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ACQUISITION,
TECHNOLOGY
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March 8, 2005

FROM: Performance Based Payments Working Group

TO: Ms. Deidre Lee
Director, Defense Procurement and Acquisition Policy (DPAP)

SUBJECT: DoD Internal Assessment of Performance Based Payments

I. Executive Summary:

In DoDIG Report Number D2001 CK-0061, "Administration of Performance-Based Payments Made to Defense Contractors", the DoDIG performed a judgmental review of a limited number of contracts. Based on this review, the DoDIG asserted that contracting personnel frequently failed to follow the FAR, the DFARS, and the Performance Based Payments (PBP) Guide. However, the DoDIG findings addressed contract actions negotiated prior to the issuance of FAR guidance on performance-based payments (*Federal Register* dated March 27, 2000, 65 FR 16282), the AT&L User Guide for Performance Based Payments, and the on-line training course.

In response to the DoDIG recommendations, DPAP agreed to establish a working group to review DoD implementation of performance-based payments and provide recommendations for (1) increasing the use of performance based payments as the method of contract financing on DoD contracts (e.g., what should be done to increase the number of contracts that utilize performance-based payments); and (2) improving the efficiency of performance based payments when used on DoD contracts (e.g., what should be done to improve the use of performance-based payments on those contracts that provide for such contract financing).

This report contains a detailed description of the group's effort, the results of the working group review, and recommendations for increasing and facilitating the use of performance based payments. The key recommendations, with references to the supporting report findings, are as follows:

A. Revise the FAR to address the following:

1. Require inclusion of the solicitation provision "Invitation to Propose" and the standard performance based payments clause in all solicitations expected to result in contracts that would exceed the thresholds in FAR 32.104 for providing contract financing, unless the contracting officer has documented, in writing, that PBP's are not appropriate for the particular contract. This will enable the contractor the opportunity to provide key information regarding any proposed performance based payments (e.g., a description of the events, payments, estimated dates of completion, etc.). (*Checklist Item 1*)
2. Eliminate the requirement that the solicitation include a description of the basis for payment and liquidation for PBP payments, since it is often more practical for the contractor to provide this information as part of its proposal (*Checklist Item 1*).
3. Clearly state that the use of PBP's for sealed bid contracts is prohibited (the FAR currently only states that the PBP provisions in Part 32 "do not apply" to sealed bid contracts). (*Checklist Item 7*).
4. Clearly state that both PBP's and public vouchers can be used on the same contract when the contract contains both fixed price and cost reimbursement line items (*Checklist Item 9*).
5. Revise FAR 32.1001(e) to remove the term "prompt payment. Users may incorrectly assume that this refers to the Prompt Payment Act; however, PBP's are not subject to this Act (*Checklist Item 20*).
6. Revise potential conflicts/confusion among FAR 32.1007(a), FAR 32.1007(b), and FAR 42.302(a) (12). FAR 32.1007(a) addresses responsibility, while (b) is entitled "Review and Approval". However, (b) also addresses responsibility. In addition, FAR 32.1007(a) requires that the contracting officer responsible for "administering" the contract also be the one responsible for reviewing and approving the PBP's. Under FAR 42.302(a)(12), this is a function that may be retained by the PCO. Thus, the ACO could administer most of the contract but the PCO could retain the PBP review/approval function (*Checklist Item 29 and Public Comment E*).

7. Revise FAR 32.1004(a) to clarify that events that do not require meaningful effort or action (e.g., passage of time) must not be included as events or criteria for PBP's. (*Checklist Items 30 and 36*).
8. Revise FAR 32.1004 to specifically state that each event must be identified in the contract as severable or cumulative (*Checklist Items 40 thru 43*).
9. Revise FAR 32.1004(b) to specifically discuss the need to assure that payments are not disproportionate to the approximate value of effort required to complete the contract (e.g., the events are not front-loaded or back-loaded). (*Checklist Item 48 and Public Comment F*).
10. Revise the FAR and related guidance to address ID/IQ contracts, particularly in regard to whether PBP schedules are established at the contract or order level (*Public Comment C and Contracting Personnel Comment V*).
11. Revise the FAR to discourage or prohibit the use of provisions that limit performance based payments to the lesser of actual cost or successful performance (*Public Comment D*).
12. Revise the FAR to require the Contracting Officer to document the file as to why PBP's were not used when a contractor proposes PBP's but the contract includes progress payments (*Public Comment I and Contracting Personnel Comment H*).
13. Revise the FAR to address, in both the progress payments section and the performance based payments section, the price adjustments that are required when competitive contracts include some bids with PBP and others with progress payments (*Public Comment J*).
14. Revise the FAR to discourage or prohibit cost verification when payment is based on accomplishment of a performance event (*Public Comment O*).
15. Revise the FAR to require that the effective yield of the PBP financing rate be at or above the effective yield provided using progress payments, since the contractor accepts the same or more risk when using PBP's (*Public Comment Q*).

B Revise the DFARS to address the following:

Move the discussion of making payments from DFARS 232.1001(d) to DFARS 232.1001(e), to align this discussion with FAR 32.1001(e), which refers to agency policies for making payments (*Checklist Item 20*).

C. Revise the Guide and related training to address the following :

1. Include the Guide as part of the PGI to maximize use by contracting personnel (*Contracting Personnel Comments E and CC*).
2. Add a provision stating that when the Contracting Officer anticipates providing contract financing, the solicitation shall provide the contractor with the option of proposing either performance-based payments (52.232-32) or progress payments based on cost (52.232-16), unless the Contracting Officer has determined that one of these financing methods is not practical (*Checklist Item 1*).
3. Discuss the importance of each item in the PBP summary schedule. In addition, eliminate the requirement that the funding information be included in the schedule, since DFARS will require that such information be included in the Payment Instructions under Section G (*Checklist Items 14 and 15*).
4. Emphasize the importance of including, in solicitations for competitive negotiations that request offeror's to propose PBPs, a description of what terms the offers must include and a description of how proposed PBP terms will be evaluated (*Checklist Item 2*).
5. Provide a discussion of the need for adjusting competitive proposals when some include PBP's and others include progress payments. Include examples and develop a model of how to make the adjustment (*Checklist Item 3, Public Comment J, and Contracting Personnel Comments O and P*).
6. Emphasize that final payments and delivery payments must not be included as part of the PBP schedule of payments. Include examples to illustrate why this is a problem. (*Checklist Item 23 and Contracting Personnel Comment U*).

7. Amend the PBP schedule to include a description of the validation criteria (*Checklist Item 15*).
8. Provide a detailed description of the services DFAS, the ACO, and DCAA can offer the contracting officer in developing the PBP processing structure. (*Checklist Items 16, 17, and 18, and Contracting Personnel Comments R and AA*).
9. Include a discussion of the FAR requirements for processing PBP payments and why it is important that the contract specify this process (*Checklist Item 19*).
10. Include a discussion of the standard contract payment terms for PBP's (*Checklist Item 20*).
11. Include a discussion of the FAR requirements for the contract to specify the liquidation rates and/or designated dollar amounts (*Checklist Items 22, 24, and 25*).
12. Include a discussion of the need for the contract to clearly identify which CLINs are subject to liquidation and which ones are not (*Contracting Personnel Comment X*).
13. Include examples of events that do not constitute meaningful effort or action. This includes a discussion of why signing the contract and the number of customer complaints are not appropriate payment events (*Checklist Items 30 and 34, and Contracting Personnel Comment N*).
14. Include examples of adequate and inadequate event descriptions (*Checklist Item 32*).
15. Include a discussion of the need for metrics to target only those requirements that are essential to completion of the particular milestone at issue (*Public Comment L*).
16. Include a discussion of the importance of including metrics for each and every event (*Checklist Item 33*).
17. Include a discussion of potential disadvantages of including too many events in the contract (*Checklist Item 37 and Contracting Personnel Comment K*).
18. Include a discussion, with examples, of the requirement that each event be identified as severable or cumulative, and that each cumulative event specifically state which are the dependent events (*Checklist Items 40 thru 43*).

19. Revise the guide to provide a discussion, with examples, of the FAR requirement to identify the finance amounts to a specific contract line item or subline item when the payment is on a deliverable item basis (*Checklist Item 45*).

20. Include examples of payments that are not proportionate to the approximate value of the effort required to complete the contract (*Checklist Item 48*).

21. Include a discussion on the use of electronic posting of contracts, particularly the need to assure that the PBP schedules (and any revisions) are posted as part of the electronic contract data (*Checklist Item 50*).

22. Include a discussion, with examples, of the development of performance-based milestones (*Public Comment A and Contracting Personnel Comment G*).

23. Develop a training action plan to maximize the number of Contracting Officers that receive the PBP training. This training action plan should be implemented after the current PBP guidance and training are revised to reflect the recommendations of the team (*Public Comment G and Contracting Personnel Comment F*).

24. Include additional advantages and disadvantages of PBP's to those already included in the Guide. Public comments and comments from contracting personnel added a number of additional advantages and disadvantages (*Public Comment H and Contracting Personnel Comment L*).

25. Include a discussion of the need to address PBP's as early in the acquisition process as practical, including during pre-award negotiations (*Public Comment K and Contracting Personnel Comment S*).

26. Include examples of situations when PBP's may not be appropriate (*Contracting Personnel Comment A*).

27. Develop a set of financial tools for use by Contracting Officers in performing cash flow analyses in the structuring of PBP's (*Contracting Personnel Comment C*).

28. Include a discussion of the need to have sufficient information, including (when appropriate) expenditure profiles, to negotiate the PBP schedules (*Contracting Personnel Comment D*).

29. Include a discussion of the importance of maintaining consistency in regard to the CLIN level vs. contract level requirements throughout contract performance. If the original PBP's are at contract level, modifications should be at contract level and vice-versa (*Contracting Personnel Comment J*).

30. Include a discussion of limits at the ACRN level. (*Contracting Personnel Comment W*).

D. Issues Appropriately Addressed by E-Business

When contracts are on EDA and the PBP schedule is referenced as an attachment, the attachment has not been posted to EDA (*Contracting Personnel Comment Y*).

II. Detailed Report:

1. Background

In DoDIG Report Number D2001 CK-0061, "Administration of Performance-Based Payments Made to Defense Contractors", the DoDIG performed a judgmental review of a limited number of contracts. Based on this review, the DoDIG asserted that contracting personnel frequently failed to follow the FAR, the DFARS, and the Performance Based Payments (PBP) Guide. However, the DoDIG findings addressed contract actions negotiated prior to the issuance of FAR guidance on performance-based payments (Federal Register dated March 27, 2000, 65 FR 16282), the AT&L User Guide for Performance Based Payments, and the on-line training course.

2. DoDIG Recommendations

In their report D2001CK-0061, "Administration of Performance-Based Payments Made to Defense Contractors", the DoDIG recommended that DPAP take the following actions in regard to the use of performance based payments on DoD contracts:

A. Establish a working group to monitor the effectiveness of expanded performance-based payments implementation through 2005. This team should monitor adherence to policy, recommend policy changes, establish performance measures, and assess the benefits of using performance-based payments.

B. Obtain and incorporate comments from procuring contracting officers, the Defense Contract Audit Agency, and the Defense Contract Management Agency on the User's Guide to performance-based payments and implement as mandatory guidance.

C. Establish procedures requiring the procuring contracting officer to obtain Defense Contract Management Agency and Defense Contract Audit Agency input before finalizing the event description, event prices, and event measurement criteria or to document the justification for not obtaining the input. The procuring contracting officers should also document the justification for not using Defense Contract Management Agency and Defense Contract Audit Agency input.

3. DPAP Response

In response to the DoDIG recommendations, DPAP agreed to establish a working group to review DoD implementation of performance-based payments and provide recommendations for (1) increasing the use of performance based payments as the method of contract financing on DoD contracts (e.g., what should be done to increase the number of contracts that utilize performance-based payments); and (2) improving the efficiency of performance based payments when used on DoD contracts (e.g., what should be done to improve the use of performance-based payments on those contracts that provide for such contract financing).

4. Working Group Tasking

The working group for performance based payments was tasked to (a) determine contracting personnel adherence to FAR, DFARS, and the Guide in implementing performance based payments, (b) obtain input from the public and from contracting personnel on how to improve the requirements/guidance on performance based payments contained in the FAR, DFARS, and the Guide, and (c) review/revise the current procedures for requiring the procuring contracting officer to obtain Defense Contract Management Agency (DCMA) and Defense Contract Audit Agency (DCAA) input. Note that, contrary to the DoDIG assertion, the User's Guide currently includes guidance for obtaining DCMA and DCAA input. Nevertheless, the working group review included a determination of if/how the current guidance on DCMA and DCAA participation could be improved.

5. Composition of Working Group

The DoD working group was initially comprised of members from DPAP, Army, Navy, DCMA, DCAA, and DFAS. In addition, the Air Force joined the team as a member during the analysis portion of the review.

6. Scope of Working Group Review

The Working Group review included (A) determining compliance with current FAR, DFARS, and the Guide, (B) obtaining input from contracting personnel on how to improve the current

process, and (C) obtaining input from the public on how to improve the current process.

- (A) In determining compliance with current FAR, DFARS, and the Guide, the working group statistically sampled the universe of contracts that utilized performance based payments during FY 2004. The sample includes only those contract actions that were entered into subsequent to the November, 2001, issuance of the Guide. Thus, any delivery orders under contracts entered into prior to November of 2001 were excluded from the universe. The working group developed a checklist (included as TAB C of this report) that evaluated the contracts against the requirements/guidance contained in FAR, DFARS, and the Guide.
- (B) To obtain input from contracting personnel, group members were tasked to query their personnel regarding how to (i) increase the use of performance based payments as the method of contract financing on DoD contracts (e.g., what should be done to increase the number of contracts that utilize performance-based payments); and (ii) improve the efficiency of performance based payments when used on DoD contracts (e.g., what should be done to improve the use of performance-based payments on those contracts that provide for such contract financing).
- (C) To obtain input from the public, a Federal Register Notice was issued on September 9, 2004 (FR 174, Volume 69, Page 54651). The Federal Register Notice requested public input regarding how to (i) increase the use of performance based payments as the method of contract financing on DoD contracts (e.g., what should be done to increase the number of contracts that utilize performance-based payments); and (2) improve the efficiency of performance based payments when used on DoD contracts (e.g., what should be done to improve the use of performance-based payments on those contracts that provide for such contract financing).

7. Results of Working Group Review

The detailed results of the working group review are shown at TAB A. A draft Federal Register Notice responding to the public input received is at Tab B.

III. Concurrence.

All of the group members (listed below) participated in the analysis and concur with the contents of this report.

David J. Capitano, Chairman
Performance Based Payments Working Group

Members

Timothy J. Frank, DCMA
Roseanne Hurst, DFAS
Deborah E. Neville, DCAA
Susan Orris, Army
Ronald Ostrom, Navy
Lt Col John M. Tenaglia, Air Force

Attachments:

TAB A - Results of Working Group Review
TAB B - Draft Federal Register Notice
TAB C - Performance Based Payments Checklist

Detailed Results of Working Group Review

The results of the working group review are as follows:

1. Review of Contracts:

A. Solicitation:

Checklist Item 1:

(i): Issue: Was the performance based payments (PBP) clause included in the solicitation?

Results: The review disclosed that the PBP clause was included in 44% of the solicitations for the contracts sampled.

(ii): Issue: Did the solicitation include a description of the basis for payment and liquidation? This description is required by 32.1005 - Solicitation Provision and Contract Clause.

Results: The review found that this description was included in 81% of the solicitations that had the PBP clause.

