

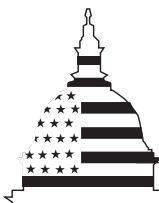
GAO

Report to the Chairman, Subcommittee
on Technology and Procurement
Policy, Committee on Government
Reform, House of Representatives

September 2002

CONTRACT MANAGEMENT

Guidance Needed for Using Performance- Based Service Contracting



G A O

Accountability * Integrity * Reliability

Contents

Letter		1
	Results in Brief	2
	Background	3
	How Contracts Exhibited Performance Attributes Varied	4
	Guidance on Performance-Based Contracting Needs Improvement	8
	Conclusions	9
	Recommendations for Executive Action	9
	Agency Comments	10

Appendix I	Scope and Methodology	11
-------------------	------------------------------	-----------

Appendix II	Performance-Based Service Contracting in the Federal Acquisition Regulation	14
--------------------	--	-----------

Appendix III	Major Performance-Based Service Contracting Events	17
---------------------	---	-----------

Appendix IV	GAO Contact and Staff Acknowledgments	19
--------------------	--	-----------

Tables		
	Table 1: Contracts Maximizing Contractor Initiative to Achieve Desired Outcomes	5
	Table 2: Contracts That Did Not Clearly Exhibit All Four Performance-Based Attributes	6
	Table 3: Contracts That Were More Complex and Risky	8
	Table 4: Service Contracts Reviewed	12

Abbreviations

DOE	Department of Energy
FAR	Federal Acquisition Regulation
FPDS	Federal Procurement Data System
GAO	General Accounting Office
GSA	General Services Administration
NASA	National Aeronautics and Space Administration
OMB	Office of Management and Budget
OFPP	Office of Federal Procurement Policy
OMB	Office of Management and Budget
SEC	Securities and Exchange Commission



United States General Accounting Office
Washington, DC 20548

September 23, 2002

The Honorable Tom Davis
Chairman, Subcommittee on Technology and
Procurement Policy
Committee on Government Reform
House of Representatives

Dear Mr. Chairman:

Federal agencies spent roughly \$136 billion last year acquiring services ranging from clerical support and consulting services to information technology services, such as network support, to management and operations of government facilities, such as national laboratories. To achieve greater cost savings and better outcomes with this spending, the Congress and the administration have encouraged greater use of performance-based service contracting. Under this approach, the contracting agency specifies the outcome or result it desires and leaves it to the contractor to decide how best to achieve the desired outcome.

You requested that we evaluate whether service contracts characterized by agencies as performance-based contain basic performance-based attributes. These attributes include descriptions of what outcomes the agency is looking for rather than descriptions of how services should be performed; measurable performance standards; quality assurance plans that describe how the contractor's performance will be evaluated; and positive and negative incentives, when appropriate.

To respond to your request, we asked five major government agencies—the Department of Energy (DOE), the Department of the Treasury, and the Department of Defense; the National Aeronautics and Space Administration (NASA); and the General Services Administration (GSA)—to identify contracts that they considered to be models of performance-based service contracting. On the basis of the contract type and service provided, we reviewed 25 contracts to assess whether they exhibited performance-based attributes and discussed our findings with agency and contracting officials. Appendix I discusses our scope and methodology.

Results in Brief

Most of the 25 contracts we reviewed exhibited at least one of the performance-based attributes but there was a range in the degree to which they exhibited these attributes.

- On one end were nine contracts that clearly exhibited all of the attributes. These were contracts for services widely performed in the commercial sector, such as custodial services, building maintenance, and advertising. These contracts lend themselves to performance-based contracting because measuring and specifying intended outcomes is relatively straightforward, and there is little need for the government to specify a host of unique requirements or to play a strong role in how the contract is executed.
- On the other end were four contracts, also for services widely performed in the commercial sector, which did not clearly exhibit all of the attributes. While the contracts included performance incentives, they were very prescriptive in how the work should be carried out. By being as prescriptive as they were, the agencies did not enable their contractors to find better, more cost-effective ways of doing business using performance-based contracting.
- In between this range were 12 contracts for more unique and complex services. In most of these cases, agencies strived to build in performance-based attributes but they appropriately found that they still needed to be prescriptive and to exert strong oversight, because the services themselves presented safety, cost, and/or technical risks.

