Contract Financing: Performance Based Payments Review

Presented By:

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Contract Administrator
Performance Based Payment (PBP) - Definition

- **Performance based payment** is an alternative to progress payments for contract financing. The financing is based upon specified performance criteria being accomplished versus cost accumulation which is the basis for progress payments (Preferred method of contract financing).

**Per Statute: 10 U.S.C. 2307 (b)**

(b) Performance-Based Payments — Whenever practicable, payments under subsection (a) shall be made on any of the following bases:

1. Performance measured by objective, quantifiable methods such as delivery of acceptable items, work measurement, or statistical process controls.
2. Accomplishment of events defined in the program management plan.
3. Other quantifiable measures of results.
PBP Definition Cont…

**PBP** is:

- Provided financing to Contractors performing fixed price contracts or fixed priced CLINs on a mixed type contract
- Paid based upon contractor performance of definitive criteria established within each contract
- Represent expenses the contractor could reasonably expect to incur in order to achieve completion of each defined criteria or event
- Fully recoverable in the event of default

**PBP**s are not:

- Advanced payments
- Payment for accepted goods or services
- Payments for partial deliveries
- Payments based solely on incurrence of costs
- an incentive arrangement

**PBP Limitation:**

- Can be established on a contract basis or line item basis
- Cannot exceed 90% of the contract price (or line item price if using line item basis)
Authority to Use PBPs  
FAR Subpart 32.10 & DFAR 232.10

• FAR 32.1001(a): Policy- Performance Based Payments are the preferred Government financing method when the CO finds them practical and the contractor agrees to their use.

• FAR 52.232-32: Performance Based Payments

• FAR 32.1004(b): Establishing Performance Based Payment Amounts

• DFARS 232.10: Performance Based Payments

• DFARS PGI 232.1001 (a): Contracting Officers Actions, PBPs
When to use PBP’s!

- **Basic Criteria:**
  - > $2.5M contract - Large Business
  - > $150K contract - Small Business
  - FAR 32.104(d)(2) & (3)
    - Unable to bill for delivery of product for a time after work begins
      - Large business - normally 6 months
      - Small business - normally 4 months
    - Has a financial need or unable to get private financing
- **Ideally contractor has a mature, stable production program**
- **Not as practicable for service contracts**
Benefits

• Benefits to Contractor
  • Improved cash flow
  • Reduced cost of oversight and compliance
  • Management team focus on technical and schedule progress

• Benefits to Government
  • Oversight and compliance costs may be reduced
  • Risk of overpayment may be reduced
• **Risks to Contractor**
  - No payment if PBP event not successfully completed
  - Usually bear risk for property loss, theft, destruction or damage
  - Comparable to Progress Payment requirements

• **Potential risks to Government**
  - Poor completion events
  - Poor completion criteria
  - Event values not commensurate with milestone activities
  - Front loading of event values
Government Personnel

- Defense Contract Management Agency (DCMA)
- Defense Contract Audit Agency (DCAA)
- Defense Finance and Accounting Services (DFAS)
Steps for Performance Based Payments

- Step 1: Establish PBS events
- Step 2: Define the completion criteria for PBP events
- Step 3: Evaluate the Contractors Expenditure Profile
- Step 4: Establish event values
- Step 5: Incorporate the PBP arrangement into the Contract via special contract provisions
- Step 6: Post Award Orientation Conference
Establishing Appropriate PBP Events

- Entitles the Contractor to receive a performance based financed payment after verification an activity has been successfully completed during the performance of a contract
- Integrated Master Plan
- Integrated Master Schedule
- Types
  - Severable (Stand Alone)
  - Cumulative (Dependent)
- No Magic number
Milestone Examples

- Inappropriate Milestone Examples
  - Milestone 1: Kick-off Meeting
  - Milestone 2: Place POs
  - Milestone 3: Signing modifications

- Appropriate Milestone Examples
  - Milestone 4: Receipt of 90% of Bill of Material Value (all critical parts delivered)
  - Milestone 5: Completion of Subassembly
### Milestone Example: Appropriate

