A|PTAC
Association of
Procurement Technical Assistance Centers

APTAC Body of Knowledge Competency Guide
C. Basics of Contracting with Government Entities
C.18 Contract Types

Description

Federal government contracts are divided into two main types of contract – fixed price and cost reimbursement. Each has subcategories of contract types that apply depending on the acquisition situation. Descriptions and when they are used are provided for the most common types of contracts small businesses perform. The less common types of contracts are listed without descriptions; however, additional information on their applicability and use can be found in the references provided.

Fixed-Price Contracts

Fixed-price types of contracts provide for a firm price or, in appropriate cases, an adjustable price. The types of fixed-price contracts are:

1. Firm-Fixed Price
2. Fixed-Price Contract with Economic Price Adjustment
3. Fixed-Price Contracts with Prospective Price Redetermination
4. Fixed-Ceiling-Price Contract with Retroactive Price Redetermination
5. Firm-Fixed-Price, Level-of-Effort Term Contract
6. Fixed-Price Incentive Contract
7. Fixed-Price Contract with Award Fee

Common Types of Fixed-Price Contracts for Small Businesses:

1. **Firm-Fixed Price**: Provides a price that is not subject to any adjustment on the basis of the contractor's cost in performing the contract. This contract type places upon the contractor maximum risk and full responsibility for all costs and resulting profit or loss. It provides maximum incentive for the contractor to control costs and perform effectively.

   Use when: Acquiring commercial items or other supplies or services on the basis of reasonably definite functional or detailed specifications.

2. **Fixed-Price Incentive**: A 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. The two forms of fixed-price incentive contracts are: firm target and successive targets.

   (a) Fixed-Price Incentive (Firm Target): Specifies a target cost, a target profit, a price ceiling (but not a profit ceiling or floor), and a profit adjustment formula.

   Use when: 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.

   (b) Fixed-Price Incentive (Successive Targets): All of the following elements are negotiated at the outset: (1) an initial target cost, (2) an initial target profit, (3) an initial profit adjustment formula, (4) the production point at which the firm target cost and firm target profit will be negotiated, (5) a ceiling price that is the maximum that may be paid to the contractor.

Use when: Appropriate when available cost or pricing information is not sufficient to permit the negotiation of a realistic firm target cost and profit before award; sufficient information is available to permit negotiation of initial targets; and 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.

Cost-Reimbursement Contracts

Cost-reimbursement types of 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 purpose of obligating funds and establishing a ceiling that the contractor may not exceed (except at its own risk) without approval. One of the key requirements for use of a cost-reimbursement contract is that the contractor's cost accounting system must be determined adequate by the government for determining costs applicable to the contract. The types of cost-reimbursement contracts are:

1. Cost Contract
2. Cost-Sharing Contract
3. Cost-Reimbursement Incentive Contract
4. Cost-Plus Fixed Fee Contract
5. Time and Materials Contract (a hybrid type)
6. Labor Hour Contract
7. Letter Contract

Common Types of Cost Reimbursement Contracts for Small Businesses:

1. **Cost Reimbursement Incentive**: Appropriate when a firm-fixed-price contract is not appropriate and the required 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 or fee payable under the contract to the contractor's performance.

   (a) Cost-Plus-Incentive Fee: A contract that provides for an initially negotiated fee to be adjusted later by a formula based on the relationship of total allowable costs to total target costs. The contract specifies a target cost, a target fee, minimum and maximum fees, and a fee adjustment formula. 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.

Use when: Appropriate for services or development and test programs when a cost-reimbursement contract is necessary and a target cost and a fee adjustment formula can be negotiated that are likely to motivate the contractor to manage effectively.

(b) Cost-Plus-Award Fee: A contract that provides for a fee consisting of a base amount (which may be zero) fixed at inception of the contract, if applicable and at the discretion of the contracting officer, and an award amount that the contractor may earn in whole or in part during performance and that is sufficient to provide motivation for excellence in the areas of cost, schedule, and technical performance.

