated cost but without an increase in fee.

(i) If term is used the contract should provide a specific level of effort within a definite time period. If FAA considers performance satisfactory, the fixed fee is payable at the expiration of the agreed upon period.

(j) For multiple award contracts, the CO should make a determination about splitting the potential work under the contract vehicle to determine the share of fixed fee. This type of award is not recommended for multiple award contracts as it is difficult to determine which work will go to which Contractor in advance.

e. *Cost-Plus-Incentive Fee.*

(1) Description:

(a) Provides for the initially negotiated fee to be adjusted later by a formula based on the relationship of total allowable costs to total target costs.

(b) Specifies a target cost, target fee, minimum and maximum fees, and a fee adjustment formula.

(c) After contract performance, the fee payable to the contractor is determined in accordance with the formula.

(2) Use When:

(a) A cost-reimbursement contract is necessary and a target cost and fee adjustment formula can be negotiated that are likely to motivate the contractor to manage effectively.

(b) Development and test programs are required.

(c) Technical performance incentives may be included and it is highly probable that the required development of a major system is feasible and FAA has established its performance objectives, at least in general terms.

(3) Considerations:

(a) The fee adjustment formula provides, within limits, for increases in fee above target fee when total allowable costs are less than target costs and decreases in fee below target fee when total allowable costs exceed target costs.

(b) The increase or decrease is intended to provide an incentive for the contractor to manage the contract effectively.

(c) When total allowable cost is greater than or less than the range of costs within which the fee-adjustment formula operates, the contractor is paid total allowable costs, plus the minimum or maximum fee.

(d) The fee adjustment formula should provide an incentive that will be effective over the full range of reasonably foreseeable variations from target cost.

(e) If a high maximum fee is negotiated, the contract must also provide for a low minimum fee that may be a zero fee or, in rare cases, a negative fee.

(f) Costs are determined according to FAA Cost Principles.

(g) Contractor's accounting system is adequate for determining costs applicable to the contract.

f. *Cost-Plus-Award Fee*.

(1) Description:

(a) Provides for a fee consisting of:

(i) a base amount fixed at inception of the contract;

(ii) an award amount that the contractor may earn in whole or in part during performance and that is sufficient to motivate excellent performance; and

(iii) a performance evaluation plan that specifies the criteria for determining the award fee to be paid. Additional detailed guidance on developing a performance evaluation plan, measurable award fee criteria, calculating award fee, and other basic guidelines about administering cost-plus-award-fee contracts are in Appendix G1 of this Section.

(b) The amount of the award fee to be paid is based on FAA's judgmental evaluation of the contractor's performance. This determination is made unilaterally by FAA and is not subject to the "Disputes" clause.

(2) Use When:

(a) The uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use a fixed-price contract.

(b) The total value of the contract is high enough to justify the higher administrative costs when compared to another contract type.

(c) The contractor's accounting system is adequate for determining costs.

(d) The work to be performed is such that it is neither feasible nor effective to devise predetermined objective incentive targets applicable to cost, technical performance, or schedule.

(e) The likelihood of meeting acquisition objectives will be enhanced by using a contract that effectively motivates the contractor toward exceptional performance and provides FAA with the flexibility to evaluate both actual performance and the condition under which it was achieved.

(3) Considerations:

(a) The CO should weigh the cost of higher contract administration costs against the expected benefit of selecting a cost-plus-award-fee contract.

(b) A ceiling price which the contractor may not exceed without the CO's approval is included.

(c) Costs are determined according to FAA Cost Principles.

(d) The CO must develop measurable award fee criteria to evaluate contractor performance. The CO evaluation must contain narrative comments as the bases for

judging contractor performance, identifying specific contractor strengths, weaknesses and deficiencies.

(e) Contract contains an award fee determination plan which discusses the method FAA will use to determine how much the award fee will be paid.

(f) General topics of an award fee plan:

(i) Performance discriminators must be clearly described as these are the bases for grading and scoring methods used to translate evaluation findings into recommended award fee amounts or ranges.

(ii) Frequency of evaluations, total award fee, and amount of fee allocated per performance evaluation period.

(iii) Process for making changes to the plan.

(iv) Termination (describes how the final period of evaluation will be treated should the contract be terminated).

(g) Number of evaluation criteria and the requirements they represent may differ widely among contracts. The criteria and rating plan should motivate the contractor to improve performance in the areas rated, but not at the expense of a least minimum acceptable performance in all other areas.

(h) Provide for evaluation at stated intervals during performance, so that the contractor is periodically informed of the quality of its performance.

(i) Partial payment of fee should generally correspond to the evaluation periods.

g. *Cost-Plus-Percentage of Cost.*

Description: Provides for reimbursement of cost plus an agreed upon percentage of incurred cost as fee. The amount of fee increases as cost increases. This type of contract rewards inefficient and ineffective performance, or failure to control cost, with higher amounts of fee.

THIS CONTRACT TYPE IS PROHIBITED.

4 Incentive Contracts **Revised 4/2022**

a. *General.*

(1) Incentive contracts are designed to obtain specific program objectives by establishing reasonable and attainable targets clearly communicated to the contractor, and by establishing

incentives to motivate contractor performance and
discourage inefficiency. The basic categories of incentive contracts are fixed-price incentive and cost-reimbursement incentive. Award-fee contracts are also a type of incentive contract.

(2) When predetermined, formula-type incentives on technical performance or delivery are included in a contract, increases in profit or fee are provided only for contractor achievement surpassing the targets, and decreases are provided for to the extent that such targets are not met. The incentive increases or decreases are applied to performance targets rather than minimum performance requirements.

b. *Cost Incentives*.

(1) Most incentive contracts include only cost incentives, which take the form of a profit or fee adjustment formula and are intended to motivate the contractor to effectively manage costs. No incentive contract should provide for other incentives without also providing a cost incentive (or constraint).

(2) Excluding cost-plus-award-fee contracts, incentive contracts include a target cost, a target profit or fee, and a profit or fee adjustment formula that (within the constraints of a price ceiling or minimum and maximum fee) provides:

(a) Actual cost that meets the target will result in the target profit or fee;

(b) Actual cost that exceeds the target will result in downward adjustment of target profit or fee; and

(c) Actual cost that is below the target will result in upward adjustment of target profit or fee.

c. *Performance Incentives.*

(1) Performance incentives may be considered for specific product characteristics (*e.g*., range, speed, maneuverability) or other specific elements of the contractor's performance. These incentives should relate profit or fee to results achieved by the contractor, compared with specified targets.

(2) To the extent practicable, positive and negative performance incentives should be considered for service contracts involving objectively measurable tasks when quality of performance is critical and incentives are likely to motivate the contractor.

(3) Technical performance incentives may involve a variety of specific characteristics that contribute to the overall performance of the end item. The incentives on individual technical characteristics should be balanced so that no one of them is

exaggerated to the detriment of the overall performance of the end item.

(4) Performance tests and/or assessments of work performance are generally essential in order to determine the degree of attainment of performance targets. The contract should be as specific as possible in establishing test criteria (such as testing conditions, instrumentation precision, and data interpretation) and performance standards (such as the quality levels of services to be provided).

(5) Because performance incentives present complex problems in contract administration, the CO should negotiate incentives in full coordination with Government engineering and pricing specialists.

(6) It is essential that the Government and contractor agree explicitly on the effect that contract changes (e.g., changes pursuant to the exercising of a "Changes" clause) will have on performance incentives.

(7) The CO must exercise care, in establishing performance criteria, to recognize that the contractor should not be rewarded or penalized for attainments of Government-furnished components.

d. *Delivery Incentives*.

(1) Delivery incentives should be considered when improvement from a required delivery schedule is a significant Government objective. It is important to determine the Government's primary objectives in a given contract (*e.g.*, earliest possible delivery or earliest quantity production).

(2) Incentive arrangements on delivery should specify the application of the reward-penalty structure in the event of Government-caused delays or other delays beyond the control, and without the fault or negligence, of the contractor or subcontractor.

e. *Structuring Multiple-Incentive Contracts*. A multiple-incentive arrangement should:

(1) Motivate the contractor to strive for outstanding results in all incentive areas; and

(2) Compel trade-off decisions among the incentive areas, consistent with the Government's overall objectives for the acquisition. Because of the interdependency of the Government's cost, the technical performance, and the delivery goals, a contract that emphasizes only one of the goals may jeopardize control over the others. Because outstanding results may not be attainable for each of the incentive areas, all multiple- incentive contracts must include a cost incentive (or constraint) that operates to preclude rewarding a contractor for superior technical performance or delivery results when the cost of those results outweighs their value to the Government.

f. *Checklist for Incentive Contracts.*

Pre-award:

- Was a review of incentive fee contracting at AMS Procurement Guidance T3.2.4.A.4 a.-e. completed?
- Is it likely the incentive affects cost, schedules or quality in a positive way?
- Are there potential unintended negative consequences in the incentive on costs, schedules or quality?
- Is the incentive challenging and attainable?
- Is the incentive affordable for FAA?
- Are resources available to properly formulate and monitor the contract?
- Can risks and cost benefits be assessed?
- Can incentives be objectively measurable?
- Do incentives correlate to the desired results?
- What form should the incentive take?
- Was there market research and open communications with vendors in developing the incentive?
- Are there evaluation factors related to the incentive?
- Are multiple incentives (i.e., combination of cost, performance/delivery, or quality incentives) appropriate?
- Does the incentive fee plan provide clear direction on how the incentive fee will be applied and monitored?
- What is appropriate contract type - CPIF or FPI?
- Are there any goals where multiple incentives conflict?
- Does the incentive have the requisite limits?

Post-award:

- Is the incentive effective?
- Do incentive assumptions need to be reassessed?
- Are contractors being rewarded for simply meeting contract requirements?
- Is the incentive focused on the objective?
- How effective are the tools and processes being used to monitor the incentive?
- Is there a need to revise the incentive due to changes in requirements or contract developments?

5 Indefinite Delivery Revised 10/2021

a. *General.* There are three types of indefinite delivery contracts: definite quantity; requirements; and indefinite-quantity. An indefinite delivery contract permits flexibility in both quantity and delivery time, and in ordering products or services after requirements materialize. These contract types are appropriate when the exact times or exact quantities of future deliveries are not known at the time of contract award, and FAA wants a firm commitment from the contractor to accept all orders placed in accordance with the contract terms. Other considerations for indefinite delivery contracts include:

(1) Contracts may provide for any appropriate cost or pricing arrangement.

(2) Cost or pricing arrangements that provide for an estimated quantity of supplies or services (e.g., estimated number of labor hours) must comply with the appropriate cost and pricing procedures.

(3) Prices remain fixed for the duration of the contract unless specific provisions are included for price adjustments.

(4) A separate public announcement is not required for orders placed under a requirements or indefinite quantity contract.

(5) Contract schedule should include the names of organizations authorized to issue orders.

(6) The contract may include provisions for placing oral, electronic, or facsimile orders. Funds should be properly obligated and oral orders confirmed in writing.

(7) When determining which contract, cost and pricing arrangements to include, all justifications and approvals for such arrangements must be made and obtained prior to entering into the indefinite delivery contract.

(8) The contract may include program management task orders. The determination to award program management task orders will be made on a case-by-case basis and driven by program requirements, scope, complexity, dollar value, and risk. Some factors that the program office may consider in its decision to award program management task orders include the following:

- Major stakeholder visibility.
- Complexity of the procurement scope and impact on the program's mission.
- Overarching program oversight of individual projects/task orders.
- Centralized coordination with vendors in managing the overall technical requirements, performance monitoring, and status reporting across the program.
- Indefinite delivery contracts must be identified as "D" type contracts. Orders issued under indefinite delivery contracts are the obligating vehicle for funding and for proper tracking of funds within the FAA's Procurement System.

b. *Definite Quantity.*

(1) Description:

Provides for delivery of a definite quantity of specific supplies or services for a fixed period, with deliveries or performance to be scheduled at designated locations upon order.

(2) Use When:

(a) FAA can determine in advance that a definite quantity of supplies or services will be required during the contract period and the supplies or services are regularly available or will be available after a short lead-time.

(b) The FAA's total requirements are known but the delivery schedule or locations are not known in advance.

(3) Considerations:

(a) Limits FAA's and the contractor's obligation to the quantity specified in the contract.

(b) May also contain provisions to order option quantities.

c. *Indefinite Quantity.*

(1) Description:

(a) Limits FAA's obligation to the minimum quantity specified in the contract.

(b) Provides for delivery of an indefinite quantity within stated limits, of specific products or services during a fixed period; with deliveries to be scheduled by placing orders with the contractor.

(c) Also known as a delivery order contract.

(2) Use When:

(a) The FAA cannot predetermine, above a specified minimum, the precise quantities of supplies or services that will be required during the contract period.

(b) The FAA does not wish to commit itself for more than a minimum quantity.

(c) A recurring need is anticipated.

(d) Funds for other than the stated minimum quantity are obligated by each delivery order, and not by the contract itself.

(3) Considerations:

(a) The schedule of items should include a realistic estimate of total orders to be placed during the contract term.

(b) Contract may include a maximum or minimum quantity that FAA may order under delivery order and the maximum that it may order during a specific period of time.

(c) The contract should contain a minimum quantity of supplies or services that the contractor may be required to deliver, if ordered. The minimum quantity should be more than nominal but should not exceed the amount that FAA is fairly certain to order.

(d) Making multiple awards may be beneficial. In making this determination, the CO should exercise sound business judgment as part of acquisition planning. The administrative cost of multiple contracts may outweigh any potential benefits.

(e) If multiple awards are anticipated, include a notice to offerors.

d. *Requirements Contract.*

(1) Description:

(a) Provides for filling all actual product or service requirements of designated government activities during a specified period with delivery or performance scheduled

by placing orders with the contractor.