<table>
<thead>
<tr>
<th>Contract Award Delivery</th>
<th>Contract Price</th>
<th>PB Total</th>
<th>Final Payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec-15</td>
<td>$ 61,809,439</td>
<td>$ 55,628,495</td>
<td>$ 6,180,944</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Event</th>
<th>Event Description</th>
<th>Acceptance Criteria</th>
<th>Event %</th>
<th>Cumulative %</th>
<th>Event Value</th>
<th>Cumulative Value</th>
<th>Event Date (Est.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Complete Lay-up Bond Shop Process</td>
<td>Signed (DCMA QA) Bond-Shop Routing completion</td>
<td>22%</td>
<td>22%</td>
<td>$13,852,737</td>
<td>$13,852,737</td>
<td>Jan-16</td>
</tr>
<tr>
<td>B</td>
<td>Complete A/C Paint</td>
<td>Signed (DCMA QA) Bond-Shop Routing completion</td>
<td>24%</td>
<td>46%</td>
<td>$14,650,066</td>
<td>$28,502,803</td>
<td>Mar-16</td>
</tr>
<tr>
<td>C</td>
<td>Complete Load 624 Processes</td>
<td>Signed (DCMA QA) Bond-Shop Routing completion</td>
<td>22%</td>
<td>22%</td>
<td>$13,852,737</td>
<td>$13,852,737</td>
<td>Jan-16</td>
</tr>
<tr>
<td>D</td>
<td>Complete Post-Splice</td>
<td>Signed (DCMA QA) Bond-Shop Routing completion</td>
<td>24%</td>
<td>46%</td>
<td>$14,650,066</td>
<td>$28,502,803</td>
<td>Mar-16</td>
</tr>
<tr>
<td>E</td>
<td>Install Upper and Lower Skins</td>
<td>Signed (DCMA QA) Bond-Shop Routing completion</td>
<td>22%</td>
<td>22%</td>
<td>$13,852,737</td>
<td>$13,852,737</td>
<td>Jan-16</td>
</tr>
<tr>
<td>F</td>
<td>Gear Operation</td>
<td>Signed (DCMA QA) Bond-Shop Routing completion</td>
<td>24%</td>
<td>46%</td>
<td>$14,650,066</td>
<td>$28,502,803</td>
<td>Mar-16</td>
</tr>
<tr>
<td>G</td>
<td>Install Propoter</td>
<td>Signed (DCMA QA) Bond-Shop Routing completion</td>
<td>22%</td>
<td>22%</td>
<td>$13,852,737</td>
<td>$13,852,737</td>
<td>Jan-16</td>
</tr>
<tr>
<td>H</td>
<td>Install Wing/Fuselage</td>
<td>Signed (DCMA QA) Bond-Shop Routing completion</td>
<td>24%</td>
<td>46%</td>
<td>$14,650,066</td>
<td>$28,502,803</td>
<td>Mar-16</td>
</tr>
<tr>
<td>I</td>
<td>Pass Final Flight Test</td>
<td>Signed (DCMA QA) Bond-Shop Routing completion</td>
<td>22%</td>
<td>22%</td>
<td>$13,852,737</td>
<td>$13,852,737</td>
<td>Jan-16</td>
</tr>
</tbody>
</table>
### Milestone Example, Cont.

**Contract N00019-12-C-2001 (MYPII) V-22 Performance Based Payment Event Matrix**  
CLINS 0001, 0004, 0006, 0101, 0106, 0201, 0301, 0401

