Government Contracting Overview

Course Overview

Selecting contractors that can best meet the Government's needs is a vital acquisition function. Proper contractor selections result from a decision making process that must provide for the fair and impartial treatment of all competing offerors, while minimizing the cost of the process to Government and industry.

This course gives an overview of basic Government contracting rules and the market research process, the process for developing criteria that is used to evaluate contractors during source selection, and the use of the uniform contract format.

Learning Objectives

- Explain comprehensive market investigation for a product or service.
- Evaluate financial capability of contractor as part of market research and pre-award surveys.
- Evaluate market research options against Operational Requirements Document (ORD) criteria.
- Identify the steps of best value trade-offs and how the process is applied to the source selection process.
- Identify source selection criteria (factors and standards), and methods of assigning and weighting priorities in preparation for a source selection.

Course Introduction

DoD CONTRACTING PRINCIPLES AND PRACTICES

The basic contracting rules for all Federal Government agencies are set forth in the Federal Acquisition Regulation (FAR). Additional rules unique to DoD are set forth in the DoD FAR Supplement (DFARS).

How DoD Buys

Almost 98 percent of DoD’s purchase transactions are for $100,000 or less. Although they account for less than 20 percent of DoD's procurement dollars, they total in the billions of dollars each year. Most of these transactions are accomplished using simplified acquisition procedures. Oral solicitations or very brief written requests for quotations are issued to prospective suppliers in the local purchasing area. The successful quoter is issued a purchase order, and compliance with the order (i.e., delivering the product or performing the service) constitutes contract acceptance and fulfillment. Purchases over $100,000 are made by sealed bidding by competitive proposals, or (in unusual circumstances only) by other-than-competitive procedures. Sealed bids are used when the Government knows exactly what it needs, while competitive proposals allow flexibility in
defining the exact requirement or the terms and conditions of the procurement. Procurement by sealed bidding begins with the issuance of an invitation for bids (IFB) containing all the information bidders need to respond. The IFB states the needs of the purchasing activity and defines the work in sufficient detail to permit all bidders to compete on the same basis. It also identifies all factors to be considered in evaluating the bids. A standard form is provided on which bids are submitted, and a specific time is set for bid opening. The opening is held in public and the contract is awarded to that responsible bidder whose bid offers the best value to the Government. When sealed bids are not appropriate, competitive proposals are solicited. The purchasing office issues a request for proposals (RFP). After reviewing the proposals received, the contracting officer ordinarily will negotiate with those suppliers that have submitted acceptable proposals, seeking the most advantageous best value contract for the Government.

**Types of Contracts**

DoD generally uses fixed-price contracts to acquire products and services. Cost-reimbursement contracts are used only when fixed-price contracts are not feasible. Most research and development (R&D) contracts are of the cost-reimbursement type. Fees under cost-reimbursement contracts are either fixed at the outset or subject to adjustment in accordance with a formula established in the contract. When unusual circumstances exist, a letter of intent may be used to authorize a contractor to start work before the final contract is executed. It is national policy that a fair proportion of the products and services used by DoD shall be purchased from small, small disadvantaged, and women-owned small businesses. Certain factors limit DoD's ability to contract with small business. Vast amounts of facilities and working capital are required to produce major weapons systems. In many cases, even the resources of large business can be strained by performance and cost risks. To offset these factors, DoD has implemented a major program to ensure the award of a fair proportion of its contracts to small businesses. This program includes special personnel to assist small businesses, and the following purchasing procedures:

- Permitting offers on less than the total requirements and allowing the maximum time possible for preparation of offers.

- Setting aside, for award to small business only, any procurement where there is a reasonable expectation that at least two responsible small businesses will offer the products of small business concerns at reasonable prices. Most purchases under $100,000 are reserved for competition among small business only.

- Setting aside a portion of procurement that would otherwise be too large for a total small business set-aside. Any business, large or small can compete for the non set-aside portion. A small business is then given the opportunity to receive a contract for the set-aside portion at the price of the non set-aside portion.

- Encouraging large DoD contractors to subcontract with small, small disadvantaged
and women-owned small businesses.

In addition to helping all small business firms, DoD provides special emphasis to increase participation by small disadvantaged business firms. The main features are as follows:

- Seeking small disadvantaged business firms to supply the needed products and services, and setting aside for small disadvantaged business firms those solicitations where DoD can expect to obtain satisfactory performance, adequate competition, and a reasonable price from among the respondents.

- Contracting directly with the Small Business Administration (SBA), which will then subcontract the work to small businesses certified by the SBA as being socially and economically disadvantaged. DoD and SBA identify products and services that can be provided by small disadvantaged businesses that have an SBA-approved business development plan. The FAR (Subpart 19.8) provides detailed information on this procedure.

- Encouraging special attention to small disadvantaged business firms by DoD's large prime contractors in their programs of subcontracting.

DoD awards contracts only to contractors found to be responsible. The purchasing activity must evaluate the offerors in order to make a positive finding as to responsibility. Getting accepted as a "responsible" contractor is not equivalent to getting on a qualified products list. A vendor cannot arrange for a survey at their convenience and wait until they are approved before submitting an offer. The determination of responsibility is done only in connection with an offer when a particular vendor is the apparent low or otherwise successful offeror.

To be found responsible, a offeror must be able to demonstrate that they

1. have, or are able to obtain, adequate financial resources;
2. are able to comply with the delivery requirements;
3. have a satisfactory record of performance;
4. have a satisfactory record of integrity and business ethics;
5. have, or are able to obtain, the necessary organization, experience, accounting and operational controls, and technical skills;
6. have, or are able to obtain, the necessary production, construction, and technical equipment and facilities; and
7. are otherwise qualified and eligible to receive an award under applicable laws and regulations.

Sometimes a contracting officer proposes to reject the apparent successful offer of a small business firm because of doubt as to whether the firm is sufficiently responsible to perform the contract. In that event, the case must be referred to the SBA. If the SBA determines that the small business firm is responsible, it issues a Certificate of
Competency (CoC) to the contracting officer, who then must award the contract to the small business firm.