(b) Funds are obligated by each delivery order, not by the contract itself.

(c) Also known as a delivery order contract.

(2) Use When

(a) The FAA anticipates recurring requirements but cannot predetermine the precise quantities of products or services that designated FAA activities will need during a definite period.

(b) The contract states a realistic estimated total quantity.

(c) The estimate is based on the most current information available, such as previous requirements or consumption.

(3) Considerations:

(a) Estimated requirements are not a representation to an offeror or contractor that the estimated quantity will be ordered, or that conditions affecting requirements will be stable or normal.

(b) Contract may include a maximum limit of the contractor's obligation to deliver and the FAA's obligation to order.

(c) Contract may specify minimum/maximum quantities that the FAA may order under each individual order and the maximum it may order during a specified period of time.

(d) If contract is to acquire work on exiting FAA property (e.g., repair, modification or overhaul), the schedule should specify that failure of FAA to furnish such items in the amounts or quantities described in the schedule as 'estimated' or 'maximum' will not entitle the contractor to any equitable adjustment in price under the FAA property clause of the contract.

6 Time-and-Materials / Labor-Hour Revised ~~10/2021~~10/2023

a. Description:

A time-and-materials (T&M) or labor-hour (LH) contract provides for acquiring supplies or services on the basis of direct labor hours at specified fixed hourly rates. Fixed hourly labor rates include wages, overhead, general and administrative expenses, and profit. A T&M contract also includes provisions for acquiring materials at actual cost (and may include a handling fee).

b. Use When:

A T&M or LH contract may be used when no other contract type is suitable, and it is not possible at the time of award to accurately estimate the extent or duration of the work or to anticipate costs with any reasonable degree of confidence. T&M and Labor Hour contracts may be issued as an Indefinite delivery contract which is coded as a "D" type contract when multiple orders are anticipated given the uncertainty in the extent and duration of the work.

c. Considerations:

(1) *Justification*. The CO must document the basis for selecting a T&M or LH contract, including task orders placed against an ordering vehicle. This justification must explain:

(a) Why no other contract type is suitable;

(b) Why it is not possible to accurately estimate the extent or duration of the work or to anticipate costs with any reasonable degree of confidence;

(c) The market research conducted; and

(d) How the requirement has been structured to best allow for another contract type with less risk (such as fixed-price) to FAA in future procurements. This may include transitioning individual line items to fixed-price (for example, materials), while keeping other line items as T&M (for example, installation services).

(2) *Approval of Long Term Contracts*. The Chief of the Contracting Office ~~must~~(COCO) must approve any T&M or LH contract with a total period of performance ~~period~~ of more than ~~five~~5 years ~~(base period plus options, or~~in duration. This does not include contracts where a 5-year period is extended by ~~modification).~~ exercise of AMS Clause 3.2.4-34, "Option to Extend Services." In that instance, approval is not needed and the contract's duration must not exceed 5 years and 6 months (66 months). The CO documents the basis for the performance period, includes this information in the T&M or LH justification required by paragraph c. (1) above, and sends to the justification to the COCO for approval. Non-T&M or LH contracts that have T&M or LH line items that are 15% of the contract price or less ~~-~~do not need COCO approval.

(3) *Ceiling*. T&M or LH contracts must include a ceiling price established at the time of contract award. There must be a documented relationship between the ceiling price established at the time of award and the amount of work expected to be performed. The CO must justify and document consistent with AMS Single-Source Selection Policy any ceiling price increase. As part of this justification and documentation, the CO must conduct an analysis of pricing and other relevant factors to determine if the ceiling increase is in the FAA's best interests. The CO also should consider if effort in excess of the ceiling price, where appropriate, should be completed using a fixed-price contract modification.

(4) *Labor Categories*. T&M or LH contracts should establish only those labor categories necessary for the required work. The program official and CO must jointly document the basis

for selecting labor categories to be used. The contract should specify any minimum education, experience, and other qualifications required for each labor category.

(5) *Hourly Rates*. T&M or LH contracts must specify for each labor category, separate fixed hourly rates that include wages, overhead, general and administrative expense, and profit. For noncompetitive awards, the contract must specify fixed hourly rates for each labor category, whether performed by contractor personnel, subcontractor personnel, or employees of a division, subsidiary, or affiliate of the contractor under a common control.

(6) *Material Costs*.

(a) Materials are:

(1) Direct materials: Those materials that enter directly into the end product or are consumed in connection with the furnishing of the end product or service;

(2) Subcontracts: For supplies or incidental services for which there is not a labor category in the contract;

(3) Other direct costs: Includes incidental services for which there is not a labor category in the contract, travel, and computer usage charges; and

(4) Applicable indirect costs.

(b) Material costs are compensable only if the contract provides for such costs.

(c) When included as part of material costs, material handling costs (or fees) must include only costs excluded from the labor-hour rate. These costs may include all appropriate indirect costs allocated to direct materials in accordance with the contractor's usual accounting procedures.

(7) *Monitoring*. T&M or LH contracts provide limited incentive for a contractor to control costs or efficiently use labor. FAA personnel must closely monitor a contractor's performance to ensure efficient work methods and adequate cost controls are in place. Methods of monitoring generally relate to the dollar value and risk associated with the contract, and may include:

(a) *Random Sampling*. Random sampling is a statistically based method that assumes receipt of acceptable performance if a given percentage or number of scheduled assessments is found to be acceptable;

(b) *100% Inspection*. This surveillance/assessment type is preferred for those tasks that occur infrequently; including tasks that cannot be random sampled because the sample size for a small lot may exceed the lot size;

(c) *Periodic Surveillance*. Periodic sampling is similar to random sampling, but it is planned at specific intervals or dates; or

(d) *Customer Feedback*. Customer feedback is firsthand information from the actual users of the service.

7 Letter and Ceiling Priced Contracts Revised 9/2021

a. *General.* A letter contract is a preliminary contractual instrument that authorizes a contractor to immediately begin performance, subject to negotiating a definitive contract. A ceiling priced contract authorizes a contractor to start performance before final agreement on contract price. When issuing a letter contract, the CO must use the Letter Contract template located in Procurement Templates.

b. *Letter Contract.*

(1) Description:

(a) Provides a preliminary authorization for the contractor to immediately begin work.

(b) Includes a brief description of the work, performance period, and a limitation on the total funding amount that a contractor may expend and FAA will pay.

(c) Includes a negotiated definitization schedule. The definitization schedule will include dates for submission of the contractor's price proposal, required certified cost or pricing data or other than certified cost and pricing data and, if required, subcontracting plans; a date for the start of negotiations; and a target date for definitization. Definitization should occur within 180 days after the date of the ceiling-priced/letter contract or before completion of 40% of the work to be performed, whichever occurs first. When appropriate, extensions beyond 180 days or 40% completion of the work to be performed may be made upon the demonstrated need due to emergency. Such extensions must be approved by the applicable division manager or AAQ-1.

(d) Contractor agrees to be bound by the AMS termination, changes and disputes provisions.

(2) Use When:

(a) The FAA's interests demand that the contractor be given a binding commitment so that work can start immediately and negotiating a definitive contract is not possible in sufficient time to meet the requirement.

(b) Emergency or other special situations for limited amounts.

(3) Considerations:

(a) A letter contract should not be used for contract modifications.

(b) Should not be used to commit the FAA to a definitive contract in excess of the funds available at the time the letter contract is executed.

(c) Should not be amended to satisfy a new requirement unless that requirement is inseparable from the existing letter contract. Any such amendment is subject to the same requirements and limitations as a new letter contract.

c. *Ceiling Priced Contract.*

(1) Description:

(a) A written contractual instrument that contains all required AMS provisions, except for final agreement on contract price or cost.

(b) Contains all requirements for performance or delivery. (2) Use

When:

(a) The FAA's interests demand that the contractor be given a binding commitment so that work can start immediately and negotiating a definitive contract price or cost is not possible in sufficient time to meet the requirement.

(b) The ceiling priced contract contains the maximum price or cost to be negotiated; the contract type for the definitized contract; FAA's maximum liability pending definitization; a definitization schedule; and a provision which permits the CO to determine a reasonable price or cost (subject to the disputes provisions).

(3) Considerations:

(a) Use of a ceiling-priced contract for a cost-reimbursement contract should not be construed to alter the obligation of the parties to complete performance of the cost type contract.

(b) Each ceiling priced contract must include a negotiated definitization schedule. The definitization schedule should include dates for submission of the contractor's price proposal, required cost or pricing data and, if required, make-or-buy and subcontracting plans; a date for the start of negotiations; and a target date for definitization.

(c) The definitization schedule should provide for definitization of the contract within 180 days after the date of the ceiling-priced contract or before completion of 40% of the work to be performed, whichever occurs first.

8 Multi-year Contracting Revised 7/2007

a. *Description.* Multi-year contracting is a special method of acquiring known requirements for supplies or services for up to five program years, without total program funding at the time of basic contract award. Funds are obligated only for the first program year's requirements. Contract performance after the first year is contingent on appropriations for each subsequent program year. If appropriations are not made, then FAA must cancel the contract and the contract may provide for a cancellation payment to the contractor. Multi-year contracts differ from multiple year contracts in that multi-year contracts obtain more than one year's requirement without establishing and having to exercise an option for each program year after the first.

b. *Multi-year Authority*. Specific legal authority authorizes or restricts FAA's use of multi-year contracts. Before planning a multi-year contract, the CO must obtain legal counsel's concurrence.

c. *Benefits*. Advantages of using multi-year provisions include to:

(1) Lower costs;

(2) Enhance standardization;

(3) Reduce administrative burden associated with contract award and administration;

(4) Ensure substantial continuity of production or performance, to avoid annual startup costs, pre-production testing costs, make-ready expenses, and phase-out costs;

(5) Stabilize contractor workforces;

(6) Avoid establishing quality control techniques and procedures for a new contractor each year;

(7) Broaden the competitive base, with opportunity for participation by contractors not otherwise willing or able to compete for lesser quantities, particularly in cases involving high startup costs; and

(8) Provide incentives to contractors to improve productivity through investment in capital facilities, equipment, and advanced technology.

d. *Considerations.* When deciding whether to use multi-year provisions, the CO should consider:

(1) There will be a continuing requirement consistent with current plans for the proposed contract period. The minimum need for the item to be purchased is expected to remain substantially unchanged during the proposed contract period in terms of production rate, acquisition rate, and total quantities;

(2) The contract will require a substantial initial investment in plant or equipment, or there will be a substantial contingent liability for assembling, training, or transporting a specialized workforce;

(3) The contract will encourage competition and promote economies in operation;

(4) The contract will promote safety or efficiency of the National Airspace System and will result in reduced total costs;

(5) There is reasonable expectation that throughout the contemplated contract period FAA will request funding for the contract at the level required to avoid contract cancellation;

(6) There is a stable design for the item to be acquired and the technical risks associated with such item are not excessive; and

(7) There are realistic estimates of both cost of the contract and anticipated cost avoidance through the use of multi-year provisions.

e. *Services*. Fixed-price and fixed-price incentive contracts for the following services, and supplies related to those services, may be acquired using multi-year provisions:

(1) Operation, maintenance, and support of facilities and installations;

(2) Operation, maintenance, and modification of aircraft, vehicles, and other highly complex equipment;

(3) Specialized training requiring high quality instructor skills, including training of pilots and aircrew members and foreign language training; and

(4) Base services, including ground maintenance, aircraft refueling, bus transportation, and refuse collection and disposal.

f. Multi-year provisions should not be used to acquire construction or real property.

g. *Soliciting Offers and Pricing*

(1) The CO may solicit separate offers for the current one-year program requirements alone and for the total multi-year program requirements. Separate offers allow the CO to determine which alternative provides the lowest unit price and whether there are potential savings from using multi-year provisions. When in FAA's best interest, the CO may solicit offers for the

total multi-year requirements only.

(2) Multi-year contracts allow certain costs to be amortized over the entire contract quantity, resulting in identical (level) unit prices for all items or services. When level unit pricing is not in FAA's best interest, the CO may use variable unit pricing, provided that for competitive proposals there is a valid method of evaluation.

(3) Given the longer period of performance for a multi-year contract, the CO should consider risk when negotiating a profit or fee objectives and should consider financing arrangements that reflect contractor's cash flow needs.

h. *Cancellation.* If a multi-year contract is canceled, FAA should fairly compensate a contractor for the work done and for preparations made for the canceled portion of the contract. The specific dollar amount of "fair compensation" is only determined if the contract is actually canceled. The contractor submits a cancellation claim, the CO evaluates it, and the parties negotiate the "fair compensation," called the cancellation charge, which FAA will pay to the contractor. A cancellation charge is the amount of unrecovered costs that would have been recouped through amortization over the full term of the contract, including the term canceled. The cancellation ceiling is the maximum cancellation charge that the contractor can receive in the event of cancellation. For each point in time when the FAA could cancel the contract, there is a unique cancellation ceiling.

(1) Whether, or to what extent, cancellation provisions are included in multi-year contract depends on the circumstances. The CO may use modified cancellation provisions or exclude cancellation provisions when appropriate.

(2) If cancellation occurs, the contractor is entitled to payment in accordance with contract terms and conditions. The terms of cancellation should outline cancellation procedures, cancellation points in time, the way in which cancellation will be funded, types of costs to be included in the cancellation charge, and cancellation ceiling.

(3) Cancellation charges need not be funded before cancellation. The CO should determine whether to fund the cancellation ceiling or treat it as a contingent (unfunded) liability.

