




McCORMICK POLICY AND PROCEDURES MEMORANDUM

Date: November 21, 2007

From: Joseph T. Walsh, Jr., Senior Associate Dean 

Subject: Fixed Price Contracts

cc: McCormick Deans, Directors and Chairs
McCormick Department and Research Center Business Managers

Overview

Most sponsored research contracts that the University receives are the *cost reimbursement* type, in which the University is expected to deliver what it can accomplish given the available funds from the sponsor and period of performance agreed to in the contract. This is the contract type that many sponsors use in funding research at the University, and the contract type under which the University generally prefers to perform work.

However, the government (and for-profit sponsors) sometimes prefer to do business using *fixed-price* type contracts. This type of contract binds the University to providing specific deliverables at a price agreed to *before* the project period of performance. This contract type places most of the risk on the party performing the work (the University), as the costs to provide the deliverables may be greater than anticipated. On the other hand, the costs to provide the deliverables may be less than anticipated, and the residual balance must be handled in a manner consistent with the University's nonprofit mission. Therefore, a fixed-price contract at the University requires particular management at the three stages of its "lifecycle".

Because McCormick has witnessed an increase in the number (and dollar value) of its fixed price contracts over the last few years, the need for a schoolwide policy to govern this particular sponsored research activity has grown.

I. Pricing (pre-award budget management)

Developing a fixed price contract budget is much like developing a budget for sponsored research under other award mechanisms. *All* anticipated line items of direct cost expense (faculty/research staff effort, fringe, equipment, materials/supplies, travel, tuition, etc.) required to provide the sponsor's deliverable(s) should be carefully identified and summed. Per NU effort reporting policies, **PIs are expected to commit some level of effort (>0%)** to research projects, including those under fixed price contracts. The appropriate federal or nonfederal full indirect cost rate should then be applied.

When developing budgets for fixed price contracts, keep in mind that sponsors are often interested in receiving cost figures to support a *very specific* deliverable(s); fixed price contracts are not typically used by sponsors to support relatively open-ended scientific inquiry (*grants* are

typically the award mechanism for this). The specificity of the sponsor's desired deliverable(s) should guide the PI/University's pricing.

Oftentimes only the *total* cost of the project (inclusive of both direct and indirect costs) is communicated, or "quoted" to the sponsor. However, the ultimate integrity of this total cost, or "price", of the University's project work depends upon the integrity of each line item. Careful planning at the pricing stage of a fixed price contract will ensure a sound, reliable quote to the sponsor and result in a more effective and compliant expensing of the account.

Federal regulations such as the Truth In Negotiations Act ("TINA") and the False Claims Act ("FCA") specifically govern the pricing stage of federal contracting. Under TINA, the government can recover for defective pricing resulting when contractors and/or subcontractors do not provide accurate, complete, and current data during contract negotiations. The FCA is more inclusive than TINA, as the FCA governs the entire lifecycle of a federal contract (e.g., cross-charging, improper cost allocation, product substitution, failure to comply with contract specifications). But the FCA protects the government against contractors knowingly submitting defective claims and/or pricing within the contract proposal.

II. Expensing (post-award budget management)

Administering fixed price contracts require the same careful monitoring necessary for effectively managing all sponsored accounts. Effort reports must be appropriately and timely completed to document all personnel time spent on the project. Appropriate project-specific expenses must be charged in a timely fashion, including any faculty salary recovery. Late cost transfers should be minimized. The PI should notify departmental and central administration (OSR and ASRSP) business managers when the deliverable has been successfully provided to the sponsor. At that time spending on the project should cease.

The university's reputation as a research partner, in part, rests on accurate and reasonable budgetary estimates during the proposal stage and the prudent management of expenses during the award execution phase.

III. Closeout (disposition of deficit or surplus)

Preparation for the closeout of a fixed price award should include a full review of project-specific personnel and non-personnel expenses. A review of personnel expenses should include the following information: the effort level and type promised to the sponsor, the project-specific effort certified in ERS and the related salary expenses charged to the award. In general, certified effort should be no less than 75% of the effort level promised to the sponsor in the pricing stage. **Project-specific personnel time certified in ERS must be funded/recovered to the greatest extent possible from the fixed price contract sponsored account.** Other originally-proposed line items should be carefully reviewed by the departmental business manager and the PI, and compared to the actual project expenses, to ensure the integrity of the closeout.

If the principal investigator (PI) underestimates costs on a fixed price contract, the University (in order of PI, department and school) must underwrite the difference with a nonsponsored account. In the cases where *more* faculty effort than estimated/promised must be expended to provide the deliverable(s), cost sharing of this faculty effort may be possible from the McCormick Faculty Salary Account (with the cost sharing formally assigned to the project in ERS), if the fixed price account has been fully expended.

If a balance remains in the account at the end of the performance period, the PI may not have accurately assigned all legitimate charges to the project or overestimated the costs to conduct the research. While the costs of a sponsored project can be difficult to estimate with 100% accuracy, *fixed price contract accounts absorbing few or no costs charged over the course of the performance period suggests unreasonable management of the award, and are an audit risk.*

Policy Statement

Effective immediately, the following policy will be in force to address residual positive balances at the end of performance periods for fixed price contracts:

The PI and associated department business manager should conduct a final effort/accounting reconciliation and review (see page 2 for more information) to ensure that all legitimate costs (including maximum salary recovery against project-certified effort in ERS) have been charged to the contract, and that all pending charges and encumbrances have cleared. (This is normally done in coordination with Accounting Services for Research and Sponsored Programs (ASRSP) during the project close-out process). Please note that at closeout ASRSP will charge the appropriate project-specific indirect cost rate to all fixed price contract residual balances.

When a residual balance of 20% of the original award or less remains (after all of the appropriate direct and indirect costs are applied to the balance), the department may coordinate with ASRSP to transfer the residual to a designated account under the PI's financial management authority for use in the furtherance of the university's research mission.

When a residual balance of greater than 20% of the original award remains (after all of the appropriate direct and indirect costs are applied to the balance), the departmental business manager shall initiate a journal voucher to distribute the direct cost residual balance in equal thirds to PI-, department- and school-managed designated accounts. This handling of the residual balance reinforces the importance of accurate pricing and appropriate expensing on a fixed price contract sponsored account and is consistent with the University's nonprofit mission. This handling of the residual balance also recognizes that departments and schools (along with PIs) are responsible for negative audit results on all sponsored accounts under their management.

Fixed price contract closeout paperwork must be submitted to the office of the Associate Dean for Administration, Finance & Planning for review. Please note that all project effort reports must be complete before McC Dean's Office review. Per NU effort reporting policies, PIs are expected to commit some level of effort (>0%) to research projects, including those under fixed price contracts.

Upon review, if academic year faculty effort was certified on the project in ERS without the corresponding salary expenses having been recovered, the McC Dean's Office will initiate late-cost transfer and effort recertification exception forms to recover the appropriate academic year salary costs, thereby removing this cost-shared effort against the account. (This will be true regardless of the amount of the residual balance.) In this case, the released funds generated by this salary recovery will be wholly recovered by the Dean's Office.

Justifications for significant price overestimations or underestimations may be requested from investigators by the McC Dean's Office when closing out fixed price contract sponsored accounts. Future proposals for investigators' fixed price contract work will be approved partially on the basis of reasonable and successful previous management.