Crosswind Learning

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Project Management Professional (PMP)® Exam

Crosswind Success Series: PMP® Exam Bootcamp Manual

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Contract Type	Risk for Buyer	Risk for Seller	Description	Example
Time and Materials (T&M)	Minimal	Minimal	The time and materials contract is typically used **for smaller initiatives, staff supplementation,** the initial piece of a project where discovery occurs before the full details of the project are known, or for materials on an initiative to complement the labor.	A buyer hires a technical writer at $75 per hour to supplement its staff or a buyer has a bathroom added to her house at $50 per hour plus the cost of materials.

15.1.8. Share

A share is a contract component that divides any remaining money (typically the difference between the total price and actual seller's costs) between the buyer and the seller. It is normally a negotiated split between the two parties. It is typically different from a traditional incentive fee in that an incentive fee pays compensation based on certain measurable performance metrics that have been established and agreed upon.

It is very important to understand and be able to calculate the total share and the amounts that will be allotted to the buyer and to the seller.

Example: The buyer and seller have contracted for the seller to provide a debit card add-on system in all 50 of the buyer's retail stores. The total price is to be $50,000. The need for implementation is great because the old systems are being leased and must be returned by a particular date. Both parties negotiate and agree that if the project's actual cost is below the baseline (target) cost, the buyer and seller split the difference 60%/40%. The project accrues an actual cost of $45,000 when complete. Calculate the share total amount and the share for the buyer and seller.

The project has a $5,000 share amount ($50,000 - $45,000). Of that $5,000, 60% goes to the buyer and 40% to the seller. The buyer keeps $3,000 and the seller gets $2,000. With the actual cost of $45,000 and the share amount of $2,000, the seller is paid $47,000 on the contract.

15.1.9. Point of Total Assumption

The calculation for the point of total assumption establishes the point in a cost curve where the seller's profit starts to diminish when taking into consideration the share ratio on cost overruns. As costs increase past the point of total assumption, a reduction in seller profit occurs until the ceiling price is met. Once the ceiling price is met, every dollar in cost results in a dollar loss for the seller. Contrary to what fixed-price may imply, a contract of this sort can be negotiated so that the buyer agrees to share in cost overruns or under-runs. This calculation is typically used in government or defense-type contracts.

Point of Total Assumption Variables and Calculation for a Fixed Price Incentive Fee (FPIF) Contract	
Purpose	To calculate the point in a cost curve where the seller's profit starts to diminish when taking into consideration the share ratio for cost overruns
Target Cost (TC)	The expected cost of the work in the contract (Ex: $1,000,000)
Target Profit (TP)	The expected profit of the work in the contract (Ex: $200,000)
Profit Rate at Target Cost	The profit margin of the target profit compared to the target cost (target profit/target cost) (Ex: 20%)
Target Price	The total of the target cost and target profit; i.e. the total target value of the contract work barring any cost savings or overruns (Ex: $1,200,000)
Ceiling Price	A firm price cap which may be expressed as a percent of the target cost (Ex: 140% of cost or $1,400,000) *Note that the buyer is not expected to pay more than the ceiling price.*
Share Ratio (SR)	The ratio that establishes the percentage of cost savings or cost overruns that will be assigned to the buyer and to the seller (Ex: 70/30) *Note that cost savings or overruns impact the total contract amount and profit.*
Point of Total Assumption (PTA)	The point in a cost curve where the seller's profit starts to diminish when taking into consideration the share ratio on cost overruns (Ex: $1,285,714.29) *Note that as seller costs exceed the target price and the point of total assumption is met, the cost overruns are shared between buyer and seller until the ceiling price is reached. After the ceiling price is reached any additional cost overruns are entirely assumed by the seller.*
Point of Total Assumption Formula	$\text{PTA} = \left[\dfrac{\text{Ceiling Price} - \text{Target Price}}{\text{Buyer Share}}\right] + \text{Target Cost}$ $\$1{,}285{,}714.29 = \left[\dfrac{\$1{,}400{,}000 - \$1{,}200{,}000}{0.70}\right] + \$1{,}000{,}000$ *Note that the difference between ceiling price and target price is divided by the buyer's share.*

15.1.10. Scope of Work

Know the different types of scope of work.

Scope of work is typically the part of the contract that describes what the seller will do for the buyer. When the scope of work is complete, the main work of the contract is complete and closing can begin. Because the level of detail and planning in a contract may vary, there are two main approaches available to develop the scope of work in the contract.

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