(iii): Issue: Was the Invitation to Submit PBP provision included in the solicitation?

Results: The review found that the provision was included in 39% of the contracts sampled. Thus, 61% of the time this provision was not included in contracts that eventually ended up using performance based payments.

Team Analysis/Recommendations: The results for Checklist Items (1)(i) thru (1)(iii) indicate that DoD is probably not encouraging the use of PBP payments in the solicitation. The team believes the current language at FAR 32.1005 does not adequately encourage the inclusion of this clause, and as such should be revised.

The current language requires inclusion only when the solicitation "may result in contracts providing for performance based payments". Such a requirement is ambiguous.

The Team believes the clause should be put in all solicitations unless the contracting officer has documented, in writing, that PBP's are not appropriate for the particular contract.

The Team also noted that, in some cases, it is not possible and/or practical to provide a description at the time of solicitation. For example, the PCO may want to use PBP's, but would prefer that the contractor provide the basis for payment and liquidation as part of its proposal (this could be to increase competition or may be because the specific events/outcomes cannot be determined until after contractor proposals have been submitted). The team, therefore, recommends revising the current FAR language to recognize this impracticality.

Finally, the Team believes that there is some confusion as to if/when the solicitation can contain both the PBP clause (FAR 52.232-32) and the Invitation to Propose Performance-Based Payments (FAR 52.232-28). The Team believes that when the PBP clause is included in the solicitation, the Invitation to Propose should also be included. This will enable the contractor the opportunity to provide key information regarding any proposed performance based payments (e.g., a description of the events, payments, estimated dates of completion, etc.). Therefore, the team recommends revising FAR 32.1005 and 32.503 as follows:

32.1005 - Solicitation Provision and Contract Clause

a) Insert the **[provision at 52.232-28, Invitation to Propose Performance-Based Payments, and the]** clause at 52.232-32, Performance-Based Payments, **[in solicitations likely to result in fixed price contracts unless the Contracting Officer determines that performance based payments are not practical for the contract. When the provision and clause are included, the solicitation should also include a]** with the description of the basis for payment and liquidation **[if that information is available at the time the solicitation is issued]**—as required in 32.1004 in—
~~(1) Solicitations that may result in contracts providing for performance based payments; and~~
~~(2) Fixed price contracts under which the Government will provide performance based payments~~
.....
~~-(b)~~

~~(1) Insert the solicitation provision at 52.232-28, Invitation to Propose Performance Based Payments, in negotiated solicitations that invite offerors to propose performance based payments.~~
~~(2) Use the provision with its Alternate I in competitive negotiated solicitations if the Government intends to adjust proposed prices for proposal evaluation purposes (see 32.1004 (e)).~~

32.502-3 -- Solicitation Provisions.

(1) Insert the clause at 52.232-16, Progress Payments, in **[fixed price contracts unless the Contracting Officer determines that such payments will not be practical for that contract.]**

~~(i) Solicitations that may result in contracts providing for progress payments based on costs; and~~
~~(ii) Fixed price contracts under which the Government will provide progress payments based on costs.~~

.....
The team also recommends adding the following language to the Procedures, Guidance, and Instructions (PGI):

[When the Contracting Officer anticipates providing contract financing, the solicitation shall provide the contractor with the option of proposing either performance-based payments (52.232-32) or progress payments based on cost (52.232-16), unless the Contracting Officer has determined that one of these financing methods is not practical.]

Checklist Item 2:

(i): Issue: For competitive procurements, does the solicitation include the terms for performance based payments?

Results: The review found that 57% of the solicitations for competitive procurements included the terms for PBP's.

(ii) Issue: For competitive procurements, does the solicitation state how performance based payments will be evaluated in determining award?

Results: The review found that 43% of the solicitations stated how PBP's would be evaluated in determining award.

Team Analysis/Recommendations: The team believes that it is important for the solicitation to include the terms and conditions for PBP's, and that it is imperative that potential offerors are informed of how the PBP terms will be used in determining who will receive the contract. The team believes the current requirements need to be emphasized in the Guide, including an explanation of why it is important for the solicitation to include this information. The Team also believes this emphasis should extend to the PBP training materials.

Checklist Item 3:

Issue: When it is a competitive procurement, whether the proposals were adjusted to reflect bidding of PBP's (required by FAR 32.205(c)).

Results: Seven of the contracts sampled were competitive procurements. None of these had documentation showing an adjustment to reflect the bidding of the PBP's.

Team Analysis/Recommendations: The Team recommends revising the Guide and related training to provide a discussion of the need for adjusting competitive proposals when some include PBP's and others include progress payments. The discussion should include examples and possibly a model of how to make the adjustment. In addition, the Guide and related training should emphasize the need to document the adjustments in the files.

Checklist Item 4:

Issue: Was the cognizant DCAA office listed in the contract?

Results: The review found that 12% of the contracts listed the cognizant DCAA office.

Team Analysis/Recommendations: No action necessary. This was obtained for informational purposes to allow for potential follow-up on certain issues. There is currently no requirement to list the cognizant DCAA office, and the team does not believe there needs to be one.

Checklist Item 5:

Issue: Was this a fixed price contract (PBP's may be used on fixed price contracts only)?

Results: The review found that 100% of the contracts were fixed price.

Team Analysis/Recommendations: No action necessary (100% compliance).

Checklist Item 6:

Issue: Were PBP's used on fixed price line items only (PBP's may be used only on fixed-price line items)?

Results: The review found that 100% of the contracts used PBP's on fixed-price line items only.

Team Analysis/Recommendations: No action necessary (100% compliance).

Checklist Item 7:

Issue: Was this contract awarded using sealed bid procedures (the current FAR states that PBP provisions do not apply to sealed bid contracts)?

Results: The review found that one of the contracts was awarded using sealed bid procedures.

Team Analysis/Recommendations: While it was clearly intended to prohibit PBP's on sealed bid contracts (as well as on cost-reimbursement and architect-engineer contracts), the current FAR does not specifically state this. FAR 32.1000 only states that the PBP provisions in the FAR do not "apply" to such contracts. This is not the same as stating that PBP's cannot be used on such contracts. In addition, some confusion exists as to whether PBP's can be used on fixed price line items under "cost reimbursement contracts". The Team believes that PBP's should be permitted on all fixed price line items, regardless of whether the contract is "cost-reimbursement" or "fixed-price". Therefore, the Team recommends the following revisions to FAR 32.1000:

This subpart provides policy and procedures for performance-based payments under noncommercial purchases pursuant to Subpart 32.1. **[Performance based payments shall not be used for]** ~~This subpart does not apply to~~

(a) Payments under cost-reimbursement ~~contracts~~ **[line items]**;

(b) Contracts for architect-engineer services or construction, or for shipbuilding or ship conversion, alteration, or repair, when the contracts provide for progress payments based upon a percentage or stage of completion; or

(c) Contracts awarded through sealed bid procedures.

Checklist Item 8:

Issue: Was this a contract for architect-engineer services (the current FAR states that the PBP provisions do not apply to architect-engineer services)?

Results: The review found that none of the contracts were for architect-engineer services.

Team Analysis/Recommendations: No action necessary.

Checklist Item 9:

Issue: Does the contract provide for other forms of contract financing (FAR currently prohibits contracts with PBP's from also providing for progress payments based on cost)

Results: The review found that 12% of the contracts provided for other forms of contract financing. Of these contracts, five provided for cost reimbursable public vouchers and one included progress payments based on cost. The contracts that provided for cost reimbursement public vouchers included both fixed price and cost-reimbursement line items.

Team Analysis/Recommendations: The current FAR language prohibits the use of other financing methods when PBP's are provided. However, the language fails to recognize that some contracts have both fixed price and cost reimbursement line items. The Team believes there is no logical reason to preclude the use of public vouchers on such contracts.

Therefore, the Team recommends the following revision to FAR 32.1003:

The contracting officer may use performance-based payments only if the following conditions are met:
(a) The contracting officer and offeror are able to agree on the performance-based payment terms;
(b) The contract is a fixed-price type contract; and
(c) The contract does not provide for other methods of contract financing, except that advance payments in accordance with Subpart 32.4, or guaranteed loans in accordance with Subpart 32.3 [**and interim payments under separate cost reimbursement line items**] may be used.

Checklist Item 10:

Issue: Does the contract specifically state the amount of each performance based payment either as a dollar amount or a percentage of a specifically identified price?

Results: The review found that 100% of the contracts specifically stated the amount as a dollar amount or a percentage.

Team Analysis/Recommendations: 100% Compliance. No action necessary.

Checklist Item 11:

Issue: For those contracts that pay PBP's on an overall contract basis, do the PBP's exceed 90% of the total contract price (FAR limits PBP's to 90% or less of the contract price)?

Results: Of the contracts that provided for PBP's on an overall contract basis, the PBP payments for 15% of those contracts exceeded 90% of the contract price. The reason for this was the inclusion of delivery payments and final payments in the PBP schedules.

Team Analysis/Recommendations: The Guide and the training should be revised to specifically state that delivery payments and final payments should not be included as part of the PBP schedule of payments, including examples to illustrate this.

Checklist Item 12:

Issue: For those contracts that pay PBP's on a line item basis, do the PBP's exceed 90% of the price of any line item to which they apply (FAR limits PBP's to 90% or less of the line item)?

Results: Of the contracts that provided for PBP's on a line item basis, the PBP payments for 23% of those contracts exceeded 90% of the contract price. The primary reason for exceeding the 90% was the inclusion of delivery payments and/or final payments in the PBP schedule.

Team Analysis/Recommendations: The Guide and the training should be revised to specifically state that delivery payments and final payments should not be included as part of the PBP schedule of payments, including examples to illustrate this.

Checklist Item 13:

Issue: Does the contract specifically provide for or specifically preclude payment on an individual ACRN in excess of the liquidation rate for that particular ACRN (FMR Volume 10, Chapter 10)

Results: The review disclosed that 10% of the contracts specifically provided for or specifically precluded payment on an individual ACRN in excess of the liquidation rate for that particular ACRN.

Team Analysis/Recommendations: The Team recommends that the FMR be reviewed to determine the need for this ACRN requirement and the Guide revised to address it as necessary.

Checklist Item 14:

Issue: As required by the PBP guide, does the contract include a summary of the PBP agreement? If so, does the summary include (i) the PBP event number, (ii) a brief description of the event, (iii) the contract line item or subline item to which each event applies, (iv) a statement as to whether the event is severable or cumulative, (v) the funding information for the event, (vi) the value of the

event, and (vii) the estimated date when each event is expected to occur?

Results: The review found that 98% of the contracts had a PBP schedule (Chapter 4 of Guide). Of these contracts, the review found the following:

- (i) 83% of the contracts included PBP event numbers.
- (ii) 98% of the contracts included a brief description of the event
- (iii) 92% of the contracts included the contract line item or subline item number to which each event applies. One of the contracts that did not include the contract line item or subline item had both cost and fixed price items, making it imperative that the CLINs be referenced in the schedule.
- (iv) 46% of the contracts stated whether the events were severable or cumulative.
- (v) 60% of the contracts provided the funding information related to the event
- (vi) 100% of the contracts included the value of each event.
- (vii) 65% of the contracts provided an estimated date of occurrence for each event.

Team Analysis/Recommendations: The Team believes that the Guide is clear on what is required in the summary schedule. However, the Guide does not provide an explanation as to why such information is important, i.e., how the information will be used. The Team therefore recommends that the discussion of the summary schedule in the guide be expanded to discuss the importance of each item in the summary schedule. For example, the guide can explain the importance of providing the CLINs, particularly in situations where there are both cost type and fixed price line items. The Team also recommends that the PBP training be expanded to include this same discussion, as well as some exercises that require the student to complete a PBP summary schedule. In regards to funding information, the Team recommends deleting this requirement from the PBP schedule, since such information will be required to be included in the

Payment Instructions under Section G under the current DFARS Payment and Billing Instructions case. In conjunction with the current case on Payment and Billing Instructions, DFARS 32.1007(b)(2) should be reviewed to assure that it adequately addresses when the ACRN/CLIN must be annotated on the invoice.

Checklist Item 15:

Issue: Does the contract include a description of how accomplishment of each event will be validated?

Results: The review found that 69% of the contracts included a description of how accomplishment of the event will be validated.

Team Analysis/Recommendations: The summary form in the Guide currently does not include a column for describing the validation criteria for accomplishment of the event. The Team recommends that the summary form be revised to add such a column. In addition, the Team recommends adding training materials to discuss the importance of including PBP validation criteria in the contract. The training materials should also include an exercise in filling out a summary schedule that includes completing a column regarding the validation criteria.

Checklist Item 16:

Issue: Was the contract payment office (e.g., DFAS) consulted when the contract's PBP processing structure was designed (this is specified in the Guide)?

Results: The review found that 10% of the contracts had involved the contract payment office in designing the PBP processing structure.

Team Analysis/Recommendations: The Guide currently states that Contracting officers should consult with the contract payment office and the ACO when designing the contract PBP processing structure. However, the Team does not believe that it is necessary or practical to consult with the payment office in developing the PBP processing structure for every contract. Therefore, the Team recommends a change to Page 16 of the PBP Guide to reflect language similar to the following:

Contracting officers should consult with ~~the payment disbursement office normally the Defense Finance and Accounting Service (DFAS)~~ as well as the ACO, when designing the contract PBP processing structure. Contracting Officers should also obtain DFAS input when designing the PBP processing structure for new programs, hybrid contracts (contracts that contain both fixed price and cost type line items). DFAS can also provide assistance in those instances where the contracting officer is creating a PBP schedule for the first time or implementing a new or innovative idea. By involving DFAS early in such situations, potential payment problems can be identified early in the process thereby avoiding potential payment delays.

Checklist Item 17:

Issue: Was the ACO consulted when the PBP processing structure was designed (specified in PBP guide)?

Results: The review found that 69% of the contracts involved the ACO in designing the PBP processing structure.

Team Analysis/Recommendations: The Team believes it is important for the ACO to be consulted in the design of the PBP processing structure. While the requirement is currently in the Guide, there is no explanation of why this is important, i.e., what value is provided by the Contract Management Team, including the ACO and other specialists. The Team therefore recommends that the Guide be expanded to discuss the importance of including the Contract Management Team in the PBP process. The Team also recommends emphasizing the importance of consulting the ACO in the design of the PBP processing structure. The ACO can provide assistance by reviewing the proposed events and validation criteria for clarity and technical verifiability; reviewing the valuations for each event; performing cash flow analysis; reviewing the PBP schedule and liquidation provisions; assuring that the PBP schedule complies with applicable FAR and DFARS requirements; and reviewing the effectiveness of the PBP processing structure.

Checklist Item 18:

Issue: Was DCAA consulted when the PBP processing structure was designed (specified in PBP guide)?

Results: The review found that 14% of the contracts involved DCAA in designing the PBP processing structure.

Team Analysis/Recommendations: The Team believes that, for many contracts, it would be beneficial for DCAA to be consulted in the design of the PBP processing structure. While the requirement is currently in the Guide, there is no explanation of why this is important, i.e., what value does DCAA provide. The Team therefore recommends that the Guide be expanded to discuss the importance of including DCAA in the PBP process. The Team also recommends emphasizing the importance of consulting the DCAA in the design of the PBP processing structure. The following should be added to the Guide to provide the services DCAA can offer in the PBP process:

Auditors and financial liaison advisors (FLAs) with DCAA can provide valuable financial advice to contracting officers and buying commands considering the use of PBPs. Further, DCAA provides audit assistance in PBP reviews. Audit assistance includes establishing and valuing PBP events, determining consideration for converting progress payments to PBP's, and evaluating PBP subcontract events. Audit assistance is also provided for the evaluation of expenditure profile information, including verifying data on costs incurred for prior contracts. The evaluations of the expenditure profiles assist in assuring that PBPs established on the contract are commensurate with the value of the performance-based event or performance criteria and do not result in an unreasonably low or negative level of contractor investment in the contract (FAR 32.1004(b)(3)(ii)).

