

# 16.403-1 Fixed-price incentive (firm target) contracts.

(a) *Description.* A fixed-price incentive (firm target) contract specifies a target cost, a target profit, a price ceiling (but not a profit ceiling or floor), and a profit adjustment formula. These elements are all negotiated at the outset. The price ceiling is the maximum that *may* be paid to the contractor, except for any adjustment under other *contract clauses*. When the contractor completes performance, the parties negotiate the final cost, and the final price is established by applying the formula. When the final cost is less than the target cost, application of the formula results in a final profit greater than the target profit; conversely, when final cost is more than target cost, application of the formula results in a final profit less than the target profit, or even a net loss. If the final negotiated cost exceeds the price ceiling, the contractor absorbs the difference as a loss. Because the profit varies inversely with the cost, this contract type provides a positive, calculable profit incentive for the contractor to control costs.

(b) *Application.* A fixed-price incentive (firm target) contract is appropriate when the parties can negotiate at the outset a firm target cost, target profit, and profit adjustment formula that will provide a fair and reasonable incentive and a ceiling that provides for the contractor to assume an appropriate share of the risk. When the contractor assumes a considerable or major share of the cost responsibility under the adjustment formula, the target profit *should* reflect this responsibility.

(c) *Limitations.* This contract type *may* be used only when-

(1) The contractor's accounting system is adequate for providing data to support negotiation of final cost and incentive price revision; and

(2) Adequate cost or *pricing* information for establishing reasonable firm targets is available at the time of initial contract negotiation.

(d) *Contract schedule.* The *contracting officer shall* specify in the contract schedule the target cost, target profit, and target price for each item subject to incentive price revision.

**Parent topic:** [16.403 Fixed-price incentive contracts.](#)