



Performance-Based Service Contracting

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1. **DEFINITION:** (a) Method of contracting where the Government defines the *results* it is seeking, rather than the *process* by which those results are attained. Also included are the standards against which contractor performance will be measured, and positive and/or negative incentives. (Reference FAR 2.101)

(b) Benefits:

- Better prices and performance;
- The Government is released from having to develop detailed specifications and define the process;
- The contractor has more flexibility on how he achieves the desired results;
- Less day-to-day surveillance is required; and
- Contractors are motivated to be innovative and to save money (we must evaluate cost vs. benefit!).

(c) What's So New About This? NOTHING, in the commercial world. They long ago realized they do not have the expertise to tell their suppliers how to do the work. From the Government perspective, not only is the statement of work *results vs. process*-oriented, it has a new title: Performance Work Statement (PWS). (The hidden benefit here is that the Government does not always have the expertise to prepare a statement of work with fully-developed requirements.) The burden is on the contractor to accomplish the results we require. He measures his own performance by developing and implementing a Quality Control (QC) plan, plus the Government measures his performance against standards established in the contract. A newer approach is to develop a statement of objectives (SOO), which provides a basic outline of the current situation, the desired results, and lists any existing constraints (compliance with statutes, security, architecture, etc.). Using this newer approach, the offerors will propose a solution or an approach that then becomes our PWS.

(d) Key Elements of Performance-Based Service Contracts (PBSCs):

- PWS or SOO (what, where, when, how many)
- Quality Assurance Plan (QAP) (tip: we should only measure and incentivize those things over which the contractor has control)
- Metrics and incentives, such as bonuses (monetary or otherwise), share-in-savings, positive performance evaluations, automatic option exercises, extended contract terms, few inspections.

2. WHY DO WE NEED TO DO THIS?!?!?

(a) FAR 37.102 has established the policy to use a performance-based contracting approach for all services except construction, A&E, services incidental to commodity purchases, and utilities. Use of any other approach has to be justified. Pilot contracts yielded cost savings and increased customer satisfaction.

(b) Improves business results!

(c) Government Performance and Results Act (GPRA) of 1993 mandates accountability.

(d) The current administration has set a goal for FY2002, requiring each agency to have 20 percent of its eligible service contracts be done as performance-based contracts. That percentage will increase to 50 percent in 2005.

3. BARRIERS TO PERFORMANCE-BASED CONTRACTING:

- (a) Fear of change and lack of understanding;
- (b) Fear of loss of control, because the COTR is not overseeing all the details; and
- (c) Fear that it takes more time than traditional contracting. It does take more up-front time/planning.

4. COMPETITIVE SOURCING:

- (a) Definition: A strategy for acquiring goods and services that are not considered to be core business functions. Competitive sourcing (i.e., outsourcing) is a standard commercial practice; it allows for better strategic focus, saves money, provides expertise of those whose core business functions ARE that service or product being acquired, stimulates competition and encourages innovation. Further, for manufacturers, it reduces the cost of assets on contractor balance sheets, since the primes will not have to make large capital investments in production equipment. Since the Government is contracting out so many of its non-core business functions, PBSC's are gathering momentum.
- (b) Competitive Sourcing Initiatives: OMB Circular A-76 and Federal Activity Inventory Reform (FAIR) Act. A-76 initiatives have shown that outsourcing saves money, even when the Government wins the competition. By coming up with its most efficient organization, or MEO, the Government can do the work in-house.

5. ROLE OF THE PROGRAM OFFICE:

- (a) Identify requirements that may be suited for PBSC and meet with the **TEAM** to discuss (i.e., program office, contracting officer, and any other stakeholder);
- (b) Develop the PWS or SOO, the standards, and acceptable quality levels, and monitor performance. An important element here is to take a baseline measurement of the current service level;
- (c) Get trained in PBSC's as a team, to ensure everyone understands the concepts and goals; and
- (d) Perform market research. Identify sources that could provide what is needed and learn as much as possible about the industry's commercial practices.

6. ROLE OF THE CONTRACTING OFFICER (CO):

- (a) Meet **early and often** with the program office. COMMUNICATE!
- (b) Advocate for and educate on the benefits of performance-based contracting;
- (c) Determine the acquisition method and the schedule, including contract type; and
- (d) If time permits, obtain industry comments on the PWS or SOO, QAP, and incentives.

