Comparison of Major Contract Types

	Firm-Fixed-Price (FFP)	Fixed-Price Economic Price Adjustment (FPEPA)	Fixed-Price Incentive Firm Target (FPIF)	Fixed-Price Award-Fee (FPAF)	Fixed-Price Prospective Price Redetermination (FP^{3}R)	Cost-Plus-Incentive-Fee (CPIF)	Cost-Plus-Award-Fee (CPAF)	Cost-Plus-Fixed-Fee (CPFF)	Cost or Cost-Sharing (C or CS)	Time & Materials (T&M)
Principal Risk to be Mitigated	None. Thus, the contractor assumes all cost risk.	Unstable market prices for labor or material over the life of the contract.	Moderately uncertain contract labor or material requirements.	Risk that the user will not be fully satisfied because of judgmental acceptance criteria.	Costs of performance after the first year because they cannot be estimated with confidence.	Highly uncertain and speculative labor hours, labor mix, and/or material requirements (and other things) necessary to perform the contract. The Government assumes the risks inherent in the contract -benefiting if the actual cost is lower than the expected cost-losing if the work cannot be completed within the expected cost of performance.				
Use When . . .	The requirement is well-defined. •Contractors are experienced in meeting it. •Market conditions are stable. •Financial risks are otherwise insignificant.	The market prices at risk are severable and significant. The risk stems from industry-wide contingencies beyond the contractor's control. The dollars at risk outweigh the administrative burdens of an FPEPA.	A ceiling price can be established that covers the most probable risks inherent in the nature of the work. The proposed profit sharing formula would motivate the contractor to control costs to and meet other objectives.	Judgmental standards can be fairly applied by the fee determining official. The potential fee is large enough to both: •Provide a meaningful incentive. [1] •Justify related administrative burdens.	The Government needs a firm commitment from the contractor to deliver the supplies or services during subsequent years. The dollars at risk outweigh the administrative burdens of an FPRP.	An objective relationship can be established between the fee and such measures of performance as actual costs, delivery dates, performance benchmarks, and the like.	Objective incentive targets are not feasible for critical aspects of performance. Judgmental standards can be fairly applied. Potential fee would provide a meaningful incentive.	Relating fee to performance (e.g., to actual costs) would be unworkable or of marginal utility.	The contractor expects substantial compensating benefits for absorbing part of the costs and/or foregoing fee or •The vendor is a non-profit entity	No other type of contract is suitable (e.g., because costs are too low to justify an audit of the contractor's indirect expenses).
Elements	A firm-fixed-price for each line item or one or more groupings of line items.	A fixed-price, ceiling on upward adjustment, and a formula for adjusting the price up or down based on: •Established prices. •Actual labor or material costs. •Labor or material indices.	A ceiling price •Target cost •Target profit •Delivery, quality, and/or other performance targets (optional) •Profit sharing formula	A firm fixed-price. •Standards for evaluating performance. •Procedures for calculating a fee based on performance against the standards	Fixed-price for the first period. •Proposed subsequent periods (at least 12 months apart). •Timetable for pricing the next period(s).	Target cost •Performance targets (optional) •A minimum, maximum, and target fee •A formula for adjusting fee based on actual costs and/or performance	Target cost •Standards for evaluating performance •A base and maximum fee •Procedures for adjusting fee, based on performance against the standards	Target cost •Fixed fee	Target cost •If CS, an agreement on the Government's share of the cost. •No fee	A ceiling price •A per-hour labor rate that also covers overhead and profit •Provisions for reimbursing direct material costs
Contractor is Obliged to:	Provide an acceptable deliverable at the time, place and price specified in the contract.	Provide an acceptable deliverable at the time and place specified in the contract at the adjusted price.	Provide an acceptable deliverable at the time and place specified in the contract at or below the ceiling price.	Perform at the time, place, and the price fixed in the contract.	Provide acceptable deliverables at the time and place specified in the contract at the price established for each period.	Make a good faith effort to meet the Government's needs within the estimated cost in the Contract, Part I the Schedule, Section B Supplies or services and prices/costs.				Make a good faith effort to meet the Government's needs within the ceiling price.
Contractor Incentive *(other than maximizing goodwill)* [1]	Generally realizes an additional dollar of profit for every dollar that costs are reduced.	Generally realizes an additional dollar of profit for every dollar that costs are reduced.	Realizes a higher profit by completing the work below the ceiling price and/or by meeting objective performance targets.	Generally realizes an additional dollar of profit for every dollar that costs are reduced; earns an additional fee for satisfying the performance standards.	For the period of performance, realizes an additional dollar of profit for every dollar that costs are reduced.	Realizes a higher fee by completing the work at a lower cost and/or by meeting other objective performance targets.	Realizes a higher fee by meeting judgmental performance standards.	Realizes a higher rate of return (i.e., fee divided by total cost) as total cost decreases.	If CS, shares in the cost of providing a deliverable of mutual benefit	
Typical Application	Commercial supplies and services.	Long-term contracts for commercial supplies during a period of high inflation.	Production of a major system based on a prototype.	Performance-based service contracts.	Long-term production of spare parts for a major system.	Research and development of the prototype for a major system.	Large scale research study.	Research study.	Joint research with educational institutions.	Emergency repairs to heating plants and aircraft engines.
Principal Limitations in FAR/DFARS Parts 16, 32, 35, and 52[2]	Generally NOT appropriate for R&D.	Must be justified.	Must be justified. Must be negotiated. Contractor must have an adequate accounting system. Cost data must support targets.	Must be negotiated.	MUST be negotiated. Contractor must have an adequate accounting system that supports the pricing periods. Prompt redeterminations.	The contractor must have an adequate accounting system. The Government must exercise surveillance during performance to ensure use of efficient methods and cost controls. Must be negotiated. Must be justified. Statutory and regulatory limits on the fees that may be negotiated. Must include the applicable Limitation of Cost clause at FAR 52.232-20 through 23.				Labor rates must be negotiated. MUST be justified. The Government MUST exercise appropriate surveillance to ensure efficient performance.
Variants	Firm-Fixed-Price Level-of-Effort.		Successive Targets (FPIS)		Retroactive Redetermination			Completion or Term.		Labor Hour (LH)

