

Contract Pricing and Financing

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Agenda

- ▶ Contract Types and Pricing Considerations
 - ▶ Contract types
 - ▶ Risks and incentives associated with different contract types
- ▶ Contract Financing
 - ▶ Progress Payments
 - ▶ Performance Based Payments
- ▶ Examples, pitfalls, successes, etc.
 - ▶ Industry perspective
 - ▶ Government perspective

Contract Pricing



Contract Types

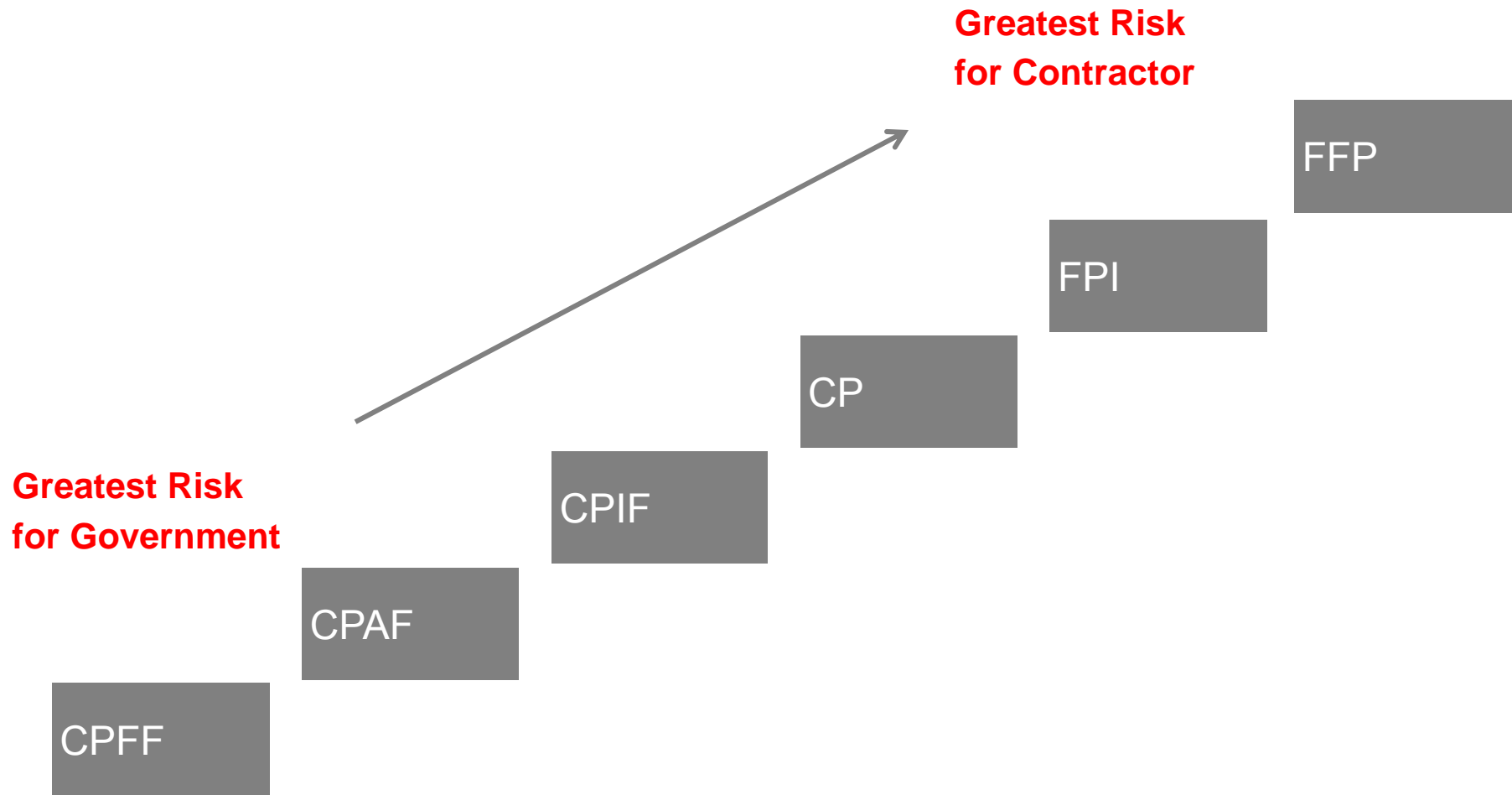
- ▶ Contract types included (FAR Part 16):
 - ▶ Fixed Price
 - ▶ Cost-Reimbursement
 - ▶ Others
 - ▶ Time-and-Materials or labor hour
 - ▶ Letter Contracts
 - ▶ Agreements