Though our review focused on a small sample of contracts, it does raise concern as to whether agencies have a good understanding of performance-based contracting and how to take full advantage of it. Agency officials themselves pointed to the need for better guidance on performance-based contracting and better criteria on which contracts should be called “performance-based.”

The Office of Federal Procurement Policy recognizes this is a problem and is in the initial stages of developing new guidance examining how to improve agency use of performance-based contracting. The recommendations in this report focus on the office’s need to consider an in-depth evaluation of agencies’ use of performance-based contracting as it proceeds with this effort.

The Office of Federal Procurement Policy provided oral comments on a draft of this report and concurred generally with the views expressed in the draft.

Background

Performance-based contracts clearly spell out the desired end result expected of the contractor. The manner in which the work is to be performed is left up to the contractor. Contractors are given as much freedom as possible in figuring out how best to meet the government's performance objective. Traditionally, government service contracts have tended to emphasize inputs rather than outcomes. For example, contracts typically have detailed the procedures and processes to be used in delivering a service; amount and type of equipment; and/or time and labor to be used.

Performance-based contracts offer significant benefits. Primarily, they encourage contractors to be innovative and to find cost-effective ways of delivering services. By shifting the focus from process to results, they also promise better outcomes.

In view of the potential benefits, the Office of Management and Budget (OMB) has been encouraging greater use of performance-based contracting—setting a general goal of making performance-based contracts 20 percent of all eligible service contracting dollars.¹ In 2001, agencies reported using performance-based contracting methods on about \$28.6 billion, or 21 percent of the \$135.8 billion total obligations incurred for services. Specifically, of about 360,000 service contract actions during fiscal year 2001, agencies reported that about 41,000 (approximately 11 percent) were performance-based.²

According to Office of Federal Procurement Policy (OFPP) guidance, performance-based contracts should have the following attributes.

¹ Specifically, OMB established greater use of performance-based contracts as one of several government-wide reforms to be highlighted by the President for the fiscal year 2002 budget. Under OMB's guidance, if an agency determined that greater use of performance-based contracts would significantly enhance its operations, the agency was to include a performance goal in its fiscal year 2002 performance plans as required by the Government Performance and Results Act. For agencies that set a goal of making greater use of performance-based service contracts, in March 2001, OMB created a goal of awarding contracts over \$25,000 using performance-based methods for not less than 20 percent of total eligible service contracting dollars awarded during fiscal year 2002.

² These data are based on information from the Federal Procurement Data System. Since October 2001, the mandatory format for submitting data to the system on each contract action exceeding \$25,000 includes a check box to indicate whether performance-based service contracting was used.

-
1. Describe the requirements in terms of results required rather than the methods of performance of the work. Agencies should structure performance work statements in contracts around the purpose of the work to be performed, that is, what is to be performed rather than how to perform it. For example, instead of telling the contractor how to perform aircraft maintenance or stating how many mechanics should be assigned to a crew, the contract should state that the contractor is accountable for ensuring that 100 percent of flight schedules are met or that 75 percent of all aircraft will be ready for flight.
 2. Set measurable performance standards. Standards should be set in terms of quality, timeliness, and quantity among other things. Agencies should ensure that each standard is necessary, carefully chosen, and not unduly burdensome. Failure to do so can result in unnecessarily increased contract costs. Agencies should also ensure that standards are not set so high that they could drive up the cost of service or too low that they may act as a disincentive to good contract performance.
 3. Describe how the contractor's performance will be evaluated in a quality assurance plan. A good quality assurance plan should include a surveillance schedule and clearly state the surveillance methods to be used. The plan should focus on the quality, quantity, and timeliness of the performance outputs to be delivered by the contractor, among other things, and not on the steps required or methods used to produce the service.
 4. Identify positive and negative incentives, when appropriate. Incentives should be used when they will induce better quality performance and may be either positive or negative, or a combination of both. They should apply to the most important aspects of the work, rather than every individual task.

