Types of Government Contracts

A primer on four common types found in RFPs

There are several types of government contracts, and the differences between them are not trivial. Each requires a unique approach to bidding, and a unique approach to performing the work. Understanding the distinct challenges and opportunities of each contract is vital if your business is to succeed as a government contractor.

After a government agency determines a need, it conducts program management activities and develops an acquisition strategy. Part of this strategy involves determining which contract type will best serve the government's needs.

Most government contracts over $150,000 are sent through a competitive bidding process overseen by a contracting officer. This process can be conducted through sealed bidding or negotiated procurement.

Government contracts belong to two general categories: fixed-price and cost-reimbursement. The contract type defines the expectations, obligations, incentives and rewards for both the government and the contractor during an acquisition. The contract type also dictates:

- The degree and timing of the responsibility assumed by the contractor for the costs of performance
- The amount and nature of the profit incentive offered to the contractor for achieving or exceeding specified standards or goals

Understanding the numerous sub-types within these categories is a dizzying prospect for any proposal team. In this paper, we provide a primer on many of the types you will run into.

**Fixed-Price Contracts**

Fixed-price contracts are used by all federal agencies and generally provide a firm price. An adjustable price level may sometimes be used for a ceiling price, a target price (including target cost), or both. Unless otherwise specified in the contract, the ceiling price or target price is subject to adjustment only through contract clauses providing for equitable adjustment, or other revision of the contract price under stated circumstances. The contracting officer uses firm-fixed-price or fixed-price with economic price adjustment contracts when acquiring commercial items.

Under a fixed-price contract, the contractor agrees to deliver the product or service required at a price not in excess of the agreed-to maximum. Fixed-price contracts should be used when the contract risk is relatively low, or defined within acceptable limits, and the contractor and the government can reasonably agree on a maximum price. An example of a low-risk contract would be one for follow-on production. Examples of higher-risk contracts, in which fixed-price would
likely not be used, are concept studies or basic research. Contracts resulting from sealed bidding are firm-fixed-price (FFP) contracts, or fixed-price contracts with economic price adjustment.

**Contracting Using Fixed-Price Contracts**

All federal agencies use fixed-price contracts, so the opportunities for contractors are numerous and widespread. Fixed-price contracts are also the most common type we see in state and local procurements.

President Obama officially endorsed a preference for fixed-price contracts in a March 2009 memo to heads of executive departments and agencies. He wrote, “There shall be a preference for fixed-price type contracts. Cost-reimbursement contracts shall be used only when circumstances do not allow the agency to define its requirements sufficiently to allow for a fixed-price type contract.”

**Types of Fixed-Price Contracts**

**Firm-Fixed-Price (FFP) Contract**

A firm-fixed-price (FFP) contract 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 maximum risk and full responsibility for all costs and resulting profits or loss on the contractor. It provides maximum incentive for the contractor to control costs and perform effectively, and imposes a minimum administrative burden upon the contracting parties. The contracting officer may use an FFP in conjunction with an award-fee incentive when the award fee or incentive is based solely on factors other than cost. The contract type remains FFP when used with these incentives.

The contract price is the price bid, with no incentives or fees added. Cost responsibility is placed wholly on the contractor. FFP is the preferred type when cost risk is minimal, or can be predicted with an acceptable degree of certainty.

Government contracting officers are required to use firm-fixed-price or fixed-price with economic price adjustment contracts when acquiring commercial items or when awarding contracts resulting from sealed bidding procedures.

**Firm-Fixed-Price (FFP) Level-Of-Effort Term Contract**

Under this type of contract, the contractor is required to devote a specified level of effort over a stated period of time for a fixed dollar amount. This contract type is usually used for investigation or study in a specific research and development area. The FFP level-of-effort term contract has strict limitations. The contract generally is used for studying a specific research and development area with a report as the final product. It specifies the contract performance in general terms, and obligates the contractor to devote a specified level of effort over a stated period of time for a fixed price. The price is based on effort expended, not results achieved.