**THE DoD SYSTEM OF SPECIFICATIONS AND STANDARDS**

DoD has exact specifications for many of the products and services it buys repeatedly. A program manager should be familiar with the types of specifications, and should know how to obtain them. Specifications are comprehensive descriptions of the technical requirements for material, equipment, and services. In addition to its specifications, DoD uses standards that establish the engineering and technical limitations and applications of items, materials, processes, methods, and engineering practices. Standards are used to ensure maximum uniformity in materials and equipment and to foster interchangeability of parts used in these products. Standards may be separately stated in a description of a need, but frequently they are also included in military specifications. Though use of Military specifications and standards continues within DoD, there is increasing emphasis on maximizing the utilization of commercial specifications and standards whenever practicable. The Department of Defense Single Stock Point (DoDSSP) was created to centralize the control, distribution, and access to the extensive collection of Military Specifications, Standards, and related standardization documents either prepared by or adopted by the DoD. The DoDSSP mission and responsibility was assumed by the Defense Automated Printing Service (DAPS) Philadelphia Office, in October 1990. The responsibilities of the DoDSSP include electronic document storage, indexing, cataloging, maintenance, publish-on-demand, distribution, and sale of Military Specifications, Standards, and related standardization documents and publications comprising the DODSSP Collection. The DoDSSP also maintains the Acquisition Streamlining and Standardization Information System (ASSIST) management/research database. Although the DODSSP Collection contains over 50,000 line items, not all documents specified in Government procurements are included (e.g.: engineering drawings, some Departmental documents, and the majority of all Non-Government / Industry Standards). The Department of Defense Index of Specifications and Standards (DoDISS) contains the complete list of Standardization documents in the DoDSSP Collection. This reference publication is available online to all ASSIST subscribers, on CD-ROM for single issue or subscription purchase or in paper format from the Superintendent of Documents.

**DoD Central Contractor Registration (CCR)**

On October 1, 1996, the DoD implemented the capability for contractors to register in the CCR. The DoD has determined the CCR acquisition reform initiative will assist the Department in complying with recent legislation. CCR is the single DoD registration for contractors who conduct business or who are interested in conducting business with the Department. CCR allows Federal Government contractors to provide basic information on business capabilities, and financial information one time to the government.

**Market Research** is the continuous process of gathering and analyzing data on:
As part of market research, teams evaluate the potential of the commercial marketplace to meet system performance requirements. Research may uncover how the performance requirements can be reasonably modified to facilitate the use of potential commercial items, components, specifications, standards, processes, technology, and sources. Teams typically focus on these Market Research areas:

- Potential suppliers
- Industry practices
- Distribution practices
- Terms and conditions
- Technologies
- General capabilities
- Product performance characteristics
- Product differentiation
- Cost drivers

Program managers have overall responsibility for market research.

A contracting specialist will also serve on the team and has primary responsibility for addressing contracting or business related market research issues such as standard commercial business practices, requirements of law/regulations unique to the item, and size and status of potential sources. The team will use market research techniques to obtain information on these issues.

Market research techniques include:

- Reviewing catalogs and other vendor literature
- Reviewing previous market research results
- Contacting industry or trade associations
- Reviewing trade journals
- Attending meetings or conferences with industry

There are two main activities in the market research process: Market Surveillance and Market Investigation. Market surveillance is an ongoing process, while market investigation is a more formal and focused effort that is best conducted by a team of contracting and functional experts with backgrounds in engineering, logistics, and other related areas.

Laws Affecting Market Research

DoD 5000 series documentation states that commercial and non-developmental items should be considered as the primary source of supply.
The team will use market research techniques to:

- Conduct analysis to determine the availability and suitability of existing commercial and non-developmental items prior to the commencement of a development effort, during the development effort, and prior to the preparation of any product description.
- Conduct market research and analysis to identify and evaluate possible dual use technologies and commercial suppliers throughout research and development.

Market research may determine that while there are no commercial items that meet all of the system requirements, one or more available systems can meet the majority of the requirements. Therefore, the team should consider modifying the user's requirement or modifying the available products.

**Market research can be used to make decisions on how an item or service will be purchased.**

Title 10 United States Code 2377 [http://www.arnet.gov/far/current/html/FARMTOC.html](http://www.arnet.gov/far/current/html/FARMTOC.html) and the *Federal Acquisition Regulations* (FAR) 10.001 require DoD to evaluate how the desired performance requirements could reasonably be modified to facilitate the use of potential commercial or non-developmental items, components, specifications, open standards, processes, technology and sources. The results of the evaluation should be included as part of the initial Operational Requirements Document (ORD).

FAR 10.001 states that appropriate market research must be conducted prior to soliciting offers from potential suppliers. Research results at this stage can assist in describing DoD needs; in developing overall acquisition strategy; and in identifying terms, conditions, and practices appropriate for the item acquired. Market research is mandatory before soliciting any offers above the Simplified Acquisition Threshold (SAP), and discretionary for solicitations below the Simplified Acquisition Threshold. The SAP threshold is $100,000. In all cases, the timing, depth, and extent of market research efforts should be in consonance with the value and complexity of the procurement. The scope of such efforts will vary, depending upon the type and amount of information needed to support preparation of the solicitation.

**Several laws and regulations have influence on how the Government will buy an item or service.**

10USC 2304 [http://www2.brtrc.com/amc/hbecu_mi/2304.htm](http://www2.brtrc.com/amc/hbecu_mi/2304.htm),

41USC 253 [http://www4.law.cornell.edu/uscode/41/253.html](http://www4.law.cornell.edu/uscode/41/253.html) and

FAR 6.101 [http://farsite.hill.af.mil/reghtml/regs2afmcfars/fardfars/far/06.htm](http://farsite.hill.af.mil/reghtml/regs2afmcfars/fardfars/far/06.htm)

require, with certain limited exceptions, that the Government promote and provide for full and open competition in soliciting offers and awarding Government contracts.
Competition is usually defined as having two or more contractors who plan to respond to a solicitation. Market research should never be used to promise or even suggest to any one contractor that they will get Government work. Rather, the goal of market research is to find several contractors able to offer different prices and ideas/processes in a competitive market place. Other laws require the Government to look for and promote small business, including small-disadvantaged companies, small women-owned companies, and Historically Under-utilized Business (HUB) zone companies. (See FAR 19.5 and 5000.1-R 2.3.2). These laws and policies can be very complicated, but one core requirement is that the contracting officer and program manager must set aside a procurement for only small business participation if two or more capable small businesses are going to compete. Therefore, one purpose of market research is to search for small businesses capable of performing the effort.

Uniform Contract Format

The Uniform Contract Format (UCF) is a standardized format for structuring Government solicitations and contracts. The UCF is a table of contents for organizing contractual documents. This means that you can open up and read almost any Government contract and it will be structured the same way as other Government contracts (one exception is FAR 12, where the Commercial contracts' tailored format is allowable). Once you understand this format, reading contracts is much easier.