Checklist Item 19:

Issue: Does the contract specify the process for submitting and approving PBP requests (specified in the Guide)?

Results: The review found that 61% of the contracts specified the process for submitting and approving PBP requests.

Team Analysis/Recommendations: While the requirement is in the Guide, there is no explanation for why this is important. The Team recommends expanding the Guide to include a discussion of what the FAR requires in terms of PBP processing, and why it is important to include the process for submitting and approving PBP requests in the contract, i.e., all parties in the process (PCO, contractor, ACO, payment office, DCAA) need to have a clear and common understanding of the process to avoid potential delays and/or disputes. The Team also recommends that this discussion be emphasized in the PBP training materials.

Checklist Item 20:

Issue: Did the contracting officer use the standard prompt payment terms for performance based payments (required by DFARS 232.1001(d)).

Results: The review found that 67% of the contracts used the standard prompt payment terms required by DFARS 232.1001(d).

Team Analysis/Recommendations: The Team believes both the FAR and DFARS need to be corrected.

FAR 32.1001(e) refers the user to the agency policy for making payment of contracting financing payments. However, in making this statement, FAR 32.1001(e) refers to the agency policy for making "prompt" payment of contract financing payments. This may cause confusion, since FAR Part 32 states that contract financing payments are not subject to the Prompt Payment Act. The Team therefore recommends revising FAR 32.1001 (e) to read as follows:

Performance-based payments are contract financing payments that are not subject to the interest-penalty provisions of prompt payment (see Subpart 32.9). However, each agency must make these payments in accordance with the agency's policy for contract financing payments.

In regard to DFARS, the provision that refers to agency policies for making payments is contained in FAR 32.1001(e). Therefore, the user will go to DFARS 232.1001(e) to find the DoD policy for making financing payments. However, the DoD policy is currently contained in DFARS 232.1001(d), not DFARS 232.1001(e). Therefore, the user may have overlooked the DFARS requirement, since it does not correspond to the FAR requirement. The Team therefore recommends moving DFARS 232.1001(d) to become DFARS 232.1001(e). The Team also recommends discussing the standard payment terms in the Guide, and including this same discussion in the PBP training materials.

Checklist Item 21:

Issue: Does the contract permit contractor PBP requests to be submitted more frequently than monthly (this is prohibited by FAR 52.232-32(b))?

Results: The review disclosed that none of the contracts permitted submittal of PBP invoices more frequently than monthly.

Team Analysis/Recommendations: 100% compliance. No action necessary.

Checklist Item 22:

Issue: Does the contract specify the liquidation rate or designated dollar amount that will apply to deliverables made during the contract period (required by FAR 32.1004(d))?

Results: The review disclosed that 71% of the contracts specified the liquidation rate or designated dollar amount that will apply to deliveries during the contract period.

Team Analysis/Recommendations: While this requirement is clearly stated in FAR 32.1004(d), the Team believes it would be helpful if it was also included in the Guide, with a discussion of exactly how it works (including examples). In addition, the PBP training should include such a discussion and related examples.

Checklist Item 23:

Issue: Does the method of liquidation ensure complete liquidation no later than final payment (required by FAR 32.1004(d))?

Results: The review disclosed that 94% of the contracts ensured complete liquidation no later than final payment. The reason the other contracts did not ensure complete liquidation was because the PBP schedule included delivery payments and/or final payments.

Team Analysis/Recommendations: The Team recommends that the Guide and related training be revised to state that delivery payments and final payments should be excluded from the PBP schedule, i.e., they should not be included as PBP payments.

Checklist Item 24:

Issue: For those performance based payments that are on a delivery item basis, is the liquidation amount for each line item a percent of that delivery item price that was previously paid under performance-based finance payments or a designated dollar amount (required by FAR 32.1004(d)(1))?

Results: The review disclosed that 79% of the contracts included the liquidation amount or designated dollar amount.

Team Analysis/Recommendations: While this requirement is clearly stated in FAR 32.1004(d)(1), the Team believes it would be helpful if it was also included in the Guide, with a discussion of exactly how the liquidation and designated dollar amounts work (including examples). The PBP training should also include such a discussion and related examples.

Checklist Item 25:

Issue: For performance based payments that are on a whole contract basis, is the liquidation a pre-designated liquidation amount or liquidation percentage (required by FAR 32.1004(d)(2))?

Results: The review disclosed that 63% of the contracts included a liquidation amount or liquidation percentage.

Team Analysis/Recommendations: While this requirement is clearly stated in FAR 32.1004(d)(2), the Team believes it would be helpful if it was also included in the Guide, with a discussion of exactly how it works (including examples). In addition, the PBP training should also include such a discussion and related examples.

Checklist Item 26:

Issue: For those contracts with more than one appropriation account, did the Contracting Officer provide instructions to the payment office for distribution of financing payments to the respective fund accounts and were such instructions consistent with the liquidation provisions?

Results: The review disclosed that 57% of the contracts provided instructions to the payment office. In those cases where instructions were provided, those instructions were consistent with the liquidation provisions of the contract.

Team Analysis/Recommendations: The issue regarding payment instructions will be resolved as a result of the publication of a final rule under DFARS CASE 2003-D009, Payment and Billing Instructions. Therefore, no further action is necessary for this item.

Checklist Item 27:

Issue: For those contracts with foreign military requirements, did the contracting officer provide instructions for distribution of the contract financing payments to each country's account?

Results: The review disclosed that, for contracts with foreign military requirements, 100% of the contracts contained the required payment instructions.

Team Analysis/Recommendations: No action necessary (100% compliance).

Checklist Item 28:

Issue: Whether the contract includes a provision that entitles the Government to take title to the property acquired or produced under the contract.

Results: The review disclosed that 100% of the contracts included the provision.

Team Analysis/Recommendations: No action necessary (100% compliance)

Checklist Item 29:

Issue: Whether the contracting officer responsible for administration of the contract is also responsible for review and approval of the performance based payments.

Results: The review disclosed that 67% of the time the contracting officer responsible for administration of the contract was also responsible for review and approval of the performance based payments.

Team Analysis/Recommendations: The Team believes that the high rate of noncompliance is most likely due to the potential confusion in the current FAR language. This includes the wording in FAR 32.1007(a) and (b). FAR 32.1007(a) addresses responsibility, while (b) is entitled "Review and Approval". However, (b) also addresses responsibility. This should be reviewed to determine if and to what extent these paragraphs can be combined or reorganized. In addition, there is a possible conflict between FAR 32.1007(a) and FAR 42.302(a)(12). FAR 32.1007(a) requires that the contracting officer responsible for "administering" the contract also be the one responsible for reviewing and approving the PBP's. However, FAR 42.302(a)(12) is a function that may be retained by the PCO, i.e., not delegated to the ACO. As such, the ACO could administer most, if not all, of the contract; yet, under FAR

42.302(a)(12), the PCO could retain the review/approval function for PBP's. In such cases, the contracting officer responsible for "administering" the contract would not be the same as the contracting officer responsible for reviewing/approving PBP's. The FAR should be reviewed to determine if any changes are needed to address this potential conflict.

Checklist Item 30:

Issue: Whether all of the events require meaningful effort, i.e., do they signify true progress in completing the contract effort (stated in Guide, Page 11).

Results: The review disclosed that 10% of the contracts contained one or more events that did not require meaningful effort. The description of these events included the following:

- (a) Certification by the program manager that the payment was funded.
- (b) Design Activities Initiated - Top Level Part Number Assigned
- (c) Attend the kickoff meeting
- (d) Mobilize a crew
- (e) Attend "Post-Award Conference"
- (f) Provide a copy of meeting minutes to attendees.

Team Analysis/Recommendations: The Team believes that FAR 32.1004(a) needs to be revised to add other events that do not require meaningful effort or action but are being included as PBP events. In addition, the Guide and related training should be revised to provide specific examples, such as those found in the review, of events that do not constitute meaningful effort or action.

Checklist Item 31:

Issue: Whether the events were based on objective, quantifiable methods or events defined in the management plan (required by FAR 32.1002).

Results: The review disclosed that 100% of the contracts contained objective, quantifiable methods or events defined in the management plan.

Team Analysis/Recommendations: No action necessary (100% compliance).

Checklist Item 32:

Issue: Whether the events are clearly and precisely defined (stated in Guide, Page 12).

Results: The review disclosed that 100% of the contracts included events that were clearly and precisely defined.

Team Analysis/Recommendations: While the contracts included acceptable descriptions of the defined events, the Team also found that some of the events would benefit from an expanded description of the event(s). The Team therefore recommends revising the Guide and related training to include examples of adequate and inadequate event descriptions.

Checklist Item 33:

Issue: Whether the metrics for the events are objective (stated in Guide, Page 12).

Results: The review found that 100% of the contracts contained objective metrics for the events.

Team Analysis/Recommendations: No action necessary (100% compliance)

Checklist Item 34:

Issue: Whether the signing of the contract is an event for which accomplishment triggers payment (this should not be included as an event per FAR 32.1004(a)(1) and the Guide, Page 11).

Results: The review found that 6% of the contracts included signing the contract as an event for which accomplishment triggered payment.

Team Analysis/Recommendations: This requirement is already in the FAR and the Guide. The Team recommends providing greater emphasis in the Guide and training materials by adding

multiple examples and providing discussions of why signing the contract is an inappropriate payment event.

Checklist Item 35:

Issue: Whether exercising an option is an event for which accomplishment triggers payment (this should not be included as an event per FAR 32.1004(a)(1) and the Guide, Page 11)

Results: The review disclosed that none of the contracts included exercising an option as a payment event.

Team Analysis/Recommendations: No action necessary (100% compliance).

Checklist Item 36:

Issue: Whether payments are based simply on passage of time (e.g. three weeks into the critical design review). Page 11 of the Guide states that passage of time should not be a payment event.

Results: The review disclosed that 4% of the contracts reviewed included a payment event or events that were passed simply on the passage of time.

Team Analysis/Recommendations: While this issue is discussed in the Guide, it is not addressed in FAR. Therefore, the Team recommends revising FAR 32.1004(a)(1) to include the passage of time as an example of an item that should not be included as a payment event.

Checklist Item 37:

Issue: Whether the number of events provided for in the contract are too few or too many.

Results: The results disclosed that the number of events ranged from 3 to 186. However, when reviewed in the context of the period of performance of the contract, the number of events per month were generally not unreasonable. For example, four of the contracts had 50 events or more. One of these had 56 events and a five year performance period - this equates to about one event per month. Another contract had 52

events, which were comprised of 13 items with 4 events for each item (i.e., 4 events for each item times 13 items equates to 52 events). Another contract had 58 events and a three year performance period - an average of about 1.5 events per month. The fourth contract had 156 events, including multiple events per month. The contract had a period of performance of 39 months, equating to an average of 4 events per month. However, it is important to note that in establishing the events for this contract, the PCO worked with the cognizant DCMA office; thus, there was agreement with the approving office that the number of events were reasonably verifiable.

Team Analysis/Recommendations: While the number of events generally appeared reasonable, the Team notes that the Guide does not address the possibility of too many PBP events. The Guide should be reviewed to include a discussion of potential disadvantages of including too many events in the contract (e.g., administrative burden of verification).

Checklist Items 38 and 39:

Issue: Was the range between events (the minimum and maximum times) reasonable (stated on Page 12 of the Guide).

Results: The review found that the ranges appear to be reasonable. The range varied from 0 days (some contracts had two events on the same day) to a maximum of 6 months.

Team Analysis/Recommendations: No action necessary. The ranges between events are reasonable.

Checklist Items 40, 41, 42, 43:

Issue: Whether the contract specifies that the events are severable or cumulative, and if cumulative whether the contract permits payment of a cumulative event even though a dependent event has not been completed (the Guide requires that the PBP schedule state whether the events are severable or cumulative; FAR 32.1004(a)(2) does not permit payment of a cumulative event if the dependent event has not been completed).

Results: The review disclosed that 87% of the contracts specified whether the events were severable or cumulative. For those contracts that included cumulative events, 68% of the events specified the dependent events, and 64% of the

contracts were structured so that payment of a cumulative event could not be made unless the dependent events had been completed.

Team Analysis/Recommendations: FAR 32.1004 should be revised to specifically state that each event must be identified in the contract as severable or cumulative (this requirement is currently only in the Guide). In addition, the Guide and training should be revised to emphasize the requirement that each event identified as cumulative specifically state which are the dependent events. The Guide and training should include examples of PBP schedules that provide adequate descriptions of cumulative and dependent events.

Checklist Items 44:

Issue: When the payment is on a deliverable item basis, whether each event or performance criteria is part of the performance necessary for that deliverable item (required by FAR 32.1004(a)(2)).

Results: The review disclosed that 96% of the contracts included event or performance criteria that were part of the performance necessary for that deliverable item. For the one contract that did not include such necessary criteria, the performance criteria was to obtain contract funding.

Team Analysis/Recommendations: As noted in the recommendations to Checklist Item 30, the Team believes that FAR 32.1004(a) may need to be revised to add other events that do not require meaningful effort or action but are being included as PBP events. In addition, the Guide and related training should be revised to provide specific examples, such as the one found in the review, of events that do not constitute meaningful effort or action.

Checklist Items 45:

Issue: When the payment is on a deliverable item basis, whether the finance amounts were identified to a specific contract line item or subline item (required by FAR 32.1004(a)(2)).

Results: The review disclosed that 88% of the items identified the finance amounts to specific contract line items or subline items.

Team Analysis/Recommendations: The Team recommends revising the Guide and training materials to include a discussion, with examples, of what is required (and why it is required) when performance based finance amounts are made on a deliverable item basis.

Checklist Items 46:

Issue: Whether DCAA was involved in selecting and defining the PBP events.

Results: The review found that DCAA was involved 4% of the time in selecting and defining the PBP events.

Team Analysis/Recommendations: The Team recommends that the Guide be revised to describe the specific assistance that DCAA can provide in the selection and defining of PBP events. The following should be added to the Guide to provide the services DCAA can offer in the PBP process:

Auditors and financial liaison advisors (FLAs) with DCAA can provide valuable financial advice to contracting officers and buying commands considering the use of PBPs. Further, DCAA provides audit assistance in PBP reviews. Audit assistance includes establishing and valuing PBP events, determining consideration for converting progress payments to PBP's, and evaluating PBP subcontract events. Audit assistance is also provided for the evaluation of expenditure profile information, including verifying data on costs incurred for prior contracts. The evaluations of the expenditure profiles assist in assuring that PBPs established on the contract are commensurate with the value of the performance-based event or performance criteria and do not result in an unreasonably low or negative level of contractor investment in the contract (FAR 32.1004(b)(3)(ii)).

Checklist Items 47:

Issue: Whether DCMA was involved in selecting and defining the PBP events.

Results: The review found that DCMA was involved 47% of the time in selecting and defining the PBP events.

Team Analysis/Recommendations: The Team recommends that the Guide be revised to describe the specific assistance that DCMA can provide in the selection and defining of PBP events. This includes reviewing the proposed events and validation criteria for clarity and technical verifiability; reviewing the valuations for each event, performing cash flow analysis; reviewing the PBP schedule and liquidation provisions, assuring that the PBP schedule complies with applicable FAR and DFARS requirements, and reviewing the effectiveness of the PBP processing structure.

