



Federal Acquisition Institute

# Knowledge Nugget: Contract Types Transcript

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[Knowledge Nuggets: Contract Types]

Choosing the right contract type is a critical part of acquisition planning, and the Federal Acquisition Regulation—or FAR—provides a wide variety of contract types that are available for Contracting Officers to use.

FAR part 16 describes the different contract types that may be used in acquisitions.

Contract types can generally be classified into three categories: fixed-price contracts, cost-reimbursement contracts, and time-and-materials and labor-hour contracts. Selecting the appropriate contract type is very important, as it is a driver of risk, incentives, and obligations for both the Government and the contractor.

Under a fixed-price contract, the Government assumes the least amount of risk, and under a cost-reimbursement contract, the Government assumes the greatest amount of risk. Time-and-materials contracts and labor-hour contracts fall somewhere in the middle of the spectrum.

Let's learn a little more about the three general categories of contract types. First we'll talk about fixed-priced contracts.

[Subpart 16.2, Fixed-Price Contracts]

Fixed-price contracts pay the contractor a fixed amount, which is agreed upon at contract award. This contract type places maximum risk and responsibility for performance on the contractor.

[Firm-fixed-price contracts (FAR 16.202)]

In firm-fixed-price contracts, which are the most common type of fixed-price contracts, the contractor is paid a fixed amount for supplies or services when there are reasonably definite functional or detailed specifications, and the Contracting Officer can establish a fair and reasonable price at the time of contract award.

For example, if the contract provides for a payment of \$450,000 upon delivery of 5,000 widgets, and the cost of each individual widget rises during the contract performance, the contractor will still be paid only \$450,000 for all of the widgets. Firm-fixed-price contracts provide the maximum incentive for the contractor to control costs and perform effectively, and impose minimal administrative burden on the contracting parties.

[Professional woman balances “risk” and “administrative burden” in her hands evenly. A “firm-fixed-price contract” is beside her.]

When circumstances prevent the agency from adequately defining requirements necessary to allow for a fixed-price contract, and when there is uncertainty regarding contract performance, then it might be appropriate for a Contracting Officer to consider a cost-reimbursement type contract.

[Subpart 16.3, Cost-Reimbursement Contracts]

Cost-reimbursement contracts provide for payment of allowable incurred costs, to the extent prescribed in the contract. The most common type of cost-reimbursement contract is cost-plus-fixed-fee, or CPFF, which also pays the contractor a fixed-fee as profit.

[Professional woman balances “cost” and “risk” in her hands. “Resources,” “delays,” and “expectations” fall on the “risk” side, causing the “risk” side to lower and the “cost” side to raise, until she eventually loses balance and drops both “cost” and “risk,” which pile on the floor at her feet. A “cost-reimbursement contract” is beside her.]

Cost-reimbursement contracts are the most risky for an agency due to potential cost escalation, and because the agency pays the majority of all costs associated with the contract regardless of whether or not the contract is completed.

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 the approval of the Contracting Officer.

Before using a cost-reimbursement contract, consider the conditions listed in FAR 16.301-2 and -3.

[Application, FAR 16.301-2]

[Limitations, FAR 16.301-3]

It is important to note that the FAR prohibits the use of a cost-reimbursement contract when acquiring commercial items.

[Subpart 16.6, Time-and-materials & Labor-hour contracts]

In both time-and-materials and labor-hour contracts, the contractor is paid a fixed hourly rate—that includes wages, overhead, general and administrative expenses, and profit—for labor performed under the contract.

Time-and-materials contracts also reimburse the contractor for the allowable actual cost of materials, while labor-hour contracts have no reimbursement for materials. Time-and-materials contracts may only be used when it's 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.

For example, a time-and-materials contract might be used for emergency repair service. The contract will pay for the hours that the workers spent repairing the item and the materials that they used to repair it.

A labor-hour contract is a variation of the time-and-materials contract, differing only in that materials are not supplied by the contractor. For example, if the Government awarded a labor-hour contract for janitorial cleaning services, the contractor would be paid a fixed hourly rate for the actual hours the employees spent cleaning; there would be no reimbursement for cleaning supplies under this type of contract.

So, how do you choose which type of contract is right to use for your acquisition? When selecting and negotiating the appropriate contract type, consider these factors found in FAR 16.104.

[Factors to consider (FAR 16.104):

- Price competition
- Type and complexity of the requirement
- Urgency of the requirement
- Period of performance or length of production run
- Acquisition history
- Combining contract types]

[FAR part 16, Types of Contracts

- Describes each contract type
- Provides guidance on limitations
- Identifies contract clauses]

FAR part 16 describes each contract type, provides guidance on limitations, and supplies contract clauses to use in solicitations. Be sure to consult the FAR for the most recent information on contract types when you are preparing a solicitation.

For more detailed information about the various contract types, please visit [www.acquisition.gov](http://www.acquisition.gov) and search "FAR part 16, Types of Contracts." Or, enroll in the FAC 068 Contract Types course, which can be accessed through [www.FAI.gov](http://www.FAI.gov); then, select FAITAS.

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