PART I – SCHEDULE

Section A. Solicitation/Contract Form

A cover sheet for a Request for Proposals (RFP) is a Standard Form (SF) 33 that contains basic information such as the issuing office, address and contract number.

Section B. Supplies or Services and Prices/Cost

A brief description of the contract deliverable (item, quantity, etc.), each covered by a contract line item number. Prices are entered subsequent to solicitation.

Section C. Description/Specifications/Work Statement

Actual tasks to be completed for the contract, including the Statement of Work (SOW) or Statement of Objectives (SOO).

Section D. Packaging and Marking

Special packaging/marking requirements such as preservation, protection and bar coding.

Section E. Inspection and Acceptance
Place of inspection, who will inspect and acceptance criteria.

Section F. Deliveries or Performance

The time, place, method of delivery or performance.

Section G. Contract Administration Data

Accounting and paying office information.

Section H. Special Contract Requirements

Requirements unique to the program and the contract such as security clearances, warranties, options, incentives, government-furnished equipment, etc.

PART II – CONTRACT CLAUSES

Section I. Contact Clauses

Commonly referred to as "boilerplate" and not to be overlooked. This section includes standard clauses of considerable power defining rights and responsibilities of contracting parties. It also contains clauses required by procurement regulations or law that pertains to the particular procurement.

PART III – LIST OF COMMENTS, EXHIBITS AND OTHER ATTACHMENTS

Section J. List of Attachments

A list of all attached forms and specifications, including:

- Security form
- Data Orders
- Contract Data Requirements List (CDRL)
- Statement of Work (SOW)
- Specifications
- Financial Data

PART IV – REPRESENTATIONS AND INSTRUCTIONS (included in solicitations/RFP’s only)

Section K. Representations, Certifications and other Statements of Offerors

Any special representations required of offerors, such as small/disadvantaged business status or EEO compliance.
Section L. Instructions, Conditions and Notices to Offerors

How to organize proposal (volumes, page limits), types of contract and where to obtain copies of documents and instructions on what information the Government wants the contractor to provide. It is the information that will be evaluated by the government. There is a direct connection between section L and section M.

Section M. Evaluation Factors for Award

How the government intends to evaluate proposals. Evaluation factors provide a meaningful comparison and discrimination between competing proposals. Typical factors or evaluation criteria include schedule, management, technical approach and past performance. Price or cost is evaluated in every source selection.

Source Selection

Before a solicitation is issued, a Source Selection Plan (SSP) should be prepared by the source selection Integration Product Team (IPT), reviewed by the Contracting Office, Source Selection Board, Source Selection Advisory Council (SSAC), and approved by the Source Selection Authority (SSA). Any source selection information in the plan must be protected to ensure the fairness and integrity of the source selection process.

The Steps for evaluation and selection of a source for contract award are:

1. Compare each proposal to the requirements and evaluation criteria in the RFP.
2. Conduct price and/or cost analysis to determine fair and reasonable price.
3. Compare/contrast the merits (strengths and weaknesses) of each proposal.
4. Select the source for contract award.

Evaluation Factors

The source selection decision is based on a comparative assessment of proposals against all evaluation factors provided in the solicitation. Evaluation factors inform offerors of the importance the Government attaches to various aspects of a proposal. Evaluation factors are a list, in order of relative importance, of those aspects of a proposal that will be evaluated both quantitatively and qualitatively.

The Best Value Continuum is a recognition that the Government always seeks to obtain the best value in negotiated acquisitions using any one or a combination of source selection approaches. At one end of the continuum is the low priced technically acceptable strategy. At the other end is a process by which elements of a proposed solution can be traded off against each other to determine the solution that provides the Government with the overall best value. Tradeoffs are conducted according to the source selection evaluation factors and sub factors.

Generally, there should be a limited number of evaluation factors. Evaluation factors
should cause the evaluation process to highlight significant differences among proposals in areas of primary interest to the Government. It is counterproductive to have a large number of evaluation factors, or subdivisions of individual factors, because they force unnecessarily detailed assessment of relatively unimportant things.

As a program progresses through the acquisition phases, the Government's requirement becomes better defined, and evaluation factors become relatively more objective in nature.

Cost is always a factor in source selection. In systems acquisitions, for the purpose of selecting a source, the "cost" the Government is concerned about is the most probable life cycle cost to the Government of the proposed system. This does not preclude the need for the Government to establish the reasonableness of the proposed price or estimated cost-plus-fee of the contemplated contract.

Evaluation factors are established at the discretion of the SSA, but always include cost and quality (see FAR 15.304-c http://www.arnet.gov/far/current/html/Subpart_15_3.html ). Quality is usually evaluated with technical, management or past performance criteria. Subject to certain limitations and thresholds, past performance and participation of small disadvantaged business concerns is also evaluated.

* Typically program managers will be deeply involved in comparing the contractors technical and management proposal and past performance information with the evaluation criteria in the RFP.

**Alpha Contracting**

Alpha contracting was coined within the Army to apply to an innovative technique that takes the contract negotiation process and converts it from a consecutive process into a concurrent process. From solicitation development, through proposal preparation, to evaluation, negotiation, and award, alpha contracting relies on a team approach to concurrently develop a scope of work, price that scope, and prepare the contract to execute the scope. A variety of sole source acquisition processes have been developed based on the promise of integrated and concurrent, rather than sequential, effort. These processes include the Army’s alpha contracting, and numerous Air Force efforts tailored for particular requirements: one-pass, paradigm, 8-step, Product Enhancement/Product Improvement (PEPI). Despite some significant variations, each process incorporates similar fundamental features. Open communication, partnership agreements, early Defense Contract Audit Agency/Defense Contract Management Agency involvement, and reaching agreement on labor hours/mix prior to a formal solicitation are all characteristics of a cultural change in the way the government and industry now work together. In contrast to the traditional approach, the alpha techniques force the joint government/contractor team to agree to each task and its associated hours before progressing. If there is disagreement, more data is collected to arrive at a complete understanding of the tasks. The techniques use joint development, which implies an open and interactive sharing of data. The Integrated Product Team (IPT) is vital to alpha
techniques and all members are held mutually accountable for their area. Alpha negotiation, with a few exceptions, is used to negotiate sole source awards (other than full and open competition) and modifications to on-going contracts.