Checklist Items 48:

Issue: Whether the events are disproportionate to the appropriate value of the amount of progress that the underlying events represent (e.g., are the event values "front-loaded"). The need to avoid disproportionate values is stated in the Guide, Page 15.

Results: The review disclosed that 6% of the contracts included disproportionate values. Of these contracts, one contract provided for payment of 40 percent of the contract price for issuance of a bill of materials and another 20 percent at the start of assembly. Two other contracts provided for payment of 80 percent of the contract value when the contract was only halfway complete.

Team Analysis/Recommendations: Revise FAR 32.1004(b) to specifically discuss the need to assure that payments are not disproportionate to the approximate value of the amount of the effort that is needed to complete the contract (e.g., the events are not front-loaded or back-loaded). The Guide and training materials should also be revised to provide examples of front-loading and back-loading.

Checklist Items 49:

Issue: Whether the PBP payment schedule was revised to reflect any modifications that were issued (required by FAR 32.1004(b)(5)).

Results: The review disclosed that 100% of the contracts properly adjusted the PBP payment schedule to reflect a change resulting from a modification or modifications.

Team Analysis/Recommendations: No action necessary (100% compliance)

Checklist Items 50:

Issue: Whether the payment office was notified when changes were made to the PBP events, and whether a revised summary form was completed and distributed to all parties that have a role in overseeing the payments (stated in the Guide, Page 21).

Results: The review found that the payment office was notified 100% of the time when changes were made to the PBP events. In addition, the review disclosed that the summary form was completed 93% of the time when changes were made to the PBP events.

Team Analysis/Recommendations: The review shows compliance with the current provisions. However, to assure that the revised schedules are properly distributed in the increasingly automated environment, the Team recommends that the Guide be revised to address the use of electronic transfer, particularly the need to assure that the schedules are posted as part of the electronic transfer of the contract data.

Checklist Items 51:

Issue: When a contract is converted from progress payments to performance based payments, were all previously paid progress payments incorporated into the first PBP event payment, and if so, were such payments properly re-allocated to the applicable line items.

Results: The review disclosed that, for 100% of the contracts, all previously paid progress payments were

incorporated into the first PBP payment and were properly re-allocated to the applicable line items.

Team Analysis/Recommendations: 100% compliance. No action necessary.

Checklist Items 52:

Issue: When a contract is terminated, whether the unliquidated PBP's were repaid.

Results: None of the contracts selected for this review were terminated.

Team Analysis/Recommendations: No action necessary. None of the contracts were terminated.

2. Public Comments

A summary of the public comments received in response to the Federal Register Notice and the team recommendations are as follows:

A. Training on Methods of Designing Performance-Based Payment Milestones

Comment: One commenter stated that the greatest need is for training of contracting officers and requiring activity personnel on the methods of designing performance-based payment milestones that are (1) truly performance based and (2) tied effectively to incentives, where appropriate. The training should also emphasize the "preferred method" status of PBP's, and the collaborative effort (between contracting officers and the requiring activity/end user) that is necessary to design effective and meaningful PBP schemes.

Team Response: The Team agrees that adding training in these specific areas, particularly the development of performance-based milestones, would facilitate the use and effectiveness of PBP's.

B. Performance Based Payments as the Method of Preferred Financing

Comment: One commenter believes that progress payments are preferable over performance based payments. This commenter believes that while progress payments are based on costs incurred, milestones for performance based payments are highly influenced by the contractor, and are skewed in their favor. The number of milestones on many programs may be greater than the line items on a contract, and the fact that the milestones are negotiated/established at the beginning of the contract, does not take into account the fact that the contract changes over the lifetime, and makes many milestones dubious and/or unnecessary as the contract matures. This commenter also stated that he believes the time necessary to establish these milestones makes for a number of additional negotiations during the life of the contract, which adds time to administration, rather than streamlining the effort. While establishing milestones is supposed to flag problem contracts when a milestone is missed or not billed, the commenter believes that

the loss position in a progress payment catches many more people's attention, since a single milestone could be lost in a myriad of milestones established in the contract. As such, the commenter believes that the policy of utilizing performance based payments as the financing vehicle of choice is a bad idea.

Another commenter stated that DPAP should issue a policy stating that performance based payments are the preferred method of financing on fixed price contracts when the contractor concurs.

A third commenter stated that progress payments are easier for the contract specialist because all the contract specialist has to do is make sure the FAR and DFARS progress payment clauses are in the solicitation. Conversely, performance based payments are a tremendous amount of extra work. General milestones are included in the solicitation and once award is made detailed performance based payment milestones must be negotiated. The commenter asserted that in most cases the milestones cannot be finalized in a competitive procurement, because depending on who gets the award, manufacturing processes may be different and events happening at different times. The commenter noted that a DCMA contract administrator said performance based payments are easier for them, that there is a lot of administrative work they have to do associated with progress payments that the contract specialist is not aware of. In addition, the commenter believed that after having used performance based payments on five contracts, the experience would make it easier to use such payments in the future.

Team Response: Performance based payments generally require more up-front work than progress payments. However, this is offset by the reduced administrative effort that results from the elimination of cost verifications. In addition, performance based payments increase competition, since some commercial firms do not have accounting systems that are acceptable for progress payments. The Team believes that revised guidance and training, particularly with regard to the establishment of the performance based payment milestones, should facilitate the performance based payment process.

C. Indefinite Delivery/Indefinite Quantity Contracts

Comment: One commenter noted that establishing PBP's under ID/IQ contracts at the "contract" level rather than the "order" level results in an administrative quagmire for both DCMA and DFAS. The commenter recommended that this issue be addressed as

it has in the areas of progress payments. The commenter asserted that the similarity of each is highlighted at FAR 32.1001(c) and (d), Policy. These provisions state, in pertinent part, that "Performance -based payments are fully recoverable, in the same manner as progress payments..." and that "For Government accounting purposes, the Government should treat performance-based payments like progress payments based on costs under Subpart 32.5." The commenter therefore recommends adding a paragraph to FAR 52.232-32, Performance Based Payments that is substantially the same as that at FAR 52.232-16(m), Progress Payments.

Team Response: The Team agrees that FAR coverage is needed to address ID/IQ contracts, particularly in regard to if/how PBP's are established (i.e., contract vs. order level). The Team therefore recommends that a FAR case be established to review this issue.

D. Lesser of Cost and Performance Payment

Comment: One commenter stated that FAR 32.1002 sets forth the basis or bases upon which PBP's might be made, none of which involve cost. There are instances where contract provisions have been included where PBP's are limited to the lesser of a specified PBP schedule amount or incurred costs. The commenter recommended prohibiting such practices. The comment also recommended that, alternatively, a related example might be included at FAR 32.1004 (a) as not being an appropriate criteria or "event". The commenter asserted that this is consistent with the intent of PBP's. The commenter stated that reliance on FAR 32.1004(b)(3) to introduce cost as a basis for payment is overreaching at best.

Team Response: The Team believes that the benefits of PBP's are significantly reduced when there is a requirement to use the lesser of cost or performance payment. The Team therefore recommends a FAR case be established to review this issue.

E. Responsible Official for Reviewing/Approving Performance Based Payments

Comment: The commenter notes that FAR 32.1007(a) indicates that the contracting officer responsible for administration of the contract shall be responsible for review and approval of performance-based payments. Where contracts are administered by

other than the Procuring Contracting Officer (PCO), the contract administration function of reviewing and approving/disapproving contractors' requests for either PBP's or progress payments are normally not retained by the PCO, but delegated to the Administrative Contracting Officer (ACO). The commenter states that there are instances where review and approval of PBP's are not delegated to ACOs, notwithstanding the delegation of all other contract administrative functions, an inefficient practice given the ACOs' presence in or proximity to contractor manufacturing facilities, and familiarity with contractors' business and other systems. The commenter recommends that FAR 42.302(a) (or alternatively DFARS 242.302) require that performance based payments be delegated to the ACO, unless the PCO can demonstrate compelling circumstances as to why the function should not be delegated.

Team Response: FAR 32.1007(a) requires that the contracting officer responsible for "administering" the contract also be the one responsible for reviewing and approving the PBP's. However, FAR 42.302(a)(12) is a function that may be retained by the PCO, i.e., not delegated to the ACO. As such, the ACO could administer most, if not all, of the contract; yet, under FAR 42.302(a)(12), the PCO could retain the review/approval function for PBP's. In such cases, the contracting officer responsible for "administering" the contract would not be the same as the contracting officer responsible for reviewing/approving PBP's. The FAR should be reviewed to determine if any changes are needed to address this potential conflict.

F. Valuation of PBP Events

Comment: One commenter recommended that valuation of PBP events receive increased emphasis because the commenter believes it continues to be a weakness of contracting officers.

Team Response: The Guide currently addresses the need for valuations to be commensurate with work performed. However, the Team agrees that amending the Guide and training to provide examples of inappropriate valuations (e.g., front or back-loading of payments) would be beneficial.

G. Increased Education and Emphasis on Use of Performance Based Payments

Comment: One commenter noted the reluctance of some PCO's to include performance based payments even when the contract is a good candidate for use of such payments. This commenter recommended more education and emphasis on the use of performance based payments. Another commenter also recommended increased PBP education. This commenter asserted that "contractors and DOD Buying Commands truly are unaware of the benefits of PBP and especially how to structure a PBP Contract to achieve the mutual benefits PBP provide. Progress Payments are most Acquisition Personnel's (Government and Private) comfort zone. They understand them and have used them for years." This commenter suggested increasing education via a "PBP Road Show" presented by OSD, with assistance from DOD personnel who have a wealth of PBP experience and knowledge. The commenter also suggested presentations by OSD personnel to contractors would also be beneficial.

Team Response: The Team believes that increased training would facilitate the use and effectiveness of PBP's. The Team recommends developing a training action plan to maximize the number of Contracting Officers that receive the PBP training. This training action plan should be implemented after the current PBP guidance and training are revised to reflect the recommendations of the team.

H. Advantages/Disadvantages of PBP's

Comment: One commenter identified the following advantages and disadvantages of PBP's:

Advantages of PBP

- PBP drives the Program Team to focus on performance events; and consequently the related PBP billing.
- PBP helps maintain the program schedule; Progress Payments do not provide an insight into schedule performance.
- PBP provides the Contractor an opportunity for increased cash flow; if the billing event is completed ahead of schedule, then payment is received earlier.

➤ PBP enables reduced cost of administration and streamlined oversight. Progress payments require a separate system approval by the Government. Material Management and Accounting Systems are not required for PBP contracts.

Disadvantages of PBP

➤ Use of PBP requires the agreement of both parties to the contract. This complicates the source selection process and can disadvantage the offeror seeking the use of PBP.

➤ Additional effort is required to track each PBP event due date and monitor completion status of each event. This is particularly difficult in a production build environment. The PBP billing schedule is often made more complicated than necessary.

➤ Despite the Government's policy that PBP is the preferred method of financing, certain Contracting Officers have not fully adopted the practice. This puts the contractor offering PBP at a disadvantage in a competitive source selection, and could even cause the offeror to be declared non-responsive.

Team Response: The Team recommends that these potential advantages and disadvantages be reviewed and as appropriate included as part of the revisions to the PBP guide and related training.

I. Make PBP "Required" Rather Than "Preferred"

Comment: One commenter noted that the FAR language stating "PBP are the *preferred* Government financing method when the Contracting Officer finds them practical" provides considerable discretion for the Contracting Officer to include progress payments, which are much easier to include in the solicitation. The commenter therefore recommends that the FAR 32.1001(a) be revised to require PBP rather than make their use arbitrary. The commenter asserted that there should be very few circumstances where Progress Payments are used. This commenter stated that the OSD (AT&L) policy letter of November 13, 2000 requested that PBP be the sole financing method by FY 2005. The commenter also recommends that, from a policy perspective, OSD

(AT&L) issue an update to the November 13, 2004 policy letter that reinforces the emphasis on PBP as the "mandatory" form of contract financing.

Team Response: The Team does not believe it is advisable to mandate a particular form of contract financing. However, the Team believes that the FAR should be revised to provide a more assertive requirement for the use of PBP's. The Team therefore recommends that the FAR be reviewed to address this issue. In particular, the FAR should be reviewed to determine whether the "preferred" standard should be revised to place more emphasis on the use of performance based payments. For example, when a contractor proposes PBP's but the contract includes progress payments, the FAR should require a Contracting Officer to document in the contract file why PBP's were not used.

J. FAR 52.232-28, Invitation to Proposed Performance Based Payments

Comment: One commenter stated that FAR 52.232-28. Invitation to Propose Performance-Based Payments, requires the Contracting Officer to include evaluation criteria in competitive solicitations. The commenter believes that this not only increases the complexity of the evaluation, but discourages offerors from proposing PBP due to the potential downgrading of the proposal. The commenter therefore recommends revising FAR 52.232-28 to delete Alternate 1. There should be no penalty for offering PBP. In a competitive solicitation, the contracting officer can ensure that the offer is consistent with the PBP criteria of 32.1004 and 52.232-28.

Team Response: The Team recommends reviewing the regulations to determine if/when adjustments to price are needed to reflect offers with PBP and offers with progress payments. In addition, current guidance and training should be revised to provide examples and/or models that can be used by Contracting Officers in evaluating such offers.

K. Facilitating Implementation of PBP's

Comment: One commenter stated that use of PBP's can be facilitated if PBP discussions between the PCO and the contractor begin immediately after a proposal is submitted. A PCO may require additional detail (expenditure profile by CLIN) or may want to talk to the ACO. By the time pre-award

negotiations begin, the PCO should be well aware of the PBP financing request with no opportunity for "delay pending availability of supplemental data or outstanding questions." In certain situations, it may be feasible to delegate responsibilities for establishing the PBP criteria to the ACO. This commenter also stated that PBP's can be further facilitated by requiring a detailed PBP plan and supporting expenditure profile to be submitted with the proposal.

Team Response: The Team recommends that current guidance and training state the need to address PBP's as early in the acquisition process as practical, including during pre-award negotiations.

L. Developing PBP Billing Events

Comment: One commenter recommended updating the PBP Users Guide to provide additional examples on how to develop PBP billing events. The commenter stated that emphasis should be on milestones relative to the expenditure profile, and not individual CLIN prices and schedules. Another commenter recommended some mandatory training on how to establish payment criteria. A third commenter recommended issuing guidance and initiating training stating that, as part of the acquisition planning and contract formation process, each PBP event should be formulated so that it is objective, quantifiable, and as easy to measure as possible. For example, tying PBP events to already defined program reviews, tests, or manufacturing plan milestones or other events on the integrated program schedule for manufacturing activities is often the best course. For services, tying PBP events to program reviews, key performance milestones or other suitable events is good business practice. This commenter noted that defining a PBP event as "100% completion" of tasks should be avoided, since there are frequently minor action items left open even when a major milestone is otherwise considered accomplished. The commenter also recommended revising FAR 32.1007(d), which prohibits payment of PBP for incomplete performances to address cases where the milestones are materially met, but not by a 100% standard. The commenter recommends that FAR be revised to "allow for Contracting Officer (CO) discretion for payment of partial amounts of PBP when a specified milestone is not met." The commenter states that this change would address those instances when a milestone is not achieved by a very small margin. The commenter recommended the following revision to paragraph (d) of FAR 32.1007:

(d) Incomplete performance. As a general rule, the contracting officer should not approve a performance-based payment until the specified event or performance criterion has been successfully accomplished in accordance with the contract. However, the contracting office may approve a prorated amount of payment for partial performance if it is in the Government's best interest to do so. If an event is cumulative, the contracting officer shall not approve the performance-based payment unless all identified preceding events or criteria are accomplished.