Contract Types

- ▶ Two key overall categories of basic contract types:
 - ▶ Fixed Price type contracts
 - ▶ Cost type contracts

- ▶ Decision as to which type to use is a result of assessing degree of risk to the Government and the Contractor
 - ▶ Fixed Price is riskier to the contractor
 - ▶ Cost type is riskier to the Government
 - ▶ More firm contract requirements lend themselves to fixed type
 - ▶ Less firm requirements, for example research and development requirements, lend themselves to cost type contracts

Contract Risk Profile



Contract Types

▶ Fixed Price Types

- ▶ Firm Fixed Price – price not subject to adjustment
- ▶ Firm Fixed Price with EPA – upward or downward adj based on specified contingencies
- ▶ Firm Fixed Price Level of Effort – payment based on effort expended rather than results achieved
- ▶ Fixed Price Incentive Firm Target – profit rate adjusts based on cost performance
- ▶ Fixed Price Incentive Successive Target – negotiate initial targets/profit rate adjusts based on cost performance; at production point, negotiate firm targets or FFP
- ▶ Fixed Price Prospective Redetermination – FFP initially, redetermine price during future performance
- ▶ Fixed Price Retroactive Redetermination – Fixed ceiling price, price redetermined after completion of contract

▶ Cost Reimbursements Types

- ▶ Cost – costs are reimbursed with no fee
- ▶ Cost Sharing – costs are reimbursed only for agreed-upon portion of allowable costs, no fee
- ▶ Cost Plus Incentive Fee – fee rate adjusts based on cost performance
- ▶ Cost Plus Award Fee – costs are reimbursed, base fee; rest of fee is earned based on various criteria (technical, schedule and cost)
- ▶ Cost Plus Fixed Fee – costs are reimbursed, contractor entitled to fixed fee

Contract Types

- ▶ Time & Materials
 - ▶ Provides for acquiring supplies or services on the basis of:
 - ▶ Direct labor hours at specified fixed hourly rates that include wages, overhead, general and administrative expenses, and profit; and
 - ▶ Materials at cost, including, if appropriate, material handling costs as part of material costs
- ▶ Labor-Hour
 - ▶ Variation of the time-and-materials contract, differing only in that materials are not supplied
- ▶ May be used only when it is not possible at the time of placing the contract to estimate accurately the extent or duration of the work or to anticipate costs with any reasonable degree of confidence.

Contract Financing



Contract Financing Overview

- ▶ FAR Part 32 – Contract Financing
 - ▶ Providing Contract Financing
 - ▶ Order of preference
- ▶ Progress Payments
- ▶ Performance Based Payments
- ▶ Examples, pitfalls, and success of financing
- ▶ Questions

Contract Financing - Basics

FAR 32.104 – Providing Contract Financing

- ▶ FAR 32.104(a) Prudent contract financing can be a useful working tool in Government acquisition by expediting the performance of essential contracts. Contracting Officers must consider the criteria in this part in determining whether to include contract financing in solicitations and contracts. Resolve reasonable doubts by including contract financing in the solicitation. The contracting officer must-
 - ▶ FAR 32.104(a)(1): provide Govt financing only to the extent actually needed for prompt and efficient performance...
 - ▶ FAR 32.104(a)(4): Include the form of contract financing deemed to be in the Government's best interest in the solicitation (see [32.106](#) and [32.113](#))