This contract type may be used only when the following conditions are met:

- The work to be performed cannot be clearly defined
- The desired level of effort can be agreed upon in advance of performance
- It is reasonably probable that the goal cannot be achieved with an expenditure of less than the stipulated effort
- The contract price does not exceed $100,000, except with approval of the chief of the contracting office

**Firm-Fixed-Price (FFP) Materials Reimbursement Type Contract**

This contract type is used in the purchase of repair and overhaul services to provide a fixed price for services with reimbursement for cost of materials used.
### Fixed-Price Contract with Award Fees

Objective criteria are used whenever possible to measure contract performance. However, there may be other situations in which the government wishes to motivate a contractor and other incentives cannot be used because contractor performance cannot be measured objectively due to subjective criteria (e.g., quality/appearance, adhering to schedule/handling delays, technical ingenuity).

In those cases, award fee provisions may be used in fixed-price and cost-reimbursement contracts. It is important that award fees be tied to identifiable interim outcomes, discrete events or milestones, as much as possible. They must be structured in ways that will focus the government’s and contractor’s efforts on meeting or exceeding cost, schedule, and performance requirements.

Fixed-priced award fee contracts establish a fixed price, which includes normal profit, to be paid for satisfactory contract performance. An award fee earned will be paid in addition to the fixed price. The contract will provide for periodic evaluation of the contractor’s performance against an award-fee plan. Contracting officers may use award fees when they want to motivate a contractor, since other incentives cannot be used when contractor performance cannot be objectively measured.

The amount of the award fee that is actually paid is determined by the government’s evaluation of the contractor’s performance based on criteria established in the contract. This determination is made unilaterally by the government and is not subject to the disputes clause. It is usually paid in increments of three, four, or six months based on the contractor’s performance during that period. The ability to earn award fees is directly linked to achieving desired program outcomes.

### Fixed-Price Contract with Economic Price Adjustment

This type of contract provides for upward and downward revision of the stated contract price upon the occurrence of specified contingencies. Economic price adjustments are of three general types:

- **Adjustments based on established prices**: These price adjustments are based on increases or decreases from an agreed-upon level in published or otherwise established prices of specific items or the contract end items.
- **Adjustments based on actual costs of labor or material**: These price adjustments are based on increases or decreases in specified costs of labor or material that the contractor actually experiences during contract performance.
- **Adjustments based on cost indexes of labor or material**: These price adjustments are based on increases or decreases in labor or material cost standards or indexes that are specifically identified in the contract.

The contracting officer may use a fixed-price contract with economic price adjustment in conjunction with award-fee performance or delivery incentives when the award fee or incentive is based solely on factors other than cost. The contract type remains fixed-price with economic price adjustment when used with these incentives. Government contracting officers are also required to use firm-fixed-price or fixed-price with economic price adjustment contracts when acquiring commercial items or when awarding contracts resulting from sealed bidding procedures.

A fixed-price contract with economic price adjustment may be used when:

- There is serious doubt concerning the stability of market or labor conditions that will exist during an extended period of contract performance, and
- Contingencies that would otherwise be included in the contract price can be identified and covered separately in the contract.
Price adjustments based on established prices should normally be restricted to industry-wide contingencies. Price adjustments based on labor and material costs should be limited to contingencies beyond the contractor’s control.

**Fixed-Price Incentive (FPI) Contracts**

A fixed-price incentive (FPI) contract is a fixed-price type contract with provisions for adjustment of profit. FPI contracts provide for adjusting profit and establishing the final contract price by a formula based on the relationship of final negotiated total cost to total target cost. The final contract price is based on a comparison between the final negotiated total costs and the total target costs. The final price is subject to a price ceiling, negotiated at the outset. This contract is appropriate when all of the following conditions are met:

- An FFP contract is not suitable.
- The nature of the procurement is such that the contractor’s assumption of a degree of cost responsibility will provide a positive profit incentive for effective cost control and performance.
- If the contract includes performance and/or delivery incentives, the requirements provide a reasonable opportunity for the incentives to have a meaningful impact on how the contractor manages the work.

There are three forms of FPI contracts: firm target, successive target, and fixed-price award fee (FPAF). The FPI firm target contract is used most frequently.

**FPI Firm Target Contract**: A fixed-price incentive firm target contract consists of the following basic elements:

- Target cost
- Target profit
- Price ceiling (but not a profit ceiling or floor)
- Profit Adjustment Formula (PAF)

These elements are all negotiated at the outset.