Team Response: The Team agrees that adding training in these specific areas, particularly the development of performance-based milestones, would facilitate the use and effectiveness of PBP's. The Team therefore recommends that current guidance and training be revised appropriately. However, the Team does not believe it is advisable to revise the FAR to provide for partial payments of PBP milestones when the milestone is not met. The Team believes the solution to this issue is in the development of the milestone metrics. If there are minor tasks that are not an integral part of the milestone completion, the metric for the milestone should list these minor tasks and state that they are not part of the milestone completion requirements. This will assure that the parties agree upfront on what the metrics are, rather than arguing later about "partial payment". In addition, partial payment raises an issue of how to make such a payment (how do the parties determine how much of the payment is made) and significantly reduces the effectiveness of PBP's, which are predicated on satisfactory performance of the milestone requirement. The Team therefore recommends that guidance and training be enhanced to address the development of the performance metrics, targeting milestone requirements that are integral and necessary to completion of the contract.

M. Increasing Use of PBP's

Comment: One commenter stated that current policy and regulatory implementation of PBP's are generally adequate. DoD policy now clearly states that PBP's are the preferred form of contract financing employed by the Government. However, the commenter stated that the initial effort involved in identifying objective payable events may cause some Contracting Officer's to remain reluctant to adopt the use of PBP's. The commenter recommends adopting a policy stipulating that, for all major

fixed price production programs in which the end item delivery cycle exceeds 12 months, the Contracting Officer must obtain a waiver from the Head of the Contracting Activity in order to use progress payments rather than PBP's.

Team Response: The Team does not believe it is advisable to require a waiver to use performance based payments or progress payments. The Team believes this decision should be made by the Contracting Officer.

N. Revising Milestones

Comment: One commenter noted that sometimes new leadership (program manager or PCO) wishes to revise the initially established events, which tends to negate the benefits of PBP's by adding administrative effort. The commenter recommended issuing a policy stating that previously established milestones or criteria should remain stable unless payments are in violation of the general restrictions on financing payments in FAR Part 32.

Team Response: The Team does not believe it is advisable to preclude the Contracting Officer's ability to modify PBP events. However, the Team notes that, absent a change in contract performance requirements, modifying the PBP events must be made by mutual agreement of the parties.

O. Verification of Incurred Cost for PBP's

Comment: One commenter recommended prohibiting verification of incurred costs as part of PBP's. The commenter stated that one important advantage of PBP is the elimination of government auditing of incurred costs. In addition, it is not clear what the Government intends to do with the incurred cost information. Regardless of the costs incurred to achieve a performance milestone, the payment terms in the contract will prevail. If there is a need to limit payments to a percentage of incurred costs, the original contract terms should establish progress payments as the correct contract payment mechanism. The commenter is concerned that the language at FAR 32.1004(a)(3)(ii) may be causing contracting officers to request incurred cost data for each milestone. The commenter notes that the second sentence of this paragraph states that "the contracting officer may request expenditure profile information to confirm that the contractor's investment is sufficient." The commenter recommends that the FAR

be revised and/or guidance be issued by DPAP and DCMA to make it clear that the expenditure profiles may only be requested during the contract pre-award stage.

Team Response: The Team agrees that including verification of costs incurred as a requirement for payment significantly diminishes the value of using PBP's. The Team recommends that the FAR be reviewed to address this issue, including a discussion of the difference between expenditure profiles and incurred costs.

P. Single Financing and Liquidation Rate

Comment: One commenter recommended establishing one financing and liquidation rate until the DFAS and other DoD payment systems are capable of systematically handling multiple financing rates. The commenter believes that one rate will make it much simpler for DoD and the contractor to administer, pay, and closeout contracts. In addition, in recognition of the fact that existing contracts are of mixed types and have multiple rates, the commenter recommends that DFAS and other payment offices promptly initiate a system change to provide the capability within the payment system to handle multiple financing rates and contract types in the same contract on an automated basis.

Team Response: The Team believes that it is important for the Contracting Officer to have the flexibility in the negotiation of the contract financing and liquidation rates, rather than forcing a single financing and liquidation rate for all contracts.

Q. Financing Rates Should Provide Financing Incentives for PBP Use

Comment: One commenter recommended that PBP financing rates offer true financing incentives above that which could be achieved with the no-risk, administratively burdensome 80% progress payment option. The commenter notes that the FAR currently states that performance based financing must be prudent and not exceed 90% of the contract price. The commenter asserts that there have been numerous situations where rates significantly lower than 90% have been awarded, and that this trend is a disincentive for contractors to accept the risks associated with meeting performance based financing events. The

commenter has further asserted that there have been situations where the actual PBP rates awarded provided lower effective financing than the 80% progress payment option. Therefore, the commenter recommends that DPAP issue guidance to the field advising PCO's to issue PBP rates that offer true financial incentive. The commenter further recommend that the guidance state that the 90% rate should be used on an ordinary basis, and that lower rates should be used only when significant justification exists.

Team Response: The Team agrees that providing PBP financing at or below the effective rate for progress payments does not facilitate the use of PBP's. The Team recommends that the FAR be reviewed to address this issue.

R. Use of Production Lead Times In Lieu of Performance Events

Comment: One commenter recommended permitting PBP based on production lead times for mature programs with reliable production processes, rather than using performance events. The commenter stated that this is a common commercial practice and is appropriate in situations when the lead times and production processes are well known. The commenter asserts that this would result in a contract that is both simple to award and simple to administer, since the effort to validate and approve events would be eliminated.

Team Response: The Team does not believe that passage of time should be an acceptable performance based event, even when the lead times and production processes are well known. When the production processes are well known, the Team believes it should not be difficult to establish objective performance milestones in a manner that would require minimal validation effort.

S. Eliminate Requirement to Bill at Contract Line and ACRN Level

Comment: One commenter recommended simplifying the contract administration and payment process by eliminating the requirement for contractors to bill and for DFAS (or other payment offices) to pay PBP financing requests by contract line and ACRN. The commenter asserted that PBP financing should be treated the same as progress payment financing by having the DoD payment systems allocate the billing amount to all ACRN's on the contract. The commenter asserts that adoption of this recommendation would eliminate the need for preparation of

complex billings and the maintenance of manual spreadsheets by the contractor and DoD. The commenter also recommends that DPAP and the Comptroller issue updated policy that requires the assignment of one CLIN to one ACRN for each event, absent compelling reasons to do otherwise.

Team Response: The current case on Payment and Billing instructions will revise the DFARS to provide the contracting officer with twelve options, including the ability to have the payment office allocate the costs at the CLIN/ACRN level. The Team believes this DFARS revision will mitigate the commenter's concern.

T. Segregation of Billings Into Multiple Invoices

Comment: One commenter recommended permitting billings to be segregated into multiple invoices where a problem with a funding source, accounting station, or FMS customer is expected to delay payment. The commenter believes that this option provides contractors with the ability to receive payment on time for a portion of the billing when problems arise with a particular funding source, accounting station, or FMS customer, and while also minimizing reconciliation and the risk of expiring funds.

Team Response: The Team recommends that a DFARS case be established to consider addressing instances in which a portion of the invoice is payable, but other portions are not due to problems with a funding source, accounting station, or FMS customer.

U. Corrected or Delayed Billings of Prior Month Do Not Preclude New Billings

Comment: One commenter recommended that guidance be issued stating that a corrected or delayed billing from a prior month does not preclude a contractor from issuing a new billing for PBP events achieved in a subsequent month.

Team Response: The Team recommends that current guidance and training address the processing of current invoices when there are corrected and/or delayed billings from a prior period.

3. Comments from Contracting Personnel

A. Exemption for Unsuitable Situations

Comment: One commenter recommends additional guidance on appropriate application, including exemption for especially unsuitable situations. Another commenter stated that PBP's are not well suited to all fixed price contracts. The commenter asserted that several factors argue against their use, including (1) the trend to service contracting (vice supply) has an accompanying increase in the use of fixed price per month negating the need for contract financing, (2) contracts for development, initial production, and limited quantities of future weapon systems have disproportionately high risk of changes, formal (or worse yet) informal, (3) schedule risk inherent in almost all non-commercial production is magnified when financing is tied to "milestones", and (4) it is difficult to structure PBP's for application in competitive environments.

Team Response: The Team recommends that current guidance and training be reviewed and if appropriate amended to provide situations when PBP's may not be appropriate. In regards to the specific recommendations regarding fixed price contracts, the Team notes that when the contract provides for a fixed price payment each month, then the use of PBP's would not be appropriate. In regards to competitive environments, the Team does not believe that the existence of competition should hinder the use of PBP's. However, additional guidance and training in the area of evaluation of proposals with PBP versus those with progress payments would facilitate the use of PBP's.

B. Tools for Financial and Cash Flow Analysis

Comment: One commenter recommends focusing education and training on financial analysis, and on tools and techniques to perform cash flow analysis. The commenter stated that AFMC and DAU have prototypes. Another commenter stated that defense industry marketers and defense buyers/PCOs are not used to any financial analysis, and have lost any expertise or even familiarity with concepts like Weighted Average Cost of Capital and Return on Investment. The commenter believes that these are the key to effectively addressing the timing and valuation of PBP events.

Team Response: The Team recommends reviewing the current requirement for a financial evaluation when PBP's are used. If the requirement remains, the Team recommends that DAU coordinate with the services to develop a set of financial tools and techniques for Contracting Officer's to use in evaluating and structuring PBP's.

C. Evaluating Expenditure Profiles in Establishing PBP's

Comment: One commenter stated that PBP's are difficult to structure. The commenter further stated that a robust expenditure profile is the basis for any meaningful discussion of PBP's. In competitive or TINA-exempt situations, visibility into the cost proposal is often inadequate to structure PBP's. There is a limited ability to evaluate the expenditure profile. In competition, it is difficult to compare differing PBP schedules in trade-off analysis. In either case there is a limited level of detail in the baseline to properly evaluate change proposals.

Team Response: The Team recommends that current guidance and training be amended to include an emphasis on the need to have sufficient information, including (when appropriate) expenditure profiles, to negotiate the PBP schedules.

D. Extensive Effort Required to Develop PBP's

Comment: One commenter stated that negotiating PBP's for contracts or modifications is very time-consuming and costly. This commenter believes that industry is often reluctant to negotiate (often for lack of understanding) and their initial offers are frequently "front-loaded" to offset risks associated with overly optimistic schedules. The commenter further stated "Our offices have estimated that including PBP's in negotiation often adds 30-40% to the amount of time and effort involved. A contract with PBP's will frequently require that the entire PBP schedule (timing and amount) be reopened, even when a contract change affects few line items." A second commenter stated that, on development contracts, PBP are very difficult to set up and maintain since milestones could change or dates for milestones could change. The commenter stated that on larger programs, PBP can be difficult to set up and are just one more thing to justify, document and worry about negotiating. The commenter asserted that the only plus is that contractors will accept less fee since the timing of the preponderance of the money they

receive will get there much earlier than if they were getting only progress payments.

Team Response: Performance based payments generally require more up-front work than progress payments. However, this is offset by the reduced administrative effort that results from the elimination of cost verifications. In addition, performance based payments increase competition, since many commercial firms do not have accounting systems that are acceptable for progress payments. The Team believes that revised guidance and training, particularly in regard to the establishment of the performance based payment milestones, should facilitate the performance based payment process. In addition, the Team recommends an action plan to make such training available to contractors as well as Government personnel. In regards to changes, a contract change that affects a few line items may require a change in the timing of the PBP schedule; however, major revisions to the PBP schedule should be limited to performance changes that result from the changed line items.

E. Update DoD PBP Guide

Comment: One commenter recommended that the DoD Guide for PBP be reviewed for update/revision.

Team Response: The Team agrees and is recommending significant revisions to the PBP guide, as well as considering including the Guide as part of the PGI.

F. Training of Government and Contractor Personnel

Comment: Two commenters recommended increasing the training available for contracting personnel (both PCO and ACO personnel), program personnel and contractor personnel. Such training should include explicit guidance and a thorough concentration on the formulation and valuation of appropriate events/milestones. Two other commenters recommended more training in the use of PBP's at the buying command. This commenter noted that contracting officers need a complete understanding of how to structure an event schedule, what evidence of completion is acceptable, etc. Another commenter stated that contractors need to be better educated in the use of PBP's.

Team Response: The Team believes that increased training of both Government and contractor personnel will facilitate the use and effectiveness of PBP's. The Team recommends developing a training action plan to maximize the number of Contracting Officers and contracting personnel that receive the PBP training. This training action plan should be implemented after the current PBP guidance and training are revised to reflect the recommendations of the team.

G. Developing Milestones

Comment: One commenter recommended providing additional guidance on Best Practices for implementation of performance-based payments, specifically in the area of establishing milestones. Another commenter recommended better training of personnel on performance and manufacturing processes. A third commenter recommended developing more tools to assist in the use of PBP's. For example, a list of suggested milestone events for production type contracts would be helpful. A fourth commenter recommended improving the quality of the PBP schedules. This commenter asserted that PCOs are switching over to PBP's without requiring the contractors to have milestones that make sense (both the event itself and the values established). A fifth commenter recommended that all Government personnel responsible to develop or negotiate PBP events receive appropriate training to ensure they fully understand how PBP's work, to learn about appropriate examples of PBP events and the actual mechanics of how PBP's are validated to understand the impact a particular event might have on the contract administrator and QA personnel. Another commenter recommended establishing clearly defined, tangible payment events that do not require interpretation by either the Government or Contractor as to what the event means. Another commenter recommended more education for multifunctional teams on how to establish milestones, including how to analyze the schedules, what documentation the various ERP systems provide, and how to translate program goals into cash flow. Another commenter stated that milestone events need to be events that accomplish something, and have realistic values. The commenter asserted that milestone events such as "start weld process for widget" and verifications such as "opening the work order" do not represent meaningful effort. Another commenter noted the need to establish more appropriate milestone events and define them better.

Team Response: The Team agrees that adding training regarding the development of performance-based milestones would facilitate

the use and effectiveness of PBP's. This could also include guidance that emphasizes the need for contracting personnel to understand the performance and manufacturing processes when developing the milestones, and the need to analyze any schedules or other documentation provided by the contractor. It also would emphasize, by providing examples, those actions that do not represent actual performance and as such should not be included as an event. However, the Team does not believe it is feasible to develop a "list of suggested milestone events for production type contracts", nor is it feasible to develop a general list of payment events. However, revising the guidance and training to include an emphasis on the need to understand the manufacturing process before developing the milestone events and to emphasize the need for the events to be clearly defined is appropriate. The Team therefore recommends that current guidance and training be revised appropriately.

H. Make PBP "Required" Rather Than "Preferred"

Comment: One commenter recommended making PBP the "Required" vice "Preferred" form of financing. Another commenter recommended more regulation to make it difficult for Contracting Officers to use any other type of financing. This commenter recommended following the example of undefinitized contract actions (UCAs), which used to proliferate. The commenter asserts that when the services were required to approve UCAs at a very high level, use of UCAs declined quickly.