<table>
<thead>
<tr>
<th>Event</th>
<th>Cumulative/Severable</th>
<th>Payment Event</th>
<th>Success Criteria</th>
<th>Verification</th>
<th>Schedule</th>
<th>Payment Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>E1</td>
<td>Severable</td>
<td>Supplier EOQ Payment Request</td>
<td>Invoice of Supplier EOQ PBP events according to Boeing Month End October 2013 Accounting Calendar</td>
<td>DCMA verification through validation of supplier EOQ costs entered into EAS GL account or booked actuals Parts will be V-22 unique.</td>
<td>See clauses 9-01, H-14 and the PBP Payment Schedule</td>
<td>See clauses 9-01, H-14 and the PBP Payment Schedule</td>
</tr>
<tr>
<td>E2</td>
<td>Severable</td>
<td>Supplier EOQ Payment Request</td>
<td>Invoice of Supplier EOQ PBP events according to Boeing Month End December 2013 Accounting Calendar</td>
<td>DCMA verification through validation of supplier EOQ costs entered into EAS GL account or booked actuals Parts will be V-22 unique.</td>
<td>See clauses 9-01, H-14 and the PBP Payment Schedule</td>
<td>See clauses 9-01, H-14 and the PBP Payment Schedule</td>
</tr>
<tr>
<td>E3</td>
<td>Severable</td>
<td>Supplier EOQ Payment Request</td>
<td>Invoice of Supplier EOQ PBP events according to Boeing Month End February 2014 - 2006 Accounting Calendar</td>
<td>DCMA verification through validation of supplier EOQ costs entered into EAS GL account or booked actuals Parts will be V-22 unique.</td>
<td>See clauses 9-01, H-14 and the PBP Payment Schedule</td>
<td>See clauses 9-01, H-14 and the PBP Payment Schedule</td>
</tr>
<tr>
<td>E4</td>
<td>Severable</td>
<td>Supplier EOQ Payment Request</td>
<td>Invoice of Supplier EOQ PBP events according to Boeing Month End June 2014 Accounting Calendar</td>
<td>DCMA verification through validation of supplier EOQ costs entered into EAS GL account or booked actuals Parts will be V-22 unique.</td>
<td>See clauses 9-01, H-14 and the PBP Payment Schedule</td>
<td>See clauses 9-01, H-14 and the PBP Payment Schedule</td>
</tr>
<tr>
<td>E5</td>
<td>Severable</td>
<td>Supplier EOQ Payment Request</td>
<td>Invoice of Supplier EOQ PBP events according to Boeing Month End August 2014 Accounting Calendar</td>
<td>DCMA verification through validation of supplier EOQ costs entered into EAS GL account or booked actuals Parts will be V-22 unique.</td>
<td>See clauses 9-01, H-14 and the PBP Payment Schedule</td>
<td>See clauses 9-01, H-14 and the PBP Payment Schedule</td>
</tr>
<tr>
<td>E6</td>
<td>Severable</td>
<td>Supplier EOQ Payment Request</td>
<td>Invoice of Supplier EOQ PBP events according to Boeing Month End December 2014 Accounting Calendar</td>
<td>DCMA verification through validation of supplier EOQ costs entered into EAS GL account or booked actuals Parts will be V-22 unique.</td>
<td>See clauses 9-01, H-14 and the PBP Payment Schedule</td>
<td>See clauses 9-01, H-14 and the PBP Payment Schedule</td>
</tr>
<tr>
<td>A</td>
<td>Cumulative</td>
<td>Start of Lay-up in Composite Center</td>
<td>Start of Part # (901-031-150-XXX) Cockpit Belly Skin, in composite Center, Shop 83649</td>
<td>Visual verification by DCMA of commencement of part #901-031-150-XXX Cockpit Belly Skin</td>
<td>See clauses 9-01, H-14 and the PBP Payment Schedule</td>
<td>See clauses 9-01, H-14 and the PBP Payment Schedule</td>
</tr>
</tbody>
</table>

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21 June 2013

Attachment 1(a) N00019-12-C-2001  
Page 1 of 3
Establish the completion criteria for PBP event

• Establishing successful PBP events completion criteria
  • Define the completion criteria as clearly and precisely as possible, including a specified completion date.
  • Understand the product and processes

• Understanding a “successful” completion of an event
  • Readily measurable and verifiable
  • Identified in the contract with a detailed description of what constitutes a successful performance
Evaluate the Contractors Expenditure Profile

- The expenditure profile represents the expected financing need over the life of the contract.
- Government evaluation
  - Follow-On Contracts (Same or Similar items)
  - No Prior contracts
Establishing PBP Event Values

• Setting dollar or percentage values for the events themselves and are commensurate with the values of the events

• PBPs cannot, in total, exceed 90% (based on regulatory constraints) of the price of the contract or line item to which they apply.