7. ACQUISITION PLANNING CONSIDERATIONS:

(a) **Contract Type:** Fixed-price contracts are preferred; the risks to the Government and to the contractor are manageable because the PWS or SOO can be objectively prepared. Cost-reimbursement contracts can be used when the desired outcome is less clear, making the performance risk greater. Remember to use commercial item/service contracts to the greatest extent possible.

(b) **Incentives:**

(1) Monetary

- Fixed-price contracts, by their nature, include positive monetary incentives. If it costs the contractor less to perform, his profit margin goes up. A negative incentive can also be included in case the desired results are not achieved (deduction should be equal to the value of the service lost).
- Cost-plus-incentive-fee (CPIF) or fixed-price-incentive-fee (FPIF) contracts can be used when there is some latitude in achieving the desired results. The ability to succeed or fail is controlled by the Contractor; the Government's ability to influence contractor performance is limited to specific areas.
- CPIF with multiple incentives contracts include setting a target cost, along with minimum and maximum values for cost, fee, technical performance, and schedule. Funds available for fees are divided into pools so that there is no overlap.
- Cost-plus-award-fee (CPAF) and fixed-price-award-fee (FPAF) contracts are used when a mechanism to motivate a contractor is desired, but performance cannot be measured objectively or where the Government's performance objectives can only be stated in general terms. Both types require an award-fee plan as a part of the contract. Incremental adjustments to the criteria in work authorizations can be made.
- Share-in-savings.

Remember: If a financial incentive is promised, MAKE SURE THE MONEY IS COMMITTED TO PAY IT AT THE TIME OF CONTRACT AWARD OR OPTION EXERCISE!

(2) Non-Monetary

- Revised schedule
- Reduced oversight
- Positive performance evaluation
- Automatic extension of contract term or option exercise (FAR Part 17 still applies)
- More frequent payments
- Lengthened contract term (award term contracting) or purchase of extra items (award purchase)
- Publish article(s) in agency newsletter or speak at agency seminars
- Letters of appreciation to individual employees may translate to bonuses
- Use trade space for licensing, access to agency officials, etc.
- Use those FAR clauses that can be negotiated to your advantage

(c) Market Research. Information to be obtained includes a thorough understanding of marketplace practices, a list of the best available sources to perform the services or provide goods, best method to conduct the acquisition (e.g., analysis of alternatives), and best practices involved in that particular commodity or service.

How to conduct market research:

- Gather a team together and decide on a team leader;
- Establish basic needs (i.e., output/results) statement;
- Identify sources to contact (brainstorm);
- Develop interview questions and conduct interviews; and
- Prepare report of findings and present to C.O. Report should include how research was conducted, what was learned, comparative pricing, commercial terms and conditions, whether commercial items will meet the needs, and identify any existing contractual vehicles that might suffice.

The level of effort put into market research, including the size of the team, should be commensurate with the size of the procurement.

(d) Analyze the Requirement

(1) What to Look For:

- Desired results/deliverables (what outcome is required?);
- Resources needed (are they available?);
- Workload frequency/quantity to desired work;
- Standards of acceptability;
- Objective performance measures (don't forget to take baseline measures so progress can be assessed!); and
- How much will it cost? (independent Government cost estimate)

(2) Summarize the Job → Determine needs (what outputs/services are needed?); this forms the basis for the PWS or SOO, performance standards and the QAP. Describe the background of the program, the overall mission, the results required, and any constraints involved (legal, environmental, security, etc.).

Translate the task into a performance requirement (e.g., "Provide a help desk for desktop/network support" becomes "Establish and man a help desk with properly qualified personnel to answer customer questions and resolve problems.")

Develop Performance Standards. Use commercial standards where practicable; ensure the standard is needed and not unduly burdensome (**Let the offerors propose them.**). *Components of standards* are indicators (essential characteristics of acceptable performance), delivery time, error rates (accuracy), operational costs, responsiveness, adherence to specifications, etc. Must be measurable, easy to apply, and attainable.

Define Acceptable Quality Levels. Must be realistic, stating the minimum standard, percentage of errors allowed, cost trade-offs, etc.

(e) Methods of Surveillance:

- (1) 100% inspection (this is recommended only where health and safety are at issue; otherwise, it is not cost-effective and is too stringent);
- (2) Random Sampling (good for recurring tasks or production requirements);
- (3) Periodic Inspection (use a pre-determined plan based on analyses of agency resources and requirements);

- (4) Customer Input (good for service-oriented tasks; use a standard form to document); and
- (5) Contractor Self-Reporting (for things like system maintenance, the contractor can provide system records that document performance; for development projects, monthly reports can detail problems encountered and what was done to resolve them).