Contract Financing - Basics

FAR 32.106 – Order of preference

- ▶ Private Financing without Govt Guarantee (pay on title change)
- ▶ Customary Contract Financing (see FAR 32.113).
- ▶ Loan Guarantees
- ▶ Unusual Contract Financing (see FAR 32.114).
 - ▶ FAR 32.114 states, “Any contract financing arrangement that deviates from this part is unusual contract financing. Unusual contract financing shall be authorized only after approval by the head of the agency or as provided for in agency regulations.”
- ▶ Advance Payments (see FAR 32.402(b))

Customary Contract Financing

FAR 32.113 Customary contract financing

- ▶ The solicitation must specify the customary contract financing offerors may propose. The following are customary contract financing when provided in accordance with this part and agency regulations:
 - ▶ (a) Financing of shipbuilding...progress payments based on a percentage
 - ▶ (c) Financing of supplies or services awarded under the sealed bid method...([Part 14](#))... progress payments based on costs
 - ▶ (d) Financing of supplies or services awarded under the competitive negotiation... ([Part 15](#))...either progress payments...or performance-based payments (but not both)
 - ▶ (e) Financing of supplies or services awarded under a sole-source acquisition ([Part 15](#))...either progress payments...or performance-based payments (but not both)

Contract Financing - Liquidation

Liquidation of Contract Financing Payments

- ▶ The Government recoups financing payments through the deduction of liquidations from payments that would be due upon acceptance of contract deliverables.
- ▶ The contracting officer applies a liquidation rate to the contract price of contract items delivered and accepted.
- ▶ The ordinary method is that the liquidation rate is the same as the financing method rate. (Financing/Liquidation)
 - ▶ Progress Payments: (80%/20%)
 - ▶ Performance Based Payments: (90%/10%)

Progress Payments



Progress Payments

- ▶ **“Definition.** Progress payments are a form of contract financing used with fixed price contracts when acquiring non-commercial items; part of customary contract financing, but preferred over advance payments (FAR 32.001, 32.102, 32.113).” (DAU site – [click here](#))
- ▶ Typically used when contract has significant time between award and delivery
- ▶ Must be in best interest of the government (e.g., lower pricing, more favorable terms) per FAR 32.005

Progress Payments

- ▶ Per FAR 32.5-1
 - ▶ “The customary progress payment rate is 80 percent, applicable to the total costs of performing the contract.” (85% for small businesses)
 - ▶ Progress payments can also be made based on a contracts percentage of completion. This is typically only found on construction contracts as defined by FAR 36.201. (e.g., shipbuilding)

Progress Payments

- ▶ Key difference between progress payments and payments on a cost type contract per DAU ([click here](#)):
 - ▶ Under a cost-reimbursement contract, the contractor is paid 100% of actual, allowable costs. Under fixed price contracts, the contractor receives a percentage of incurred costs, per the progress payment rates stated in FAR 32 and DFARS 232;
 - ▶ Under a cost-reimbursement contract, the contractor is operating under the “best efforts” terms of the Limitation of Cost (FAR 52.232-20) or Limitation of Funds (FAR 52.232-22) clauses. There is no “best efforts” language in fixed price contracts.

Progress Payments

- ▶ Progress Payments Procedural Notes
 - ▶ Progress payments will be made to contractor when billed but not more than monthly (FAR 52.232-16)
 - ▶ Progress payments are recoverable under default
 - ▶ FAR 52.232-16(f) - Control of costs and property. The Contractor shall maintain an accounting system and controls adequate for the proper administration of this clause.
 - ▶ There are provisions in FAR 32.5 and FAR 52.232-16 that allow a contracting officer to have discretion over adjusting or removing progress payments if performance (cost or physical) is not meeting the terms of the contract.