Team Response: The Team does not believe it is advisable to mandate a particular form of contract financing. However, the Team believes that it may be possible to revise the FAR to provide a more assertive requirement for the use of PBP's. The Team therefore recommends that the FAR be reviewed to address this issue. In particular, the FAR should be reviewed to determine whether the "preferred" standard should be revised to place more emphasis on the use of performance based payments. For example, when a contractor proposes PBP's but the contract includes progress payments, the FAR should require a Contracting Officer to document in the contract file why PBP's were not used.

I. Standard DCMA Verification Method

Comment: One commenter recommended implementing a standardized means for DCMA verification of completion of milestone events.

Team Response: The Team does not believe that there can be a "standardized means of DCMA verification". Since each contract will have a different set of performance events, it would be impractical to establish a standard verification method.

J. Structuring PBP's at the CLIN vs. Contract Level

Comment: One commenter noted that CLIN structuring is very important to the proper liquidation of payments. The FAR provides for payment at the CLIN level or the contract level. It is important to structure the CLINs and the milestones at the appropriate level and not change in mid-stream.

Response: The Team agrees that changing from CLIN level to contract level (or vice-versa) during contract performance is generally not advisable. The Team therefore recommends that the guidance and training be revised to emphasize the importance of maintaining consistency in regard to the CLIN level vs. contract level requirements throughout contract performance.

K. Limiting the Number of Milestones

Comment: One commenter recommended including a limitation on the number of PBP milestones. This commenter asserted that some contractors are used to a steady cash flow from Progress Payments. Thus, they desire many PBP milestones, to mirror the cash flow they received under progress billings.

Response: The Team believes that the number of milestones should not have arbitrary limits, but does recognize that an inordinate number of milestones increases administrative burden and dilutes the performance benefits of PBPs. While current guidance addresses the need to avoid too few milestones, it does not address the issue of too many milestones. The Team therefore recommends that current guidance (and related training) be revised to address the need to avoid too many, as well as too few, milestone events.

L. Advantages/Disadvantages of PBP's

Comment: Several commenters identified the following advantages and disadvantages of using PBP's:

Advantages:

- PBP usage negates the requirement for prospective contractors to have government approved accounting systems. This elimination helps to reduce the administrative burden on both the contractor and the government. Conversely, progress payments' reliance on costs necessitates the use of an approved accounting system and further serves to alienate prospective contractors.
- PBP structure fosters teamwork by engaging industry and government personnel in a common endeavor. The concerted effort to devise and adhere to the program schedule and sufficiently measure technical progress, encourages full participation in achieving milestones while realizing reduced administrative and monitoring costs. Progress payments, however, are amenable to cost-based methodologies to provide contract financing. Teamwork is not an integral part of the process and reductions in oversight and administrative costs are unlikely.
- PBP's, in most cases, generate a more favorable cash flow position for contractors than do progress payments. The frequency of payments for successfully performing contractors is generally quicker than would be expected using progress payments. The prospect of receiving payments upon the completion of milestones is enticing to contractors since the potential to recoup investment dollars, sooner, is high.
- If the PBP milestone is not met/satisfied, it is easier for the Government to withhold payment and the contractor is more likely to immediately respond to Government concerns.
- PBP's work well when used on contracts that have a mature stable program where program offices understand the manufacturing process and with prime contractors that have financial stability.
- PBP's provide an incentive for the contractor to meet critical milestones and in most cases exceed performance over traditional progress payments.
- Improved cash flow, the contractor can get 90% of price instead of 80% of cost.

- Only technical verification needed is to ensure that the milestone events are completed.
- Less work: PBP's do not require a DCAA approved accounting system.
- Less work: PBP's do not require periodic Estimates-to-Completion.
- Easier to administer (as long as the events are clearly defined).
- Fewer reviews and less surveillance is required.
- Better for smaller companies who may not have all of the necessary accounting controls in place for Progress Payments.
- Allows ACOs to obtain security for financing when necessary, which can result in lower risk to the government.
- PBP's reduce the overall program risk.
- The contractor won't get paid if it does not meet the performance events, which is a good incentive to stay on schedule.
- Pay for performance rather than just pay for work.
- Lower risk to Government, if events are properly negotiated and validated.
- A contracting officer will know much sooner that a contractor is in performance difficulty and can get involved earlier.
- Reduced risk of overpayment versus work completed (provided PBP event schedules are appropriately developed before or at the time of contract award).
- Advantage for contractors is that work can be financed at an appropriate level without the need for meticulous accounting procedures.

- Use of PBP's should increase the number of interested sources by encouraging proposals from smaller vendors with the capability to perform but without the accounting system required to manage progress payments.

Disadvantages:

- Progress payments are less controversial and are well understood by all parties. They are much easier to handle and less work by the PCO, ACO and PM functional people as well as the contractor. Obtaining consensus with sole-source contractors on milestone events for performance-based payments can be difficult. For the most part, every time work is added or deleted from a contract, performance-based payments must be changed making changes administratively burdensome.
- The PCO office has the extra negotiation of the milestones and the payment amounts assigned to each milestone. This requires more effort up front than just incorporating the Progress Payment Clause. Assessing a value associated with a particular milestone is difficult because the payment amount must represent achievement/worth. With the reduction in workforce, this just adds additional burdens to the acquisition professionals.
- Some efforts do not lend themselves well to PBP contracts, such as repair contracts, since the actual repair may be unknown and varies with each unit. PBP also does not work well on certain non-recurring activities for example CRI's (Cost Reduction Initiatives) due to the limitation of advanced payments.
- IDIQ contracts do not always lend themselves to PBP contracts or require that milestones be established for each order which may be different than previous orders.
- PBP's, due to regulatory authority, limit flexibility to have other types of financing. This forces workarounds and creates multiple contracts to one source in order to provide a total solution, ultimately increasing acquisition cost.
- PBP's are a bit arduous and extremely time consuming to set up.

- It is often difficult to identify discernable events.
- Potential for advance payments: There is a pronounced learning curve in the development of PBP event schedules, and until a buying command "gets it right", the PBP's might effectively be advance payments, e.g. payments for events that either can't be adequately verified or that don't appropriately represent the effort being paid for under a given PBP event.
- Too easily manipulated into a "Rapid Cash Tool" for the contractor.
- Milestones can be tied to production oriented events but still not be on any critical path, resulting in continued payments for a product that is late or non-produceable. They end up being no better than a progress payment in stopping payments when product is not forthcoming.
- It is difficult to administer contracts with ambiguous events.
- PBP event verification can be quite time-consuming for Government QA personnel.
- Scope changes to the contract which would affect individual PBP CLINs (but that should seldom occur) require considerable extra work. Progress payments don't have this problem.
- The contract value threshold limitations, e.g. \$2M for large businesses, reduce the use of PBP's.
- The "clerical" aspects are time consuming - preparing the invoice in the proper format/numbering sequence, and providing the cert and secondly, obtaining appropriate "proof" that event has satisfactorily been completed.
- Over the life of the contract, requires every bit as much work (if not more) to administer than a progress payment.
- Review of Progress Payments is a reasonably simple process that does not require much in the way of resources. PBP's require more post contract issuance, DCMA involvement in their administration.

Team Response: The Team recommends that these potential advantages and disadvantages be reviewed and as appropriate included as part of the revisions to the PBP guide and related training.

M. Incrementally Funded FFP R&D Contracts

Comment: One commenter noted that there are problems with incrementally funded FFP R&D contracts. While PBP's may be fully funded for the fiscal year, the payment office may not pay the full amount of each payment.

Team Response: The FMR currently precludes the financing of an ACRN if that financing exceeds the liquidation rate multiplied by the unliquidated obligation of the stated ACRN. The Team recommends that the FMR be reviewed to determine the need for this ACRN requirement and the Guide revised to address it as necessary.

N. Use of Customer Complaints as a Performance Event

Comment: One commenter stated that, due to budget cuts, some clients do not want to use assessment procedures for some of the non-technical services such as grounds or janitorial. The clients would like to use customer complaints as the only method of assessment.

Team Response: The Team does not believe that the number of customer complaints is a basis for making PBP payments. The basis for PBP payments is the achievement of performance objectives, not whether the performance of the objective does or does not result in a specified number of customer complaints. The Team recommends that current guidance and training be revised to address this issue.

O. Evaluating PBP's on Competitive Procurements

Comment: Using PBP on competitive contracts has normally resulted in a delay in the award while the milestones are being negotiated and dollars assigned. The differences between the operation and manufacturing process between companies create the problem. Some contractors want more milestones than are listed and some don't want to use PBP in any case. It is also

impossible in most cases to determine which DCMA activity should be coordinated with up front.

Team Response: The Team recognizes that competitive contracts may require some additional analysis. The Team believes that such analysis can be facilitated by providing guidance and training on the evaluation of competitive proposals that include different sets of milestones and/or both PBP and progress payments. The Team therefore recommends that current guidance and training include discussions and examples of such evaluations on competitive contracts.

P. Solicitations Should Use Term "Financing" Rather Than "Progress Payments"

Comment: Issue solicitations and evaluation factors that specify "financing" instead of Progress Payments, so that when they negotiate they can use PBP's without risking a protest. Until solicitations come out more universally stating "financing" rather than progress payments we'll have that section L & M problem and performance based payments won't be used even when the Government and contractor agree they would be beneficial.

Team Response: The Team agrees that the solicitations and evaluation factors should not focus on the need to do an evaluation just for PBP's. A financing evaluation should be made anytime there is a competitive contract in which competing proposals include different financing mechanisms. The Team therefore recommends revising the FAR to reference the need to evaluate differences in financing between proposals, rather than focusing solely on those that propose PBP's.

Q. Use of PBP's Without Contractor Agreement

Comment: Expand the use of FAR 52.232-15, Progress Payments Not Included, and either FAR 52.232-32, Performance Based Payments or FAR 52.232-28, Invitation to Propose Performance Based Payments, in solicitations. This would deny Progress Payments as a source of financing to contractors by eliminating the availability of Progress Payments. Contractors would then only have the choice of PBP's for contract financing. (Note: This would violate the current FAR provision at 32.1001(a) that contractors must agree to the use of PBP's).

Team Response: The Team believes that enhancement of the regulations, training, and guidance can significantly improve the use of PBPs. While the team also agrees that PBP is the preferred method of financing, the team does not believe that contractors should be forced to accept PBPs instead of progress payments.

R. DCMA/DCAA Involvement Prior to Contract Award

Comment: One commenter stated that it is important to get DCMA/DCAA involved prior to contract award. The commenter asserted that early involvement makes it a lot easier to forestall problems later on that might hold up approval of the PBP payment request. Another commenter recommended that the guidance emphasize the use of DCMA in developing PBP schedules. A third commenter stated that DCMA should be actively solicited by the PCO for input on appropriate PBP events before finalizing any PBP event schedules.

Team Response: The Team believes that DCMA and/or DCAA should be consulted when such consultation is necessary and cost effective. The Team therefore recommends revising the guidance and training to require the PCO to consider using DCMA and DCAA, and to include information in the guide/training on what services/value DCMA and DCAA can provide in the development of the PBP's.

S. Require Milestones and Values in Contractor Proposals

Comment: One commenter recommended having PCO's require the contractor to provide the milestones and values that can be supported at the same time the contractor submits the proposal.

Team Response: The Team recommends that current guidance and training be revised to provide increased emphasis on the need to address PBP's as early in the acquisition process as possible, including requesting milestones and values in the solicitation when PBP's are a potential part of the procurement.

T. Develop a MOCAS Module for PBP's

Comment: One commenter recommending developing a MOCAS module for PBP's, which would make PBP administration and payment more automated. MOCAS ties PBP's into the PPR payment software,

which requires a lot of manual work that could be eliminated.

Team Response: Enhancements to MOCAS are being deferred while the MOCAS system undergoes a "re-hosting". The Team recommends that once this is complete, development of a PBP module for MOCAS be considered.

U. Including Delivery Items in the PBP Schedule

Comment: Including delivery items as part of the PBP schedule causes payment problems for DFAS and could lead to 100% of the item being paid as a PBP.

Team Response: The Team recognizes that including delivery items in the schedule may result in violating the current FAR provision that prohibits PBP payments from exceeding 90% of total price. The Team review of sampled contracts found this to be a problem in several instances. The Team therefore recommends revising current guidance and related training to address this issue.

V. IDIQ Contracts That Provide for Progress Payments and PBP's

Comment: One commenter noted a problem with contracts that authorize both progress and performance based payments. This commenter stated that there is currently discussion on whether delivery orders under IDIQ contracts can contain different financing methods.

Team Response: The FAR currently prohibits the use of progress payments and performance based payments on the same contract. However, the Team recognizes the unique nature of IDIQ contracts, and the continuing discussions over whether each order is a separate contract. The Team therefore recommends that the FAR and the guidance be revised to address the issue of using both progress payments and performance based payments on separate delivery orders under the same IDIQ contract.

W. Exceeding PBP Limits at the ACRN Level

Comment: One commenter noted that there is a requirement at FMR Volume 10, Chapter 10, which prohibits exceeding the PBP limit at the ACRN level. This commenter asserted that, while DFAS is

required to comply with this requirement, many contracting offices believe that FMR Volume 10 applies to DFAS and not to them. The commenter recommended that the requirement, if it is a valid one, be included in the PBP guide on performance based payments and possibly the DFARS PGI.

Team Response: The Team recommends that the FMR be reviewed to determine the need for this ACRN requirement and the Guide revised to address it as necessary.

X. Liquidating PBP's

Comment: One commenter stated that DFAS is liquidating improperly when the PBP's are at the CLIN level. The commenter stated that while some of the improper liquidation is due to DFAS applying PBP liquidation in the same manner as progress payment liquidation (e.g., from any ACRN on the contract), contracting officers could help this situation by entering specific payment instructions in the contract which clearly identify which CLINs are subject to liquidation and which ones are not.

Team Response: The Team agrees that it is important for the contract to include payment instructions that clearly identify which CLINs are subject to liquidation and which ones are not. The Team therefore recommends revising current guidance and training to address this issue.

Y. PBP's and EDA

Comment: One commenter asserted that contracts are on EDA and the PBP schedule is referenced as an attachment but the attachment has not been posted to EDA.

Team Response: The Team recommends that this issue be forwarded to the E-Business Directorate.

Z. Correcting Prior PBP's for Changes in PBP Schedule

Comment: No documentation exists on the proper way to correct PBP's that have been paid IAW the schedule in the contract but for some reason the schedule needs to be modified after payment is made.

Team Response: Modification to events should be prospective only. If an event has been paid, that means it has been accomplished. Such events should not be subject to change.

AA. DFAS Involvement in Developing the PBP Schedule

Comment: One commenter stated that the requirement in the OSD PBP guide for DFAS to be consulted on every PBP schedule may no longer be necessary or even cost effective. This commenter stated that, as we work towards increasing the use of PBP's, it will become almost impossible for DFAS to review every PBP schedule. The commenter recommended developing some criteria for inclusion in the guide that can be used to determine when DFAS review is necessary.

Team Response: The Team agrees that DFAS should be consulted only when such consultation is necessary and cost effective. The Team therefore recommends revising the guidance and training to require the PCO to consider using DFAS, and to include information in the guide/training on what services/value DFAS can provide in the development of the PBP schedule.

BB. Development of DFAS Standard Checklist for Reviewing PBP Schedules

Comment: One commenter recommended that DFAS develop a standard checklist for reviewing PBP schedules to ensure that any payment office concerns are identified and that no matter who in the payment office reviews the schedule, they are consistent.

Team Response: The Team recommends forwarding this comment to DFAS for consideration.

CC. Changing Title of PBP Guide

Comment: To make finding the OSD guide in the AT&L alphabetical index easier, recommend changing the title to "Performance Based Payments User's Guide" (from User's Guide to Performance Based Payments).