(4) All program years except the first are subject to cancellation. Each subsequent program year has a cancellation ceiling. Cancellation ceilings should exclude amounts for items included in prior program years. The cancellation ceiling for each program year is reduced in direct proportion to the remaining requirements subject to cancellation.

(5) Multi-year contracts may allow reimbursement of unrecovered non-recurring costs included in the price of canceled items to protect the contractor against loss resulting from cancellation.

(6) In determining cancellation ceilings, the CO should estimate reasonable pre- production or startup, labor learning, and other non-recurring costs to be incurred by an 'average' prime contractor or subcontractor, which would be applicable to, and which normally would be

amortized over, the items or services to be furnished under the multi- year requirements. Non-recurring costs include such costs, where applicable, as plant or equipment relocation or rearrangement, special tooling and special test equipment, pre- production engineering, initial rework, initial spoilage, pilot runs, allocable portions of the costs of facilities to be acquired or established for the conduct of the work, costs incurred for the assembly training and transportation of a specialized workforce to and from the job site, and unrealized labor learning. Costs should not include any costs of labor or materials, or other expenses (except as indicated above), which might be incurred for performance of subsequent program year requirements. The total estimate of the above costs must then be compared with the best estimate of the contract cost to arrive at a reasonable percentage or dollar figure. To perform this calculation, the CO should obtain in-house engineering cost estimates identifying the detailed recurring and non-recurring costs, and indicating labor learning implications.

(7) The CO should establish cancellation dates for each program year's requirements regarding production lead time and the date by which funding for these requirements can reasonably be established. The CO should include these dates in the schedule, as appropriate.

i. The CO should limit the FAA's payment obligation to an amount available for contract performance. The CO must insert the amount for the first program year in the contract upon award and modify it for successive program years upon availability of funds. If the contract is terminated for convenience of the FAA in whole, including items subject to cancellation, the FAA's obligation must not exceed the amount specified in the schedule as available for contract performance, plus the cancellation ceiling.

9 Options Revised 9/2021

a. An option is a unilateral contractual right through which FAA may, within a specified time, chose to purchase additional quantities of supplies or services or extend the term of a contract. Options can be an effective method of managing risk, reducing administrative costs of resoliciting for recurring requirements, and motivating contractor's performance. Options do not guarantee contractors that FAA will acquire more than the basic contract quantity or extend the period of performance.

b. Options may be stated as increased quantities of supplies or services, or may be expressed in terms of:

(1) Percentage of specific contract line items.

(2) Increase in specific contract line items.

(3) Additional numbered line items.

(4) Extensions to the term of the contract.

c. *Services.* Generally, contracts with options for recurring services should be limited to five years.

Contracts subject to the Service Contract Labor Standards cannot exceed five years, including options.

d. *Evaluation of Option/Exercise at Award*. The solicitation must state whether the CO will evaluate offers inclusive or exclusive of options and, if applicable, state whether options will be exercised at the time of award. If the CO may exercise an option at award, the solicitation must specify the price at which FAA will evaluate the option (highest option price offered or option price for specified requirements).

e. *Price Limitation*. A solicitation may allow options to be offered without or with price limitation. Solicitations may require options to be offered at prices no higher than those for the initial requirement. Solicitations that limit option prices should specify that FAA will accept an offer containing an option price higher than the basic price only if the acceptance does not prejudice any other offeror.

f. *Priced Options*. Priced options contain specific option pricing and, if applicable, an appropriate economic price adjustment index. Priced options give FAA a unilateral right to purchase additional quantities or extend a contract period at pre-agreed prices and terms. Priced options are appropriate when the market is relatively stable, price inflation is fairly predictable, the nature of the requirement is not likely to change significantly between award and the time the option is exercised, or when it may be difficult to test the market at a future date.

g. *Unpriced Options*. For unpriced options, the terms and conditions are agreed to at the time of basic contract award but option prices are not agreed to until exercise. Unpriced options may include a not-to-exceed amount established at the time of basic contract award (otherwise exercise of the option requires single source justification). Unpriced options may be bilaterally exercised after agreement on prices.

h. *Public Announcement.* A public announcement is not required for option exercise.

i. *Option Exercise*. The CO makes a prudent business decision whether to exercise an option. The CO, consulting with the program official, should consider funding availability, option prices, and contractor performance (timeliness and quality) when arriving at this decision. The CO may also consider:

(1) A new solicitation, an informal analysis of prices, or examination of the market would not produce better prices or a more advantageous offer than that offered by the option.

(2) The time between award of the basic contract and option exercise is so short that it indicates the option price is the lowest price obtainable or the more advantageous offer.

j. *Economic Price Adjustment*. For options that include an economic price adjustment, the CO should determine the effect of that adjustment on option prices before exercise.

k. *Notification*. The CO must notify the contractor that FAA is exercising an option using the Notice of Intent to Exercise Option template located in Procurement Templates; options are not self-

exercising. When exercising an option, the CO provides written notice to the contractor within the time period specified in the contract. The contract terms may also require the CO to give preliminary notice of intent to exercise an option.

10 Basic Agreement Revised 7/2007

A basic agreement is a written instrument of understanding, negotiated between FAA and a contractor, which contains contract clauses applying to possible future contracts between the parties. During the basic agreement's term, separate future contracts will incorporate by reference or attachment the required and applicable clauses agreed upon in the basic agreement. A basic agreement is not a contract.

a. *Application.* A basic agreement should be used when a substantial number of separate contracts may be awarded to a contractor during a particular period and significant recurring negotiating problems have been experienced with the contractor. Basic agreements may be used with negotiated fixed-price or cost-reimbursement contracts.

b. *Contents.* Basic agreements should contain the clauses required by AMS and other appropriate clauses that the parties agree to include in each contract.

c. *Termination.* Each basic agreement will provide for discontinuing its future applicability upon 30 days written notice by either party. The CO should annually review each basic agreement before the anniversary of its effective date and revised as necessary. Basic agreements may need to be revised before the annual review due to mandatory statutory requirements. A basic agreement may be changed only by modifying the agreement itself and not by a contract incorporating the agreement. Discontinuing or modifying a basic agreement must not affect any prior contract incorporating the basic agreement. COs may obtain and use existing basic agreements of another agency when practical.

d. *Exclusions.* A basic agreement does not cite appropriations or obligate funds, or state or imply any agreement by FAA to place future contracts or orders with the contractor.

e. *Incorporating contract.* Each contract incorporating a basic agreement includes a scope of work and price, delivery, and other appropriate terms applicable to the particular contract. The basic agreement should be incorporated into the contract by specific reference (including reference to each amendment) or by attachment. Clauses pertaining to subjects not covered by the basic agreement, but applicable to the contract being negotiated, should be included in the same manner as if there were no basic agreement.

11 Basic Ordering Agreement Revised 7/2007

A basic ordering agreement is a written instrument of understanding, negotiated between the FAA and a contractor. A basic ordering agreement contains terms and conditions applying to future contracts (orders) between the parties during its term, a description, as specific as practicable, of

supplies or services to be provided, and methods for pricing, issuing and delivering future orders under the basic ordering agreement. A basic ordering agreement is not a contract.

a. *Application.* A basic ordering agreement may be used to expedite contracting for uncertain requirements for supplies or services when a substantial number of requirements for the type of supplies or services covered by the agreement are anticipated to be purchased from the contractor but specific items, quantities, and prices are not known at the time the agreement is executed. Under proper circumstances, the use of these procedures can result in economies in ordering parts for equipment support by reducing administrative lead-time, inventory investment and inventory obsolescence due to design changes.

b. *Contents.* Each basic ordering agreement describes the method for determining prices to be paid to the contractor for the supplies or services. It also includes delivery terms and conditions or specifies how they will be determined, dispute provisions, and any special payment provisions. The agreement contains a list of FAA activities authorized to issue orders under the agreement. Each basic ordering agreement specifies the point at which the order becomes a binding contract (e.g., issuance of the order, acceptance of the order in a specified manner, or failure to reject the order within a specified number of days). The agreement also contains a statement that failure to reach agreement on price for any order issued before its price is established will be processed as a dispute under the dispute provisions included in the basic ordering agreement.

c. *Administration.* The CO should annually review each basic ordering agreement before the anniversary of its effective date and revised as necessary. Basic ordering agreements may need to be revised before the annual review due to mandatory statutory requirements. A basic ordering agreement should be changed only by modifying the agreement itself and not by individual orders issued under it. Modifying a basic ordering agreement does not retroactively affect orders previously issued under it.

d. *Issuing Orders.* A CO representing any Government activity listed in a basic ordering agreement may issue orders for supplies or services covered by that agreement. A CO may issue orders under basic ordering agreements on any appropriate contractual instrument that incorporates by reference the provisions of the basic ordering agreement. The CO should neither make any final commitment nor authorize the contractor to begin work on an order under a basic ordering agreement until prices have been established, unless the order establishes a ceiling price limiting FAA's obligation and either:

(1) The basic ordering agreement provides adequate procedures for timely pricing of the order early in its performance period; or

(2) The need for the supplies or services is compelling and unusually urgent. For example, FAA would be seriously injured, financially or otherwise, if the requirement were not met sooner than would be possible if prices were established before the work began. The CO should proceed with pricing as soon as practical. In no event should an entire order be priced retroactively.

B Clauses

view contract clauses

C Procurement Forms Revised 9/2021

D Procurement Samples Revised 9/2021

E Procurement Templates Revised 9/2021

Document Name
Notice of Intent to Exercise Option
Letter Contract

F Procurement Tools and Resources Revised 9/2021

G Appendices Revised 9/2021

1 Appendix - Award Fee Revised 4/2021

1. Introduction

This appendix includes additional explanation of award fee. It focuses on award fee under cost-reimbursement contracts, but the general concepts apply to award fee on other types of contracts.

An award fee contract provides a separate amount that a contractor may earn, in whole or in part, based on FAA's periodic evaluations of its performance. Award fee is intended to reward contractor performance, considering both the levels of performance and conditions under which the contractor

achieved those levels. Award fee gives FAA flexibility to judgmentally evaluate contractor performance, and to quickly change evaluation plans to reflect changes in FAA management emphasis or concern.

2. Award Fee Provisions

A cost-plus-award fee contract includes an estimated cost, a base fee, an award fee, and an evaluation and fee payment plan. The contract also includes a clause specifying that award fee determinations are made unilaterally by the designated Fee Determination Official (FDO), according to the approved evaluation plan, and determinations are not subject to appeal under the Disputes clause.

3. Administrative Cost Versus Benefit

Award fee requires added administrative activities. Tailoring an award fee approach avoids an administrative burden disproportionate to any expected improvements in a contractor's performance and overall project management. When deciding whether to use award fee, the Contracting Officer (CO) should consider administrative cost versus expected benefit. Administrative cost includes staff time to monitor, evaluate, document, brief and otherwise implement award fee. Cost drivers include frequency of evaluation periods, and number of people involved in administering award fee. Benefits, which may be intangible and difficult to estimate, could include dollars saved by enhanced technical capability.

4. Fees

The total amount of base fee (if any) and award fee is established at contract award. The sum of base fee and award fee should reflect the overall character, difficulty, and uncertainty of the effort.

Base fee is a fixed amount, similar to fixed fee, that a contractor earns for basic risk of contract performance. Base fee is optional; FAA may decide instead to reward contractor performance solely through award fee. When base fee is used, the amount should be limited so that it does not undermine the effectiveness of award fee. Base fee payments are generally made as part of the regular cost voucher process.

Award fee is a separate amount sufficient enough to reward the contractor for all levels *above* minimally acceptable performance. Actual award fee earned by the contractor is determined by FAA's assessment of performance against criteria included in an evaluation plan. The contractor can earn any amount of available award fee, from none to all. The contractor does not earn any award fee for less than satisfactory performance. Award fee available, but not earned, for an evaluation period is forfeited by the contractor and cannot carry forward to subsequent evaluation periods.

When establishing award fee, the CO may consider weighted guidelines profit/fee analysis factors, such as contractor effort, complexity of the effort, labor and indirect costs, cost risk, and other factors as applicable. Award fee should not be excessive, but should be large enough to adequately motivate contractor performance.

One of the most difficult situations is a hybrid contract, where there might be multiple performance incentives in addition to an award fee. The amounts allocated to each fee area must be sufficient to adequately motivate and reward a contractor to excel in each. There should be a balance in which no fee area is either so insignificant that it offers little reward or so large that it overshadows all other areas. The number of factors being incentivized also plays a part. When too many factors are incentivized, the prospect increases of any one item being too small (and thus overlooked), or the incentives being (or perceived as being) inconsistent and working at cross purposes. Using too many factors can also be confusing and increase the administrative burden.

5. Combination with Other Contract Types

A hybrid contract may be appropriate when certain aspects of a contract performance are best suited to objective measurement and other portions are suited to subjective measurement. For example, an incentive fee might be used for cost control and award fee to reward technical performance. Given the interrelationship between contract costs and the other critical performance elements, the CO should ensure that combinations of objective cost control incentives and subjective/objective award fee determinations do not result in a contractor making trade-off decisions inconsistent with FAA objectives and performance priorities. Poorly structured incentives can result in increased costs with little or no improvement in performance or cost savings with a corresponding loss in performance. No performance element should be incentivized more than once. If a separate incentive is used for cost, then cost control cannot also be rewarded in the award fee. Similarly, performance elements should be carefully structured and defined to avoid overlap, and to preclude downgrading in multiple elements for a single type of poor performance. When using hybrid contracts, financial data must be segregated to allow different cost and fee payments based on each type of contract and to provide specific management information and accountability for the work under the different types of contract. Because of the complexity in structuring and administering a hybrid contract, the CO should be reasonably sure that increased administrative costs will be offset by potential benefit.