[1] Goodwill is the value of the name, reputation, location, and intangible assets of the firm.

[2] Comply with any USD(AT&L), DPAP or other memoranda that have not been incorporated into the DFARS or DoD Directives or Instructions.

DSMC MAY 2008

Department of Defense Guidance

- Defense Acquisition Guidebook
  - Acquisition Strategy
    - Contract Type
    - Contract Incentives
- Federal Acquisition Regulation and Defense Federal Acquisition Regulation Supplement
  - FAR Part 7 -- Acquisition Planning
  - FAR Part 16 -- Types of Contracts

Acquisition Strategy

DAG 2.3.16.3.6.Contract Type For each major contract, the acquisition strategy identifies the type of contract planned (e.g., firm fixed-price (FFP); fixed-price incentive, firm target; cost plus incentive fee; or cost plus award fee) and the reasons it is suitable, including considerations of risk assessment and reasonable risk-sharing by the Government and the contractor(s). The acquisition strategy should not include cost ceilings that, in essence, convert cost-type research and development contracts into fixed-price contracts or unreasonably cap annual funding increments on research and development contracts. Fixed-price development contracts of $25 million or more or fixed-price-type contracts for lead ships require the prior approval of the USD(AT&L) (DFARS Section 235.006), regardless of a program's Acquisition Category.

Acquisition Strategy

DAG 2.3.16.3.7.Contract Incentives The Acquisition Strategy should explain the planned contract incentive structure, and how it incentivizes the contractor(s) to provide the contracted product or services at or below the established cost objectives. If more than one incentive is planned for a contract, the Acquisition Strategy should explain how the incentives complement each other and do not interfere with one another.

Acquisition Planning

<u>**FAR 7.105 -- Contents of Written Acquisition Plans.**</u>

(b) *Plan of action* –

(4) *Acquisition considerations.*

(i) For each contract contemplated, discuss contract type selection (see Part 16); use of multiyear contracting, options, or other special contracting methods (see Part 17); . . . . Provide rationale if a performance-based contract will not be used or if a performance-based contract for services is contemplated on other than a firm-fixed-price basis (see 37.102(a) and16.505(a)(3)).

Policies

FAR 16.102

- Sealed bid contracts shall be firm-fixed-price contracts or fixed-price contracts with economic price adjustment.
- Contracts negotiated under Part 15 may be of any type or combination of types.
- Contract types not described in the FAR shall not be used, except as a deviation under Subpart 1.4.
- The cost-plus-a-percentage-of-cost system of contracting shall not be used.
- No contract may be awarded before the execution of any determination and findings (D&F's) required by FAR Part 16.

Factors in Selecting Contract Types

FAR 16.104

- Price competition.
- Price analysis.
- Cost analysis.
- Type and complexity of the requirement.
- Urgency of the requirement.
- Period of performance or length of production run.
- Contractor's technical capability and financial responsibility.
- Adequacy of the contractor's accounting system.
- Concurrent contracts.
- Extent and nature of proposed subcontracting.
- Acquisition history.

Negotiating Contract Type

FAR 16.103(a)

- Selecting the contract type is generally a matter for negotiation.
  - Requires the exercise of sound judgment.
- Negotiating contract type and prices are closely related and should be considered together.
- The objective is to negotiate a contract type and price (or estimated cost and fee)
  - That will result in reasonable contractor risk.
  - Provide the contractor with the greatest incentive for efficient and economical performance.