The use of this contract is appropriate when the contractor and government can negotiate at the outset a firm:

- Target cost
- Target profit
- Profit adjustment formula that provides a fair and reasonable incentive
- A ceiling price that provides for the contractor to assume an appropriate share of the risk

When the contractor assumes a significant share of the cost responsibility under the profit adjustment formula, the target profit should be reflective of that risk. After performance of the contract, final costs are negotiated and the contract price is established by using the PAF. If the final costs are less than the target costs, then the application of the percentage sharing formula will yield a final profit greater than the target profit. Conversely, when final cost is more than the target cost, application of the formula results in a final profit less than the target profit, or even a net loss. If the final negotiated cost exceeds the price ceiling, the contractor absorbs the difference as a loss. This contract type is applicable when FFP contracts are inappropriate and it is desirable for the contractor to assume some cost responsibility, and when a firm target cost, target profit, and a formula can be negotiated at the outset.

**FPI Successive Target Contract**: An FPI successive target contract is an incentive contract that operates in the same way as an FPI firm target contract, except that one or more revisions in the target cost and target profit may be made during performance. This contract is applicable under the same circumstances as the FPI firm target contract except that a realistic firm target cost and target profit cannot be negotiated at the outset.
Fixed-Price with Prospective Price Redetermination

A fixed-price contract with prospective price redetermination provides for a firm fixed price for an initial period of contract deliveries or performance and prospective redetermination, at a stated time or times during performance, of the price for subsequent periods of performance. This type may be used in acquisitions of quantity production or services for which it is possible to negotiate a fair and reasonable firm fixed price for an initial period, but not for subsequent periods of contract performance. The initial period should be the longest period for which it is possible to negotiate a fair and reasonable firm fixed price. Each subsequent pricing period should be at least 12 months.

The contract may provide for a ceiling price based on evaluation of the uncertainties involved in performance and their possible cost impact. This ceiling price should provide for assumption of a reasonable proportion of the risk by the contractor and, once established, may be adjusted only when using contract clauses providing for equitable adjustment or other revision of the contract price under stated circumstances.

Fixed-Ceiling-Price with Retroactive Price Redetermination Contracts

A fixed-ceiling-price with retroactive price redetermination contract provides for a ceiling price and retroactive price redetermination within the ceiling after completion of the contract. The redetermined price takes into consideration management effectiveness and ingenuity. This contract type is appropriate for research and development contracts estimated at $100,000 or less, when a fair firm fixed price cannot be established and the amount involved and short performance period make the use of any other fixed-price contract type impracticable.

Cost-Reimbursement and Cost-Plus Contracts

Cost-reimbursement, or cost-plus, is a type of contract where a contractor is paid for all of its allowed expenses up to a set limit, plus additional payment to allow the company to make a profit.

Cost-reimbursement contracts contrast with fixed-price contracts, in which the contractor is paid a negotiated amount regardless of incurred expenses.

Under a cost-reimbursement contract, the contractor agrees to provide its best effort to complete the required contract. These contracts provide for payment of allowable incurred costs, to the extent prescribed in the contract. They include an estimate of total cost to obligate funds and establish a ceiling that the contractor cannot exceed (except at its own risk) without the approval of the contracting officer.

Cost-reimbursement contracts may be used only when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy.


Agencies that use this contract type include these, among others:
- Federal Transit Administration
- National Weather Service
- U.S. Department of Defense
**Pros and Cons of Using Cost-Reimbursement Contracts**

A cost-plus contract is often used when long-term quality is a much higher concern than cost, such as in the United States space program. In contrast to a fixed-price contract, a cost-plus contractor has little incentive to cut corners. The final cost may also be less than a fixed-price contract because contractors do not have to inflate the price to cover risk.

However, this contract type does have some disadvantages. There is limited certainty as to what the final cost will be, and there is less incentive to be efficient compared to a fixed-price contract. It requires additional oversight and administration to ensure that only permissible costs are paid and that the contractor is exercising adequate overall cost controls. Properly designing award or incentive fees also requires additional oversight and administration.