**Contract Modifications**

Once the contract has been awarded, the Government frequently has to modify the contractual agreement. Some modifications are done unilaterally and require no negotiation such as contract funding, exercise of options, and determination of award fee. Some modifications are done only by negotiations between the government and the contractor. Generally the two parties will negotiate a change to the contract cost/price/fee/profit, change the wording in the specification and statement of work, change the contract performance schedule and change or add contract clauses, before work on the new effort begins. This type of contract change is called a “supplemental agreement”. Sometimes, for reasons such as safety problems or urgent operational needs, the contractor will be directed by the Government contracting officer to begin work before the final price, schedule, specification changes, etc. are negotiated. This is called a change order. All change orders are negotiated and defined as quickly as possible, and in accordance with a negotiating schedule.

**Working together to develop a cost proposal**

In Alpha contracting, the government and contractor teams work together to develop the basis of the contractor's cost proposal. Together, the two teams evaluate the labor hours, labor mix, subcontractor bids, vendor bids, material costs, travel costs, rates, factors, etc. In order to be a valuable, contributing member of this cost estimating team, the government personnel must be knowledgeable of the contractor's cost accounting system.

**Cost Accounting**

The effective use of the company’s capital is a key concern in the overall management process. This includes management of the capital invested in plant and equipment and the current assets that circulate in day-to-day operations. The cost accounting system of the company supports management in its planning and control activities. Budgets provide plans against which costs can be measured, evaluated and controlled. The information provided by the cost accounting system provides a basis for various management decisions particularly related to product pricing, cost reduction, and resource allocation. There are three essential tasks within this cost accounting arena:

- Cost determination: what does it cost to produce an item?
- Cost control: what should costs be?
- Performance evaluation: were assets used efficiently?
Cost accounting can be differentiated from financial accounting by examining the primary users of the information being generated by the accounting system. The financial statements, which are end products of the financial accounting process, are used by sources outside of the company to make investment decisions or to determine the financial health of the firm. Cost reports, which are end products of the cost accounting process, are used internally by personnel of the company. Most of the reports generated by the cost accounting process are extremely sensitive and are frequently closely held, even within the company. For example, cost accounting reports typically provide detailed proprietary data relating to the costs of manufacturing and selling each product. Another differentiator between financial and cost accounting is the frequency of outputs. The financial accounting system usually generates reports on a monthly basis, while the cost accounting system often generates reports on a weekly, daily and in some cases on a real-time basis. Cost accounting is a necessary function for any business, but is generally of little consequence for those outside the company. In the Defense environment, however, the internal cost accounting of contractors is an area of significant concern for the customer, i.e., the program manager and the buyer. DoD has much greater interest in and knowledge about the internal cost structure of suppliers than a commercial customer would because DoD negotiates many contracts based on the contractor’s cost rather than a free market price mechanism. Generally, the financial interest of defense contractors is best served by charging, consistent with Government regulations, as many costs as possible directly to contracts and structuring indirect costs in a way that properly allocates maximum costs to Government contracts. It is essential that Government personnel be familiar with the contractor’s cost accounting system in order to determine that the component elements of the negotiated price are fair and reasonable. Because of this, it is necessary for program managers to understand the vocabulary and structure of cost accounting.

Cost Accounting Key Terms

**Cost** - Cost is a measurement, in monetary terms, of the amount of resources used for some purpose.

**Cost Objective** - To help make decisions, managers want to know the cost of something. This something is called a cost objective. The cost objective may be defined as any activity for which a separate measurement of cost is desired. Cost objectives may be contracts, products, departments, or any other desired grouping. The cost accounting system typically (1) accumulates cost by some “natural” classification such as material or labor, and (2) then allocates or traces these costs to the cost objective.

**Direct Cost** - Any cost that is identified specifically traceable to or caused by a cost objective. Direct costs are most often broken down into direct material and direct labor costs but are not solely limited to items that are incorporated in the end product as material or labor. Costs identified specifically with a contract are direct costs of that contract. All costs identified specifically with other final cost objectives of the contractor are direct costs of those cost objectives.
**Direct Labor** - The services (hours) of employees who work directly in making a product or producing a service. Examples would be the wages of an assembly worker in a production line, or the salary of an engineer working on a research and development contract.

**Direct Materials** - Includes all the material that becomes a part of the finished product -- this includes the raw materials, interdivisional transfers, purchased parts and subcontracted items required to manufacture and assemble completed products. A direct material cost is the cost of material used in making a product and is directly associated with a change in the product.

- Raw materials - Includes raw and processed material in a form or state that requires further processing.
- Subcontracted items - Parts, components, assemblies, and services produced or performed by other than the prime contractor in accordance with the prime contractor’s design, specifications, or directions, and applicable only to the prime contract.
- Interdivisional transfers - Materials sold or transferred between a prime contractor’s divisions, subsidiaries, or affiliates that are under a common control.
- Purchased parts - There are two categories of purchased parts: standard parts utilized by many companies in many different applications such as nuts, bolts, and screws; and parts, components or simple subassemblies built by others but not manufactured to the prime contractor’s design.

**Other Direct Costs** - Costs for special facility rental, computer, reproduction, travel by direct personnel, consultants, etc. These costs must be attributable to a single cost object to be considered direct.

**Indirect Cost** - Any cost not directly identified with a single cost objective, but identified with two or more cost objectives. Indirect costs include all costs that are not direct. Indirect costs usually include support type costs that are required to continue operations and which are not associated with a single product or contract. Examples generally include items such as the cost of buildings and equipment in which production takes place, the cost of indirect labor such as plant security or production control, and the cost of fringe benefits such as vacation time and pension costs.

**Overhead Cost** - Overhead costs are indirect costs that support a specific part or function of the company but not the whole company. They are product-related costs but can be identified with more than one cost objective. For example, maintenance costs of the factory can logically be associated as support costs to the various manufacturing jobs performed in the factory. Likewise, the cost of the engineering library would logically be associated with the engineering department (and not with material handling or the accounting department.)

**General and Administrative Cost** - G&A costs are costs which cannot logically be associated with any particular group of cost objectives but are required to
support the business as a whole. Common examples of G&A costs would include salary of the chief executive officer, legal and accounting costs, marketing expenses, independent research and development costs, and bid and proposal costs.

The Nature of an Accounting System

An accounting system provides a formal method of accumulating financial data that represents the financial results of operating a business. As the accounting system relates to developing price and cost proposals for the federal government as well as accumulating costs under those contracts, it can be subdivided into several specific areas for brief individual discussion:

The Cost Allocation Process:

The difficult part of cost accounting deals with how to allocate costs to each final cost objective (product). The accounting system must identify and collect costs and assign those costs appropriately to contractor organizational units, products and contracts. A main question is- “how much cost should be assigned to a specific cost objective?” In the case of a direct cost, the answer is relatively straightforward -- assign all of the direct cost to the cost objective that benefits from the cost incurrence. Direct costs are, by definition, costs incurred to perform that cost objective. With indirect costs, however, the assignment or allocation of costs to a cost objective is more difficult.