Consider the following when deciding how to monitor contractor performance: Criticality of work to be performed, the relative importance of some tasks to others, lot size/frequency of service, surveillance period, stated performance standard, performance requirement, availability of agency people/resources, and cost-effectiveness of surveillance vs. task importance. Build language into the contract that will allow for an analysis of WHAT's being measured after 2 years—it may be that what's being measured is not adding to the value of the contractor's work, nor is it getting the Government what it wanted. If we're missing the mark, we need to have the flexibility to correct that. Here's a sample paragraph:

The Government reserves the right to modify performance standards and/or metrics during the life of this contract, in order to ensure that the right outcomes are being assessed and that the performance standards are appropriate. Any changes will be accomplished via a bilateral contract modification.

(f) Definition of Performance Measure: Quantitative or qualitative method or characteristic for describing the Contractor's performance. There are 3 types of measures:

- (1) Economy: Obtain appropriate quality/quantity at the best price.
- (2) Efficiency: Best use of resources (quality vs. time, work per hour, etc.).
- (3) Effectiveness: Was the objective accomplished? (Are customers satisfied? Are requirements met? Were goods/services delivered on time?)

(g) Analysis of Results: Evaluate the data you gather in terms of:

- (1) Goals/standards vs. actual results (Contractor should receive no reward for MEETING standards);
- (2) Trends (compare to previous periods);
- (3) Compare results to other relevant data (may need to weight some factors to attribute relative importance);
- (4) Refine measures, if needed, if data is not as useful as it could be.

(h) Characteristics of Good Performance Measures:

- (1) Measure important things (don't attempt to measure too many things);
- (2) Simple, but not too simple;
- (3) Can be audited and validated (quantifiable measures preferred, as they are less subjective);
- (4) Attainable and worth the cost;
- (5) Level of detail corresponds to the intent of the stated measure and expectation; and
- (6) Can be consistently combined with other measures to reflect corporate priorities.

8. WRITING THE PWS or SOO

The PWS or SOO describes the requirements the Contractor must meet in terms of outcome or results. The "how" is left to the Contractor. (If the Government issues a SOO as part of a solicitation, the successful offeror's approach will become the PWS, or "Section C" of the contract.) The performance standards that will be used to measure shall also be described, or the solicitation can request that each offeror submit their own

suggested standards. The SOO is a very brief statement of objectives (2 to 10 pages, depending upon complexity), to which vendors respond. Also, consider writing outcome-based work statements, even where there are no opportunities for positive monetary incentives. The FAR requires that a mechanism be included to decrement payments for performance below the stated acceptable levels.

Remember: A poorly written work statement cannot be "repaired" by incentives!

(a) Performance-Based Specifications/Requirements describe the required outcome/result, NOT how it should be provided or performed. Approaches or methods for attaining results should be left up to the Contractor.

(b) Format is the same as for traditional SOW's. Include an introduction, background information, scope, applicable documents, performance standards, constraints, and deliverables. All that is required is enough detail for the contractor to know what is required; the Government can then measure whether the contractor has complied, and to what degree (See Attachment 7).

(c) Labor Category Descriptions: Who needs 'em? In PBSC's, remember to focus on results not process. However, if the contract is for "bodies" and labor categories will be included, follow these guidelines"

- Avoid being too specific and too general;
- Use the phrase "experience in" rather than "knowledge of" (the latter requires an interview for proof);
- Be clear and definitive (no "should's" or "desirables");
- If a college degree is required, state "bachelor's degree from an accredited college or university;"
- Experience should be recent and relevant;
- Remember the goal: Provide a benchmark for required credentials (don't describe the work to be performed);
- Descriptions of typical tasks expected to be performed are helpful;
- Resumes should only be required for key/senior personnel; and
- For certain categories, such as IT professionals, state any required certifications (e.g., Microsoft Certified Engineer, or MSCE). FAR 39.104 now prohibits the use of minimum experience and educational requirements.

(d) Once you've completed a template, as shown in the attachments, the left-hand column (expected outcomes and/or results) can basically become the PWS.