Use when: When a fixed-price contract is not appropriate and when the Government wishes to motivate a contractor and other incentives cannot be used because contractor performance cannot be measured objectively.

2. **Cost-Plus-Fixed Fee**: A contract that provides for payment to the contractor of a negotiated fee that is fixed at the inception of the contract. The fixed fee does not vary with actual cost, but may be adjusted as a result of changes in the work to be performed under the contract.

   Use when: Circumstances do not allow the agency to define its requirements sufficiently to allow for a fixed-price type contract or uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract. For example – The contract is for the performance of research or preliminary exploration or study, and the level of effort required is unknown or the contract is for development and test, and using a cost-plus-incentive-fee contract is not practical.

3. **Time and Materials**: Also known as a "Fixed Unit Price" contract. Time-and-materials contracts and labor-hour contracts are not fixed-price contracts.

   (a) Time and Materials: Provides for acquiring supplies or services on the basis of direct labor hours at specified fixed, fully loaded, hourly rates that include wages, overhead, general and administrative expenses, and profit and actual cost for materials.

   (b) Labor-Hour: A labor-hour contract is a variation of the time-and-materials contract, differing only in that materials are not supplied by the contractor. Fully loaded firm-fixed-hourly rates are established for each classification of labor.

   Use when: It is not possible at the time of placing the contract to estimate accurately the extent or duration of the work or to anticipate costs with any reasonable degree of confidence.

4. **Letter Contracts**: These are written preliminary contractual instruments that authorize the contractor to begin immediately manufacturing supplies or performing services. The contract will include a clause containing a schedule for submission of the contractor's proposal, start date of negotiations, and target date for finalizing contract terms.

Use when: The Government'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.

Indefinite Delivery Contracts

Although this subject focuses on contract types, it is important to provide information on Indefinite Delivery contracts since they are commonly used and your clients may encounter these contract vehicles.

Indefinite Delivery (ID) contracts can be either fixed price or cost reimbursement. There are three types: (1) definite-quantity contracts, (2) requirements contracts, and (3) indefinite-quantity contracts. The appropriate type of indefinite-delivery contract may be used to acquire supplies and/or services when the exact times and/or exact quantities of future deliveries are not known at the time of contract award.

Indefinite-Quantity (IDIQ): Provides for an indefinite quantity, within stated limits, of supplies or services during a fixed period. The Government places orders for individual requirements. Quantity limits may be stated as number of units or as dollar values.

Use when: The Government cannot predetermine, above a specified minimum, the precise quantities of supplies or services that the Government will require during the contract period, and it is inadvisable for the Government to commit itself for more than a minimum quantity. Use an indefinite-quantity contract only when a recurring need is anticipated.

Contract Type Restrictions

The use of certain contract types is prohibited or required in certain circumstances: (1) cost-plus-a-percentage-of-cost contracts are absolutely prohibited; (2) cost-reimbursement contracts cannot be used to acquire commercial items; and (3) contracts resulting from sealed bidding must be firm-fixed-price or fixed-price with an economic price adjustment.

Other Contract-Type Terms You May Hear

Hybrid Contracts

A contract does not have to consist of line items that are only fixed price or cost reimbursable. A contract may have some fixed price line items and some cost reimbursement line items within a single contract. These are called hybrid contracts. Often the total dollar of the line item(s) that represent the largest portion of the contract is how the contract is referred. If most of the funds apply to the fixed-price line items then it may be referred to as a fixed-price contract and vice versa for cost-reimbursement line items.

Fixed-Unit-Price Contracts

This term is associated with Time and Materials contracts, in which, fully loaded firm-fixed-unit prices are specified for each classification of labor. Materials are charged at actual cost with no mark-up. Shipping and handling costs that are specific to the materials being paid at cost and cannot be estimated as indirect costs in the hourly rate loading, can be added to the materials cost, with advance approval and proper documentation.

REFERENCES

1. Federal Acquisition Regulation, Part 16, Types of Contracts
2. Congressional Research Service, Contract Types: An Overview of the Legal Requirements and Issues, Kate M. Manuel, Legislative Attorney, October 1, 2010