6. Organization and Administration

The most effective organizational and administrative approach differs with each situation. The overall objective is to not impose an unreasonable administrative burden, considering the value and complexity of the contract. The following are basic guidelines:

a. Avoid creating too many organizational layers. Excessive layers contribute to unnecessary paperwork, delays in turnaround time, and inordinate staffing demands.

b. At the same time, the CO and project manager's assessments should be reviewed by higher level management officials who have a broader perspective and are not involved in the daily interaction with the contractor. Evaluations must be based on contractually required performance.

c. Tailor performance evaluation plans to the specific situation, but do not reinvent the wheel. The tailored, case-by-case application of successfully used procedures and practices generally works best.

d. The objective is to evaluate performance and not micromanage it. The Government tells the

contractor what results are expected and important. It then evaluates and rewards the contractor as appropriate for achieving or exceeding the desired results. Communication with contractor personnel about performance should not lead to Government direction in a manner that compromises the contractor's responsibility or ability to manage under the contract.

7. Organizational Levels and Functions

The following basic organizational structure is appropriate for most situations. This structure and responsibilities may be modified to fit the circumstance:

a. Fee Determination Official

b. Performance Evaluation Board (with chairperson)

c. Performance Evaluation Coordinators *(optional)*

d. Performance Monitors

Fee Determination Official (FDO) -The FDO is organizationally senior to the Performance Evaluation Board (PEB) members. The FDO is identified by position title, and not name, in the award fee evaluation plan. This establishes the level of the award fee determinations, while eliminating the need to modify the contract if the incumbent FDO changes. The FDO's responsibilities include:

a. Establishing the PEB

b. Approving the award fee evaluation plan and any changes required during performance, unless the FDO delegates responsibility for changes to the plan to the PEB.

c. Considering the PEB report for each evaluation period and discussing it with the PEB Chair and, if appropriate, with others such as the contractor.

d. Determining the amount of award fee earned and payable for each evaluation period. In the cases where all evaluation ratings are interim except the last one, determining the amount of interim award fee to be paid for each evaluation period. The FDO ensures the amount and percentage of award fee earned accurately reflects the contractor's performance.

e. Justifying and documenting for the contract file any variances between the PEB recommendation and FDO determination.

f. Signing the award fee determination letter specifying the amount of award fee earned and the basis for that determination for the evaluation period.

Performance Evaluation Board (PEB) - The PEB is established by the FDO. The PEB brings a broader management perspective to the evaluation process than at the monitor level (and PEB members should be at a higher management level than performance monitors). The qualifications of PEB members will vary depending on the nature, dollar value and complexity of the contract. The PEB should include at least members with overall responsibility for the technical and contracting aspects of contractor performance. Board members should be familiar with the type of work to be evaluated and be able to devote enough time to their assignment to perform thorough and prompt reviews. The PEB should be established in sufficient time so it can develop (or oversee development) and distribute an approved evaluation plan *before* the start of the first evaluation period. PEB responsibilities include:

a. Conducting ongoing evaluations of contractor performance based on Performance Monitor reports and additional performance information as may be obtained from the contractor and other sources. The PEB evaluates contractor's performance according to the standards and criteria stated in the performance evaluation plan.

b. Submitting a PEB report to the FDO covering the Board's findings and recommendations for an award fee amount for each evaluation period.

c. Recommending appropriate changes in the performance evaluation plan for approval by the FDO (if plan changes are not delegated to the PEB), if any.

Performance Evaluation Board (PEB) Chair - The FDO designates one PEB member as the Chair. The functions of a PEB Chair include:

a. Scheduling PEB meetings, controlling attendance and chairing the meetings.

b. Recommending appointment of nonvoting members to assist the PEB perform its functions, e.g., a recording secretary.

c. Appointing monitors for the contract effort and assuring they are provided appropriate instructions and guidance.

d. Requesting and obtaining performance information from other personnel involved in observing contractor performance, as appropriate.

e. Obtaining help from other personnel to consult with the PEB, as needed.

f. Preparing and obtaining approval of the PEB report and other documentation such as PEB minutes.

g. Ensuring the timeliness of award fee evaluations.

Performance Monitors - Monitors provide continuous evaluation of the contractor's performance in specific assigned areas of responsibility. This often daily oversight is the foundation of the award fee evaluation process. Performance monitors are specialists familiar with their assigned areas of

cognizance; their monitor duties generally are in addition to, or an extension of, their regular responsibilities. In performing their duties, monitors should maintain ongoing communication with their contractor counterparts, conduct assessments in an open, objective and cooperative spirit, and emphasize applicable negative and positive performance elements. Monitors are designated by the PEB Chair. Responsibilities of Performance Monitors include:

a. Monitoring (not directing), evaluating and assessing contractor performance in their assigned areas. This activity is conducted according to contract requirements and the award fee plan so that evaluations are fair and accurate.

b. Periodically preparing a Performance Monitor report for the PEB and, if necessary, providing verbal presentations as well.

c. Recommending any needed changes in the performance evaluation plan for consideration by the PEB and the FDO.

Performance Evaluation Coordinator (PEC) – In certain high dollar value, complex efforts, the following organizational level also might be used. Performance Evaluation Coordinators provide centralized direction to the various performance monitors and consolidate the findings of the performance monitors for review at the next highest evaluation level. The PEC level should be used only when a very large number of performance monitors are involved in the evaluation process. Each PEC (appointed by the PEB Chair, with appropriate notification to the contractor) is responsible for one of the broad functional areas to be evaluated, such as technical or project management. PEC duties include:

a. Furnishing instructions to performance monitors in their assigned areas.

b. Ensuring that the contractor is promptly notified whenever a problem is identified requiring immediate contractor attention However, PECs should not give technical direction unless they are designated contracting officer's representatives (CORs) and their contracts contain a technical direction clause.).

c. Coordinating, consolidating and analyzing data submitted by their performance monitors and preparing a concisely written PEC report for presentation to the next highest evaluation level for each evaluation period.

8. Training

All personnel involved in award fee administration should be trained on the process. Training should begin before or immediately after contract award so that personnel understand the award fee process before beginning their duties. Training should cover the performance evaluation plan, roles and responsibilities, documentation requirements, evaluation techniques, and other areas such as:

- What is an award fee contract

- What is being evaluated
- How will information be gathered; what techniques will be used (e.g., inspection, sampling of work, observation, review of reports or correspondence, or customer surveys);
- When or how often will information be obtained (e.g., daily, weekly or monthly);
- How will performance monitors secure information from functional specialists to cover areas in which the monitors may not be personally involved; and
- Evaluation scoring processes and the need for consistency between scoring and evaluation summaries.

9. Steps in the Evaluation Process

Assuming the basic three-level organizational structure, the sequence of events leading to an award fee determination is:

a. A certain number of days before the period starts (specified in the performance evaluation plan), the contractor is provided with any changes to the performance evaluation plan. In addition, the PEB may determine that it wants to highlight a performance area that the contractor should pay particular emphasis to during the period. For instance, an area of performance during the period may be of particular risk to the program. The PEB may want to focus the contractor's attention on this area of risk by highlighting it. This may be done by issuing a "letter of emphasis" to the contractor a certain number of days prior to the start of the evaluation period, if specified in the performance evaluation plan.

b. During the course of the evaluation period, performance monitors track contractor performance. Interim (mid-term) evaluations may be used to identify strengths and weaknesses in the contractor's performance during the period being evaluated. Interim evaluations are documented and should involve the FDO.

c. At the end of the period, the performance monitors assess and document the contractor's performance, and report to the PEB.

d. The PEB considers the performance monitors' reports and any other pertinent information, including information provided by the contractor during the evaluation period, and prepares a report for the FDO with findings and recommendations.

e. The contractor may be allowed to comment on its performance during the evaluation period, using one or more of the following methods:

- The contractor may provide a written or oral self-assessment of its performance for consideration by the PEB.
- The contractor may be provided a copy of the PEB's draft findings and recommendations and may be allowed to identify factual errors. Any errors identified by the contractor would be addressed by the PEB in its final

report. The contractor's draft recommendation is not a subject for negotiation; the PEB should not engage in discussions with the contractor.
- The contractor may be provided a copy of the final PEB report at the same time as the PEB submits it to the FDO. Contractor may submit comments directly to the FDO for consideration.

f. The FDO meets with the PEB to discuss the PEB's report. The FDO then makes a final determination in writing for the amount of award fee earned and to be paid. The FDO provides the determination to the CO, who sends it to the contractor. The FDO's rating is provided to the contractor as quickly as possible after the end of the period being evaluated. The FDO and PEB should provide a debriefing to the contractor after the rating has been issued.

g. Payment to the contractor should be made as soon as possible after the end of the period. The contractor submits a separate voucher for award fee to be paid.

10. Performance Evaluation Plan (PEP)

The performance evaluation plan (PEP) includes:

- Organizational structure for award fee administration
- Method for determining award fee, including evaluation criteria and periods
- Method for implementing any changes in plan coverage

The plan should be tailored to the particular situation and should:

- Focus the contractor on performance areas of greatest importance to motivate it to make the best possible use of company resources to improve performance;
- Provide for evaluations of contractor performance levels, taking into consideration contributing circumstances and contractor resourcefulness;
- Clearly communicate evaluation procedures and provide for effective, two-way communication between the contractor and the Government personnel responsible for evaluating performance and making award fee determinations;
- Provide for an equitable and timely evaluation process;
- Establish an effective organizational structure, commensurate with the complexity and dollar value of the particular procurement, to administer the award fee provisions; and
- Be kept as simple as feasible; the simpler the plan, the more effective it is likely to be.

11. Changing the Performance Evaluation Plan

The performance evaluation plan is usually not included in the contract. This gives FAA the right to unilaterally alter the plan to reflect any changes in management emphasis. If the plan is made a part of the contract, then FAA's ability to unilaterally change the plan must be specifically stated in the contract. Unilateral changes may be made to the plan if the contractor is provided written notification by the CO before the start of the upcoming evaluation period. Changes affecting the current evaluation period must be by mutual agreement of both parties. All significant changes to the award

fee plan should be coordinated with the PEB and approved by the FDO. Examples of significant changes include revising evaluation criteria, adjusting weights to redirect contractor's emphasis to areas needing improvement, changing PEB membership, and revising the distribution of the award fee dollars. It is important that the provision for unilateral changes be clearly described in the contract. The fact that the plan can be unilaterally changed does not give the FAA the right to unilaterally change other award fee provisions or other terms of the contract, absent contract language allowing it to do so.

12. Performance Evaluation Factors

It is neither necessary nor desirable to include all functions required by the statement of work as part of the performance evaluation plan. However, those functions selected should be balanced so that a contractor, when making trade-offs between evaluation factors, assigns the proper importance to all of the critical functions identified. For example, the plan should emphasize a combination of technical performance and cost considerations, because an evaluation plan limited to technical performance (alone) might result in increased costs out of proportion to any benefits gained.

Spreading the potential award fee over a large number of performance evaluation factors dilutes emphasis. Instead, broad performance factors should be selected, such as technical, project management and cost control, supplemented by a limited number of subfactors describing significant evaluation elements over which the contractor has effective management control. Prior experience can be helpful in identifying those key problem or improvement areas that should be subject to award fee evaluations.

Some basic areas of performance need to be evaluated and rewarded on every contract. Other areas are critical only in some instances. Cost control will always be included as an evaluation factor for cost-plus-award fee contracts, if there isn't a separate cost incentive in the contract. In general, controlling the cost of the system/equipment or service being provided, its quality (technical merit, design innovation, reliability, etc.), and its timely delivery will always be important-- although their relative importance and the measure of what constitutes good performance may vary. The relative importance of the factors and the method of evaluating a contractor should be tailored to fit the needs of individual procurement. For example, providing an item on time is generally critical to the contract. However, earlier delivery might also be of benefit to the Government and worth incentivizing. On the other hand, early deliveries might be of no benefit, or even cost the Government money if companion technologies are not yet available resulting in increased costs to the Government for storage.

The evaluation factors used in award fee should not be standardized. Rigid standardization tends to generate evaluation plans that are either too broad or include factors inapplicable to a given function. In either case, evaluators are likely to experience difficulties in providing meaningful comments and ratings. It is preferable to tailor performance evaluation plans and factors to fit the circumstances. As contract work progresses from one evaluation period into the next, the relative importance of specific performance factors may change.

Depending on the situation, performance evaluation factors may include outcomes, outputs, inputs or a combination of the three. An outcome factor is an assessment of the results of an activity

compared to its intended purpose. Outcome-based factors are the least administratively burdensome type of performance evaluation factor, and should provide the best indicator of overall success. Outcome-based factors should be the first type of evaluation factor considered, and are often ideal for non-routine efforts.

An output factor is the tabulation, calculation, or recording of activity or effort and can be expressed in a quantitative or qualitative manner. Output factors may be more desirable for routine efforts. When output factors are used, care should be taken to ensure that there is a logical connection between the reported measures and the program's mission, goals, and objectives. Examples of outcome and output factors:

Outcome: Safely install and ensure the lighting systems are certified and operational to satisfy needs.

Output(s):

- Deliver lighting systems to airports no later than July 15, 2008.
- Assemble and certify lights at each airport not later than December 15, 2008.
- Install and ensure lighting compatibility at each airport by January 5, 2009.

Outcome: Ensure program spare parts are maintained at a level sufficient to provide a 6-month supply at normal monthly draw down.

Output: Store a minimum of 1,000 program spare parts.

Input factors refer to intermediate processes, procedures, actions or techniques that are key elements influencing successful contract performance. These may include testing and other engineering processes and techniques, quality assurance and maintenance procedures, subcontracting plans, purchasing department management, and inventory, work assignment and budgetary controls.

