This one hits close to home, folks.

If you are a site member, you know we've published two technical articles, and made several speeches and presentations, on the subject of Performance-Based Payments (PBPs). Suffice to say, we are sensitive to anything that impacts use of PBPs.

Coming almost unnoticed out of the Federal Acquisition Streamlining Act (FASA) of 1994, PBPs became the DOD's "preferred method" for providing contract financing payments for competitively awarded firm, fixed-price acquisitions of noncommercial goods and services in March, 2000. (See Federal Acquisition Circular 97-16.) Almost immediately, DOD policymakers became enamored of PBPs and sought to implement them on a majority of qualifying acquisitions within five years—a goal that was achieved within 12 months!

Without rehashing our previous writings, let's simply say that PBPs were created because of a

couple of reasons that made a whole lot of sense at the time—and which continue to make sense to us today. The PBP rationale includes:

- The DOD found the prior contract financing method (customary progress payments based on contractor costs incurred) to be both difficult to understand and burdensome to administer.

- Reduction in “non-value-added cost-based oversight”.

- Emphasized schedule and technical progress.

- Reinforced roles of government program managers and reduced roles of accountants and auditors.

- Lowered barriers that prevented commercial contractors from entering the DOD marketplace, thus increasing competition while allowing DOD to access leading-edge commercial technology.

Importantly, implementation of PBPs tied contractor financing payments to measurable program performance. No longer did a contractor receive financing payments simply for spending money; the contractor actually needed to make tangible progress towards completion.

In our articles, we speculated about the linkage between PBPs and the termination of the A-12 Avenger II stealth attack fighter program in 1991. Then Secretary of Defense Dick Cheney terminated the program for default after payment of more than $2 billion in cost-based progress payments. More than 20 years later, that T4D action is still being litigated and the Pentagon is

still trying
to recover its “progress” payments from the two prime contractors involved.

Regarding the impact of PBP usage on contract oversight, we wrote in December, 2005 (in Con tract Management
magazine)—

Reductions to administrative burdens associated with cost-based billings. Since PBP trigger events are a ‘yes-or-no’ technical decision, there are no associated costs to review. For instance, compliance with FAR Part 31 cost principles or the Cost Accounting Standards is not a requirement for PBP payment requests. The contractor does not need to develop a government-spe cific accounting or billing system that is subject to audit and adequacy determination. The substantial resources normally devoted to complying with government-unique accounting rules can be applied elsewhere.

Despite the seemingly unassailable rationale for use, there is one DOD constituency who has, from the beginning, resisted use of PBPs and fought them at every turn. Can you guess that DOD stakeholder?

If you answered “DCAA” then you win a prize!

DCAA has never accepted PBPs, perhaps recognizing that the more PBPs are used, the less there is a need for DCAA to perform “non-value-added cost-based oversight” such as detailed reviews of progress payment requests. Here’s a challenge: go look at DCAA’s website (http:// www.dcaa.mil
) under “standard audit programs” and find the standard audit program associated with PBPs.

Go on. We’ll wait right here.

You couldn’t find one, could you? Despite decade of usage, DCAA still doesn’t acknowledge them.

Okay, we hear you saying, “But why should DCAA have an audit program for something they aren’t supposed to audit?” That would make sense except for the fact that many Contracting Officers want DCAA to audit contractors’ use of PBPs even though they really shouldn’t be doing so. So when a Contracting Officer asks DCAA to audit some aspect of PBPs, there is no audit guidance to guide the auditors.

And now it looks like DCAA has won its fight against PBPs.

We **warned** readers about the September 14, 2010 Memo from Dr. Ash Carter (USD, AT&L). That memo included the following tactic—

Reverse a decade of practice and restore DOD’s preference for using customary progress payments based on cost incurred, with other contract financing options being agreed-upon only with a commensurate reduction in contractor profit, based on increased cash flow.

We said at the time—

… we are disappointed to see the end of DOD’s regulatory preference for Performance-Based Payments and the return of customary progress payments. The debacle of the A-12 program taught many that progress payments had little to do with actually making progress, and everything to do with the ability to spend money. It looks to us like that lesson has been forgotten.

On April 29, 2011, the Honorable Shay Assad, Director of DOD’s Defense Procurement and Acquisition Policy (DPAP), **issued a memo** that officially ended DOD’s preference for PBPs. The memo said—

As a matter of practice, for new contract awards, the basis for negotiations for fixed-price contracts shall be 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.

Why does DOD want to walk away from PBPs? Because (in the words of the memo)—

PBPs offer the contractor improved cash flow as compared to customary progress payments. … 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.

So Mr. Assad is basically saying that since contractors will drop their price in return for a promise of accelerated cash flow, the DOD needs to approach contract negotiations in such a manner as to capture that price reduction. Which is fine, insofar as it goes. But when one looks at the barriers DOD is putting into place when a contractor would want to propose use of PBPs, one comes to the conclusion that DOD really doesn't want to use them.

The memo says—

… 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. … 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. … The negotiated consideration must be specifically approved by the clearance official or one level above the contracting officer, whichever is higher.

"What's the problem with the foregoing?" we hear you asking.

Well, consider that PBPs are only used on firm, fixed-price contracts. That contractor effort described above is quite often going to be a direct-charged effort. Which means that either the

contractor eats the cost of that effort from its expected profit, or it bids that effort into its firm, fixed-price. So the submitted price will be higher than it otherwise would be, because of the mandatory effort now required to use PBPs.

Moreover, when customary progress payments are used, there is an administrative cost on both sides of the contract. (Elimination of those administrative costs was one of the primary benefits associated with use of PBPs.) Those costs are going right back into future contractor bids, because the contractor must now assume that only customary cost-based progress payments are going to be used.

Finally, the DOD is once again setting itself up for a repeat of the A-12 debacle. We've already **noted** the return of fixed-price development contracts. Now comes the return to cost-based progress payments on such contracts. Those two "return to what didn't work before" trends are *exactly* what led to that multi-billion dollar poster child for DOD waste of taxpayer funds.

So nice job, Mr. Assad. You managed to reverse one of the more important innovations of Clinton-era acquisition reform. You've opened the door for contractors to increase their offer prices at a time when the DOD (and indeed the entire Federal government) is focused on lowering those very prices. And you've managed to recreate the environment that led to one of the worst DOD weapon system "train wrecks" in history.

Oh, and we forgot to mention that now we've got a *nice* conflict between the Assad guidance and the requirements of FAR 31.1001, which establishes the policy of the United States that "Performance-based payments *are the preferred Government financing method* when the contracting officer finds them practical, and the contractor agrees to their use." (Emphasis added.) We have to ask whether DOD has submitted a request to the FAR Councils for a FAR Deviation, as required by FAR Subpart 1.4?