Cost Reimbursable Contract

Construction Procurement Guidelines

October 2019

Overview

Under a cost reimbursable contract, the contractor is paid its actual costs for the work completed. This places significant financial risk on the client and so these approaches tend to be used where the nature or scope of the work can't be adequately defined, either due to time constraints or the fact that the work is of an urgent nature, eg where there is a need to carry out critical emergency or repair work.

The final cost of the project won't be known during award of contract and therefore this approach has a high degree of financial risk for the client.

Information prepared for tender using this approach may include an outline specification, drawings and an estimate of costs.

Contract documents need to clearly set out the costs that the contractor is entitled to have reimbursed.

Cost management under this arrangement can be complex, as some costs (which directly relate to the project) will be relatively straightforward to determine, while other (indirect) costs might not be.

Direct costs to attribute to a project may include:

- labour
- materials
- hired plant
- sub-contractors.

Indirect costs (that may be shared across several projects) may include:

- head office costs including overheads and profit
- staff costs
- manufacturing facilities
- owned plant.

For simplicity, indirect costs might be calculated on a pro-rata basis and charged, along with profits, as a pre-agreed lump sum or percentage fee.

Cost reimbursable contracts require a significant degree of cost management expertise to ensure that all costs claimed by the contractor are properly due under the contract. Clients without in-house expertise will need to either employ appropriate resources or contract a professional quantity surveyor. Costs will usually be calculated based on the contractor's accounts and other records, which should be made available to the client on an open-book basis. The client may also need on-site activities monitored to verify that the costs being claimed are legitimate, reasonable, and that there's no double counting.

Cost reimbursable contracts can be subject to misuse, particularly where there are insufficient financial controls in place to monitor costs and ensure the contractor is operating efficiently. Poor financial control will result in poor public value, particularly where a contractor is operating inefficiently or incompetently. As the contractor is being paid for all work executed, any inefficiencies due to poor productivity are paid for by the client. This can be overcome by incentivising the contractor to operate more efficiently by the introduction of a target cost.