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A Note Concerning Fixed Fee Contracts and Residual Funds¹

Whenever the university receives funds from sources external to the university to support the research, creative, training, and public service activities of UMass Boston faculty members, staff members, and students, an agreement is executed that establishes the terms and conditions of the award. These awards can be organized into three types; namely, grants, contracts, and cooperative agreements²:

Grant—a grant creates a voluntary relationship between a sponsor and a recipient in which: (a) the principal purpose of the relationship is the transfer of money, property, services, or anything of value from the sponsor to the recipient; (b) a public purpose is specified with a defined scope of work enumerating certain performance objectives to be achieved during a specific period of performance; and (c) no substantial involvement is anticipated between the sponsor and the recipient during the accomplishment of the public purpose. In competitive situations, the sponsor states its willingness to support work of a general type in a request for applications (RFA) and solicits proposals from potential recipients. Respondents compete for the grant award, with the sponsor using evaluation criteria to review submitted applications. The grant recipient makes no guarantees other than the work will be done as described and that generally accepted management practices will be followed

Contract—a contract creates a legal relationship between a sponsor and a recipient in which the principal purpose of the relationship is the acquisition, by purchase, lease, or barter, of property or services for the direct benefit or use of the sponsor. In competitive situations, the sponsor states the work to be undertaken or the problem to be solved in a request for proposals (RFP) or an invitation for bids (IFB). Respondents compete for the contract award that is open to all

¹ A number of sources were consulted in the preparation of this *Note*. Although not specifically quoted and cited, this *Note* may contain selected phrases and excerpted elements of the published materials of Northern Arizona University, Texas Tech University Health Sciences Center, University of Georgia Research Foundation, University of Minnesota, University of Oregon, University of West Florida, U.S. Navy, and Western Illinois University.

² The statutory provisions relating to the choice of agreement are contained in the Federal Grant and Co-operative Agreement Act (31 USC 6301-6308) and the Federal Acquisition Regulations (FAR; 48 CFR Chapters 1-99). In addition, specific agencies have explicit authority to enter into grants, contracts, and cooperative agreements. The cost and audit principles contained in the Office of Management and Budget circulars A-21, A-110, and A-133, as well as the federal government's cost accounting standards, apply to federal funding of sponsored programs. A future *Note* in this series will provide detailed information on the various rules and regulations that apply to these different types of research agreements.

respondents or bidders, with proposals or bids evaluated using specific technical and business evaluation criteria.

Cooperative agreement—a cooperative agreement creates a relationship between a sponsor and a recipient in which: (a) the principal purpose of the relationship is the transfer of money, property, services, or anything of value from the sponsor to the recipient to accomplish a public purpose; and (b) substantial involvement is anticipated between an individual or agency, acting for the sponsor, and the recipient during the accomplishment of the public purpose. A cooperative agreement is correctly viewed as a hybrid of a grant and a contract.

Contracts can be further subdivided into two broad categories³:

Cost Reimbursable Contract—a cost-reimbursable contract (also known as a time-and-materials contract) requires the contractor to provide a specified level of effort, over a stated period of time, on work, described in general terms in a scope-of-work document, that is designed to produce deliverables (i.e., property or services). The price specified in the contract is an agreed-upon best estimate of the total costs (direct costs plus indirect costs) for the purpose of establishing a ceiling that the contractor may not exceed (except at its own risk) without the specific approval of the sponsor. The contractor estimates the project's costs and presents them in a proposed budget using typical cost categories (e.g., salaries and wages, benefits, communications, travel, materials). The contractor bills the sponsor for allowable incurred costs according to an agreed-upon schedule (the draw), to some amount less than the maximum amount specified in the contract, with the balance (generally 20% of the total) payable upon satisfactory completion of the project.

Fixed Fee Contract—a fixed-fee contract (also known as a fixed or firm price, fee-for-service, or fixed rate contract) requires the contractor to perform work necessary to produce deliverables (i.e., property or services) specified in the contract document for a fixed dollar amount. The sponsor is not provided with a budget that breaks down the project costs by cost category because the contractor's costs of providing the deliverables are irrelevant to the sponsor. Moreover, the price is not subject to any adjustments on the basis of the contractor's cost experience in performing the contract. The sponsor's only involvement after the contract is executed is approving and paying for the deliverables. The contractor typically is paid 50% of the contract amount upon execution and is paid the remaining 50% of the contract amount upon satisfactory completion of the work and acceptance by the sponsor of all the required deliverables. In some cases, the contractor may be paid less than 50% of the contract amount up front if provision is made for partial payments to be made upon documented completion of specific contractual benchmarks. The sponsor pays the remaining balance upon final acceptance of all deliverables. A fixed fee contract, because it is based upon sponsor acceptance of deliverables and not contractor costs, does not require the return of any unspent funds to the sponsor.

From the contractor's perspective, a cost reimbursable contract is generally preferred when the work required cannot be exactly specified and when there is reasonable expectation that the deliverables cannot be achieved by expending less than the anticipated level of effort. The

³ For additional details, see the FAR, Subparts 16.2 and 16.3.

details of the work can be specified as the work progresses and the total price of the contract renegotiated if the scope-of-work is expanded or reduced. On the other hand, a fixed fee contract places upon the contractor maximum risk and full responsibility for completion of the work and the deliverables to the sponsor's specifications regardless of the actual costs incurred. Although the fixed fee contract provides the sponsor with an advantage, because the cost is known and agreed to in advance, it also provides maximum incentive to the contractor to control costs and perform efficiently with minimum administrative burden. If the total costs incurred to complete the project are less than the contract amount that is paid by the sponsor, then the contractor retains the residual funds.