While it is sometimes valuable to consider input and output factors when evaluating contractor performance, it is preferred to use outcome factors when feasible since they are better indicators of success relative to the desired result. For example, in the case of service contracts where performance is demonstrated and measurable in each evaluation period, input factors may be of value in building a historical database, but may be of little or no value in the evaluation process. Accomplishments, such as achieving small and small disadvantaged subcontracting goals, are what are important, as opposed to efforts expended. In other contracts, however, where the quality of performance cannot be determined with certainty until the end of the contract, input factors can be useful indicators of how well the contractor is achieving its ultimate performance objective. However, a heavy emphasis on input factors, while meant to provide positive motivation to the contractor in certain areas of performance, may in some cases because the contractor to divert its attention and focus from the overall output or outcome desired. Input factors are not always true indicators of the contractor's ultimate performance and so should be relied on with caution.

Some examples of performance evaluation factors, subfactors and criteria are shown below. They do not cover all possibilities, but illustrate some of the key performance areas that can be selected as

evaluation factors.

Technical Performance - Accomplishment achieved in the areas of:

- Design: Approach in design concepts, analysis, detailed execution and low cost design and manufacturing. Design of test specimens, models and prototypes.
- Development: Conception/execution of manufacturing processes, test plans and techniques. Effectiveness of proposed hardware changes.
- Quality: Quality assurance, e.g., appearance, thoroughness and accuracy, inspections, customer surveys.
- Technical: Meeting technical requirements for design, performance and processing, e.g., weight control, maintainability, reliability, design reviews, test procedures, equipment, and performance.
- Processing Documentation: Timely and efficient preparation, implementation and closeout.
- Facilities/GFE: Operation and maintenance of assigned facilities and Government Furnished Equipment.
- Schedule: Meeting key program milestones and contractual delivery dates; anticipating and resolving problems; recovery from delays; reaction time and appropriateness of response to changes.
- Safety: Providing a safe work environment; conducting annual inspections of all facilities; maintaining accident/incident files; timely reporting of mishaps; providing safety training for all personnel.
- Information Management: Ability of computer system to provide adequate, timely and cost effective support; meets security requirements; management information systems ensures accurate, relevant and timely information.
- Material Management: Efficient and effective processing of requisitions, with emphasis on priority requisitions; responsiveness to changes in usage rates.

Project Management - Accomplishment achieved in the areas of:

- Program Planning/Organization/Management: Assignment and utilization of personnel; recognition of critical problem areas; cooperation and effective working relationships with other contractors and Government personnel to ensure integrated operation efficiency; support to interface activities; technology utilization; effective use of resources; labor relations; planning, organizing and managing all program elements; management actions to achieve and sustain a high level of productivity; response to emergencies and other unexpected situations.
- Compliance with contract provisions: Effectiveness of property and material control, Equal Employment Opportunity Program, Minority Business Enterprise Program, system and occupational safety and security.
- Effectiveness in meeting or exceeding small business and small disadvantaged business subcontracting goals.
- Subcontracting: Subcontract direction and coordination. Purchase order and subcontractor administration.

- Timely and accurate financial management reporting.

Cost Control – The procurement team may consider the contractor's ability to control, adjust and accurately project contract costs (estimated contract costs, not budget or operating plan costs) through:

- Control of indirect and overtime costs. o Control of direct labor costs.
- Economies in use of personnel, energy, materials, computer resources, facilities, etc.
- Cost reductions through use of cost savings programs, cost avoidance programs, alternate designs and process methods, etc.
- "Make versus buy" program decisions.
- Reduced purchasing costs through increased use of competition, material inspection, etc.

The predominant consideration when evaluating cost control should be an objective measurement of the contractor's performance against the estimated cost of the contract, including the cost of undefinitized contract actions when appropriate. The estimated cost baseline should be adjusted to reflect cost increases or decreases associated with changes in Government requirements or funding schedules which are outside the contractor's control. In rare circumstances, contract costs might increase for reasons outside the contractor's control and for which the contractor is not entitled to an equitable adjustment, such as weather-related. Such situations should be taken into consideration when evaluating contractor cost control. In the case of contracts for services where contractor performance is consistent and complete within each evaluation period and does not carry over into succeeding periods, negotiated estimated cost can generally be apportioned among the evaluation periods. Cost control for each evaluation period can then be measured against that period's share of the estimated costs. However, where contractor performance cannot be ascertained until the end of the contract (such as contracts for R&D) and cost expenditures can vary significantly from one evaluation period to the next, it makes more sense to evaluate interim contractor cost control against a cumulative expenditure profile that reflects the estimated cost.

13. Quantitative and Qualitative Standards

Once evaluation factors are selected, standards or criteria are developed for measuring contractor performance and assessing the amount of award fee earned.

Quantitative or objective performance measurement standards are based on well-defined parameters for measuring performance. They include customer surveys, inspection reports and test results. Quantitative measures should be used whenever the given performance can be precisely or finitely measured. Sufficient information or experience must be available to permit the identification of realistic standards against which quantitative measurements may be compared.

Unlike the predetermined targets and fee adjustment formulas used in incentive fee type contracts, any comparison of contractor performance against quantitative standards in the award fee environment will need to be tempered by a qualitative evaluation of existing circumstances. Quantitative measurements are not a substitute for judgment. Keep in mind that any reasonable assessment of effectiveness requires an evaluation process encompassing both performance levels and the conditions under which those levels were achieved. To be realistic, any standard (or range of

acceptable performance levels) should reflect the nature and difficulty of the work involved.

Qualitative or subjective performance standards rely on evaluator's opinions and impressions of performance quality. Qualitative assessments must be as informed as possible and not rely on personal bias or a purely intuitive feeling. Some examples are:

- **Staffing:** Optimal allocation of resources; adequacy of staffing; qualified and trained personnel; identification and effective handling of employee morale problems; etc.
- **Planning:** Adequate, quality, innovative, self-initiated and timely planning of activities; effective utilization of personnel; quality of responses; etc.

Another example of a qualitative standard is a "quality review" such as a questionnaire requiring "yes" or "no" answers, with a high proportion of "yes" answers indicative of high quality performance. Note that narrative support for questionnaire answers is required.

Where feasible, the quantitative or objective measures are preferred over qualitative or subjective ones. The greater the ability to identify and quantify the facts considered in arriving at a judgmental assessment, the more credible that assessment is likely to be (and the easier it will be to prepare the supporting documentation required).

14. Weighting Evaluation Factors

In addition to identifying how performance will be evaluated and measured, the detailed performance evaluation plan should indicate the relative priorities assigned to the various performance areas and evaluation factors and subfactors. This may be accomplished through the use of narrative phrases such as "more important," "important," and "less important" or through percentage weights. When percentages are used, the plan should state that they are for the sole purpose of communicating relative priorities, and do not imply an arithmetical precision to the judgmental determinations of overall performance quality and the amount of award fee earned.

When percentage weights are used, cost control could be at least 25 percent of the total award fee. When adjectives or narratives are used in lieu of explicit weights, cost control should be a substantial factor. No other factor should be less than 10 percent. This ensures that the factors are balanced and, when making trade-offs, the contractor assigns the proper importance to all factors.

The methodology used to establish percentage weights is illustrated in the following example:

Example:

First, list the primary evaluation factors in descending order of importance and assign a percentage weight to each factor starting with the most important. Assign the least important factor no less than 10 percent (unless the least important factor is cost control, which would be assigned a minimum of 25 percent). All assigned weightings for primary evaluation factors must total 100 percent. Round all numbers off to the nearest whole number to avoid giving the impression that the procedure is a precise one.

Next, assign percentage weights to the subfactors supporting each of the primary evaluation factors such that the total of the subfactor weights for each performance factor totals the assigned weight for that factor as shown in the example below. The actual factors and subfactors used as well as the weights assigned in any given contract may be different from those shown in the example. For instance, indirect cost control, subcontract costs, other direct costs, etc. should be evaluated when they are significant elements of cost.

Factors/Subfactors	**Assigned Weight**	
Technical	42%	
Design		24%
Quality		12%
Schedule		6%
Project Mgmt.	32%	
Planning		26%
Subcontracts		6%
Cost Control	26%	
Labor Cost Control		15%
Overhead Cost Control		11%
Total	100%	

15. Length of Evaluation Periods

Award fee evaluation periods should generally be between three to six months. Too short of an evaluation period can be administratively burdensome and lead to hasty or late evaluations which result in late fee determinations. Alternatively, evaluation periods may be tied to completing milestones. When linking evaluation periods to milestones, ensure evaluations do not occur at infrequent intervals or become subject to lengthy slippage.

16. Allocation of Award Fee

After the total award fee amount is established, the total pool is allocated over the award fee evaluation periods. For contracts where each evaluation is final, the allocation of award fee determines its distribution for final payment purposes. For other contracts, where all evaluations (and

payments) are interim, except the final evaluation, award fee is allocated among the evaluation periods solely for the purpose of making interim payments against the final evaluation. That final evaluation will determine the amount of total award fee actually earned by the contractor and will supersede any interim evaluations and payments made.

The distribution of the award fee pool depends on the circumstances. Contractor expenditure profiles may be considered. The total may be allocated equally among the evaluation periods if the risks and type of work are similar throughout the various evaluation periods. Otherwise, if there is a greater risk or critical milestones occur during specific evaluation periods, a larger portion of the pool may be distributed to those periods. This permits the Government to place greater emphasis on those evaluation periods. For example, if a contract has a short initial evaluation period for the contractor to become familiar with the work, the initial period of performance may have a smaller allocation while the remaining pool is divided equally among the remaining evaluation periods. If the schedule for a significant event changes, any potential award fee amount associated with that event must be reallocated accordingly for interim payment purposes.

The following example illustrates an unequal allocation of award fee among the four performance periods, reflecting different degrees of emphasis.

Estimated Cost	$5,000,000
Base Fee (0%)	0
Total Award Fee (10%)	$ 500,000
Total	$5,500,000

Evaluation Periods

	1	2	3	4	Total
Allocation (%)	10%	26%	40%	24%	100%
Allocation ($)	$50,000	$130,000	$200,000	$120,000	$500,000

17. Evaluation of Delivery or Task Order Contracts

A delivery or task order contract may provide for orders with specific requirements that are independent of any other orders' requirements and that have separate, distinct sources of funding. For such orders, an award fee amount could be allocated to each individual order along with the estimated cost. Contractor performance on each order would be evaluated against the award fee criteria on a task-by-task basis. There are instances where the Government wants to motivate the contractor's performance at the contract level versus each individual order. This condition may exist when the overriding objective is not how each individual order is executed, but how the contractor's performance of multiple orders contributes to meeting the overall contract objectives. For example, it may not be cost effective to evaluate contractor performance on a task order basis, or when unknown/undefined requirements may materialize during the contract. An unknown requirement may arise that has a higher priority than an existing order. The primary objective is for the Government/contractor team to make trade-offs between the orders in a constrained environment (funding, staffing, etc.) to ensure the optimal capability is achieved at the system performance level. Therefore, the ultimate measure of

success is judged as meeting the overall contract objectives and not necessarily on the performance of a single order. In this case it is in the Government's best interest to incentivize the contractor to focus its efforts and perspective on overall contract performance versus the individual orders. This does not preclude management of individual orders. To ensure that there is no confusion about how the contractor's performance will be evaluated, the award fee plan must clearly state whether the evaluation criteria are applicable at the contract or individual order level.

18. Interim and Final Evaluations

The decision about whether to conduct interim or final evaluations depends on the circumstance. In service contracts, the contract deliverable is a service and contractor performance is measurable at each evaluation period. Performance is usually not cumulative and its quality cannot be improved or reduced by future performance. For that reason, in service contracts, evaluations should be final and unearned award fee cannot be "rolled over" into subsequent evaluation periods or ever retroactively "taken back." On other contracts such as study, design or hardware, where the true quality of contractor performance cannot be measured until the end of the contract, the contract deliverable is an end item. Contractor performance leading up to delivery of the end item is an indication of whether and how well it will produce the end item, but it is not the end item itself. Since the actual quality of the end item cannot be determined until the end of the contract when it is delivered, the last evaluation should be final. All other evaluations and ratings would be interim.

At the end of the contract, the contractor's total performance is evaluated against the performance evaluation plan to determine total earned award fee. That final rating supersedes all interim ratings. It is not the average of the interim ratings. Instead, it reflects the contractor's position at the end of the contract rather than its interim progress toward that position. For example, how well a contractor has controlled costs can only be determined at the end of the contract when the contractor is evaluated against its final cost position. Whether the contractor was overrunning or underrunning the contract estimated cost at various points in time is irrelevant. The contractor's success is measured against the end result. Likewise, the contractor's ability to meet the contract schedule is determined when the hardware is delivered and accepted by the Government. Whether the contractor was behind or ahead of schedule during the course of the contract is not relevant in the final evaluation. The same thing is true of the other evaluation factors and subfactors.

Any significant events that contributed over the course of the contract to the contractor's position (such as delays in receipt of Government furnished equipment), should be considered in the final award fee determination. Those events should be examined as they relate to the final contract outcome and not to the individual evaluation periods in which they occurred.

19. Grading and Scoring Contractor Performance

Grading and scoring methods are used to translate evaluation findings into recommended award fee amounts or ranges. The purpose is to help the FDO decide the amount of award fee earned. These methods are evaluation tools and are not a substitute for judgment in the award fee determination process. The decision process cannot be reduced to a mathematical formula or methodology. Either a weighted or nonweighted process can be used to evaluate performance.

