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ACQUISITION,
TECHNOLOGY
AND LOGISTICS

APR 27 2011

MEMORANDUM FOR COMMANDER, UNITED STATES SPECIAL OPERATIONS COMMAND (ATTN: ACQUISITION EXECUTIVE)
COMMANDER, UNITED STATES TRANSPORTATION COMMAND (ATTN: ACQUISITION EXECUTIVE)
DEPUTY ASSISTANT SECRETARY OF THE ARMY (PROCUREMENT)
DEPUTY ASSISTANT SECRETARY OF THE NAVY (ACQUISITION AND LOGISTICS MANAGEMENT)
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE (CONTRACTING)
DIRECTORS OF THE DEFENSE AGENCIES
DIRECTORS OF THE DOD FIELD ACTIVITIES

SUBJECT: Cash Flow Tool for Evaluating Alternative Financing Arrangements

On September 14, 2010, Dr. Ashton Carter, Under Secretary of Defense for Acquisition, Technology and Logistics, issued a memorandum on the subject of Better Buying Power for the Department. In that memorandum, the Director of Defense Procurement and Acquisition Policy was directed to develop a cash flow model to be used by all contracting officers contemplating financing other than customary progress payments, such as Performance Based Payments (PBP). In addition, guidance was to be developed that ensures that the improved cash flow opportunities provide benefit to both industry (at both the prime and subcontractor level) and the taxpayer.

The timing and amount of cash flows provided to the contractor through Government financing has a measurable cost to the Government and a measurable benefit to the contractor. Those costs and benefits can be determined by performing a discounted cash flow analysis which takes into account the amount and timing of cash flows over the contract period. Discounted cash flow is the technique commonly employed by businesses to analyze the financial return on a project or investment opportunity involving a series of cash flows over time.

PBPs offer the contractor improved cash flow as compared to customary progress payments. Because of the differing view of the time-value of money between industry and the Government, PBPs provide a unique opportunity for a win-win financial arrangement. This difference in the time value of money produces a PBP price that is lower than that warranted with customary progress payments, and yet is a better financial arrangement for the contractor.

As a matter of practice, for new contract awards, the basis of negotiations for fixed price contracts shall be the use of customary progress payments. For competitive fixed-price acquisitions the request for proposal will state that the proposal and award will be based on the use of customary progress payments. After agreement on price, or contract award in the case of competitive acquisitions, the contractor shall have the flexibility to propose PBPs for the

Government's consideration. This will allow the contracting officer to determine the reasonableness of the consideration being offered by the contractor for a more favorable payment structure.

PBPs are not practical for use on all fixed price contracts and require considerable effort between the contractor and Government to identify the appropriate PBP events and establish the proper completion criteria for those events. Therefore, the contractor should be instructed that if PBPs are desired, a proposed PBP schedule should be submitted which includes all PBP events, completion criteria and event values along with the contractor's expected expenditure profile. This will allow the Government and the contractor to determine the practicality of PBPs for that contract. If PBPs are deemed practical, the Government must evaluate and negotiate the details of the PBP schedule.

The contracting officer must clearly identify the consideration received in the post negotiation clearance document whenever a payment schedule more favorable to the contractor than customary progress payments is negotiated. Because the tool we developed uses the cash flows provided by customary progress payments as the baseline against which to determine the win-win arrangement, it is perfectly suited to evaluate the consideration offered. The negotiated consideration must be specifically approved by the clearance official or one level above the contracting officer, whichever is higher.

The Excel-based analysis tool we developed will allow the contracting officer and industry to easily compare the financial cost and benefits of using PBPs versus customary progress payments. The model will also determine a win-win price that equitably accounts for the cost, benefits and potential risk associated with PBPs. This tool can be found on the Cost, Pricing and Finance section of our website, under PBP Analysis Tool, at:

PBP Tool: http://www.acq.osd.mil/dpap/cpf/Performance_based_payments.html

All contracting officers shall utilize this tool on new fixed-price type contract awards resulting from solicitations issued on or after July1, 2011, whenever PBPs are contemplated for contract financing. This tool will clearly support a win-win settlement position that reflects adequate consideration to the Government for the improved contractor cash flow.

Federal Acquisition Regulations prohibits contracts from having both progress payments and PBP financing on a contract at the same time. Therefore, for modifications to contracts that already use PBP financing, the basis for negotiation must also be PBPs. In those situations, the tool above can be used in the same manner to help determine the win-win price for the modification.

A continuous learning course on PBPs is being developed by the Defense Acquisition University with an anticipated completion date of May 2011. The course number and title will be CLC 057 – Understanding Performance Based Payments and the Value of Cash Flow. Additionally, my Cost, Pricing and Finance Directorate is updating the DoD Performance Based Payment Guide. I recommend utilizing each of these resources, once available, to assist in establishing effective PBPs.

This memorandum remains in effect until incorporated into the Defense Federal Acquisition Regulation Supplement or its companion resource, Procedures, Guidance, and Information, or otherwise rescinded.

In all cases where there is some alternative financing arrangement other than PBPs being contemplated, the Contracting Officer shall submit that proposed arrangement to my office for review and concurrence prior to the utilization of such alternative financing arrangement. My point of contact for this matter is Mr. Dave Mabee, at 703-602-0288 or Dave.Mabee@osd.mil.

Shay D. Assad
Director, Defense Procurement
and Acquisition Policy

cc:
President, Defense Acquisition University