**Types of Cost-Reimbursement Contracts**

**Cost Contracts**

Cost contracts are cost-reimbursement contracts under which the contractor receives no fee. Only costs incurred in the performance of the contract are paid. This contract type is often used in research and development, particularly with nonprofit organizations and facilities contracts.

**Cost-Plus-Fixed-Fee (CPFF) Contracts**

The cost-plus-fixed-fee (CPFF) contract is a cost-reimbursement contract that provides a payment of allowable costs plus a fixed fee. A CPFF may take one of two basic forms: completion or term.

*CPFF Completion Contract.* The completion form describes the scope of work by stating a definite goal or target and specifying an end product. This form of contract normally requires the contractor to complete and deliver the specified end product (e.g., a final report of research accomplishing the goal or target) within the estimated cost, if possible, as a condition for payment of the entire fixed fee. However, if the work cannot be completed within the estimated cost, the government may require more effort without a fee increase, provided the government increases the estimated amount to cover the increase in estimated cost.

*CPFF Term Contract.* The term form describes the scope of work in general terms and obligates the contractor to devote a specified level of effort for a stated time period. The term-type contract is generally used for research and development procurements of such complexity that the cost of performance cannot be reasonably estimated.

Under the term form, if the performance is considered satisfactory by the government, the fixed fee is payable at the expiration of the agreed-upon period upon contractor certification that the level of effort specified in the contract has been expended in performing the contract work. Renewal for further periods of performance is a new acquisition that involves new cost and fee arrangements.

**Cost-Plus-Incentive Contracts**

There are two types of cost-plus-incentive contracts: cost-plus-incentive-fee and cost-plus-award-fee.

*Cost-Plus-Incentive-Fee (CPIF).* The CPIF contract is a cost-reimbursement contract that provides a fee that is adjusted by formula according to the relationship of total allowable costs to target costs. This contract type is appropriate when a cost-reimbursement contract is permissible and a target cost and a fee adjustment formula likely to motivate effective contract performance can be negotiated.

A target cost, target fee, minimum and maximum fee, and fee adjustment formula are negotiated at the outset. The fee is adjusted after
contract performance, using the formula and the maximum and minimum fee limitations.

Cost-Plus-Award-Fee (CPAF). When the government wants to motivate a contractor, award fee provisions may be used. Contracting officers attempt to link award fees to identifiable interim outcomes, discrete events or milestones, and to structure them to focus the contractor on meeting or exceeding cost, schedule and performance requirements.

Cost-Sharing Contracts
The cost-sharing contract is a cost-reimbursement contract in which the contractor is reimbursed only for an agreed portion of its allowable costs and receives no fee. This contract type is frequently used for research and development contracts with private companies that stand to benefit in other ways from the project.

Of course, not all contracts fall neatly into the bucket of fixed-price or cost-reimbursement. Some contract types are a hybrid or can be either fixed-price or cost-reimbursement, depending on the situation.

Time-and-Materials Contracts
A time-and-materials (T&M) contract can seem like the Holy Grail to contractors. The government, after all, avoids them whenever possible because they shift risk from the contractor to the contracting agency.

There are good reasons, however, for contractors to approach them cautiously. T&M contracts are a hybrid of fixed-price and cost-reimbursement contracts. This type of contract is a good example of the way contractors and the government do not always have the same interests: T&M contracts present the highest risk to the government and lowest risk to the contractor, and thus are the least desirable contract type for the government. In fact, the federal government may even be phasing out these contracts.

**How Time-and-Materials Contracts Work**
Time-and-Materials (T&M) contracts allow government purchasing officials to buy supplies or services on the basis of:

- Direct labor hours at specified fixed hourly rates that include wages, overhead, profit and general and administrative expenses
- Actual material costs

A T&M contract may be used only when it’s not possible to accurately estimate the extent or duration of the work, or to anticipate costs with any reasonable degree of confidence.

Government agencies that use this contract type include the:

- Federal Transit Administration (FTA)
- Department of Defense (DOD)
- Defense Information Systems Agency (DISA)

Since DISA began using time-and-materials contracts in 1991, the agency has awarded 18 contracts with T&M provisions for an estimated total value of $1.18 billion, approximately 45 percent of the estimated value of all DISA contract awards.

**Time-and-Materials Contract Variations: Labor Hour Contracts**
The labor hour contract is a type of T&M contract that excludes materials supplied by the contractor.