One method is for evaluators to start from the satisfactory performance level and adjust the scores upwards or downwards, depending on the contractor's performance for the period. A rating table may be used as a guide. Another method is for evaluators to use "blind" evaluation sheets where they are asked to rate different criteria using numbers based on the adjectival ratings. The weights that will eventually be applied to their ratings do not appear on the sheets. This approach relieves to some extent the pressure placed on the evaluators by contractor employees.

As a general guideline, a contractor which satisfactorily meets its contractual commitment will fall into the "good" (71-80) range. To earn an "excellent" score (91-100), a contractor must provide exceptional performance--a combination of excellent cost, schedule and technical management. Some general considerations in the development of a grading and scoring methodology are as follows:

- When Government actions impact contractor performance either positively or negatively, e.g., changes in funding allocation or increased emphasis on certain technical requirements which require the contractor to make unexpected and extensive tradeoffs with other technical requirements, those actions should be considered in the scoring and grading process.
- The methodology should be kept as clear and simple as possible. In particular, the situation where specially tailored evaluation factors are force-fit to a "standard" grading table or scoring formula should be avoided.
- The maximum fee should be attainable by the contractor. To be a credible and effective motivator, an award fee contract should provide the contractor with a reasonable opportunity to earn the maximum award fee available. Although a reasonable opportunity generally does not mean absolute perfection in all possible performance areas, the contractor's performance should be outstanding in virtually all areas. On the other hand, providing a contractor the maximum fee on every contract, does not adequately address the issues of risk and effort.
- Documentation of assigned performance values is required in support of award fee recommendations and computations.

20. Award Fee Conversion Table

An award fee conversion table may be used to translates overall evaluation scores (i.e., numerical performance points) into the earned award fee amount. This conversion may be linear (e.g., direct conversion of evaluation points to percentage of award fee earned) or non-linear (e.g., a formula to translate performance points to award fee earned). Use of a conversion table does not remove the element of judgment from the award fee process. Regardless of the method used, zero award fee will be earned for an overall unsatisfactory performance.

The following rating table may be used as a guide for award fee. Earned award fee (or interim award fee amounts in the case of interim evaluations) is calculated by applying the total numerical score to the award fee pool. For example, a numerical score of 85 yields an award fee of 85 percent of the award fee pool available for that evaluation period. The table below lists the award fee evaluation adjectival ratings with their corresponding score ranges. In addition, a narrative description is also provided to assist the PEB in applying the ratings. Criteria for evaluation factors and subfactors should reflect the table.

Adjective Rating	Range of Performance Points	Description
Excellent	(100-91)	Of exceptional merit; exemplary performance in a timely, efficient and economical manner; very minor (if any) deficiencies with no adverse effect on overall performance.
Very Good	(90-81)	Very effective performance, fully responsive to contract requirements; contract requirements accomplished in a timely, efficient and economical manner for the most part; only minor deficiencies.
Good	(80-71)	Effective performance; fully responsive to contract requirements; reportable deficiencies, but with little identifiable effect on overall performance.
Satisfactory	(70-61)	Meets or slightly exceeds minimum acceptable standards; adequate results; reportable deficiencies with identifiable, but not substantial, effects on overall performance.
Poor/ Unsatisfactory	(less than 61)	Does not meet minimum acceptable standards than in one or more areas; remedial action required in one or more areas; deficiencies in one or more areas which adversely affect overall performance.

No fee will be paid when the total evaluation score is less than 61. In addition, any factor that receives a score of less than 61 for "poor/unsatisfactory" performance will not be rewarded and converted to a factor score of zero. Such zeroing-out should not be done at the subfactor level.

21. Scoring of Cost Control

Cost control should be a substantial factor in any performance evaluation plan, except when a fixed-price award fee, fixed-price incentive or cost-plus-incentive fee contract is used. The contractor's success in controlling costs must be measured against contract estimated costs, and not against budgetary or operating plan costs. The following scoring guidelines will help ensure that cost control receives the proper emphasis:

a. Whenever there is a significant cost overrun that was within its control, a contractor should be given a score of zero. If the overrun is insignificant, a higher score may be given. The reasons for the overrun and the contractor's efforts to control or mitigate the overrun should be considered in the evaluation.

b. Cost underruns within the contractor's control should normally be rewarded. However, the extent to which an underrun is rewarded will depend on the size of the underrun and the contractor's level of performance in the other award fee evaluation factors. Contractors should not be rewarded for excelling in cost control to the detriment of other important performance factors. For that reason, whether a cost

underrun is rewarded in the evaluation process and, if so, the degree to which it is rewarded depends, not only on the size of the underrun, but also on how well the contractor is performing overall in the other evaluation areas.

c. When the contractor achieves the negotiated estimated cost of the contract, it should not receive the maximum score for cost control. The maximum score for cost control should only be awarded for achieving an underrun. Some lesser score will be assigned, reflecting the degree to which the contractor has prudently managed costs while meeting contract requirements.

22. Example - Calculating Earned Fee

The following example illustrates how evaluation scores for weighted factors and subfactors are calculated to arrive at a total award fee recommendation. Again, keep in mind that the use of weighted factors to calculate an award fee amount is an evaluation aid; the result does not represent a required award fee amount.

a. Background: This CPAF contract covers design and verification testing of hardware. The contractor is also required to deliver eight production items. The total estimated cost and award fee is $300,000,000. The available award fee for the current interim evaluation period (#7) is $2,600,000. Evaluation factors and assigned weights are:

Evaluation Factor/ Subfactor		**Assigned Weight**	
Technical		42%	
	Design		24%
	Quality		12%
	Schedule		6%
Project Management		32%	
	Planning		26%
	Subcontracts		6%
Cost Control		26%	
	Labor Cost Control		15%
	Overhead Cost Control		11%

b. PEB Findings: The findings of the PEB for the most recent evaluation period are summarized below:
Contractor performance was rated very strong overall in the technical area. Accomplishments included successful design and installation of in-flight wear monitors, and successful test of a redesigned turbo pump. Some weaknesses were identified, the most serious of which was an incompatibility between two components which was not resolved during the period, resulting in a slight schedule slip. In the area of project management, strengths were identified, including communication of program activities to the proper management levels, on- schedule delivery of critical subcontracted hardware, and exceeding subcontracting goals. Weaknesses included ineffective checks and balances for processing hardware and insufficient management involvement at vendor sites which has jeopardized hardware integrity. In the cost control area, the cost overrun increased by 14% in this period due in large part to labor costs. Projected overhead increases were also reported; however, the contractor has identified and will implement cost reduction measures which are expected to ameliorate the problem. (Note - promises of future actions are not normally considered in the current period evaluation, but in this case the overhead increase is also only a projection.)

c. Calculating Weighted Performance Points**:** As a result of the evaluation, the following performance points were assigned and weighted for the subfactors:

Subfactor	**Performance Points**	**Assigned Weights**	**Weighted Performance Points***
Design	95 (Excellent)	.24	54
Quality	90 (Very Good)	.12	26
Schedule	80 (Good)	.06	11
		Total for Technical	**91**
Planning	70 (Satisfactory)	.26	57
Subcontracts	86 (Very Good)	.06	16
		Total for Project Mgmt	**73**
Labor Cost	50 (Poor/Unsat.)	.15	29
Control			
OH Cost Control	70 (Satisfactory)	.11	30
		Total for Cost Control	**59 = 0****

*Weighted Performance Points are calculated as follows: (Performance Points x Assigned Subfactor Weight)/Assigned Factor Weight = Weighted Performance Points. For example, for Design: (95 x .24)/.42 = 54

** Note that an unsatisfactory rating for a factor results in a *zero* score for that factor. The Cost Control factor received a zero score for receiving a rating of less than 61 percent. Significant cost overrun within the contractor's control should result in a score of zero for cost control.

Next, total weighted performance points were calculated for the primary evaluation factors as follows:

Weighted Factor	**Performance Points**	x	**Assigned Weight**	=	**Total Weighted Performance Points**
Technical	91	x	.42	=	38
Project Mgmt.	73	x	.32	=	23
Cost Control	0	x	.26	=	0
			Total for All Factors		61 (Sat.)

d. Converting Performance Points to Award Fee Score: The award fee percentage is the same number as the total weighted performance points. In this example, 61 weighted performance points equals 61% of available award fee. Award fee recommendation: $1,586,000 (61% of $2,600,000).

23. Example - Changes in Emphasis

If the Government's relative priorities change as work progresses from one phase into the next, or as unexpected problems or developments occur, such as schedule slippages, the evaluation plan may be revised on a unilateral basis, to communicate such changes to all parties. The following example illustrates how the Government can adjust evaluation weights to redirect contractor emphasis to areas needing improvement and the effect of that readjustment on earned award fee.

Estimated Cost	$5,000,000
Base Fee (0%)	0
Total Award Fee (10%)	$ 500,000
Total	$5,500,000

Evaluation Periods

	1	**2**	**3**	**4**	**Total**
Allocation (%)	24%	18%	18%	40%	100%
Allocation ($)	$120K	$90K	$90K	$200K	$500K

Evaluation Period 1:

Factor	**Weight**	**x**	**Performance Points**	**=**	**Weighted Performance Points**
Technical	.42	x	91 (Excellent)	=	38
Project Mgmt	.32	x	73 (Good)	=	23
Cost Control	.26	x	0 (Poor/Unsat.)	=	0
			Total		61

The contractor earns $73,200, 61% of $120,000.

Evaluation Period 2**:**

If factor weights were adjusted to increase the emphasis on cost control and its performance, and thus its performance points, remained basically the same, this would be the result:

Factor	**Weight**	**x**	**Performance Points**	**=**	**Weighted Performance Points**
Technical	.40	x	91	=	36
Project Mgmt	.32	x	73	=	23
Cost Control	.28	x	0	=	0
			59	=	0

The contractor would receive an award fee score of 2 percentage points less in the second period than it would have if the factor weights had not changed. As a result, the contractor would receive an overall score of Poor/Unsatisfactory and no award fee for the second period.

Now, assume that the contractor responds to the shift in emphasis by improving its performance in cost control from Poor/ Unsatisfact*ory to minimally satisfactory, without reducing its score in any other area*, as follows:

Factor	**Weight**	**x**	**Performance Points**	**=**	**Weighted Performance Points**
Technical	.40	x	91	=	36
Project Mgmt	.32	x	73	=	23
Cost Control	.28	x	61	=	17
					76 (Good)

By increasing its performance in cost control by 31 points (from 30 to 61) - and as a result, it's total score by 17 percent to Good--the contractor is now entitled to receive an award fee payment.

If the cost control weight had not been increased in the second period, the contractor would have continued to be paid fee (61 percent of $90,000 or $54,900) for unsatisfactory cost control performance. By changing the factor weights to put more emphasis on cost control, the contractor is either rewarded for improved cost control with more fee than it would have received had the weights had not been changed (76% of $90,000 or $68,400) or penalized for not showing improvement in that area (59 percent = no award fee payment for the period).

24. Communication

A properly structured and administered award fee contract provides effective communication among Government and contractor personnel at management levels, where decisions can be made and results achieved. A post-award conference is one way to establish communication channels early and to ensure key Government and contractor personnel understand their responsibilities. Attendees should review and discuss the performance evaluation plan and contract requirements. Frequent and honest communication is essential, both between the Government and contractor and within their respective organizational frameworks. Both Government and contractor personnel should be encouraged through the award fee process to identify potential problems as promptly as possible (as opposed to withholding such "bad news" for fear it might result in unfavorable criticism).

25. Contractor Input

The contractor may be allowed to furnish a self-assessment of its performance. Once the PEB report is prepared, the PEB may also allow the contractor to comment on the draft report. Contractor participation at this point ensures all pertinent data has been considered and no factual errors were used as a basis for decisions. Such communications, however, must not result in negotiation of award fee ratings. The ratings should be fair and reasonable, but are ultimately a unilateral Government determination. Throughout the period of performance, the contractor may be permitted to submit suggestions for improving or changing the evaluation process. In addition to the various formal communications channels, both parties should recognize that frequent, less formal discussions are valuable in ensuring ultimate program success. Both the Government and the contractor should work to eliminate any unnecessary contractual, organizational or conceptual barriers that constrain information sharing and other communications needed for successful joint problem solving.

26. Timeliness

The timeliness of award fee evaluations is critical. Long delays minimize any benefits from periodic evaluations and reports. Unless evaluation results are transmitted timely and award fee payments made promptly, the results and payments may not have the desired influence on the contractor's performance during subsequent evaluation periods. The timeliness of changes in the evaluation plan is also important. Proposed changes should be processed expeditiously and the contractor notified in advance of the evaluation period to which they apply.

27. Documentation

Performance monitors should consider the following when preparing their reports. These

questions can help assure evaluation data are complete and accurately assess how well the contractor performed in the monitors' assigned areas during the period.

a. What (in the monitor's area) was the contractor supposed to do during the period? What was actually accomplished?
b. How critical are the efforts accomplished, or not accomplished, by the contractor?
c. What was the impact of any efforts completed early or late? How critical was the time frame involved?
d. How well did the contractor perform the tasks that were accomplished?
e. What are the major strengths and weaknesses (in sufficient detail to discuss with the contractor)?
f. Were any Government-directed changes made or did any obstacles arise which impacted performance? What corrective actions were implemented? How effective were they?
g. Has the contractor efficiently and effectively used available resources (e.g., personnel and facilities) to improve its performance?
h. Has the contractor's performance been clearly assessed in regard to all tasks and specific objectives?
i. On level-of-effort contracts, what has the contractor accomplished for the dollars spent (The emphasis here is to reward the contractor for accomplishments, not to reward the spending of dollars.)