This note is written to clarify the UMass Boston procedures concerning externally funded **fixed fee contracts** and **residual funds** that may be associated with these contracts.

UMass Boston must be cautious before entering into a fixed fee contract for specified deliverables for the direct benefit or use of the sponsor because the project may present the university as an unfair competitor to for-profit businesses that provide the same type of service at a higher cost. The university may decide to proceed if it can be demonstrated that the work fits the research, education, and public service mission of the university⁴, and if the work will advance the research, creative, or scholarly activities of the faculty, staff, and students who will undertake it. If it proceeds, then the university must fully recover its costs (direct costs plus indirect costs) in performing the services, and it can neither set out to generate a profit nor be in a deficit when the project ends. For audit purposes, the university must document all expenditures to show they comply with the terms and conditions of the award, ensure that all costs are fully expensed to the sponsor, provide evidence that all personnel costs reflect actual effort, and carefully handle any residual funds. Failing to do so could be disastrous if costs are disallowed or if the university is found to be in violation of state or federal rules and regulations that govern its non-profit status.

In accordance with University of Massachusetts policy, all contract proposals must be submitted by the Office of Research and Sponsored Programs (ORSP) under the signature of the vice provost for research who is authorized to execute contracts on behalf of the university. All PIs and departments are encouraged to consult with the professional staff in ORSP to develop the project budget and price quote for a fixed fee contract that will ensure that all costs – both direct costs and indirect costs – are recovered and that the risks described above are mitigated. With careful budgeting and accurate cost accounting, there should be neither a deficit nor a substantial surplus of sponsor funds when the project ends.

All fixed fee contracts awarded to the university will be set up as a separate project grant and will require a proposal approval document with all required signatures and a detailed budget presenting all proposed direct costs in appropriate cost categories as well as the university's approved F&A costs. In certain situations, the vice provost for research may approve the use of an F&A rate that is different from the university's approved rate. However, in no case will an F&A rate of less than 10% be applied to the project's direct costs for fixed-fee projects with local

⁴ Funds received by the university from a sponsor for work that is regularly carried out and that does not fit the research, education, and public service mission may be classified by the Internal Revenue Service as unrelated trade or business income and subject to unrelated business income tax (UBIT).

governmental units in the Commonwealth of Massachusetts, Massachusetts-based businesses and industries, and Massachusetts-based nonprofit organizations⁵. The effort of all UMass Boston employees who are working on the project must be charged to the project account and all effort must be documented in accordance with the university's time and effort reporting procedures. At the end date specified in the fixed fee contract, the professional staff in ORSP will work with the PI to determine that (a) the work has been completed, (b) the deliverables and any required technical reports have been accepted by the sponsor, and (c) no outstanding items remain in question with the sponsor. A bill marked *FINAL* will then be sent by ORSP to the sponsor. The project account's balance will be determined only after the sponsor's final payment is received, all salaries and outstanding invoices have been paid, all encumbrances on the project account have been released, and all F&A costs are recovered by the university. In some cases, this may take up to 6 months to complete.

If the project's total costs exceed the sponsor's payments, then the project will present the university with a deficit. ORSP staff will write a memorandum to the PI, with copies to the department chairperson, dean or unit director, division vice chancellor, and vice provost for research, requesting the PI identify an alternative unrestricted fund source to absorb the cost overrun and clear the deficit. Money will be transferred from this alternative fund source until the university's costs are fully recovered.

If prudent fiscal and project management has allowed the PI to complete the project for less than the agreed upon price, then the sponsor's payments will exceed the total costs, yielding residual funds. Residual funds on a fixed fee contract will be recognized by the Controller's Office as deferred revenue. The ORSP staff will prepare a request to the Budget Office to transfer the residual funds to the PI's departmental RTF account⁶. When the residual funds are transferred, then the project account will be closed. Although the PI will have access to these residual funds with no restrictions imposed by the contract's requirements, the residual funds must only be used for expenditures in support of the PI's research-related activities in accordance with university policy⁷. If the PI's department does not have an RTF account, then a request can be sent to the vice provost for research that a new account be created. The department should segregate the residual funds balances by individual PIs for accounting purposes using a simple spreadsheet.

In cases where the residual funds total is significant, then the PI will be asked to provide a written explanation for why the actual direct costs of the project were substantially less than the total payments received from the sponsor. The PI must obtain the department chairperson's and the dean's or unit head's written approval and then forward the explanation to ORSP. The approval of the vice provost for research will be necessary before the residual funds can be transferred. Significant is defined as follows:

⁵ Refer to *A Note Concerning the Recovery of Facilities and Administrative Costs of Sponsored Programs* available from ORSP or from the ORSP web page.

⁶ Before the transfer request is processed, the residual funds may be used to cover any cost overruns (deficits) made by the same PI on other project accounts where he or she is responsible.

⁷ See the *University of Massachusetts Research Trust Fund Expenditure Guidelines* for an interpretation of Massachusetts General Laws Chapter 29, Section 6B, Paragraph G on the uses of funds generated on sponsored programs.

- For a fixed fee contract of less than \$25,000, when the residual funds total is \$2,500 or greater.
- For a fixed fee contract of \$25,000 or more, when the residual funds total is equal to or greater than 10% of the total payments received.

Funds to be transferred to UMass Boston from another educational or research institution, which were residual funds held at that institution for a PI who is accepting a position at UMass Boston, become the property of UMass Boston. These funds will be treated in the same manner as residual funds derived from fixed fee contracts conducted at UMass Boston.

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