How Contracts Exhibited Performance Attributes Varied

Most of the 25 contracts we reviewed exhibited at least one of the performance-based attributes, but there was a wide range in the extent to which they did. On the one end were contracts for services widely performed in the commercial sector that clearly exhibited all attributes. On the other were contracts for similar services that did not exhibit all of the attributes. In between were contracts for services that were much more complex and sophisticated. Agencies strived to build in performance-based attributes, but they found that they still needed to be prescriptive and needed to exert strong oversight because the services themselves presented considerable risks.

Contracts That Clearly Exhibited All Attributes

Nine contracts clearly exhibited all four attributes. (See table 1.) These contracts

- described what outcomes the government was looking for and left it up to the contractor to decide how best to achieve these outcomes,
- set measurable performance standards,
- subjected the contractor to a quality assurance plan, and
- included performance penalties and incentives when appropriate.

Table 1: Contracts Maximizing Contractor Initiative to Achieve Desired Outcomes

	Agency	Service
1	Army	On-line educational services to enable service men and women to pursue post-secondary degrees and vocational-technical certificates
2	Navy	Advertising campaign to support the Navy's recruitment needs
3	Air Force	Custodial services at an Air Force base
4	GSA/FTS	Information technology support services for the Securities and Exchange Commission
5	GSA/PBS	Janitorial services at two federal buildings
6	GSA/PBS	Recurring maintenance and repair services at two federal buildings
7	GSA/PBS	Systems and equipment operations and maintenance at a federal building
8	Treasury	Tour guide services for the Bureau of Engraving and Printing
9	Treasury	Firearms support services for the Federal Law Enforcement Training Center

Legend
FTS = Federal Technology Service
PBS = Public Buildings Service

Source: GAO, based on information provided by the agencies.

The nine contracts were generally for types of services that are performed widely in the commercial sector, such as custodial services, building maintenance, or advertising. These types of services lend themselves to performance-based contracting because measuring and specifying outcomes for them are relatively straightforward. Moreover, the services themselves do not present substantial risks to the government, and they do not require the government to specify numerous unique requirements or to play a strong role in how the contract is executed.

Agencies still undertook considerable efforts to build performance attributes into their contracts. For example, in contracting for advertising services for its recruiting campaign, the Navy studied how the service was performed successfully in the private sector and used the results of its study to enhance its contract. In contracting for janitorial services, GSA

collected performance and cost data to make sure it developed good measures of performance and incentives. The data were also used to obtain competitive prices on subsequent contracts.

When performance-based attributes were incorporated into the contracts, agencies generally reported positive results. For example, the Securities and Exchange Commission (SEC) was very satisfied with a contract that GSA awarded for information technology support services. SEC officials reported that the contractor took a proactive approach to improving the operations and efficiencies of their information technology resources and formed an effective partnership with the agency. In addition, the Navy found that the contractor running its recruitment advertising campaign exceeded its expectations by identifying 224,195 qualified leads in fiscal year 2001; the Navy’s goal was 208,500.

Contracts That Could Have Incorporated All Attributes but Did Not

Four contracts could have incorporated all of the attributes but did not. (See table 2.) Like the contracts above, these contracts were for relatively uncomplicated services (dormitory management, food services, military housing maintenance, and refuse collection) that lend themselves to performance-based contracting. While contracts had either positive or negative performance incentives, they were very prescriptive in how the work should be carried out.

Table 2: Contracts That Did Not Clearly Exhibit All Four Performance-Based Attributes

	Agency	Service
1	Air Force	Refuse collection and recycling at an Air Force base
2	Air Force	Maintaining housing at an Air Force base
3	Treasury	Dormitory management at Federal Law Enforcement Training Center
4	Treasury	Food management at Federal Law Enforcement Training Center

Source: GAO, based on information provided by the agencies.

Examples of the prescriptive contracts are highlighted below.

- The \$3 million Treasury dormitory management contract contained 47 pages of specifications that, among other things, detailed: the cotton/polyester fiber content of towels, bed linens, and ironing board pads; the components necessary for making up a bed; monogramming contractor employee uniforms; minimum thickness standards for trash can liners; and when and how to perform maintenance on water coolers and air conditioning equipment.