9. THE QUALITY ASSURANCE PLAN (QAP)

(a) The QAP describes what Government resources will be required to ensure that the Government gets what it is paying for. The QAP can be proposed by the Contractor (for negotiation), detailing the steps he plans to take to ensure performance is in accordance with the stated performance standards; it also assures that assessments will be uniform and consistent. Surveillance methods were described in Section 6(e). The QAP (See Attachment 6 for sample plan) becomes part of the contract administration plan, and is the key to successful performance. The QAP must be included in the solicitation so vendors know how their performance will be evaluated (it does *not* have to be in the resulting contract). In response, the offerors will develop a Quality Control Program (QCP). The QAP sets the "what," "how," and "how often" of quality assurance, and helps the offeror determine the level of resources needed to adequately staff the project. It also reflects the value of each performance requirement as a percentage of the overall contract, so the offeror can focus his resources in the appropriate areas.

(b) The QAP must specify the surveillance schedule, methods, and performance measures. The frequency of surveillance may be adjusted after the Contractor has settled in. *The level of surveillance should be commensurate with the complexity of the contract. DON'T INSPECT THE PROCESS - JUST THE OUTPUTS.* This type of process places reliance on the Contractor's QCP and on working together as **partners** to get the desired results.

(c) Where there are industry standards in place, such as ISO 9000, 9001, and 9002, they can form the basis of any QAP.

10. CONTRACT ADMINISTRATION: WHERE THE FUN BEGINS!

(a) After contract award, the COTR takes a lead role in managing the technical elements of the contract. S/he must be technically competent, must maintain complete and accurate records, and must establish and maintain a professional working relationship with the Contractor. The COTR should **build a checklist** for surveillance and must monitor Contractor performance, including following inspection and acceptance guidelines in the contract.

(b) This is where positive and negative incentives come into play. The Government needs to reinforce actions/behaviors that result in quality services/products and discourage actions/behaviors that reduce performance levels. Efforts should be made to avoid penalizing the Contractor, but if it must be done, do it.

(c) Performance-based payments: Authorized by FAR 32.10 and preferred when appropriate and made a part of a fixed-price negotiated contract. This focuses more on achievement of meaningful technical progress than on costs expended and contractor does not have to have an approved accounting system to implement. Payments can be linked to project milestones, such that payment will only be made when meaningful, measured performance achievements are reached. Milestones, then, must be reasonable (cost should not outweigh benefit) and meaningful. (Thoughtful planning is required at the contract formation stage.) Contract administration is eased, because no audit is required to determine payment amount, and the contractor can self-monitor. In a competitive environment, it may be necessary to ensure that the cost of financing is accounted for to level the playing field.

WEB SITE REFERENCES:

<http://ec.msfc.nasa.gov/hq/library/perfba.htm> This is NASA's PBC policy site.

<http://www.amsc.belvoir.army.mil/vacante.html> This is the Army Management College PBC site.

http://www.acq-ref.navy.mil/turbo2/index_ie.htm This is the Navy's Acq. Reform site, with PBC info.

<http://www.acq-ref.navy.mil/specright/index1.htm> This is another Navy site, on how to write PB specs.

<http://www.acq.osd.mil/ar/> This is Defense Dept's Acquisition Reform site, with info on PBC's.

<http://www.knownet.hhs.gov/acquisition/performDR> This is HHS's KnowNet site, with sample RFPs.

<http://www.acq.osd.mil/ar/doc/pbsaguide010201.pdf> This is the DoD PBC Guide.

<http://www.seaport.navy.mil> This is a Navy web site that has some great information on building a PBC. Click on the "Learning" tab.

<http://www.fss.gsa.gov/schedules/building2-B.cfm> This is a GSA Schedule PBC information section (toolkit), to aid in preparing performance-based task orders.

<http://www.dau.mil/pbsa> This is the Defense Acquisition Univ. site for PBCs; links to samples are very helpful.

<http://www.hanscom.af.mil/MISTSII/sooindex.htm> This is a guide for writing Statements of Objectives.

<http://acqnet.saalt.army.mil/library/final/finalfrm.htm>. This is a DoD guide to developing innovative incentives.

<http://www.afcesa.af.mil/directorate/ceo/contracts/outourcing> (Click on "Services" under "Templates on left-hand side). This site has a number of samples available for download, including market survey information, QAP's, and work statements.

http://www.fts.gsa.gov/answer/solutions_edu.htm GSA's Federal Technology Service guide to PBC's

<http://www.napm-nema.org/> This site offers an on-line training course for \$100!!!