Many issues arise when trying to determine how to allocate indirect costs. In reality, however, theory often gives way to simplified practical applications. Relatively broad categories of indirect costs are aggregated into “pools” which relate in a common way to a group of cost objectives. Then, an allocation base is selected which determines the assignment of the indirect costs in the pool to the individual cost objectives. Let’s suppose we have a manufacturing overhead cost pool comprised of the terms shown below:

<table>
<thead>
<tr>
<th>Indirect Expenses</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Indirect Labor</td>
<td>$ 1,000</td>
</tr>
<tr>
<td>Fringe Benefits</td>
<td>$ 500</td>
</tr>
<tr>
<td>Depreciation &amp; repair</td>
<td>$ 300</td>
</tr>
<tr>
<td>Indirect Operating expenses</td>
<td>$ 100</td>
</tr>
<tr>
<td>Miscellaneous Expenses</td>
<td>$ 100</td>
</tr>
<tr>
<td>Total Indirect Expenses</td>
<td>$ 2,000</td>
</tr>
</tbody>
</table>
The company must allocate these costs to contracts in accordance with a logical basis such as the amount of direct labor assigned to each contract. Let's assume that the company incurs a total of $1,500 worth of direct manufacturing labor. Below, we see that there were three contracts that formed all of the manufacturing cost objectives. These three contracts had manufacturing direct labor charges during the year as follows:

<table>
<thead>
<tr>
<th>Contract</th>
<th>Mfg Direct Labor</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>$ 750</td>
</tr>
<tr>
<td>B</td>
<td>$ 500</td>
</tr>
<tr>
<td>C</td>
<td>$ 250</td>
</tr>
<tr>
<td>Total Direct labor</td>
<td>$ 1,500</td>
</tr>
</tbody>
</table>

Using direct labor cost as the basis for allocation of indirect cost gives the following manufacturing overhead rate:

Overhead Rate = \( \frac{\text{Manufacturing Indirect Expense for the year}}{\text{Mfg Direct Labor Dollars for the year}} \)

\[
\text{Overhead Rate} = \frac{\$ 2,000}{\$ 1,500} = 133\%
\]

In other words: for each $1.00 worth of direct labor, $1.33 worth of indirect expense is allocated to each and every contract of the business.

In this example, we can see that the total amount of indirect expenses has been allocated over the total business of the contractor (the three contracts):

<table>
<thead>
<tr>
<th>Contract</th>
<th>Direct Labor</th>
<th>X OH Rate</th>
<th>= Indirect Mfg. Charge</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>$ 750</td>
<td>X 133.3%</td>
<td>= $ 1,000</td>
</tr>
<tr>
<td>B</td>
<td>$ 500</td>
<td>X 133.3%</td>
<td>= $ 667</td>
</tr>
<tr>
<td>C</td>
<td>$ 250</td>
<td>X 133.3%</td>
<td>= $ 333</td>
</tr>
<tr>
<td>Total</td>
<td>$ 1,500</td>
<td></td>
<td>$ 2,000</td>
</tr>
</tbody>
</table>

The methodology for charging each contract with its fair share of manufacturing overhead is repeated for each indirect cost.

**Types of Indirect Cost Pools**

Like kinds of indirect costs are added or “pooled” together in order to more accurately allocate all indirect costs to all of the different kinds of contracts going on at the same time within any company. Typically, manufacturing support costs such as factory supervision, machine maintenance, production supplies (i.e., sanding belts, drill bits,
rubber gloves, small tools) are all added together and divided by total manufacturer direct labor in order to arrive at a manufacturing overhead rate. Likewise, all engineering support costs such as drafting supervision, director of engineering, engineering library expense, engineering laboratory supplies are “pooled” together; divided by total engineering direct labor arriving at an engineering overhead rate. Some companies break down their overhead pool structure into many overhead rates, others have only one.

There are companies with well over one hundred different overhead pools in their accounting systems. In order to arrive at so many pools it would by necessary to break the manufacturing pool down into departmental pools such as manufacturing fabrication, manufacturing assembly, manufacturing plating, manufacturing painting, etc. The engineering pool might be segmented into engineering drafting, engineering mechanical design, engineering electrical design, production engineering, etc.

General and Administrative (G&A) expenses are by definition those expenses for the general management and administration of the business unit as a whole. This would typically include the senior management of the business unit and other indirect labor such as human resources, accounting, and legal personnel benefiting the whole business unit. Fringe benefits and other indirect expenses would be found in G&A pool much as they are in the overhead pools. Some G&A expenses are unique to the G&A pool such as corporate office allocation, bid and proposal, and independent research and development. The G&A cost allocation base should represent the total activity of the business unit. The most commonly used base for allocating the G&A pool is total-cost input (TCI). TCI is defined as all costs except those in the G&A cost pool. Thus TCI is the sum of all direct costs plus all overhead costs.

Most companies will fall somewhere between these extremes. Some smaller companies have a simple system where a single rate applies all indirect costs to all jobs. On the other hand, larger companies require multiple rates in order to properly allocate costs.

**Types of Indirect Cost in Each Pool**

There are four major categories of indirect costs that are generally found to exist in all companies and within all pools. They are:

- Indirect Labor
- Direct Charging Indirect
- Fringe Benefits
- Other Indirect Costs

**Indirect Labor:**

Certain major categories of labor are generally identified as indirect. Typical labor categories found in all overhead pools include: management, supervision, clerical, and secretarial. Conversely, certain types of other office labor such as accounting, legal, technical, and analytical support that are found only in certain pools.
Direct Charging Indirect:

There are circumstances that arise when a person hired to perform direct labor cannot charge their time direct and must temporarily charge to indirect. Common examples of this include: time on jury duty, military duty, union duty, time waiting for equipment to be repaired, time waiting for material to arrive during temporary shortages, and time used for cleaning up a work area.

Fringe Benefits:

Many companies treat all fringe benefits as indirect costs regardless of the way the person is charging. In other words, fringe benefits on direct labor and indirect labor may be categorized as indirect costs. Examples of types of costs that could be classified as fringe benefits are: FICA, holidays, vacations, all personnel type insurance, (i.e., medical, life, long term disability, workers compensation, federal and state unemployment, etc.) sick leave, education, etc.