The reporting formats used by monitors should be structured to ensure accuracy and clarity. Where possible, several evaluation parameters may be consolidated in a single format. Consistency can be achieved by using the same general format for all closely related work at a given activity. However, caution is required here. Carefully tailored evaluation plans can be compromised by inflexible and ill-conceived rating formats. Any format adopted should provide a place for the monitors to make narrative comments. These narrative comments provide detailed, pertinent information not addressed in the completed format. For example, they cover the circumstances under which reported performance levels were achieved, especially if these circumstances were abnormal in any way. These comments also discuss the contractor's efficiency in managing assigned personnel and other resources. Enough detail should be included in reports to the PEB to ensure that their findings and recommendations are accurate and fair and can be supported to the FDO.

Appropriate documentation is vital to support the PEB’s recommendations, particularly when these recommendations differ from the conclusions reported by cognizant monitors. Minutes of meetings or other documentation should summarize the information reviewed, including any additional or explanatory information provided by the contractor and the consideration given to all such information. Since the evaluation is a judgment based upon all pertinent information, that information needs to be identified, discussed and substantiated in the documentation. The FDO will want to review the documentation to satisfy any concerns regarding contractor performance before deciding whether to accept the recommended award fee or some higher or lower amount. Examples of what the FDO might look for include:

a. The facts that led to the assignment of a poor/unsatisfactory rating in any subfactor;
b. The rationale for a poor/unsatisfactory rating as opposed to a satisfactory rating; and

c. The circumstances under which a poor/unsatisfactory level was achieved and the relationships, if any, between it and any excellent performance levels reported for other subfactors.

Sufficient documentation should be provided to the FDO on which to base a decision and to explain that decision to the contractor. Similarly, the FDO must document the basis for the determination, especially in situations involving a contractor rebuttal of PEB findings and conclusions or an award fee determination different from that recommended by the PEB. Documentation of interim ratings may be less detailed since they will be superseded by the final rating at the end of the contract.

28. Payment

Final award fee payments and interim payments against interim evaluations should be made generally within 60 days after the end of the evaluation period for which payment is being made.

When the total rating for an evaluation period is "poor/unsatisfactory," no award fee is paid for that period. For example, a total award fee rating of 57 (“poor/unsatisfactory”) would yield an award fee of zero, not 57 percent. For certain contracts involving delivery of a final product, such as hardware, design or study, no award fee will be paid for a final evaluation rating of "poor/unsatisfactory." In these cases, any provisional award fee payments made as a result of "satisfactory" or better ratings (61 and above) on interim evaluations are to be repaid by the contractor.

The amount of interim award fee paid each period will not exceed the interim evaluation score (applied as a percentage) or 80 percent of the award fee allocated to the period, whichever is less. No further award fee payments will be made when the CO determines that the total amount of interim payments made to date will substantially exceed the amount which would be paid based upon the anticipated final evaluation score. The PEB should be notified of such a determination. The CO's determination should be based on a comparison of award fee amounts paid to actual evaluation scores to date, projected future scores based on a combination of past performance trends and any known data which might have an influence on future performance, and any other pertinent data. Stopping award fee payment serves two purposes: it ensures that contractors will not receive award fee which they have not earned and to which they will ultimately not be entitled, and it minimizes the award fee that will be owed the Government by the contractor at the end of the contract.

29. Provisional Payments

Long evaluation periods may require FAA to make award fee payments more frequently than at the end of each evaluation period. These provisional payments, representing a percentage of the award fee amount allocated to each evaluation period, are made at regular intervals during each period. They are superseded at the end of each period by the interim or final award fee determination amount. The percentage of allocated award fee to be paid provisionally will be stipulated in the contract and may not exceed 80 percent of available award fee in any period.

Provisional payments are discontinued during any period in which the Government determines that the total provisional payments made during that period will substantially exceed the amount which would be paid based upon the anticipated evaluation score for the period. In the event the amount of

provisional payments made exceeds the amount of the award fee determination for that period, the contractor will either credit the next payment voucher for the amount of the overpayment or refund the difference.

30. Contract Termination

If a contract with award fee is terminated for convenience after the start of an award fee evaluation period, the earned award fee amount should be determined by the FDO using the normal award fee evaluation process. The remaining available award fee dollars for all subsequent evaluation periods should not be considered available or earned and, therefore, should not be paid.

2 Appendix - Incentive Contracts Guide Revised 4/2022

1. Introduction

The purpose of this guide is to further explain incentive contracts, provide examples, and other considerations for using incentive contracts. This guide:

- Provides general guidance on when an incentive contract may be appropriate;
- Describes elements of the required cost incentive and how the elements influence profit/fee earned by a contractor, depending on the cost incurred;
- Describes the general characteristics of a performance incentive and delivery incentive;
- Provides general guidance for structuring multiple (i.e., having a cost incentive and performance and/or delivery incentives) incentive contracts;
- Provides general guidance on Fixed-Price Incentive (FPI) contracts including the importance of the Point of Total Assumption (PTA);
- Provides general guidance on FPI contracts with a firm target, and FPI with successive targets;
- Provides general guidance on Cost-Plus-Incentive-Fee (CPIF) contracts including impact of minimum and maximum fee established;
- Provides general guidance on negotiating changes to incentive contracts including possible negotiation methods and circumstances in which they would be appropriate.

2. General

(a) Incentive contracts are appropriate when supplies or services can be acquired at lower costs, and in certain instances with improved delivery or technical performance, by relating the amount of profit/fee payable under the contract to the contractor's performance. Incentive contracts are designed to obtain specific program objectives by:

(1) Establishing reasonable and attainable targets that are clearly communicated to the contractor; and

(2) Including appropriate incentive arrangements designed to motivate contractor efforts that might not otherwise be emphasized, and to discourage contractor inefficiency.

(b) When predetermined, formula-type incentives on technical performance or delivery are included, profit/fee:

(1) Increases only for achievement that surpasses the targets, and

(2) Decreases to the extent that such targets are not met.

The incentive increases or decreases are applied to performance targets rather than minimum performance requirements.

(c) The two basic categories of incentive contracts are fixed-price incentive and cost-plus-incentive-fee.

(d) Fixed-price incentive contracts are preferred when contract costs and performance requirements are reasonably certain. It is usually in the Government's interest for a contractor to assume substantial cost responsibility and an appropriate share of the cost risk, thus the preference for fixed price incentive contracts.

(e) Award-fee contracts are a separate type of incentive contract and are discussed separately under Appendices 2 and 3 of this Section T3.2.4.

3. Cost Incentives

(a) Most incentive contracts include only cost incentives, which take the form of a profit or fee adjustment formula. Cost incentives are intended to motivate the contractor to effectively manage costs. An incentive contract cannot provide for other incentives without also providing a cost incentive (or constraint).

(b) Incentive contracts include a target cost, a target profit or fee, and a profit or fee adjustment formula that provides (within the constraints of a price ceiling or minimum and maximum fee):

(1) Actual cost that meets the target will result in the target profit or fee;

(2) Actual cost that exceeds the target will result in downward adjustment of target profit or fee; and

(3) Actual cost that is below the target will result in upward adjustment of target profit or fee.

(c) *An example of a cost incentive (in a fixed-price incentive contract) based on the above is as follows*:

Target Cost $10,000,000
Target Profit $1,000,000

Target Price $11,000,000
Share Ratio 70/30 (Government/contractor) Ceiling
Price 115% of Target Cost ($11,500,000)

Actual cost of $10,000,000 would meet target cost. This results in the contractor earning the target profit of $1,000,000 because the contractor met the target cost. $11,000,00 would be paid to the contractor in total ($10,000,000 target cost + $1,000,000 target profit).

Actual cost of $11,000,000 would exceed target cost. This results in the contractor being responsible for its share of 30% of the amount over the target cost ($1,000,000 X 30% = $300,000). This amount of $300,000 is deducted from the target profit of $1,000,000 for a total of $700,000 profit. Instead of being paid a total of $11,700,000, the contractor would be paid $200,000 less because of the ceiling price ($11,500,000) – reducing the profit from $700,000 to $500,000.

-Actual cost of $9,000,000 would be under target cost. This results in the contractor earning an additional 30% of the amount below the target cost ($1,000,000 X 30% = $300,000) in addition to the target cost for a total of $1,300,000 profit. $10,300,000 would be paid to the contractor in total.

4. Performance Incentives

(a) Performance incentives may be considered with specific product characteristics (*e.g*., a missile range, an aircraft speed, an engine thrust, or a vehicle maneuverability) or other specific elements of the contractor's performance. These incentives should be designed to relate profit/fee to a contractor’s achievement, compared with specified targets.

(b) When practicable, positive and negative performance incentives should be considered with service contracts for performance of objectively measurable tasks when quality of performance is critical and incentives are likely to motivate the contractor.

(c) Technical performance incentives may be particularly appropriate in major or complex systems, both in development (when performance objectives are known and the fabrication of prototypes for test and evaluation is required) and in production (if improved performance is attainable and highly desirable to the Government).

(d) Technical performance incentives may involve a variety of specific characteristics that contribute to the overall performance of the end item. Accordingly, the incentives on individual technical characteristics must be balanced so that no one of them is exaggerated to the detriment of the overall performance of the end item.

(e) Performance tests and/or assessments of work performance are generally essential in order to determine the degree of attainment of performance targets. Therefore, the contract must be as specific as possible in establishing test criteria (such as testing conditions, instrumentation precision, and data interpretation) and performance standards (such as the quality levels of services to be provided).

(f) Because performance incentives present complex problems in contract administration, the Contracting Officer (CO) should negotiate them in full coordination with Government technical and pricing specialists.

(g) It is essential that the Government and contractor agree explicitly on the effect that contract changes (*e.g.*, pursuant to the applicable Changes clause) will have on performance incentives.

This will be dealt with in more detail in Section 11 below.

(h) The CO must exercise care, in establishing performance criteria, to recognize that the contractor should not be rewarded or penalized for attainments of Government-furnished components.

(i) *A basic example of a performance incentive is as follows:*

> Maintenance Hours per Operational Hour – Total Possible Incentive $120,000
> Minimum Value – 10 hours – 0% of incentive earned
> Average Value – 5 hours – 50% of incentive earned ($60,000)
> Maximum Value – 2 hours – 100% of incentive earned ($120,000)
> Penalty if > 10 hours -$10,000
>
> In the example above, if the contractor failed to meet the minimum value of 10 hours per operational hour, they would not receive any of the possible $120,000 in incentives. Additionally, a negative incentive of $10,000 would be deducted from the negotiated value of the contract.

5. Delivery Incentives

(a) Delivery incentives should be considered when improvement from a required delivery schedule is a significant Government objective. It is important to determine the Government's primary objectives in a given contract (*e.g.*, earliest possible delivery or earliest quantity production).

(b) Incentive arrangements on delivery should specify the application of the reward-penalty structure in the event of Government-caused delays or other delays beyond the control, and without the fault or negligence, of the contractor or subcontractor.

(c) *A basic example of a delivery incentive is as follows:*

> The total schedule incentive available must be defined in the contract with specifics as to Contract Line Item, Period of Performance etc. as needed. For this example, the total incentive amount available is $100,000.
>
> Delivery Incentive Milestones:
>
> *Positive Incentives*

20% of available incentive for completion of Critical Design Review (CDR) at least two (2) weeks ahead of schedule ($20,000)
20% of available incentive for passing Design Qualification Test (DQT) at least two (2) weeks ahead of schedule ($20,000)
15% of available incentive for passing site acceptance test at least two (2) weeks ahead of schedule ($15,000)
45% of available incentive for achieving Initial Operational Capability (IOC) at least two (2) weeks ahead of schedule ($45,000)

Negative Incentives

20% of available incentive for not achieving completion of Critical Design Review (CDR) on schedule (-$20,000) 45% for not achieving IOC on schedule (-$45,000)

The schedule for the milestones as well as what the achievement of each milestone involves must be clearly defined in the contract. For example, if the contractor fails to meet the first milestone, they lose $20,000 due to the negative incentive. If they do not meet the second, there would be no impact as there is no negative incentive. If they meet the third at least two weeks ahead of schedule, there would be a positive incentive of $15,000 earned. Meeting the last and most important milestone at least two weeks ahead of schedule would earn $45,000 for total schedule incentive earnings of $40,000.

6. Structuring Multiple-Incentive Contracts

A properly structured multiple-incentive arrangement should-

(a) Motivate the contractor to strive for outstanding results in all incentive areas; and

(b) Compel trade-off decisions among the incentive areas, consistent with the Government's overall objectives for the acquisition. Because of the interdependency of the Government's cost, the technical performance, and the delivery goals, a contract that emphasizes only one of the goals may jeopardize control over the others. Because outstanding results may not be attainable for each of the incentive areas, all multiple-incentive contracts must include a cost incentive (or constraint) that operates to preclude rewarding a contractor for superior technical performance or delivery results when the cost of those results outweighs their value to the Government.

(c) While not requiring as much administrative effort as an award fee contract, an incentive contract with multiple incentives requires some administrative effort to track how the contractor is performing in relation to the cost incentive and to the performance and/or delivery incentive. Before entering into a multiple incentive contract, Agencies must determine whether the amount of additional administrative effort is offset by potentially improved performance by the Contractor.

(d) *A basic example of a multiple incentive contract is as follows (applicable to either Fixed-Price Incentive or Cost-Plus-Incentive-Fee):*

Target Cost $100
Target Profit (Fee) $7
Target Price $107
Share Ratio 75/25
Performance Incentive Reward +$3
Performance Incentive Penalty -$1
Schedule Incentive Penalty -$1

Cost of $84 and maximum performance on schedule – profit is $14 ($16 under Target cost X 25% share = $4 + $7 Target Profit +$3 Performance Incentive Reward).

