

EASTERN MICHIGAN UNIVERSITY

**Research Accounting
Fixed Price Contract
Guidelines**

Purpose

To outline the administrative requirements for formulating, monitoring, and closing-out fixed-price agreements.

Position Statement

The University enters into fixed-price contract to conduct projects related to research, education, or public service mission of the University. The expectation is that fixed-price awards will have expenses that closely match the income received. Charges to fixed price accounts must reflect all actual effort and related costs incurred - without exception. Projects proposed and awarded to be completed under fixed price contracts are subject to the review and approval process outlined in the Division of Academic Affairs Policy on Grants and Contracts.

Definitions

A fixed-price agreement (also known as firm-fixed price, firm-price, or fee-for-service contract) is an agreement where the contractor pays a firm price for the agreed-upon work, regardless of the ultimate cost to complete the project. The level of financial risk for the University is higher than that of a cost reimbursable contract because the University must complete all work, even if there are cost overruns. In addition, the University often does not receive payment until after milestones are met, or deliverables accepted. Therefore either real or perceived problems with performance can prevent or delay payment to the University, even though expenditures have already been incurred. However, the University may also retain any unexpended balances that remain after contracted work is completed. Significant residual balances, however, call into question the integrity of the University's costing practices, or its accounting for costs related to a project and therefore should be mitigated.

Residual funds are defined as an unobligated, unspent balance remaining in a sponsored account at the conclusion of the project. A residual fund occurs when the income or revenue is greater than the expense incurred to complete the project. Residual funds may occur on fixed-price awards for seminars or conferences, certain per-study surveys and other fixed price contracts.

A significant residual fund balance is defined by the University as residual fund balance equal to or greater than 20% of the total contract price.

Federal Acquisition Regulation (FAR) defines it as ““A firm-fixed-price contract provides for a price that is not subject to any adjustment on the basis of the contractor's cost experience in performing the contract. This contract type places upon the contractor maximum risk and full responsibility for all costs and resulting profit or loss, (FAR 16.202-1).”

Characteristics of a Fixed-Price Agreement

Fixed-price agreements will typically have the following characteristics:

- Are similar to purchase orders where a work product is delivered, (i.e., container of chemicals or a computer;)
- Are routine in nature;
- Have a well-defined statement of work;
- Are where the outcome is relatively certain;
- Have a failure rate of next to zero;
- Are where the University bears the risk that a routine project does not come within the “costs” and the University has to cover those costs;
- Normally short-term in nature (< 1 year); and
- Costs are normally known.

Fixed price contracts are best used when the principal investigator has reasonable prior experience with similar projects and can:

- Provide an accurate estimate of cost, and
- Define a tangible deliverable the sponsor is to receive.

Formulating the Fixed-Price Agreement

The Principal Investigator should work through the Office of Research and Development during the planning stages of contract development and negotiation to ensure the accuracy of the contract terms and conditions. Developing Cost Estimates: Given the increased financial risk to the University inherent in fixed-price contracts, and the need to mitigate significant residual balances, developing cost estimates must be done with care. Using costing practices and standards from OMB Circular No. A-21 (codified in 2 CFR 215), even with fixed price contracts, at the proposal stage will assist the University balance the need to limit financial risk and mitigate significant residual balances.

To comply with OMB Circular No. A-21 the University is required to review fixed price contracts that show significant deviation between proposed costs and actual expenditures. If estimates are consistently and significantly higher than actual costs, the University is required to examine cost estimation procedures to address the problem.

Standards provided by OMB Circular No. A-21 used in developing cost estimates are that costs:

- must be necessary and reasonable to carry out the proposed project;
- are only allocated in proportion of benefit received by the project;
- are not prohibited by the sponsor or regulations; and
- are treated consistently across all programs, fiscal years, and direct and indirect costs pools.

Sponsor Approvals of Budget Deviations: While standards for developing cost principles are applied by the University for both fixed-price and cost-reimbursable grants and contracts, budget approval requirements identified in the federal regulations (OMB Circular No. A-110) will not apply to awards for fixed-price contracts. A fixed-price contract by definition is not subject to any adjustment on the basis of the University's actual cost experience (FAR 16.202-1), and therefore, costs incurred are not subject to prior approvals by the Sponsor.