Other Indirect Costs:

This category is neither small nor insignificant. It includes all kinds of supplies as well as such diverse items as rent, depreciation, electricity, gas, water, maintenance materials, consumables, indirect travel, small tools, and all indirect outside purchased services such as consulting, computing, printing, fumigation, etc.

Accounting for Indirect Costs on Government Contracts

Indirect costs typically represent between a third to a half of the cost on a government contract. Clearly, it is a cost area that merits the attention of both contractor management and the DoD. Analysis and control of indirect cost is, however, a complex and difficult task. Comparing rates from different contractors can be misleading. Two similar contractors can have different rates for several reasons. Accounting systems may be different. For example, one contractor may classify production control as indirect labor while another contractor charges it as direct, or one contractor may include purchasing and warehousing costs in a material handling pool while another may have some of those costs in manufacturing overhead and some in G&A.

Contractor’s rates may differ due to different products or production methods rather than from accounting variations. For example, a first contractor produces a product using a manual method while another makes the same type of product in a highly automated facility. The automated contractor is likely to have a higher overhead rate because additional depreciation of the automated equipment, an indirect cost, is charged against a smaller direct labor base. The automated contractor is likely to experience higher overhead rates than in his less automated counterpart even though his total product cost
may be lower. Such differences make it important to remember that the Government’s objective is not to reduce overhead rates but to reduce total costs.

Although comparison of rates between contractors may not be fruitful, it may be useful to chart the trend of one contractor over time. Even this trend analysis would require adjustment for accounting process, or business base changes. The most useful analysis would be one, which looked at the indirect cost and cost trends in dollars rather than at rates and rate trends. Are costs reasonable and well controlled? This type of cost analysis requires significant effort. It is the type of analysis done by the Administrative Contracting Officer (ACO) and auditor in their review and negotiation functions.

Management of indirect costs is a contractor responsibility. Contractors who do significant military business must manage their indirect costs within the framework established by government policies. The role of the ACO and auditor are to assure that the contractor has an appropriate cost accounting system and operates in accordance with his system and the government requirements. The auditor also reviews and the ACO negotiates the contractor’s overhead rates.

Program managers and their staffs are usually not involved in the day-to-day administration of contractor overhead. When prices are based on cost, however, the Program manager must understand the contractor’s cost. Although the Program manager does not directly manage costs, he or she can encourage the contractor to be an aggressive cost manager. As the customer, the Program manager has clout. As a government officer, the Program manager should get the taxpayer his money’s worth.

**Government Cost Accounting**

We have just examined the basic concepts and ideas of cost accounting. We will now examine some of the differences that there are in cost accounting for government contracts. The differences that we will look at in this discussion falls into three major areas: cost allowability, cost accounting standards, and various government unique uses of overhead rates.

**Cost Allowability** - One of the key differences between government and commercial contracting is the issue of cost allowability. In the commercial world, competition among contractors normally ensures that buyers obtain fair and reasonable prices. However, the government cannot always rely on market forces to protect its interest, as many of the supplies and services it buys are not sold to the general public. In order to protect its interests, the government has created the concept of cost allowability in Part 31 of the FAR. The other key reason that this concept and particular points of the cost principles were developed was simply a matter of public policy. The government’s policy has concluded, for example, that government contract prices should not include costs for the bad debts of a business because the government does not cause any cost for bad debts.

The government can, through a contract’s terms and conditions, determine the types and amounts of costs that can be included in contract. For contracts subject to negotiation, a
cost is considered unallowable if it fails to meet any one of five criteria established in FAR 31.201-2, “Determining Allowability:”

- Reasonableness;
- Allocability;
- Accordance with Cost Accounting Standards (CAS) or generally accepted accounting principles (GAAP);
- Contract/agreement terms; or
- Any limitation set forth in FAR 31.205 (the “Cost Principles”).

**Reasonableness (FAR 31.201-3):** Reasonableness has been one of the more difficult concepts in the regulations principally because of the subjective nature of the concept. The reasonableness of a cost is governed by two paragraphs in FAR 31.201-3, “Determining Reasonableness.” The first paragraph contains the key statement that “a cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business.” Factors used in interpretation of reasonableness are provided by paragraph (b) of this reference. A cost is reasonable if:

- The cost is generally recognized as ordinary and necessary for conducting business or performing the contract, and
- The cost reflects sound business practices, arm’s length bargaining, and the requirements of federal and state laws and regulations.
- A prudent businessperson would take similar action, considering his or her responsibilities to the business owners, employees, customers, the government, and the public.
- There are not any significant deviations from established contractor practices that inordinately increase contract costs.

Before 1987, the government had little success in disallowing cost based on unreasonableness except when it established that the contractor had abused its discretion by incurring the cost in question. Effective July 30, 1987, FAR 31.201-3 was revised to provide that:

“No presumption of reasonableness shall be attached to the incurrence of costs by a contractor. If an initial review of the facts results in a challenge of a specific cost by the contracting officer or the contracting officer’s representative, the burden of proof shall be upon the contractor to establish that such cost is reasonable.”

As a result, the burden of proof on the issue of reasonableness of contract costs shifted from the government to the contractor.

**Allocability (FAR 31.2014):** The second factor affecting allowability of cost is allocability. The cost principles consider a cost to be allocable if it is assignable or chargeable to one or more cost objectives in accordance with the relative benefits
received or other equitable relationship. The FAR states that a cost is allocable to a government contract if it:

- Is incurred specifically for the contract (a direct cost);
- Benefits both the contract and other work, or both government work and other work, and can be distributed to them in reasonable proportion to the benefits received (an overhead cost); or
- Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown (a G&A cost).

Disputes in this area usually do not address whether a cost is allocable, but rather how it is allocable. If it is direct, the entire cost can be recovered under a specific contract; however if it is indirect, only an appropriate portion of the expense can be recovered on a given contract.

Cost Accounting Standards (CAS) and Generally Accepted Accounting Practices (GAAP): Cost accounting standards relate to allocability, not allowability, of costs. The CAS are regulatory provisions that address the acceptable measurement and assignment of costs to government contracts. The GAAP are fundamental accounting principles, usually pertaining to financial accounting, that have gained acceptance over a long period of time. If a contractor’s practices do not conform to applicable CAS or GAAP, then a cost that would not have been allocated to a contract using compliant practices would be considered unallowable. In other words, if a cost is allocated to a contract using non-compliant practices and that cost would not have been allocated using compliant practices, the cost is unallowable.

