

Millennium Challenge Corporation
Program Procurement Guidance

Guidance on Choice of Contract Types Under MCC Funded Procurements

August 2007



MCC Guidance on the Choice of Contract Types Under MCC Funded Procurements

This paper provides guidance to the MCA Entity¹ on the characteristics and types of contracts that are available for Project implementation under the MCC Program Procurement Guidelines²:

Fixed-Price v. Reimbursable-Cost Contract Types

The MCC Program Procurement Guidelines, which are based on World Bank procurement principles, allow for two primary contract types for the implementation of projects under MCC funded Compacts: fixed-price contracts and reimbursable-cost contracts.³ Generally speaking, the choice of contract type is driven by the nature of the project, how well the project can be defined at the inception of the procurement process, and the capability of the Project Manager to manage the contract. Fixed-price contracts are generally suitable for activities in which the content and the duration of services, or the specifications and conditions for goods and works, are clearly defined. These contracts are usually easy to administer because payments are made against clearly specified outputs or targets. Reimbursable-cost contracts, a broader category of contracts which includes Time-Based contracts, are generally appropriate when it is difficult to determine the scope and the length of services, or the conditions and inputs for works, required under the project. Payments are based on work done at an agreed upon hourly, daily, weekly, or monthly labor rates and reimbursable items using actual expenses. Reimbursable-cost contracts need to be closely monitored and administered by the MCA Entity to ensure that the assignment is progressing satisfactorily, and payments claimed by consultants or contractors are appropriate. They typically require a great deal more oversight during implementation than fixed-price contracts.

There are certain key distinctions to be made in evaluating the usefulness of these two contract types. Under fixed-price contracts, the contractor is required to complete all requirements for the agreed-upon price, and within the timeframe established in the contract, in order to collect payment. While these contracts are subject to changes and modifications that may increase the price of the contract during project implementation, the operating assumption at the inception of the contract is that the product or service will be delivered according to the terms and conditions of the contract. Fixed-price contracts favor the MCA Entity in the contractual relationship because most of the risk involved in completing the requirement is assumed by the contractor.

In reimbursable-cost contracts, however, the MCA Entity assumes more risk within the context of the contractual relationship. These contracts are characterized by a ceiling amount for the required services or works. There is no firm commitment by the contractor to deliver all requirements within the ceiling amount and the specified

¹ The MCA Entity is the entity designated by the government of the country receiving assistance from the Millennium Challenge Account as responsible for the oversight and management of implementation of the Compact on behalf of the government.

² The Millennium Challenge Corporation (“MCC”) provides funding to foreign governments under the authority of Section 605 of the Millennium Challenge Act of 2003 (the “MCA”) (each a “Compact”) or under Section 609(g) of the MCA (each a “609g Grant Agreement”). The MCC Program Procurement Guidelines are set out in supplemental agreements between the MCC and foreign governments and apply to MCC-funded contracts between the MCA Entity and contractors, suppliers and consultants. Contracts entered into directly by MCC are governed by the Federal Acquisition Regulation, not MCC Program Procurement Guidelines.

³ MCC Program Procurement Guidelines Part 1, Section 1.A, Paragraph 2.2; Section 1.B, Subsection IV.

timeframe established in the contract, merely a promise not to exceed the expense limit, often referred to as a total estimated cost, during completion of the required task. There is no firm commitment that the work will be done by the completion date of the project.

Policy Considerations

MCC favors the use of fixed-price contracts over reimbursable-cost contracts for MCC sponsored procurements for a variety of reasons. Given the ambitious nature of MCC funded activities, the tight timeframes during which they must be completed, and the relatively limited contract management expertise of the MCA Entities, fixed-price contracts are more appropriate. This is due to the fact that at the inception of these contracts there is an operating assumption by both parties to the contract that all of the work will be completed for the agreed-upon price and within the specified timeframe. Reimbursable-cost contracts do not offer the same level of assurances, are more difficult to manage, and shift risk to the buyer.⁴

However, the most significant reason for advocating the use of fixed-price contracts over reimbursable-cost contracts has to do with the audit provisions associated with each type of contract. Fixed-price contracts do not require audits during contract performance because there is a fixed price for work required, and there is therefore no need to monitor the individual costs associated with completing the work. Reimbursable-cost contracts, however, have a ceiling price and no assumption or guarantee that the work will be completed within the ceiling price. As noted above, these contracts involve significant oversight during performance, including audit of the costs incurred. There is a requirement to audit overheads charged by the contractor during performance and a requirement to abide by MCC Cost Principles.⁵ Contract award may be conditioned on a successful pre-contract award audit to determine if the contractor is eligible to receive the award. The eligibility determination would require the contractor to have a financial management system in place capable of tracking specified costs during contract performance. While the audit provisions are not onerous requirements for U.S. firms that have significant contract experience under the Federal Acquisition Regulation (FAR), small, international or inexperienced U.S. firms who wish to participate in MCC funded procurements are likely to find them onerous, which would undermine MCC's efforts to achieve the broadest possible international participation in MCA procurements. Audit of reimbursable-cost contracts awarded by the MCA Entity is a USAID Inspector General (IG) mandate that is not subject to negotiation.

It is important to note that fixed-price contracts may take various forms and all forms of this type of contract should be explored for activity implementation. The forms of fixed-price contracts include lump-sum, unit-price and percentage-fee contracts. Lump-sum and unit-price contracts may be appropriate for activities related to goods, works, consultant and non-consultant services.

⁴ A Cost Plus contract is one form of Reimbursable Cost pricing.

⁵ See <http://www.mcc.gov/countrytools/compact/mcc-2007-cost-principles.pdf>

MCC does not prohibit the use of reimbursable-cost contracts for MCC sponsored procurements. However, for the reasons stated above, it is strongly recommended that MCA Entities consider very carefully the audit, contract management, risk and other implications for using this type of contract before making a decision in its favor.