Cost of $116 and acceptable performance with late delivery – profit is $2 ($16 over Target Cost X 25% share = $4 subtracted from $7 =$3 less $1 Schedule Incentive Penalty)

Cost of $116 and maximum performance with late delivery – profit is $5 ($16 over Target Cost X 25% share = $4 subtracted from $7= $3 less $1 Schedule Incentive Penalty plus $3 Performance Incentive Reward)

7. Fixed-Price Incentive (FPI) Contracts

(a) *Description*. A FPI contract is a fixed-price contract that provides for adjusting profit and establishing the final contract price by application of a formula based on the relationship of total final negotiated cost to total target cost. The final price is subject to a price ceiling, negotiated at the outset.

(b) *Application*. A FPI contract is appropriate when-

(1) A FFP contract is not suitable;

(2) The nature of the supplies or services being acquired and other circumstances of the acquisition are such that the contractor's assumption of a degree of cost responsibility will provide a positive profit incentive for effective cost control and performance; and

(3) If the contract also includes incentives on technical performance and/or delivery, the performance requirements provide a reasonable opportunity for the incentives to have a meaningful impact on the contractor's management of the work.

(c) *Billing prices*. In FPI contracts, billing prices are established as an interim basis for payment. These billing prices may be adjusted, within the ceiling limits, upon request of either party to the contract, when it becomes apparent that final negotiated cost will be substantially different from the target cost.

(d) *Point of Total Assumption*. The Point of Total Assumption (PTA) in FPI contracts is the point where cost increases that exceed the target cost are no longer shared by the Government according to the share ratio. At the PTA, the contractor’s profit is reduced one dollar for every additional

dollar of cost. The PTA is calculated as follows:

PTA = (Ceiling Price –Target Price)/Government Share + Target Cost

An example of a PTA calculation is as follows:

Target Cost $50,000,000
Target Profit $4,500,000 (9%)
Target Price $54,500,000
Ceiling Price 125% of Target Cost = $62,500,000
Share Ratio 70/30

PTA = ($62,500,000-54,500,000)/70% + $50,000,000
PTA = $8,000,000/70% + $50,000,000
PTA = $11,428,571 + $50,000,000 = $61,428,571

Thus, cost increases beyond the PTA of $61,428,571 are no longer shared by the Government in accordance with the share ratio – the contractor's profit will be reduced one dollar for every additional dollar of cost beyond the PTA.

(e) *General Considerations:*

(1) The higher the Government share and the higher the ceiling price, the lower the overall incentive for the contractor to control costs since they have more ability to recover such costs; and

(2) Conversely, the lower the Government share and the lower the ceiling price, the higher the overall incentive for the contractor to control costs since they have less ability to recover such costs

8. Fixed-Price Incentive (Firm Target)

(a) *Description*. A fixed-price incentive (firm target) contract specifies a target cost, a target profit, a price ceiling (but not a profit ceiling or floor), and a profit adjustment formula. These elements are all negotiated at the outset. The price ceiling is the maximum that may be paid to the contractor, except for any adjustment under other contract clauses. When the contractor completes performance, the parties negotiate the final cost, and the final price is established by applying the formula. When the final cost is less than the target cost, application of the formula results in a final profit greater than the target profit; conversely, when final cost is more than target cost, application of the formula results in a final profit less than the target profit, or even a net loss. If the final negotiated cost exceeds the price ceiling, the contractor absorbs the difference as a loss. Because the profit varies inversely with the cost, this contract type provides a positive, calculable profit incentive for the contractor to control costs.

(b*) Applicability:* A fixed-price incentive (firm target) contract is appropriate when the parties can negotiate at the outset a firm target cost, target profit, and profit adjustment formula that will provide a

fair and reasonable incentive and a ceiling that provides for the contractor to assume an appropriate share of the risk. When the contractor assumes a considerable or major share of the cost responsibility under the adjustment formula, the target profit should reflect this responsibility.

(c) *Limitations*. This contract type may be used only when-

(1) The contractor's accounting system is adequate for providing data to support negotiation of final cost and incentive price revision; and

(2) Adequate cost or pricing information for establishing reasonable firm targets is available at the time of initial contract negotiation.

(d) *Contract schedule*. The CO should specify in the contract schedule the target cost, target profit, and target price for each item subject to incentive price revision. Following the completion of performance, the parties negotiate the final cost, and the final price is established by applying the formula.

(e) An example of a Fixed-Price Incentive (Firm Target) contract is under Section 7 above.

9. Fixed-Price Incentive (Successive Targets) Contracts

(a) *Description*.

(1) A fixed-price incentive (successive targets) contract specifies the following elements, all of which are negotiated at the outset:

(i) An initial target cost.

(ii) An initial target profit.

(iii) An initial profit adjustment formula to be used for establishing the firm target profit, including a ceiling and floor for the firm target profit. (This formula normally provides for a lesser degree of contractor cost responsibility than would a formula for establishing final profit and price.)

(iv) The production point at which the firm target cost and firm target profit will be negotiated (usually before delivery or shop completion of the first item).

(v) A ceiling price that is the maximum that may be paid to the contractor, except for any adjustment under other contract clauses providing for equitable adjustment or other revision of the contract price under stated circumstances.

(2) When the production point specified in the contract is reached, the parties negotiate the firm target cost, giving consideration to cost experience under the contract and other pertinent

factors. The firm target profit is established by the formula. At this point, the parties have two alternatives, as follows:

(i) They may negotiate a firm fixed price, using the firm target cost plus the firm target profit as a guide.

(ii) If negotiation of a firm fixed price is inappropriate, they may negotiate a formula for establishing the final price using the firm target cost and firm target profit. The final cost is then negotiated at completion, and the final profit is established by formula, as under the fixed-price incentive (firm target) contract.

(b) *Application*. A fixed-price incentive (successive targets) contract is appropriate when-

(1) Available cost or pricing information is not sufficient to permit the negotiation of a realistic firm target cost and profit before award;

(2) Sufficient information is available to permit negotiation of initial targets; and

(3) There is reasonable assurance that additional reliable information will be available at an early point in the contract performance so as to permit negotiation of either (i) a firm fixed price or (ii) firm targets and a formula for establishing final profit and price that will provide a fair and reasonable incentive. This additional information is not limited to experience under the contract, itself, but may be drawn from other contracts for the same or similar items.

An example of a situation where this contract type may be appropriate is where long lead time requirements may make it necessary in the acquisition of a new system to contract for a follow-on quantity before design or production stability has been achieved.

(c) *Limitations*. This contract type may be used only when-

(1) The contractor's accounting system is adequate for providing data for negotiating firm targets and a realistic profit adjustment formula, as well as later negotiation of final costs; and

(2) Cost or pricing information adequate for establishing a reasonable firm target cost is reasonably expected to be available at an early point in contract performance.

(d) *Contract schedule*. The CO should specify in the contract schedule the initial target cost, initial target profit, and initial target price for each item subject to incentive price revision.

(e) Overall considerations for the use of fixed-price incentive (successive targets) are as follows:

(1) Successive targets are used when uncertainties do not permit the negotiation of a firm arrangement;

(2) The ability to establish a firm pricing arrangement is not limited by the availability of cost or pricing data from the contract itself.

(3) Data may be drawn on as it becomes available from other contracts for the same or similar equipment/services; and

Because this type of contract is negotiated when cost and pricing information is not sufficient to allow negotiation of a firm arrangement, contract performance uncertainties are greater than they would otherwise be the case in a fixed-price type of contract. A realistic pricing arrangement would thus not provide as great a degree of contractor cost responsibility as under a FPI contract.

A basic example of a Fixed-Price Incentive (Successive Targets) contract is as follows:

Initial Target Cost	$15,000,000
Initial Target Profit	$1,200,000
Initial Target Price	$16,200,000
Initial Share Ratio	95/5

Ceiling on Firm Target Profit $1,350,000
Floor on Firm Target Profit $1,050,000
Price Ceiling $19,500,000

At the production point in the contract, if the cost is $14,500,000, the firm target profit would be determined as follows:
Initial Target Cost $15,000,000
Negotiated Cost $14,500,000
Difference $500,000 (decrease) Contractor's Share
$25,000 (increase) Initial Target Profit $1,200,000
Firm Target Profit $1,225,000

At this point, there are two alternatives: Using the negotiated cost of $1,450,000 and the firm target profit as guides, a firm-fixed-price may be negotiated. If this is not possible, or if the parties agree that uncertainties under the remaining part of the contract make this unfeasible, a fixed-price incentive with firm targets may be negotiated. The ceiling price cannot be *increased* at this point but it may be *decreased* where firm target costs are lower than initial target costs. With a revised ceiling price of $16,700,000 and a new share ratio of 60/40 negotiated, the following is established:

Target Cost	$14,500,000
Target Profit	$1,225,000
Target Price	$15,725,000

Ceiling Price $16,700,000
Share Ratio 60/40

The final settlement at contract completion would be done as for the firm target contract described in Section 8.

If the parties negotiated an estimated cost of $17,000,000 at the production point, firm target profit would be determined as follows:

Initial Target Cost	$15,000,000
Negotiated Cost	$17,000,000
Difference	$2,000,000 (increase)
Contractor's Share	$100,000 (decrease) Initial
Target Profit	$1,200,000
Firm Target Profit	$1,100,000

If a FFP contract was not appropriate, and a sharing formula of 75/25 were negotiated, a firm incentive agreement could be set up as follows:

Target Cost	$17,000,000
Target Profit	$1,100,000
Target Price	$18,100,000
Ceiling Price	$19,500,000
Share Ratio	75/25

10. Cost-Plus-Incentive-Fee (CPIF) Contracts

(a) *Description*. The CPIF contract is a cost-reimbursement contract that provides for the initially negotiated fee to be adjusted later by a formula based on the relationship of total allowable costs to total target costs. This contract type specifies a target cost, a target fee, minimum and maximum fees, and a fee adjustment formula. Unlike FPI contracts, there is no ceiling price under this contract type.

After contract performance, the fee payable to the contractor is determined in accordance with the formula. The formula provides, within limits, for increases in fee above target fee when total allowable costs are less than target costs, and decreases in fee below target fee when total allowable costs exceed target costs. This increase or decrease is intended to provide an incentive for the contractor to manage the contract effectively. When total allowable cost is greater than or less than the range of costs within which the fee-adjustment formula operates, the contractor is paid total allowable costs, plus the minimum or maximum fee.

(b) *Application*.

(1) A CPIF contract is appropriate for services or development and test programs when:

(i) A cost-reimbursement contract is necessary where uncertainties in the work under contract make a FPI contract impracticable; and

(ii) A target cost and a fee adjustment formula can be negotiated that are likely to motivate the contractor to manage effectively.

(2) The contract may include technical performance incentives when it is highly probable that the required development of a major system is feasible and the Government has established its performance objectives, at least in general terms. This approach also may apply to other

acquisitions, if the use of both cost and technical performance incentives is desirable and administratively practical.

(3) The fee adjustment formula should provide an incentive that will be effective over the full range of reasonably foreseeable variations from target cost. If a high maximum fee is negotiated, the contract must also provide for a low minimum fee that may be a zero fee or, in rare cases, a negative fee.

(c) *Limitations*. No CPIF contract shall be awarded unless the contractor has an adequate accounting system for that type of contract.

(d) Additional considerations for use of this contract type are as follows: Because of the interrelationship between negotiated fee levels and the sharing arrangement, the wider the range between minimum and maximum fees, the greater the contractor's share percentage under the formula without limiting the range of cost variation over which the incentive is effective.

Examples of a CPIF contract are as follows:

Target Cost $10,000,000
Target Fee $750,000
Maximum Fee $1,350,000
Minimum Fee $300,000
Share Ratio 85/15

(1) Actual cost of $10,000,000 results in the contractor earning the target fee of $750,000 since the contractor has met the target cost. $10,750,000 would be paid to the contractor in total.

(2) Actual cost of $11,000,000 above the target cost results in the contractor being responsible for 15% of the amount over cost ($150,000) which is deducted from the target fee for a total of $600,000 fee. This is within the minimum and maximum fee limits specified above.

(3) Actual cost of $9,000,000 below the target cost results in the contractor earning an additional $150,000 in fee above the target fee ($900,000). This is within the minimum and maximum fee limits specified above.

11. Impact of Contract Changes

When work required under a contract is changed under a "Changes" clause or other appropriate clause of an incentive contract – either increased or decreased – adjustments may be negotiated to the target cost, target fee, share ratio, etc. as appropriate. Performance and/or schedule incentives may also be similarly renegotiated. Since late definitizations of contract changes can adversely affect the integrity of the incentive contract structure, agreements on the pricing and incentive aspects of contract changes should be negotiated as soon as possible.
Four possible methods of making equitable adjustments to incentive contracts are as follows: (a) Constant dollar – where the same dollar adjustment is applied to target, maximum and minimum fee or

profit and ceiling price;

(b) Constant percentage – where the percentage of minimum and maximum fee or the percentage of ceiling price over target cost is held constant. The constant dollar and constant percentage methods are similar except for differences in fee/profit earned at the extremes of ranges above or below the target cost;

(c) Individual element – determining the effect of the change on each element such as target cost, target fee, and ceiling price individually. This is appropriate where the degree of uncertainty varies significantly between the original contract and the changed portion. There is a flexibility to tailor the specifics of the incentive to the change; however, the disadvantage is that more administrative effort is often needed to evaluate and negotiate each individual element; and

(d) Severable change – where the change is isolated form the incentive provisions with a separate agreement reached on the change portion. This method is most appropriate where the changed portion is completely different in terms of technical and cost risk than the original contract. For instance, the contract may be CPIF while the new work may be FPI.

Overall, the method chosen depends on the extent and nature of the change as well as its impact upon the individual incentive contract elements.