CUSTOM BUILD

COST-PLUS CONTRACTING

A cost-plus contract, also termed a cost reimbursement contract, is a contract where a contractor is paid for all of its allowed expenses to a set limit plus additional payment to allow for a profit. Cost-reimbursement contracts contrast with fixed-price contract, in which the contractor is paid a negotiated amount regardless of incurred expenses. Cost-plus contracts first came into use in the United States during the World Wars to encourage wartime production by large American companies.

Types of Cost-Plus Contracts

There are four general types of cost-reimbursement contracts, all of which pay every allowable, allocatable, and reasonable cost incurred by the contractor, plus a fee or profit which differs by contract type.

- Cost plus fixed-fee (CPFF) contracts pay a pre-determined fee that was agreed upon at the time of contract formation.
- Cost-plus-incentive fee (CPIF) contracts have a larger fee awarded for contracts which meet or exceed performance targets, including any cost savings.
- Cost-plus-award fee (CPAF) contracts pay a fee based upon the contractor's work performance. In some contracts, the fee is determined subjectively by an awards fee board whereas in others the fee is based upon objective performance metrics. An aircraft development contract, for example, may pay award fees if the contractor achieves certain speed, range, or payload capacity goals.
- Cost plus percentage of cost pay a fee that rises as the contractor's cost rise. Because this contract type provides no incentive for the contractor to control costs it is rarely utilized

Usage of Cost-Plus Contracts

A cost-reimbursement contract is appropriate when it is desirable to shift some risk of successful contract performance from the contractor to the buyer. It is most commonly used when the item purchased cannot be explicitly defined, as in research and development, or in cases where there is not enough data to accurately estimate the final cost.

Pros and cons

Advantages:

- In contrast to a fixed-price contract, a cost-plus contractor has less incentive to control costs.
- 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.
- Final cost may be less than a fixed price contract because contractors do not have to inflate the price to cover their risk.

Disadvantages:

- There is limited certainty as to what the final cost will be.
- 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.
- There is less incentive to be efficient compared to a fixed-price contract