Team Response: The Team recognizes that the Guide needs to be more easily accessible. The Team recommends achieving this by including the Guide as part of the new PGI, which is a

supplement to the DFARS. The Team also recommends revising the title of the guide as recommended by the commenter.

DD. Revision to the Performance-Based Payment Clause Payment Timeframe

Comment: One team member noted a need to clarify FAR 52.232-32(c)(2), Performance-Based Payments, which provides for the following:

"The designated payment office will pay approved requests on the ____ [Contracting Officer insert day as prescribed by agency head; if not prescribed, insert "30th"] day after receipt of the request for performance-based payment."

This requirement does not indicate whether the receipt point that starts the payment timeframe clock is the designated billing office (which would most likely be the contract management office) or the payment office. DFARS 232.1001(d) indicates that the payment timeframe begins when the PBP request is received by the designated billing office. The Team member therefore recommends that FAR 52.232-32(c)(2) be revised as follows:

"The designated payment office will pay approved requests on the ____ [Contracting Officer insert day as prescribed by agency head; if not prescribed, insert "30th"] day after receipt of the request performance-based payment [**by the designated billing office**]."

Team Response: The Team recommends that a FAR case be opened to clarify FAR 52.232-32(c)(2) regarding when the payment timeframe begins.

DRAFT FEDERAL REGISTER NOTICE

Federal Register Notice

Department of Defense

Contract Financing: Performance-Based Payments

AGENCY: Department of Defense (DoD).

ACTION: Responses to Request for Public Input.

SUMMARY: The Director of Defense Procurement and Acquisition Policy (DPAP) is currently conducting an internal assessment regarding the use of performance-based payments as a method of financing for DoD contracts. As part of this assessment, a Federal Register Notice was issued on September 9, 2004 (FR 174, Volume 69, Page 54651). The Federal Register Notice requested the views of interested parties on what they believe are potential areas for improving DoD's use of performance based payments. Input was received from *** commenters in *** different subject areas. DPAP appreciates the extensive input provided.

COMMENTER RECOMMENDATIONS AND DPAP RESPONSE: A summary of the input and the DPAP response (including planned actions, where applicable) are as follows:

B. Training on Methods of Designing Performance-Based Payment Milestones

Comment: One commenter stated that the greatest need is for training of contracting officers and requiring activity personnel on the methods of designing performance-based payment milestones that are (1) truly performance based and (2) tied effectively to incentives, where appropriate. The training should also emphasize the "preferred method" status of PBP's, and the collaborative effort (between contracting officers and the requiring activity/end user) that is necessary to design effective and meaningful PBP schemes.

Response: DPAP plans to add training in these specific areas, particularly in the development of performance-based milestones.

B. Performance Based Payments as the Method of Preferred Financing

Comment: One commenter believes that progress payments are preferable over performance based payments. This commenter believes that while progress payments are based on costs incurred, milestones for performance based payments are highly influenced by the contractor,

and are skewed in their favor. The number of milestones on many programs may be greater than the line items on a contract, and the fact that the milestones are negotiated/established at the beginning of the contract, does not take into account the fact that the contract changes over the lifetime, and makes many milestones dubious and/or unnecessary as the contract matures. This commenter also stated that he believes the time necessary to establish these milestones makes for a number of additional negotiations during the life of the contract, which adds time to administration, rather than streamlining the effort. While establishing milestones is supposed to flag problem contracts when a milestone is missed or not billed, the commenter believes that the loss position in a progress payment catches many more people's attention, since a single milestone could be lost in a myriad of milestones established in the contract. As such, the commenter believes that the policy of utilizing performance based payments as the financing vehicle of choice is a bad idea.

Another commenter stated that DPAP should issue a policy stating that performance based payments are the preferred method of financing on fixed price contracts when the contractor concurs.

A third commenter stated that progress payments are easier for the contract specialist because all the contract specialist has to do is make sure the FAR and DFARS progress payment clauses are in the solicitation. Conversely, performance based payments are a tremendous amount of extra work. General milestones are included in the solicitation and once award is made detailed performance based payment milestones must be negotiated. In most cases you cannot finalize the milestones in a competitive procurement, because depending on who gets the award, manufacturing processes may be different and events happening at different times. The commenter noted that a DCMA contract administrator said performance based payments are easier for them, that there is a lot of administrative work they have to do associated with progress payments that the contract specialist is not aware of. In addition, the commenter believed that after having used performance based payments on five contracts, the experience would make it easier to use such payments in the future.

Response: Performance based payments generally require more up-front work than progress payments. However, this is offset by the reduced administrative effort that results from the elimination of cost verifications. In addition, performance based payments increase competition, since some commercial firms do not have accounting systems that are acceptable for progress payments. DPAP plans to revise guidance and training, particularly with regard to the establishment of the performance based payment milestones, to facilitate the performance based payment process.

C. Indefinite Delivery/Indefinite Quantity Contracts

Comment: One commenter noted that establishing PBP's under ID/IQ contracts at the "contract" level rather than the "order" level results in an administrative quagmire for both DCMA and DFAS. The commenter recommended that this issue be addressed as it has in the areas of progress payments. The commenter asserted that the similarity of each is highlighted at FAR 32.1001(c) and (d), Policy. These provisions state, in pertinent part, that "Performance -

based payments are fully recoverable, in the same manner as progress payments..." and that "For Government accounting purposes, the Government should treat performance-based payments like progress payments based on costs under Subpart 32.5." The commenter therefore recommends adding a paragraph to FAR 52.232-32, Performance Based Payments that is substantially the same as that at FAR 52.232-16(m), Progress Payments.

Response: DPAP will recommend that the issue of ID/IQ contracts, particularly in regard to if/how PBP's are established (i.e., contract vs. order level), be part of the FAR case to review the adequacy of the current PBP coverage.

D. Lesser of Cost and Performance Payment

Comment: One commenter noted that FAR 32.1002 sets forth the basis or bases upon which PBP's might be made, none of which involve cost. There are instances where contract provisions have been included where PBP's are limited to the lesser of a specified PBP schedule amount or incurred costs. The commenter recommended prohibiting such practices. The commenter also recommended, alternatively, including a related example at FAR 32.1004 (a) as not being an appropriate criteria or "event". The commenter asserted that this is consistent with the intent of PBP's. The commenter stated that reliance on FAR 32.1004(b)(3) to introduce cost as a basis for payment is overreaching at best, and that, minimally, clarification should be provided.

Response: The benefits of PBP's are significantly reduced when there is a requirement to use the lesser of cost or performance payment. DPAP will recommend that this issue be part of the FAR case to review the adequacy of the current PBP coverage.

E. Responsible Official for Reviewing/Approving Performance Based Payments

Comment: The commenter notes that FAR 32.1007(a) indicates that the contracting officer responsible for administration of the contract shall be responsible for review and approval of performance-based payments. Where contracts are administered by other than the Procuring Contracting Officer (PCO), the contract administration function of reviewing and approving/disapproving contractors' requests for either PBP's or progress payments are normally not retained by the PCO, but delegated to the Administrative Contracting Officer (ACO). The commenter states that there are instances where review and approval of PBP's are not delegated to ACOs, notwithstanding the delegation of all other contract administrative functions, an inefficient practice given the ACOs' presence in or proximity to contractor manufacturing facilities, and familiarity with contractors' business and other systems. The commenter recommends that, FAR 42.302(a) (or alternatively DFARS 242.302) require delegation of performance based payment review/approval, unless the PCO can demonstrate compelling circumstances for not delegating this function.

Response: FAR 32.1007(a) requires that the contracting officer responsible for "administering" the contract also be the one responsible for reviewing and approving the PBP's. However, FAR 42.302(a)(12) is a function that may be retained by the PCO, i.e., not delegated to the ACO.

As such, the ACO could administer most, if not all, of the contract; yet, under FAR 42.302(a)(12), the PCO could retain the review/approval function for PBP's. In such cases, the contracting officer responsible for "administering" the contract would not be the same as the contracting officer responsible for reviewing/approving PBP's. DPAP will recommend that this issue be part of the FAR case to review the adequacy of the current PBP coverage.

F. Valuation of PBP Events

Comment: One commenter recommended that valuation of PBP events receive increased emphasis because the commenter believes it continues to be a weakness of contracting officers.

Response: The Guide currently addresses the need for valuations to be commensurate with work performed. However, DPAP plans to amend the Guide and training to provide examples of inappropriate valuations (e.g., front or back-loading of payments).

G. Increased Education and Emphasis on Use of Performance Based Payments

Comment: One commenter noted the reluctance of some PCO's to include performance based payments even when the contract is a good candidate for use of such payments. This commenter recommended more education and emphasis on the use of performance based payments. Another commenter also recommended increased PBP education. This commenter asserted that "contractors and DOD Buying Commands truly are unaware of the benefits of PBP and especially how to structure a PBP Contract to achieve the mutual benefits PBP provide. Progress payments are most acquisition personnel's (Government and Private) comfort zone. They understand them and have used them for years." This commenter suggested increasing education via a "PBP Road Show" presented by OSD, with assistance from DOD personnel who have a wealth of PBP experience and knowledge. The commenter also suggested presentations by OSD personnel to contractors would be beneficial.

Response: Increased training should facilitate the use and effectiveness of PBP's. DPAP plans to work towards implementing a training action plan to maximize the number of Contracting Officers that receive the PBP training. This training action plan will be implemented in conjunction with the revisions to the current PBP guidance.

H. Advantages/Disadvantages of PBP's

Comment: One commenter identified the following advantages and disadvantages of PBP's:

Advantages of PBP

- PBP drives the Program Team to focus on performance events; and consequently the related PBP billing.

- PBP helps maintain the program schedule; Progress Payments do not provide an insight into schedule performance.
- PBP provides the Contractor an opportunity for increased cash flow; if the billing event is completed ahead of schedule, then payment is received earlier.
- PBP enables reduced cost of administration and streamlined oversight. Progress payments require a separate system approval by the Government. Material Management and Accounting Systems are not required for PBP contracts.

Disadvantages of PBP

- Use of PBP requires the agreement of both parties to the contract. This complicates the source selection process and can disadvantage the offeror seeking the use of PBP.
- Additional effort is required to track each PBP event due date and monitor completion status of each event. This is particularly difficult in a production build environment. The PBP billing schedule is often made more complicated than necessary.
- Despite the Government's policy that PBP is the preferred method of financing, certain contracting officers have not fully adopted the practice. This puts the contractor offering PBP at a disadvantage in a competitive source selection, and could even cause the offeror to be declared non-responsive.

Response: DPAP plans to consider these potential advantages in making revisions to the PBP guide and related training.

I. Make PBP “Required” Rather Than “Preferred”

Comment: One commenter asserted that the FAR language stating “PBP are the *preferred* Government financing method when the Contracting Officer finds them practical” provides considerable discretion for the Contracting Officer to include progress payments, which are much easier to include in the solicitation. The commenter therefore recommends that the FAR 32.1001(a) be revised to require PBP rather than make their use arbitrary. The commenter asserted that there should be very few circumstances where Progress Payments are used. This commenter stated that the OSD (AT&L) policy letter of November 13, 2000 requested that PBP be the sole financing method by FY 2005. The commenter also recommends that, from a policy perspective, OSD (AT&L) issue an update to the November 13, 2004 policy letter that reinforces the emphasis on PBP as the “mandatory” form of contract financing.

Response: It is not advisable to mandate a particular form of contract financing. However, the FAR could provide a more assertive requirement for the use of PBP's. In particular, the FAR should be reviewed to determine whether the “preferred” standard needs to place more emphasis on the use of performance based payments. For example, when a contractor proposes PBP's but

the contract includes progress payments, the FAR should require a Contracting Officer to document in the contract file why PBP's were not used. DPAP will recommend that this issue be part of the FAR case to review the adequacy of the current PBP coverage.

J. FAR 52.232-28, Invitation to Proposed Performance Based Payments

Comment: One commenter stated that FAR 52.232-28, Invitation to Propose Performance-Based Payments, requires the Contracting Officer to include evaluation criteria in competitive solicitations. The commenter believes that this not only increases the complexity of the evaluation, but discourages offerors from proposing PBP due to the potential downgrading of the proposal. The commenter therefore recommends revising FAR 52.232-28 to delete Alternate 1. There should be no penalty for offering PBP. In a competitive solicitation, the contracting officer can ensure that the offer is consistent with the PBP criteria of 32.1004 and 52.232-28.

Response: DPAP will recommend a review of the regulations to determine if/when adjustments to price are needed to reflect offers with PBP and offers with progress payments. DPAP will recommend that this issue be part of the FAR case to review the adequacy of the current PBP coverage. In addition, DPAP plans to revise current guidance and training to provide examples and/or models that can be used by Contracting Officers in evaluating competitive offers that contain different financing.

K. Facilitating Implementation of PBP's

Comment: One commenter stated that use of PBP's can be facilitated if PBP discussions between the PCO and the contractor begin immediately after a proposal is submitted. A PCO may require additional detail (expenditure profile by CLIN) or may want to talk to the ACO. By the time pre-award negotiations begin, the PCO should be well aware of the PBP financing request with no opportunity for "delay pending availability of supplemental data or outstanding questions." In certain situations, it may be feasible to delegate responsibilities for establishing the PBP criteria to the ACO. This commenter also stated that PBP's can be further facilitated by requiring a detailed PBP plan and supporting expenditure profile to be submitted with the proposal.

Response: DPAP plans to revise current guidance and training to stress the advantages of addressing PBP's as early in the acquisition process as practical, including during pre-award negotiations.

L. Developing PBP Billing Events

Comment: One commenter recommended updating the PBP Users Guide to provide additional examples on how to develop PBP billing events. The commenter stated that emphasis should be on milestones relative to the expenditure profile, and not individual CLIN prices and schedules. Another commenter recommended some mandatory training on how to establish payment

criteria. A third commenter recommended issuing guidance and initiating training stating that, as part of the acquisition planning and contract formation process, each PBP event should be formulated so that it is objective, quantifiable, and as easy to measure as possible. For example, tying PBP events to already defined program reviews, tests, or manufacturing plan milestones or other events on the integrated program schedule for manufacturing activities is often the best course. For services, tying PBP events to program reviews, key performance milestones or other suitable events is good business practice. This commenter noted that defining a PBP event as “100% completion” of tasks should be avoided, since there are frequently minor action items left open even when a major milestone is otherwise considered accomplished. The commenter also recommended revising FAR 32.1007(d), which prohibits payment of PBP for incomplete performances to address cases where the milestones are materially met, but not by a 100% standard. The commenter recommends that FAR be revised to "allow for Contracting Officer (CO) discretion for payment of partial amounts of PBP when a specified milestone is not met." The commenter states that this change would address those instances when a milestone is not achieved by a very small margin. The commenter recommended the following revision to paragraph (d) of FAR 32.1007:

(d) Incomplete performance. As a general rule, the contracting officer should not approve a performance-based payment until the specified event or performance criterion has been successfully accomplished in accordance with the contract. However, the contracting office may approve a prorated amount of payment for partial performance if it is in the Government's best interest to do so. If an event is cumulative, the contracting officer shall not approve the performance-based payment unless all identified preceding events or criteria are accomplished.