**How Agencies Use Time-and-Materials Contracts**
Time-and-material (T&M) and labor hour contracts may only be used if the contracting officer determines that no other contract type is suitable, and the contract includes a ceiling price that the contractor can only exceed at its own risk.

A contracting officer can’t use a T&M contract simply by determining that the service is offered...
commercially on a T&M basis and is being offered at a fair and reasonable price; a person must prove that the service can’t suitably be acquired any other way.

For example, to acquire a commercial item, the contracting officer must affirm that the item can’t be bought using a firm-fixed-price contract, or a fixed-price contract with an economic price adjustment.

Federal Acquisition Regulation (FAR) 16.601(c) states that the contracting officer can demonstrate the need for a T&M contract by establishing that it’s not possible, at the time of contract award, to accurately estimate the extent or duration of the work, or to reasonably anticipate costs.

Since T&M contracts carry a great deal of risk for the government, federal rules encourage agencies to use other types of contracts. Reliance on more favored contract types ensures the contractor bears the risk as often as possible. When using T&Ms, the government must also perform surveillance of contractor performance.

**Time-and-Materials Contracts and Competition**

Time-and-material (T&M) and labor hour contracts must be awarded competitively, using contract award procedures such as competitive proposals, multiple-award schedules, set-asides and sealed bids.

**Contracting Using Time-and-Materials Contracts**

Contractors using time-and-material (T&M) contracts should ensure that:

- The contract does not contain firm deliverables
- Staff members do not make verbal or written commitments to firm deliverables

**Award-Fee Contracts**

Award fee provisions are one solution to motivate contractors. They can be used with both fixed-price and cost-reimbursement contracts. Award fees must be tied to identifiable interim outcomes, discrete events or milestones as often as possible. They must also be structured in ways that focus the government’s and contractor’s efforts on meeting or exceeding cost, schedule and performance requirements.

The fee has two parts: a fixed portion, and an amount to be awarded for excellence in specific contract areas such as quality, timeliness, ingenuity and cost effectiveness. The amount that is actually paid is determined by the government’s evaluation of the contractor’s performance based on the criteria established in the contract. This determination is made unilaterally by the government and is not subject to the disputes clause. It is usually paid in increments of three, four or six months based on the contractor’s performance during that period. The ability to earn award fees is directly linked to achieving desired program outcomes.

**Award-Fee Use in Government Contracting**

Cost-plus-award-fee (CPAF) contracts are one of the most frequently used incentive contracts in the DOD and other agencies. CPAF contracts contain attributes that often result in better communication than other types of contracts between the government and the contractor, and greater contractor motivation to achieve exceptional contract performance. These attributes are normally associated with the process of monitoring and evaluating contractor performance.

The combination of contractor motivation and evaluation flexibility can prove advantageous in situations that call for a cost-reimbursement-type contract. It can also encourage more effective communication between the parties, and foster a kind of management discipline that is often difficult to sustain in other environments. For this reason, the award fee approach is as much a management tool as an incentive contract type.
White Paper

Types of Government Contracts

Indefinite Delivery/Indefinite Quantity Contracts

One of the most prevalent contract types being used by the federal government is the indefinite delivery/indefinite quantity (IDIQ) contract. These contracts can be used on both a fixed-price and cost-reimbursement basis.

When the federal government decides to buy a product or service, it doesn’t always know how many widgets, or hours of an expert’s time, it will need. Most types of contracts the government uses require it to list exact quantities, so it occasionally needs the flexibility of an IDIQ contract.

IDIQs are often multiple-award contracts, and have become quite popular in recent years. Using an IDIQ allows the government to select several possible vendors for a an agency to rely on, then ask that small group of vendors to bid against one another to complete each separate task; giving the government a competitive price for each task without initiating a new contract competition and all that it would demand of contracting officers. For industry, however, this can make winning a position on an IDIQ contract essential. It is just so easy for an agency to purchase through its IDIQs that it may rarely purchase outside of them.

An IDIQ contract provides for an indefinite quantity of a product or service, with stated limits, during a fixed period. This type of contract requires the government to order (and the contractor to furnish) at least a stated minimum quantity of supplies or services. The contracting officer decides a reasonable maximum quantity for the total contract.