-
- The \$44.1 million food service contract, also at Treasury, contained 33 pages of specifications that detailed: the provisions for picnic lunches (6-to 8-inch average length for corn-on-the-cob); specific sandwiches to be served for each day of the week; and procedures to maintain a technical library.

By being as prescriptive as they were, the agencies did not enable the contractor to develop and implement better or more cost-effective ways of doing business using performance-based contracting. As a result, they missed out on an opportunity to achieve better outcomes with their spending for services.

Twelve Contracts for More Complex, Risky Services Had Some Attributes

The remaining contracts were for services that were either unique to government, very complex and technical, and/or high risk. For example, three contracts were for operating Navy tactical test ranges, one was for launching and recovering the space shuttle, and one was for operating a nuclear facility. (See table 3.) In these cases, agencies strived to build in the attributes. However, because of the risk and complexity involved, they found that they could not forego maintaining a strong role in specifying how the work should be done as well as overseeing the work. As a result, while the contracts had some attributes, such as incentives and quality assurance plans and performance measures, they also sometimes built in very detailed work specifications, numerous performance measurements, and/or extensive oversight controls.

Two examples of these more complex situations are highlighted below.

- In contracting for management and operation services at its Savannah River Site Facility, the Department of Energy built in attributes such as incentives tied to outcomes and performance measures. DOE noted that it designed the contract to be more outcome-oriented than prior contracts. However, because of the high-risk nature of the work being done, the agency also put in 14 highly detailed “work authorizations” that required the contractor to follow many protocols and specifications in conducting the work.
- In contracting for space shuttle services, NASA built in performance measures that were tied to a quality assurance plan and built in incentive and penalty provisions to foster better performance by the contractor. NASA officials said the agency included fewer specifications than it did for the prior contract. The contract’s work specifications, however, were still very detailed (107 pages), as were the performance metrics (190). NASA officials believed that the contract went as far as it could toward building

in performance-based attributes without putting its astronauts’ lives at risk as well as risking highly expensive equipment.

Such complex situations may require strong government oversight. Our prior reports, particularly those on NASA and DOE, have called for more effective oversight for operations similar to the ones we reviewed in order to stem cost overruns, scheduling delays, and performance problems.

Table 3: Contracts That Were More Complex and Risky

	Agency	Service
1	Army	• Technical and administrative support for a DNA registry, forensic toxicology lab, pathology center, and museum
2	Navy	• Engineering, logistics, program management, and finance support services for the Naval Sea Systems Command
3,4,5	Navy	• Operating and maintaining tactical test ranges and equipment at three Navy installations • Three separate contracts
6	DOE	• Management and operations at Argonne National Laboratory (research and development)
7	DOE	• Management and operations at Savannah River Site Facility
8	NASA	• Operations support for launch and recovery of the space shuttle
9	NASA	• Avionics systems research & development and engineering for the space shuttle and the international space station
10	NASA	• Scientific, engineering, information technology, and administrative support at NASA’s Laboratory of Terrestrial Physics
11	NASA	• Contractor oversight to ensure that NASA’s technical contract requirements are met
12	NASA	• Logistical services for NASA’s Goddard Space Flight Center, headquarters, and other locations

Legend
DNA = deoxyribonucleic acid

Source: GAO, based on information provided by the agencies.

Guidance on
Performance-Based
Contracting Needs
Improvement

Though our review focused on a small sample of contracts, it raises concern as to whether agencies have a good understanding of performance-based contracting and how to take full advantage of it. Some agency officials said that they would like better guidance on performance-based contracting, particularly with respect to how it can be applied in more complex situations. Agency officials also said that there is a need for better criteria on which contracts should be labeled as performance-based.

The Office of Federal Procurement Policy recognizes that this is a problem and is in the initial stages of developing new guidance examining how to improve agencies' use of performance-based contracting. OFPP officials told us they believe that federal agencies generally need a better understanding of performance-based contracting. At present, OFPP plans to reexamine performance-based contracting for agencies and created a task force to consider the issues surrounding the definition and composition of performance-based contracting. OFPP is currently reviewing the Task Force's recommendations.