Contract Type Spectra

FFP	FP/EPA	FPAF	FPIF/FPIS	CPIF	CPAF	CPFF

HIGH RELIABILITY OF COST ESTIMATE	LOW RELIABILITY OF COST ESTIMATE
HIGH CONFIDENCE OF OUTCOME	LOW CONFIDENCE OF OUTCOME
PRICE ANALYSIS	COST ANALYSIS
RISK TO CONTRACTOR	RISK TO GOVERNMENT

Micro Purchase	Simplified Acquisition	Commercial Acquisition	Systems Development

Contract Category Characteristics

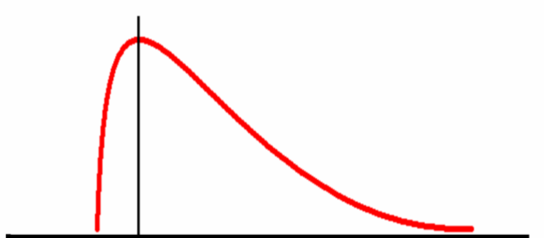
	COST-REIMBURSEMENT	FIXED-PRICE
PROMISE	Best Effort	Shall Deliver
RISK TO CONTRACTORS	Low	High
RISK TO GOVERNMENT	High	Low
CASH FLOW	As Incurred	On Delivery
PROGRESS PAYMENTS	None	% of Actual
ADMINISTRATION	Max Government	Min Government
FEE/PROFIT	Max: 6/10/15 % CPFF Contracts	NO Limit

Budget Implications

(Budget to Most Likely Price)

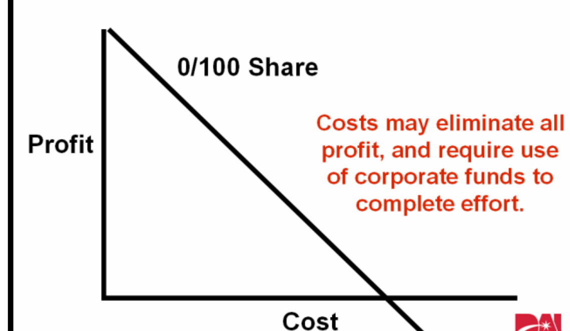
Contract Type	Budget To
FFP	Negotiated Price
FP-EPA	Negotiated Price (do not budget for EPA)
FPIF	Target Cost + Target Profit
CPFF	Estimated Cost + Fixed Fee
CPAF	Estimated Cost + Base Fee + Maximum Award Fee
CPIF	Target Cost + Target Fee

Distribution of Cost Outcomes Does Not Follow a Bell Shaped Curve



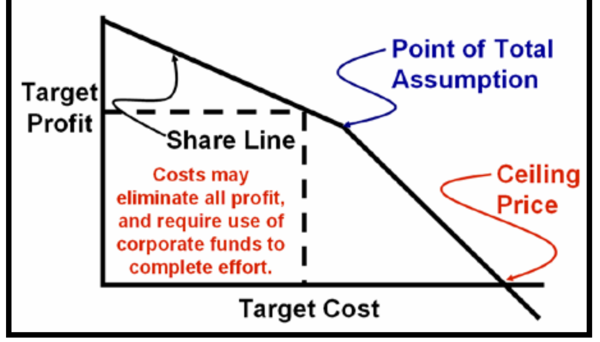
There is limited potential for underrun, but infinite potential for overrun.

Firm-Fixed-Price Contracts

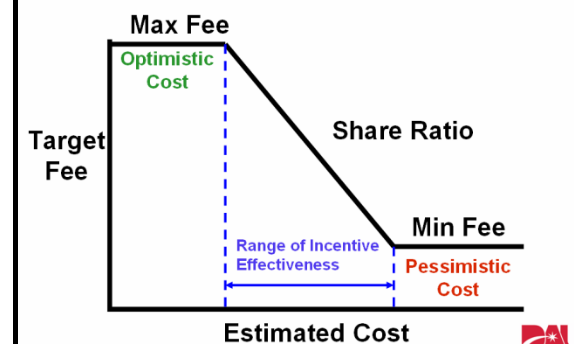


Fixed-Price-Incentive Contracts

Firm and Successive Targets



Cost-Plus-Incentive-Fee Contracts



Range of Incentive Effectiveness

- The range of incentive effectiveness (RIE) is the range over which CPIF incentives can be expected to motivate contractor performance.
- The RIE should drive the incentive structure, not result from it.
- The RIE for cost should not exceed cost estimate reliability and confidence of outcome.
- Cost share ratios may vary under and over target cost.

Guidance on Contract Types and Incentives

Contract Pricing Reference Guides
http://www.acq.osd.mil/dpap/contractpricing/index.htm

Award and Incentive Fee Contracts CoP
https://acc.dau.mil/CommunityBrowser.aspx?id=105550&lang=en-US

Incentive Strategies for Defense Acquisitions
http://www.dau.mil/pubs/misc/INCENTIVE.pdf

Constructing Successful Business Relationships: Innovation in Contractual Incentives
http://www.acquisition.gov/comp/seven_steps/library/DOAconstructing.pdf

DOD and NASA Guide: Incentive Training Guide, 1969
https://acc.dau.mil/CommunityBrowser.aspx?id=189615&lang=en-US