How Agencies Use IDIQs

The government uses an IDIQ contract when it can’t predetermine, above a specified minimum, the precise quantities of supplies or services it will require during the contract period. IDIQ contracts are most often used for service contracts and architect-engineering services. Contracts are usually awarded for both base and option years, and are exempt from bid protests.

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IDIQs are often multiple-award contracts, and have become quite popular in recent years.

The government places delivery orders (for supplies) or task orders (for services) against a basic contract for individual requirements. Minimum and maximum quantity limits are specified in the basic contract as either a number of units (for supplies) or as dollar values (for services).

For agencies, an IDIQ contract also allows a certain amount of contract process streamlining: Negotiations can be made only with the selected company, and such contracts are exempt from protest.

Types of IDIQ Contracts

IDIQ contracts can take the form of agency-specific contracts or multi-agency contracts under the government-wide acquisition contracts (GWAC) system.

Task-Order Contract (TOC) and Job-Order Contract (JOC) IDIQs

Both the TOC and JOC contract types are limited by the Federal Acquisition Regulation (FAR), which requires:

- A defined period for performance of the contract, including option years
- A total minimum and maximum of products or services
- A state of the required work
- Ordering procedures
- Minimum and maximum order limitations (optional)

Advisory and Assistance (A&A) Services

This category includes services to support or improve:

- Organizational policy development
- Management and administration
- Program and/or project management
- Administration and research and development activities.

A&A services fall under TOC contracts and are limited by the FAR.
Contracting with IDIQs

There are a few aspects of IDIQs of which contractors should be aware. The agency that makes the award is required to fund the minimum quantity order under the contract at the time of award, but this timing can vary. Contractors should specifically know:

- An agency does not commit to buy all its needs from the winning contractor, but only an identified minimum quantity of goods or services.
- Agency solicitation documents do not always clearly identify which type of indefinite-quantity contract the agency is soliciting.

IDIQ Protests. Public Law 110-181, § 843 grants the U.S. Government Accountability Office (GAO) exclusive jurisdiction for a period of three years over protests against task or delivery order awards valued at more than $10 million.

In 2008, L-3 Communications won reliance damages, but failed to recover lost profits, employee severance and relocation costs in an IDIQ protest against the U.S. Air Force.

IDIQs for Construction. In 2009, the Court of Federal Claims ruled that since the use of IDIQ contracts for construction by the U.S. Army Corps of Engineers was not specifically prohibited in the procurement of construction by the FAR, it was therefore permitted. The Court of Appeals agreed with the lower court and decided that The Corps, like other federal procurement entities, has broad discretion to determine what particular method of procurement will be in the best interests of the United States in a particular situation.
Understanding Government Types
GovWin Consulting offers custom, actionable analysis targeted to each company’s unique needs. Companies ranging from small businesses to Fortune 500 corporations can benefit from services such as indepth analysis on complex datasets and custom, proprietary and highly actionable insights and strategies that save time, cut costs and enable you to win more government business.

Deltek’s Washington Management Group is the leading consulting firm in the nation on GSA Schedule and/or VA Schedule contracts, WMG’s experts can assist a company through all phases of a schedule contract.

Deltek has recently unveiled its GovWin IQ Task Order Awards Database, which offers extensive tools to manage IDIQ and other multiple-award contracts, including the GSA Schedules. Vice President for Federal Information Solutions, Kevin Plexico, stated that “with the new release of Deltek’s GovWin IQ Task Order Awards database, companies will get analysis of spending on these contracts as well as an unprecedented level of detail on the specific projects that are being awarded. This is critical information for a company to make intelligent decisions when prioritizing how to deploy their limited business development resources.”

For new government contractors, 101-level articles on contract types and other areas of procurement are available in the GovWin knowledge library. For more marketing-type 101-level information, check out the bimonthly GovWin business development webinar series. The webinars are an educational series where you can spend 30 minutes with a government contracting business development expert and get your questions answered. Each expert will spend roughly 10 minutes on a sales strategy or business development tactic, then spend the remaining 20 minutes answering any and all of your business development questions. Archived webinars can be found http://bit.ly/bdarchive.