Conclusions

Performance-based contracting offers a viable way toward achieving savings and getting better results from contractors. Our review revealed that some agencies are taking full advantage of this contracting method for services that are widely available in the commercial sector and are finding that it is producing better outcomes. For similar services, however, some agencies are only partially applying performance-based methods and are missing opportunities to find better ways of doing business. In addition, some agencies are attempting to take the approach one step further by applying it to more complex, risky, unique endeavors but still find that they need to maintain strong government involvement in order to mitigate risks. OFPP's effort to reexamine performance-based contracting is a good step toward enhancing understanding. Nevertheless, more guidance and study on agencies' use of this method may be needed to understand how effectively agencies are applying this technique and what results they are achieving.

Recommendations for Executive Action

As part of the office's effort to reexamine performance-based contracting, we recommend that the Administrator of OFPP clarify existing guidance to ensure that performance-based contracting is appropriately used, particularly when acquiring more unique and complex services that require strong government oversight.

Because of the growing importance of performance-based contracting to the executive branch, we also recommend that the Administrator of OFPP work with agencies to periodically evaluate how well agencies understand performance-based contracting, how they are applying it to services that are widely available in the commercial sector as well as more unique and complex services, and what results they are achieving—both in terms of outcomes and cost savings.

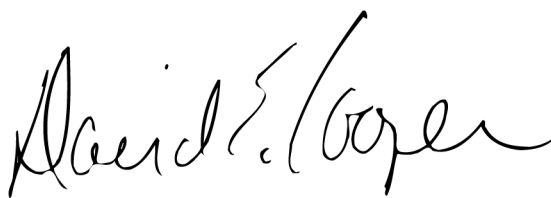
Agency Comments

On September 15, 2002, OFPP officials provided us with oral comments on the draft and generally concurred with the views and recommendations expressed in the draft report. The officials stated that OFPP, through its task force on performance-based contracting, is working on several issues that were addressed in the report. In addition to definitional issues, the task force is examining whether the expectation of cost savings is a realistic goal and whether the participation goals for fiscal year 2003 and beyond should be revisited. OFPP agrees that a clear need exists for better criteria as to when service contracts should be classified as “performance-based.”

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. We will then send copies of this report to the Secretaries of Defense, Energy, and the Treasury; the Administrators of the National Aeronautics and Space Administration, the General Services Administration, and the Office of Federal Procurement Policy; the Director, Office of Management and Budget; and interested congressional committees. We will also make copies available to others on request. In addition, this report will be available at no charge on the GAO web site at <http://www.gao.gov>.

If you have any questions about this report or need additional information, please call me on (202) 512-4125.

Sincerely yours,

A handwritten signature in black ink, reading "David E. Cooper". The signature is fluid and cursive, with the first name "David" and last name "Cooper" clearly legible.

David E. Cooper
Director
Acquisition and Sourcing Management

Appendix I: Scope and Methodology

To identify the extent to which agencies are using performance based service contracts, we utilized the General Services Administration's (GSA) Federal Procurement Data System (FPDS). The FPDS data set for fiscal year 2001 provided us with the data necessary to determine the total dollars obligated by all federal agencies for services. Using these data, we identified the subset of contracts identified as performance-based by all federal agencies. In order to determine whether certain types of services or contract types are more likely to be designated "performance-based," we stratified the data by Federal Supply Code and contract type. In addition, we used FPDS's third quarter data for fiscal year 2001 to determine the largest service procurers among federal agencies. Within this group, as shown in table 4, we identified five agencies that, in terms of dollars obligated, were among the largest reported users of performance-based service contracting: the Departments of Energy, the Treasury, and Defense (Army, Navy, and Air Force), GSA, and the National Aeronautics and Space Administration (NASA).