• Special Considerations
Event Value Rules and Restrictions

• All payment amounts must provide for liquidation upon delivery
• IAW FAR 32.1004(d): Liquidating Performance-Based Finance Payments
  • Performance-Based Financing payments must be liquidated by deducting either a percentage or a designated dollar amount from delivery payments
  • DFAS will make deductions
• Payment requests can only be submitted once in any given calendar month
  • Each request can, however, cover payment for multiple events
The special provision must contain a PBP schedule which will normally be in tabular form and will contain the following fields:

- Event Number
- Event Title or Description
- Event Value
- Cumulative or Severable Event
- If Cumulative, list of Prior Event Numbers
- Line Item (if PBPs are on a Line Item Basis)
- Fund Type
- Event Completion Criteria
- Event completion date
Post Award Orientation Conference

- Ensure all parties understand the awarded PBPs:
  - What the events are
  - How the events are determined to be completed
  - What value is associated with each event
  - Payment and liquidation process

- Type of technical evaluations/validations that must occur prior to ACO approval of PBPs

- Potential Risk Situations
• ACO Options
  • Per FAR 52.232-32(e)
    • ACO may reduce, suspend, or liquidate PBP’s when:
      • KTR fails to comply with material requirement of the contract
      • Performance of the contract is endangered by the Contractor’s
        • Failure to make progress
        • Unsatisfactory financial condition
      • KTR is delinquent in payment of any subcontractor or supplier under the contract.
    • Contract termination by default (FAR 52.232-32(j))
      • KTR must repay amount of unliquidated PBP’s
The contractor should assign a properly structured 7-character, alphanumeric invoice/shipment number on each PBP request.

- **PBPA**: 4 character prefix for US funded
- **PBPB**: 4 character prefix for FMS funded; also must include break-out by country code
- Last 3 characters are numeric and should be sequentially numbered, e.g., PBPA001, PBPA002

IAW FAR 52.232-32(m): Content of Contractor’s Certification —Performance-Based Payment request must include contractor certification. Key points for certification:

- Prepared from contractor’s books and records
- Subcontractors have been paid
- No encumbrances that impair Government’s title
- No adverse change in financial condition
- Signature
• Designated government official
  • Confirms completed payment event
  • Provides findings to ACO

• ACO verifies:
  • Receipt of documentation
  • Amount is less than or equal to incurred cost

• ACO approves or rejects
The ACO may reduce or suspend PBPs:

- When contractor:
  - Fails to comply with material requirement of the contract
  - Fails to progress
  - Becomes financially unsound
  - Is delinquent in paying subcontractors
  - Uses disapproved business systems

- When PCO requests

- ACO Notifications
PBPs and PPs: Similarities

• Criteria for Eligibility- FAR 32.104(d)(2) & (3)
• 2.5M or greater for large businesses
• Over 150K for small business (SAT)
• Fixed-priced contract, fixed-price contracts on mixed contracts
• Recoverable in case of default
PBPs and PPs: Differences

**Basis for Payment**
- PP: 80% of actual incurred costs
- PBP: Predetermined estimated amount on milestone events not to exceed actual costs

**Entitlement to Payment:**
- PP: Submission of allowable costs commensurate with progress made
- PBP: Successful and verifiable completion of performance events

**Profit:**
- PP: excluded
- PBP: Some profit may be included
• Accounting System
  • PP: Must be approved
  • PBP: Consider the adequacy of the accounting system

• Frequency of Payment
  • PP: Not more than monthly
  • PBP: Not more than monthly, may have more than one event per month

• Alternate liquidation rate
  • PP: Yes, under certain circumstances
  • PBP: Not available
PBP Resources

- Resources
  - DPAP Guidebook and Analysis Tool: http://www.acq.osd.mil/dpap/cpic/cp/Performance_based_payments.html
  - iRAPT Performance based Payments Instructions
  - PBP Users Guide
    www.navair.navy.mil/nawctsd/Resources/Library/Acqguide/pbpguide.docx
Questions