Response: Adding training in these specific areas, particularly the development of performance-based milestones, should facilitate the use and effectiveness of PBP's. However, it is not advisable to revise the FAR to provide for partial payments of PBP milestones when the milestone is not met. The solution to this issue is in the development of the milestone metrics. If there are minor tasks that are not an integral part of the milestone completion, the metric for the milestone should list these minor tasks and state that they are not part of the milestone completion requirements. This will assure that the parties agree upfront on what the metrics are, rather than arguing later about “partial payment”. In addition, partial payment raises an issue of how to make such a payment (how do the parties determine how much of the payment is made) and significantly reduces the effectiveness of PBP's, which are predicated on satisfactory performance of the milestone requirement. DPAP therefore plans to enhance the guidance and training to address the development of the performance metrics, targeting milestone requirements that are integral and necessary to completion of the contract.

M. Increasing Use of PBP's

Comment: One commenter stated that current policy and regulatory implementation of PBP's are generally adequate. DoD policy now clearly states that PBP's are the preferred form of contract financing employed by the Government. However, the commenter stated that the initial effort involved in identifying objective payable events may cause some Contracting Officer's to

remain reluctant to adopt the use of PBP's. The commenter recommends adopting a policy stipulating that, for all major fixed price production programs in which the end item delivery cycle exceeds 12 months, the Contracting Officer must obtain a waiver from the Head of the Contracting Activity in order to use progress payments rather than PBP's.

Response: It is not advisable to require a waiver to use either performance based payments or progress payments. This decision should be made by the Contracting Officer. No further action is anticipated for this issue.

N. Revising Milestones

Comment: One commenter noted that sometimes new leadership (program manager or PCO) wishes to revise the initially established events, which tends to negate the benefits of PBP's by adding administrative effort. The commenter recommended issuing a policy stating that previously established milestones or criteria should remain stable unless payments are in violation of the general restrictions on financing payments in FAR Part 32.

Response: It is not advisable to preclude the Contracting Officer's ability to modify PBP events. Absent a change in contract performance requirements, modifying the PBP events must be made by mutual agreement of the parties. No further action is anticipated on this issue.

O. Verification of Incurred Cost for PBP's

Comment: One commenter recommended prohibiting verification of incurred costs as part of PBP's. The commenter stated that one important advantage of PBP is the elimination of government auditing of incurred costs. In addition, it is not clear what the Government intends to do with the incurred cost information. Regardless of the costs incurred to achieve a performance milestone, the payment terms in the contract will prevail. If there is a need to limit payments to a percentage of incurred costs, the original contract terms should establish progress payments as the correct contract payment mechanism. The commenter is concerned that the language at FAR 32.1004(a)(3)(ii) may be causing contracting officers to request incurred cost data for each milestone. The commenter notes that the second sentence of this paragraph states that "the contracting officer may request expenditure profile information to confirm that the contractor's investment is sufficient." The commenter recommends that the FAR be revised and/or guidance be issued by DPAP and DCMA to make it clear that the expenditure profiles may only be requested during the contract pre-award stage.

Response: Including verification of costs incurred as a requirement for payment significantly diminishes the value of using PBP's. DPAP will recommend that this issue be part of the FAR case to review the adequacy of the current PBP coverage.

P. Single Financing and Liquidation Rate

Comment: One commenter recommended establishing one financing and liquidation rate until the DFAS and other DoD payment systems are capable of systematically handling multiple financing rates. The commenter believes that one rate will make it much simpler for DoD and the contractor to administer, pay, and closeout contracts. In addition, in recognition of the fact that existing contracts are of mixed types and have multiple rates, the commenter recommends that DFAS and other payment offices promptly initiate a system change to provide the capability within the payment system to handle multiple financing rates and contract types in the same contract on an automated basis.

Response: It is important for the Contracting Officer to have the flexibility in the negotiation of the contract financing and liquidation rates, rather than forcing a single financing and liquidation rate for all contracts. As such, it is not appropriate to mandate a single financing and liquidation rate for all contracts. No further action is anticipated for this issue.

Q. Financing Rates Should Provide Financing Incentives for PBP Use

Comment: One commenter recommended that PBP financing rates offer true financing incentives above that which could be achieved with the no-risk, administratively burdensome 80% progress payment option. The commenter notes that the FAR currently states that performance based financing must be prudent and not exceed 90% of the contract price. The commenter asserts that there have been numerous situations where rates significantly lower than 90% have been awarded, and that this trend is a disincentive for contractors to accept the risks associated with meeting performance based financing events. The commenter has further asserted that there have been situations where the actual PBP rates awarded provided lower effective financing than the 80% progress payment option. Therefore, the commenter recommends that DPAP issue guidance to the field advising PCO's to issue PBP rates that offer true financial incentive. The commenter further recommend that the guidance state that the 90% rate should be used on an ordinary basis, and that lower rates should be used only when significant justification exists.

Response: Providing PBP financing at or below the effective rate for progress payments does not facilitate the use of PBP's. DPAP will recommend that this issue be part of the FAR case to review the adequacy of the current PBP coverage.

R. Use of Production Lead Times In Lieu of Performance Events

Comment: One commenter recommended permitting PBP based on production lead times for mature programs with reliable production processes, rather than using performance events. The commenter stated that this is a common commercial practice and is appropriate in situations when the lead times and production processes are well known. The commenter asserts that this

would result in a contract that is both simple to award and simple to administer, since the effort to validate and approve events would be eliminated.

Response: The passage of time is not an acceptable performance based event, even when the lead times and production processes are well known. When the production processes are well known, it should not be difficult to establish objective performance milestones in a manner that would require minimal validation effort. No further action is anticipated for this issue.

S. Eliminate Requirement to Bill at Contract Line and ACRN Level

Comment: One commenter recommended simplifying the contract administration and payment process by eliminating the requirement for contractors to bill and for DFAS (or other payment offices) to pay PBP financing requests by contract line and ACRN. The commenter asserted that PBP financing should be treated the same as progress payment financing by having the DoD payment systems allocate the billing amount to all ACRN's on the contract. The commenter asserts that adoption of this recommendation would eliminate the need for preparation of complex billings and the maintenance of manual spreadsheets by the contractor and DoD. The commenter also recommends that DPAP and the Comptroller issue updated policy that requires the assignment of one CLIN to one ACRN for each event, absent compelling reasons to do otherwise.

Response: The current DFARS case on Payment and Billing instructions revises the DFARS to provide the contracting officer with twelve options, including the ability to have the payment office allocate the costs at the CLIN/ACRN level. This revision addresses the commenter's concern.

T. Segregation of Billings Into Multiple Invoices

Comment: One commenter recommended permitting billings to be segregated into multiple invoices where a problem with a funding source, accounting station, or FMS customer is expected to delay payment. The commenter believes that this option provides contractors with the ability to receive payment on time for a portion of the billing when problems arise with a particular funding source, accounting station, or FMS customer, and while also minimizing reconciliation and the risk of expiring funds.

Response: DPAP plans to establish a DFARS case to consider addressing instances in which a portion of the invoice is payable, but other portions are not due to problems with a funding source, accounting station, or FMS customer.

U. Corrected or Delayed Billings of Prior Month Do Not Preclude New Billings

Comment: One commenter recommended that guidance be issued stating that a corrected or delayed billing from a prior month does not preclude a contractor from issuing a new billing for PBP events achieved in a subsequent month.

Team Response: DPAP plans to amend current guidance and training to address the processing of current invoices when there are corrected and/or delayed billings from a prior period.

FOR FURTHER INFORMATION CONTACT: Mr. David Capitano, DPAP Policy Directorate, by telephone at (703)847-7486, or by e-mail at david.capitano@osd.mil.

Performance Based Payments
Checklist

TAB C

Contract Number _____

Date of Contract _____

Buying Office _____

Checklist Completed by _____

A. Solicitation:

1. Did the solicitation include the proper clause as provided for at FAR 32.1005:
 - (i) Was the clause at [52.232-32](#), Performance-Based Payments, included in solicitations that may result in contracts providing for performance-based payments and fixed-price contracts under which the Government will provide performance-based payments. _____
 - (ii) Did the solicitation include a description of the basis for payment and liquidation? _____
 - (iii) The solicitation provision at [52.232-28](#), Invitation to Propose Performance-Based Payments, included in negotiated solicitations that invite offerors to propose performance-based payments?

2. Is this a competitive negotiated solicitation (32.1004(e))? _____. If so, does the solicitation include the following:
 - (i) What, if any, terms must be included in all offers _____; and
 - (ii) The extent to which and how offeror-proposed performance-based payment terms will be evaluated _____

3. Did the contracting officer adjust the proposed prices to reflect the estimated cost to the Government as a result of providing PBP's? _____
- (a) If so, did the solicitation include Alternate I of 52.232-28? _____
- (b) Was the adjustment made using the method at 32.205(c)? _____

B. Contract Structure:

4. Does the contract specify the cognizant DCAA office? _____
If so, what is that office? _____
5. Was this a fixed price contract as defined at 16.2 (32.1003)? _____
6. Was PBP used on fixed price line items only (32.1003)? _____
7. Was this contract awarded using sealed bidding procedures (32.1000)? _____
8. Was this a contract for architect-engineer services or construction (32.1000)?

9. Does the contract include any other types of contract financing (32.1003)?

- (i) If so, what types of contract financing and to which contract line items do they relate? _____

10. Does the contract specifically state the amount of each performance-based payment either as a dollar amount or as a percentage of a specifically identified price (e.g., contract price, or unit price of the deliverable item) (32.1004(b)(3))?

11. If the PBP's are on an overall contract basis, do the PBP's, in total, exceed 90% of the price of the contract (32.1004(b)(2))? _____
12. If the PBP's are on a line item basis, do the PBPs, in total, exceed 90% of the price of any line item to which they apply (32.1004(b)(2))? _____
13. Does the contract specifically provide for or specifically preclude payment on an individual ACRN in excess of the liquidation rate for that particular ACRN (FMR Volume 10, Chapter 10)? _____
14. Does the contract include a summary of the PBP agreement that includes the following (Guide Page 16): _____
- (i) The PBP event number. _____
 - (ii) A brief description of the event. _____
 - (iii) The contract line item or sub-line item (CLIN or subCLIN) to which the event applies, if the PBPs are at a CLIN level. _____
 - (iv) A statement as to whether the event is severable or cumulative (and if cumulative, the required predecessor or concurrent events). _____
 - (v) The funding information related to the event. _____
 - (vi) The event's value. _____
 - (vii) The estimated date when it is expected to occur. _____

15. For each event, is there a description of how accomplishment of the event will be validated (Guide Page 8)? _____
16. Was the payment disbursing office (e.g., DFAS) consulted when the contract's PBP processing structure was designed (Page 16 of Guide)?_____ If so, was this consultation documented? _____
17. Was the ACO consulted when the contract's PBP processing structure was designed (Page 16 of Guide)?_____ If so, was this consultation documented?

18. Was DCAA consulted when the contract's PBP processing structure was designed (Page 16 of Guide)?_____ If so, was this consultation documented? _____
19. Does the contract specify the process for submitting and approving PBP requests?

20. Did the contracting officer use the following standard prompt payment terms for performance-based payments: The contractor entitlement date, if any, specified in the contract, or 14 days after receipt by the designated billing office of a proper request for payment, whichever is later (232.1001(d))? _____
21. Does the contract permit contractor PBP requests to be submitted more frequently than monthly (52.232-32(b))? _____
22. Does the contract specify the liquidation rate or designated dollar amount that will apply to deliveries made during the contract period (32.1004(d))? _____
23. Does the method of liquidation ensure complete liquidation no later than final payment (32.1004(d))? _____
24. If the performance-based payments are on a delivery item basis, is the liquidation amount for each line item a percent of that delivery item price that was previously paid under performance-based finance payments or a designated dollar amount (32.1004(d)(1))? _____

25. If the performance-based finance payments are on a whole contract basis, is the liquidation a predesignated liquidation amount or liquidation percentage (32.1004(d)(2))? _____
26. Was there more than one appropriation account (or subaccount) funding payments on the contract (32.1004(c))? _____
- (i) If so, has the contracting officer provided instructions to the Government payment office for distribution of financing payments to the respective funds accounts?
 - (ii) Are the distribution instructions consistent with the contract's liquidation provisions? _____
27. Does the contract contain foreign military sales requirements (232.1004(c))? _____
- (i) If so, has the contracting officer provided instructions for distribution of the contract financing payments to each country's account? _____
28. Does the contract include a provision that entitles the government to take title to all property acquired or produced under the contract (32.1009 and 52.232-32)? _____
29. Is the contracting officer responsible for administration of the contract also responsible for review and approval of performance-based payments (32.1007(a))? _____

C. Payment Events:

- 30. Do all the events require meaningful effort or action, i.e., do they signify true progress in completing the contract effort (Guide, Page 11)? _____

- 31. Are the events based on either (a) objective, quantifiable methods such as delivery of acceptable items, work measurement, or statistical process controls, (b) accomplishment of events defined in the program management plan, or (c) other quantifiable measures of results (32.1002)? _____

- 32. Are the events clearly and precisely defined (Guide, Page 12)? _____

- 33. Are the metrics for the events objective (Guide, Page 12)? _____

- 34. Is signing the contract an event for which accomplishment triggers a payment (Guide, Page 11)? _____

- 35. Is exercising an option an event for which accomplishment triggers a payment (Guide, Page 11)? _____

- 36. Are payments based simply on passage of time (e.g., three weeks into the critical design review) (Guide, Page 11)? _____

- 37. How many events are provided for in the contract (Page 11 of Guide)? _____

- 38. What is the minimum time between events (Guide, Page 12)? _____

- 39. What is the maximum time between events (Guide, Page 12)? _____

- 40. Are the events severable or cumulative (32.1004(a)(2))? _____

- 41. If the events are severable, does the contract specifically identify the severable events or criteria (32.1004(a)(2))? _____
- 42. If the events are cumulative, does the contract permit payment for a cumulative event or criterion even though a dependent event or criterion has not been successfully completed (32.1004(a)(2))? _____
- 43. If the events are cumulative, does the contract identify the events or criteria that are preconditions for achievement of each cumulative event or criterion (32.1004(a)(2))? _____
- 44. If the payment of performance-based finance amounts is on a deliverable item basis, is each event or performance criterion part of the performance necessary for that deliverable item (32.1004(a)(2))? _____
- 45. If the payment of performance-based finance amounts is on a deliverable item basis, is the performance-based finance amount identified to a specific contract line item or subline item (32.1004(a)(2))? _____
- 46. Was DCAA involved in selecting and defining the PBP events (Guide, Page 13)?
_____ Was that involvement documented? _____
- 47. Was DCMA involved in selecting and defining the PBP events (Guide, Page 13)?
_____ Was that involvement documented? _____
- 48. Are the event values disproportionate to the approximate "value" of the amount of progress that the underlying events represent (e.g., the event values are "front-loaded") (Guide, Page 15)

D. Contract Performance:

49. Were any contract modifications issued? _____

- (i) If so, did the contracting officer adjust the performance-based payment schedule as necessary to reflect the actions required by those contract modifications (32.1004(b)(5))?

50. Were any modifications made to the PBP events? _____

- (i) If so, was the payment office informed of the changes in PBP structure (Guide, Page 21)? _____

- (ii) Was a revised summary form completed and distributed to all parties having a role in making or overseeing payments (Guide, Page 21)? _____

51. Was the contract converted, from progress payments based on cost to PBP's, at some point in the contract (Guide, Page 8)? _____

- (i) If so, were all previously made progress payments incorporated into the first PBP event payment when the conversion is being accomplished? _____

- (ii) How were the previously made progress payments incorporated (e.g., by check, re-allocated among applicable line items, reductions on the first performance based payment event, other - specify)?

52. Was this contract terminated (Guide, Page 18)? _____

- (i) If so, were any unliquidated PBP's repaid? _____