In order to determine whether service contracts characterized by agencies as performance-based contained the attributes necessary to ensure intended results, we reviewed government regulations and guidelines regarding the definition and composition of performance-based service contracting. These sources included the Federal Acquisition Regulation (FAR), Office of Federal Procurement Policy guidelines and policy letters, and agency-specific guidance. For additional insight, we spoke with public policy and acquisition experts regarding their views on the concept of performance-based service contracting. We then asked each of the five agencies to provide us with what they considered to be their best examples of performance-based service contracts. We selected 20 of these contracts for examination on the basis of contract type and service provided. In addition, taking contract type and service provided into account, we randomly selected five contracts designated as performance-based but not offered by the agencies to determine if these contracts also contained essential performance-based attributes. The 25 contracts we reviewed at the five agencies are shown in table 4.

Table 4: Service Contracts Reviewed

Dollars in millions						
No.	Agency	Contract number	Service	Contract type	Maximum contract value	Procured as commercial service
1	Army	DAMD17-00-C-0034	Technical and administrative support for a DNA registry, forensic toxicology lab, pathology center, and museum	Cost	\$79.4	No
2	Army	DASW01-01-D-0003	On-line educational services to enable enlisted men and women to pursue post-secondary degrees and vocational-technical certificates	Fixed price	403.0	Yes
3	Navy	N00600-00-D-6048	Advertising campaign to support the Navy's recruitment needs	Fixed price	330.0	Yes
4	Navy	Multiple award contract	Engineering, logistics, program management, and finance support for the Naval Sea Systems Command	Cost	14,500.0	No
5	Navy	N00244-99-C-0056 ^a	Operating and maintaining tactical test ranges and equipment at Navy installations	Cost	78.0	No
6	Navy	N00244-99-C-0008 ^a	Operating and maintaining tactical test ranges and equipment at Navy installations	Cost	88.4	No
7	Navy	N00244-00-C-0121 ^a	Operating and maintaining tactical test ranges and equipment at Navy installations	Cost	1.0	No
8	Air Force	F45613-01-D-A001	Refuse collection and recycling at an Air Force base	Fixed price	3.8	Yes
9	Air Force	F45613-99-D-0007 ^a	Maintaining housing at an Air Force base	Fixed price	11.3	No
10	Air Force	F45613-01-F-A001	Custodial services at Air Force base	Fixed price	6.2	No
11	DOE	W-31-109-ENG-38	Management and operations of Argonne National Laboratory (research and development)	Cost	3,000.0	No
12	DOE	DE-AC09-96SR18500	Management and operations at Savannah River Site Facility	Cost	8,400.0	No
13	NASA	NAS9-20000	Operations support for launch and recovery of the space shuttle	Cost	9,700.0	No
14	NASA	NAS9-01069 ^a	Avionics systems research & development and engineering for the space shuttle and the international space station.	Cost	17.0	No
15	NASA	NAS5-99085	Scientific, engineering, information technology, and administrative support at NASA's Laboratory of Terrestrial Physics	Cost	43.0	No
16	NASA	NAS5-99200	Contractor oversight to ensure that NASA's technical contract requirements are met	Cost	34.3	No
17	NASA	NAS5-01091	Logistical services for NASA's Goddard Space Flight Center, headquarters, and other locations	Cost	154.0	No

Dollars in millions						
No.	Agency	Contract number	Service	Contract type	Maximum contract value	Procured as commercial service
18	GSA/FTS	T0001AJM030	Information technology support services for the Securities and Exchange Commission	Cost	159.0	No
19	GSA/PBS	GS-09P-99-KSC-0021	Janitorial services at two federal buildings	Fixed price	1.0	Yes
20	GSA/PBS	GS-09P-98-KSD-0018	Recurring maintenance and repair services at two federal buildings	Fixed price	2.0	Yes
21	GSA/PBS	GS-09P-97-KSC-0017	Systems and equipment operations and maintenance at federal building	Fixed price	2.0	Yes
22	Treasury	TEP-01-13	Tour guide services for Bureau of Engraving and Printing	Fixed price	2.6	Yes
23	Treasury	TFTC 00-03	Food management at Federal Law Enforcement Training Center	Fixed price	44.1	No
24	Treasury	TFTC 01-19	Dormitory management at Federal Law Enforcement Training Center	Fixed price	3.0	No
25	Treasury	TFTC 02-02	Fire arms support services for Federal Law Enforcement Training Center	Fixed price	2.4	No

Legend

DNA = deoxyribonucleic acid

DOE = Department of Energy

^a Denotes contract randomly selected during site visits.