Terms of the Contract: A contract is a bilateral agreement between parties. If in arriving at the mutually acceptable contract, the parties set a type of cost as unallowable, then that cost must be unallowable for the contract.

Cost Principles (FAR 31.205): The FAR 31.205 identifies various types of allowable and unallowable costs. The cost principles have changed over the years with regularity in response to such things as public policy considerations, administrative convenience, and congressional interest. The cost principles essentially establish three categories of costs:

- Expressly allowable.
- Partially unallowable or require special consideration.
- Expressly unallowable.

There are a total of fifty-one cost principles in this part of the FAR, covering individual topics such as interest, bad debt, compensation for personal services, cost of money, depreciation, economic planning costs, and so on. FAR requires that expressly unallowable costs, plus all directly associated costs, be identified and excluded from proposals, billings, and claims submitted to the government. “Directly associated costs”
are defined as those that would not have been incurred if the other cost (e.g., the unallowable cost) had not been incurred.

RATES

FORWARD PRICING RATES - Rates mutually agreed upon between the Administrative Contracting Officer (ACO) and the contractor, for use in preparing bids during the corporate fiscal year, are called Forward Price Rate Agreements. These rates are binding on both parties and will be used in the proposal process. Forward Pricing Rates are an output of the corporate planning process and are dependent upon information contained in the company’s business plans. Forward Pricing Rates for indirect costs are dependent upon two factors—the amount of indirect cost incurred (which is under management control) and the number of contracts (or sales volume). Forecasting sales volume is difficult in the government contract business because government contractors are dealing with a small number of customers and have little control over the demand for their products. Failure to secure one of the limited major opportunities which may be available to the firm for continuation of government business or termination of an established acquisition program by the government may have a serious effect on the volume of the firm’s business and the assumptions upon which the Forward Pricing Rates for indirect costs were initially established.

BILLING RATES - Rates used for recovery of indirect costs (overhead and G&A) during the corporate fiscal year. Use of billing rates is necessary where the government reimbursement of cost occurs during the year because the actual (true) indirect rates will not be known until the end of the year. A billing rate can be revised during the year by mutual agreement between the government and the contractor in order to avoid substantial over or under payment. Billing Rates, while still affected by estimates, do reflect more certainty about actual costs and volume than Forward Pricing Rates, since Billing Rates are recalculated periodically as the contractor progresses through his fiscal year. Billing Rates used at the start of the fiscal year will probably be very close to the Forward Pricing Rates negotiated for that fiscal year. Then, as the year progresses, the contractor records actual indirect costs incurred and projects what the estimated indirect costs will be for the remainder of the year. He likewise records and re-estimates the dollars or hours that comprise the allocation base. This enables him to develop a new set of billing rates that more accurately reflect what is actually happening. Some defense contractors recalculate billing rates each month. In such cases, the billing rates for December will be very close to the end-of-year actual rates if the contractor uses the calendar year as his fiscal year.

FINAL or ACTUAL RATES - These rates express the relationship between indirect costs actually incurred and the actual number of dollars or hours in the allocation base for each indirect cost “pool”. These are the rates that would have been used for bidding and billing purposes throughout the corporate fiscal year just ended if all contract tasks and costs had been known in advance with certainty.
SUMMARY

The following learning objectives were covered in this module:

**Perform pre-award contracts planning for the acquisition of a system product or service.**

- Explain comprehensive market investigation for a product or service
- Evaluate financial capability of contractor as part of market research and pre-award surveys.
- Evaluate market research options against ORD criteria.
- Identify the steps of best value trade-offs and how the process is applied to the source selection process.
- Identify source selection criteria (factors and standards), and methods of assigning priorities and weighting in preparation for a source selection.

1. Market research is the process of gathering and analyzing data in order to determine if products in the commercial marketplace can meet the system performance requirements. Market research teams evaluate suppliers and vendors, technologies, industry practices, cost drivers and other factors to gain a firm understanding of the availability of various products that will meet the needs of the program.

The Market Investigation Process is a more formalized and focused effort, in response to a specific need for a product, service or material, and usually includes the following steps:

- Summarizing market surveillance information
- Identify additional sources and gather more information
- Validate the information, including site visits or field testing
- Evaluate potential candidates, including trade-offs
- Document the results, and make sure they are reflected in the initial ORD

Market Surveillance is more of a continuous process rather than a stand-alone event, where a market research team is responsible for continually staying abreast of technological and product developments. This is best done by:

- Attending trade shows and conventions
• Consulting leading technical publications or DoD resources

• Obtaining product samples

2. The DoD 5000 has many criteria and laws relating to Market Research. Some key points reflected in the 5000 include:

• Encourages use of existing commercial and Non-developmental items (NDIs) as primary sources of supply

• Supports market research as a key factor in requirement definition and possible design alternatives

• Supports market research as a key factor in decisions on how an item should be purchased

3. The Uniform Contract Format established a standardized format for structuring Government contracts and solicitations. Each part of the “table of contents” has specific information that should be contained in it.

• Solicitation/Contract Form

• Supplies or Services and Prices/Cost

• Description/Specs/Work Statement

• Packaging and Marking

• Inspection and Acceptance Deliveries or Performance

• Contract Administration Data

• Special Contract Requirements

• Contract Clauses

• List of Attachments

• Representations, Certifications and other Statements of Offerors

• Instructions, Conditions and Notices to Offerors

• Evaluation Factors for Award
Of critical importance to the Contract are the evaluations factors, which list in order of importance, those aspects of a proposal that will be evaluated quantitatively and qualitatively. These factors should make it easy to highlight differences among proposals in areas of significant importance.

GLOSSARY OF TERMS

**Acquisition**  The acquiring of supplies or services by the federal government with appropriated funds through purchase or lease.

**Affiliates**  Business concerns, organizations, or individuals that control each other or that are controlled by a third party. Control may include shared management or ownership; common use of facilities, equipment, and employees; or family interest.

**Best and Final Offer**  For negotiated procurements, a contractor's final offer following the conclusion of discussions.

**Business Information Centers (BICs)**  One-stop locations for information, education, and training designed to help entrepreneurs start, operate, and grow their businesses. The centers provide free on-site counseling, training courses, and workshops and have resources for addressing a broad variety of business startup and development issues.

**Certificate of Competency**  A certificate issued by the Small Business Administration (SBA) stating that the holder is "responsible" (in terms of capability, competency, capacity, credit, integrity, perseverance, and tenacity) for the purpose of receiving and performing a specific government contract.