Review and Approval of Sponsored Projects Supported with Fixed Price Contracts: At EMU most fixed price contracts for sponsored programs are for industry-sponsored research and often result from faculty contacts with business and industry. The proposal and award process for fixed-price contracts is still subject to the same internal reviews and approvals required for grant proposals. The Principal Investigator should contact his or her ORD Project Officer during the discussion stage so that this can occur. In addition, the ORD Director is authorized on behalf of the University to approve proposals and negotiate contracts for sponsored activity, whether it is conducted under a grant or a contract. The principal investigator is not authorized to negotiate on behalf of the University.

Appropriate departmental, collegiate, and administrative reviews and approvals for conducting the project, regardless of any tentative understanding between the principal investigator and the sponsor must be obtained. These approvals are documented through the ORD transmittal process. The principal investigator cannot begin any research until these approvals are obtained, and the contract is signed.

The following are vitally important in the formulation of the fixed price agreement and should be considered when preparing the fixed-price agreement.

The cost structure and payment schedule provides for:

- Sufficient funding for the project;
- Careful planning and timing of receipt of funds;
- Use of simple and clear wording in compensation clause; no room for interpretation; and
- Sufficient cash flow to keep the project on track.

The scope of work and schedule of deliverables/outcomes should:

- Not make promises the Principal Investigator can't deliver;
- Refrain from guaranteeing certain results and use language such as "best efforts";
- Avoid ambiguous language – be specific about the outcomes anticipated;
- Not agree to deadlines that the PI or the University Business offices cannot live up to; and
- Avoid agreeing to the submission of financial reports.

Fixed-price agreements

- Do not typically require a submission of an itemized budget to the sponsor, however for internal monitoring an itemized budget is required; and
- Do carry F&A costs consistent with the University's rate policy on F&A cost.

Monitoring the Fixed-Price Agreement

It is the responsibility of the Principal Investigator and Sponsored Research Accounting to properly monitor the timing of tasks, deliverables, and final reporting of results. Most fixed-price agreements include a clause or special terms section regarding the submission and/or acceptance of a final report or product. This is usually tied to the final payment. If the terms are not met as provided by this section, then fixed-price or not, the institution has violated the agreement and total cost reimbursement may not be forthcoming. **If a liability is incurred for late submission or any violation of the contract terms then the Principal Investigator or the department will reimburse the appropriate account for the disallowance.** Therefore, it is vitally important that all parties comply with the conditions set-forth in the fixed-price agreement

Once the University agrees to a fixed price award, it must produce the deliverables within the required time frame regardless of the actual cost of doing so. At project completion, the project account may approximate zero if costs were estimated accurately and the project went as planned, or may be positive if unanticipated efficiencies were realized. Depending on the circumstances and the source of funds, an occasional residual in excess of 20% is usually not a cause for great concern. However, repeated instances of excessive residuals, especially in projects overseen by a particular investigator or within a specific department or unit, are problematic. Patterns of excessive residuals indicate that either some project costs are not being appropriately charged to the project accounts (usually meaning that the university is unintentionally subsidizing the work) or projected costs are not being estimated correctly. Inflated prices can lead to charges of violation of cost and pricing regulations if federal funds are involved. Furthermore, excessive residuals may threaten the non-profit status of the institution and/or subject the institution to unrelated business income tax liability.

Closing Out the Fixed Price Agreement

To close out a fixed-price agreement all project activity must be completed. This includes:

- The completion of all deliverables required under the fixed-price agreement;
- All costs in fulfilling the requirements of the award have been charged to the account;
- The receipt of full payment from the sponsor; and
- The F&A costs have been recovered at the University's **current federally negotiated rate** to the extent funds are available.

After verification that all costs were accurately charged to the fixed price contract and all deliverables were accepted by the sponsor, both residual and deficit balances must be transferred to a non-restricted fund account. In cases where a significant residual balance remains, the PI could be asked to provide an explanation for the deviation from estimated costs.

Residual Balances

Residual balances in the fixed-price funds will be transferred according to Eastern Michigan University's current IDC distribution.

Cost Overdrafts

Departments are responsible for any over-expenditures resulting from inaccurately-costed projects, or expenditures for which the Sponsor does not make payment. Cost overdrafts in the fixed-price fund will be charged as follows;

- 1) Principal Investigator IDC; (if funds available are not sufficient then go to step 2);
- 2) Department IDC (if funds available are not sufficient then go to step 3);
- 3) College IDC (if funds available are not sufficient then go to step 4);
- 4) Provost IDC (if funds available are not sufficient then go to step 5);
- 5) General Fund IDC

Non-Receipt of Sponsor Funds

If the sponsor does not pay in full, the deficit will follow the same procedure as cost overruns.