Source: GAO, based on information provided by the agencies.

In addition to speaking with agency officials at each location, we spoke with 18 contracting officers and 12 contractors for their perspectives. We then compared our contract specific findings with the performance-based attributes with the assumption that a contract containing these elements would have an increased likelihood of being “performance-based.”

We conducted our review from September 2001 to June 2002 in accordance with generally accepted government auditing standards.

Appendix II: Performance-Based Service Contracting in the Federal Acquisition Regulation

The Federal Acquisition Regulation defines performance-based contracting as structuring all aspects of an acquisition around the purpose of the work to be performed with the contract requirements set forth in clear, specific, and objective terms with measurable outcomes as opposed to either the manner by which the work is to be performed or broad and imprecise statements of work. The FAR establishes a policy that agencies use performance-based contracting methods to the maximum extent practicable for the acquisition of services (with certain exceptions¹). In prescribing policies and procedures for use of performance-based contracting methods, the FAR states that such methods are intended to ensure that required performance quality levels are achieved and that total payment is related to the degree that services performed meet contract standards.

The FAR requires performance-based contracts to

- describe the requirements in terms of results required rather than the methods of performance of the work
- use measurable performance standards (i.e. terms of quality, timeliness, quantity, etc.) and quality assurance surveillance plans
- specify procedures for reductions of fee or for reductions to the price of a fixed-price contract when services are not performed or do not meet contract requirements, and
- include performance incentives where appropriate.

The FAR further addresses elements of performance-based contracting, specifically statements of work, quality assurance, and contract type. The FAR specifies that in preparing statements of work, agencies shall, to the maximum extent practicable,

- describe the work in terms of “what” is to be the required output rather than either “how” the work is to be accomplished or the number of hours to be provided
- enable assessment of work performance against measurable performance standards

¹ The FAR exempts from this requirement architect-engineer services, construction, utility services, or services incidental to supply purchases. The FAR addresses performance-based contracting generally in subpart 37.6.

- rely on the use of measurable performance standards and financial incentives to encourage competitors to develop and institute innovative and cost-effective methods of performing the work, and
- avoid combining requirements into a single acquisition that is too broad for the agency or a prospective contractor to manage effectively.

The FAR requires agencies to develop quality assurance surveillance plans when acquiring services that recognize the responsibility of the contractor to carry out its quality control obligations and contain measurable inspection and acceptance criteria corresponding to the performance standards contained in the statement of work. The FAR states that the quality assurance surveillance plans shall focus on the level of performance required by the statement of work, rather than the methodology used by the contractor to achieve that level of performance.

As to contract type, the FAR states that the contract types most likely to motivate contractors to perform at optimal levels shall be chosen. The FAR specifies that, to the maximum extent practicable, performance incentives, either positive or negative or both, shall be incorporated into the contract to encourage contractors to increase efficiency and maximize performance. These incentives are required to correspond to the specific performance standards in the quality assurance surveillance plan and shall be capable of being measured objectively.

The FAR states that fixed-price contracts are generally appropriate for services that can be defined objectively and for which the risk of performance is manageable.² The FAR has been revised to implement the statutory preference for agencies to conduct acquisitions using performance-based service contracting established by section 821 of the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001 (P.L. 106-398). Specifically, there is now an order of precedence for performance-based contracts that are firm, fixed-price, then any other type of performance-based contract (such as a cost-reimbursement type), and then any contract that is not performance-based.³ The FAR further requires that acquisition plans for service contracts describe the strategies for

² A fixed-price contract provides for a firm pricing arrangement established at the time of contract award. With a firm, fixed-price contract, the contractor is paid a set price—one that is not adjusted based on costs incurred while performing the contract.

³ Generally, with cost-reimbursement contracts, the contractor is paid based on allowable incurred costs plus a fee.

implementing performance-based contracting methods or provide a rationale for not using those methods.