**Certified 8(a) Firm**  A firm owned and operated by socially and economically disadvantaged individuals and eligible to receive federal contracts under the Small Business Administration’s 8(a) Business Development Program.

**Contract**  A mutually binding legal relationship obligating the seller to furnish supplies or services (including construction) and the buyer to pay for them.

**Contracting**  Purchasing, renting, leasing, or otherwise obtaining supplies or services from nonfederal sources. Contracting includes the description of supplies and services required, the selection and solicitation of sources, the preparation and award of contracts, and all phases of contract administration. It does not include grants or cooperative agreements.

**Contracting Officer**  A person with the authority to enter into, administer, and/or terminate contracts and make related determinations and findings.

**Contractor**  A company or institution that is under contract to the government and from whom a program manager expects to receive a delivered system as specified in a contract. A contractor may also be a vendor.

**Contractor Team Arrangement**  An arrangement in which (a) two or more companies form a partnership or joint venture to act as potential prime contractor; or (b) an agreement by a potential prime contractor with one or more other companies to have them act as its subcontractors under a specified government contract or acquisition program.
COTS  Commercial off-the-shelf: defined as a product that is sold, leased, or licensed to the general public; offered by a vendor trying to profit from it; supported and evolved by the vendor, who retains the intellectual property rights.

Defense Acquisition Regulatory Council (DARC)  A group composed of representatives from each Military department, the Defense Logistics Agency, and the National Aeronautics and Space Administration and that is in charge of the Federal Acquisition Regulation (FAR) on a joint basis with the Civilian Agency Acquisition Council (CAAC).

Defense Contractor  Any person who enters into a contract with the United States for the production of material or for the performance of services for the national defense.

Electronic Data Interchange  Transmission of information between computers using highly standardized electronic versions of common business documents.

Emerging Small Business  A small business concern whose size is no greater than 50 percent of the numerical size standard applicable to the Standard Industrial Classification code assigned to a contracting opportunity.

Equity  An accounting term used to describe the net investment of owners or stockholders in a business. Under the accounting equation, equity also represents the result of assets less liabilities.

Fair and Reasonable Price  A price that is fair to both parties, considering the agreed-upon conditions, promised quality, and timeliness of contract performance. "Fair and reasonable" price is subject to statutory and regulatory limitations.

Federal Acquisition Regulation (FAR)  The body of regulations which is the primary source of authority governing the government procurement process. The FAR, which is published as Chapter 1 of Title 48 of the Code of Federal Regulations, is prepared, issued, and maintained under the joint auspices of the Secretary of Defense, the Administrator of General Services Administration, and the Administrator of the National Aeronautics and Space Administration. Actual responsibility for maintenance and revision of the FAR is vested jointly in the Defense Acquisition Regulatory Council (DARC) and the Civilian Agency Acquisition Council (CAAC).

Full and Open Competition  With respect to a contract action, "full and open" competition means that all responsible sources are permitted to compete.

Intermediary Organization  Organizations that play a fundamental role in encouraging, promoting, and facilitating business-to-business linkages and mentor-protege partnerships. These can include both nonprofit and for-profit organizations: chambers of commerce; trade associations; local, civic, and community groups; state and local governments; academic institutions; and private corporations.

Joint Venture  In the SBA Mentor-Protege Program, an agreement between a certified 8(a) firm and a mentor firm to perform a specific federal contract.

Mentor  business, usually large, or other organization that has created a specialized program to advance strategic relationships with small businesses.

NDI  Non-developmental item: any previously developed item of supply used exclusively for governmental purposes by a federal agency, a state or local government, or a foreign government with which the United States has a mutual defense cooperation agreement.
Negotiation  Contracting through the use of either competitive or other-than-competitive proposals and discussions. Any contract awarded without using sealed bidding procedures is a negotiated contract.

One-Stop Capital Shops  OSCSs are the SBA’s contribution to the Empowerment Zones/Enterprise Communities Program, an interagency initiative that provides resources to economically distressed communities. The shops provide a full range of SBA lending and technical assistance programs.

Partnering  A mutually beneficial business-to-business relationship based on trust and commitment and that enhances the capabilities of both parties.

Prime Contract  A contract awarded directly by the Federal government.

PRO-Net  SBA’s Procurement Marketing Access Network, or PRO-Net, is a "virtual" one-stop procurement shop. The database offers an electronic search engine for contracting officers and serves as a marketing tool for small businesses that register with the system. It contains the profiles of thousands of small firms.

Protégé  A firm in a developmental stage that aspires to increasing its capabilities through a mutually beneficial business-to-business relationship.

Request for Proposal (RFP)  A document outlining a government agency’s requirements and the criteria for the evaluation of offers.

SCORE  The Service Corps of Retired Executives (SCORE) is a 12,400-member volunteer association sponsored by the SBA. SCORE matches volunteer business-management counselors with present prospective small business owners in need of expert advice.

Small Business  A business smaller than a given size as measured by its employment, business receipts, or business assets.

Small Business Administration (SBA) U.S. agency that nurtures small businesses. Provides low-interest loans.

Small Business Development Centers (SBDC) SBDCs offer a broad spectrum of business information and guidance as well as assistance in preparing loan applications.

Small Business Innovative Research (SBIR) Contract  A type of contract designed to foster technological innovation by small businesses with 500 or fewer employees. The SBIR contract program provides for a three-phased approach to research and development projects: technological feasibility and concept development; the primary research effort; and the conversion of the technology to a commercial application.

Small Disadvantaged Business Concern  A small business concern that is at least 51 percent owned by one or more individuals who are both socially and economically disadvantaged. This can include a publicly owned business that has at least 51 percent of its stock unconditionally owned by one or more socially and economically disadvantaged individuals and whose management and daily business is controlled by one or more such individuals.

Standard Industrial Classification (SIC) Code  A code representing a category within the Standard Industrial Classification System administered by the Statistical Policy Division of the U.S. Office of Management and Budget. The system was established to classify all industries in the US economy. A two-digit code designates each major industry group, which is coupled with a second two-digit code representing subcategories.
**Subcontract**  A contract between a prime contractor and a subcontractor to furnish supplies or services for the performance of a prime contract or subcontract.

**Supplier**  An enterprise (not necessarily commercial); whose purpose in producing a product may or may not include making it available for the use of others; examples of a supplier include government, academic, shareware, and not-for-profit enterprises.

**Vendor**  A commercial enterprise whose purpose in producing a product is to offer it for sale in the marketplace.