Appendix III: Major Performance-Based Service Contracting Events

Agencies began to implement performance-based service contracting as early as 1978. However, implementation was not fully pursued until the past few years when Congress and the Office of Management and Budget (OMB) encouraged the use of performance-based service contracting methods.

- OFPP Pamphlet #4 “A Guide for Writing and Administering Performance Statements of Work for Service Contracts” (1980). Described how to write performance into statements of work and addressed job analysis, surveillance plans, and quality control.
- OFPP Policy Letter 91-2 (April 9, 1991). Established policy of utilizing a performance-based approach to service contracting. Prescribed policy aimed at correcting material weaknesses with service contracting. It encouraged agency heads to implement policies and to initiate any necessary staff training.
- Government Performance and Results Act (1993). Seeks to improve federal program effectiveness by focusing on results, service quality, and customer satisfaction.
- OFPP Performance-Based Service Contracting Pledge (October 1994). Officials from 27 agencies signed pledge to participate in a project to convert 26 contracts valued at about \$585 million using performance-based service contracting methods and measure effects on volunteered projects.
- OFPP Performance-Based Service Contracting Checklist Memorandum (August 1997). Lists minimum required elements that must be present for an acquisition to be considered performance-based.
- Federal Acquisition Circular 97-01 (October 1997). Amended the Federal Acquisition Regulation to implement OFPP policy letter 91-2. FAR parts 7, 16, 37, 42, 46, and 52 were changed to establish in the FAR the policy of government acquisition of services using performance-based service contracting methods.
- OFPP Report on Performance-Based Service Contracting Pilot Project (May 1998). Contract prices decreased by 15 percent after introduction of performance-based service contracting. Customer satisfaction improved by over 18 percent.
- OFPP Information on Best Practices for Performance-Based Service Contracting (October 1998). Assists agencies in developing policies and procedures for implementing performance-based service contracting. Practices derived from government and industry.
- Statutory Preference for Performance-Based Service Contracting (October 2000). Section 821 of the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001 (P.L. 106-398) established a preference for

agencies to conduct service acquisitions using performance-based contracting

- OMB Memorandum on Performance Goals and Management Initiatives for FY 2002 Budget (March 2001). Goal is to award contracts over \$25,000 using performance-based service contracting techniques for not less than 20 percent of total eligible service contracting dollars.
- Federal Acquisition Circular 97-25 (May 2, 2001). Interim rule revises the FAR to implement section 821 of the Fiscal Year 2001 Defense Authorization Act establishing a preference for agencies to conduct service acquisitions using performance-based contracting.
- Federal Acquisition Circular 2001-07 (April 30, 2002). Adopted the interim FAR rule as a final rule and amended FAR Part 7 (acquisition planning) to require contracting officers to provide a rationale (in the written acquisition plan) if performance-based service contracting is not used.

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

Ralph C. Dawn, Jr. (202) 512-4544

Acknowledgments

In addition to the person named above, Cristina Chaplain, Odilon Cuero, Michelle Dresben, Christopher Galvin, Adam Vodraska, William Woods, and John Yakaitis made key contributions to this report.

GAO's Mission

The General Accounting Office, the investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through the Internet. GAO's Web site (www.gao.gov) contains abstracts and full-text files of current reports and testimony and an expanding archive of older products. The Web site features a search engine to help you locate documents using key words and phrases. You can print these documents in their entirety, including charts and other graphics.

Each day, GAO issues a list of newly released reports, testimony, and correspondence. GAO posts this list, known as "Today's Reports," on its Web site daily. The list contains links to the full-text document files. To have GAO e-mail this list to you every afternoon, go to www.gao.gov and select "Subscribe to daily E-mail alert for newly released products" under the GAO Reports heading.

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are \$2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. General Accounting Office
441 G Street NW, Room LM
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000
 TDD: (202) 512-2537
 Fax: (202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Public Affairs

Jeff Nelligan, managing director, NelliganJ@gao.gov (202) 512-4800
U.S. General Accounting Office, 441 G Street NW, Room 7149
Washington, D.C. 20548