Progress Payments - Benefits

- ▶ **Benefits of Progress Payments:**
 - ▶ Provide an interest-free loan so the Contractor does not have to seek credit in the open-market.
 - ▶ Contractor cost-of-capital is 0% vs. current market rate.
 - ▶ Loan proceeds (progress payments) arrive quickly
 - ▶ For DoD contracts, COs must insert a standard payment due date of ***seven (7) days*** in the contract payment clause
 - ▶ Invoices are based on cost-incurred and allows recoupment of 80% of incurred cost on a monthly basis.

Performance Based Payments



Performance Based Payment

Performance Based Payments are (PBP Guide):

- ▶ Defined as: PBPs are financing payments based upon the achievement of specific, measurable events or accomplishments that are defined and valued in advance by the parties to the contract Fully recoverable in the event of default
- ▶ Considered a customary method of contract financing

Performance Based Payments are financing and therefore NOT:

- ▶ Based solely on cost (basis is milestones)
 - ▶ An incentive (PBPs are for fixed price CLINs only)
 - ▶ Payment for accepted goods or services
 - ▶ Payment for partial delivery
-
- ▶ Performance-based payments (FAR 32.1002)
 - ▶ Criteria for use (FAR 32.1003)



PBP Memo



PBP Guide

Performance Based Payment

Procedural Notes:

- ▶ Establishing specific events or measurable performance criteria is the basis for using Performance Based Payments
- ▶ The events/performance criteria can be severable or cumulative
- ▶ The Contract shall identify the events/criteria and any preconditions that must be met for payment
- ▶ Allow for contractors to invoice up to 90% of the contract price
- ▶ See FAR 32.1004 for full procedures

Performance Based Payment

- ▶ Expected Advantages of Performance Based Payments (PBP Guide)
 - ▶ Enhanced Technical and Schedule Focus
 - ▶ Reduced Cost of Oversight and Administration
 - ▶ Broadened Contractor Participation
 - ▶ Potentially Improved Cash Flow for Contractor
- ▶ Win-Win: Lower Price in Exchange for Better Cash Flow

Performance Based Payment

- ▶ Features of Good Candidates for PBP Financing
 - ▶ The underlying item(s) being acquired have a stable design
 - ▶ Production processes are well established
 - ▶ The program plan and program schedule are well defined
 - ▶ Expected outcomes are thoroughly understood by all parties

Performance Based Payment (PBP) Exercise

Examples of PBP Events & Completion criteria



PBP Example 1

- ▶ Event: Award of Subcontract XYZ
- ▶ Completion Criteria: Complete upon subcontractor signature on subcontract

PBP Example 1, cont.

- ▶ Event: Award of Subcontract XYZ
- ▶ Completion Criteria: Complete upon subcontractor signature on subcontract
 - ▶ *(Criteria okay but need to consider significance of subcontract & value of event)*

PBP Example 2

- ▶ Event: Initiate testing of software release
- ▶ Completion Criteria: Aircraft arrives in test station #2 for testing

PBP Example 2, cont.

- ▶ Event: Initiate testing of software release
- ▶ Completion Criteria: Aircraft arrives in test station #2 for testing
 - ▶ *(Bad event: what does initiate mean? Where is the accomplishment?)*

PBP Example 3

- ▶ Event: Completion of fabrication of forward fuselage
- ▶ Completion Criteria: None

PBP Example 3, cont.

- ▶ Event: Completion of fabrication of forward fuselage
- ▶ Completion Criteria: None

PBP Example 4

- ▶ Event: Attendance at Program Management Review
- ▶ Completion Criteria: ACO validates meeting minutes—demonstrates contractor attendance

PBP Example 4, cont.

- ▶ Event: Attendance at Program Management Review
- ▶ Completion Criteria: ACO validates meeting minutes—demonstrates contractor attendance
 - ▶ (Bad, does not show progress on the contract)

PBP Example 5

- ▶ Event: JS Engine Delivery
- ▶ Completion Criteria: Delivery of JS Engine to prime contractor facility. The engine must be delivered and accepted defect free.
(Severable)

PBP Example 5, cont.

- ▶ Event: JS Engine Delivery
- ▶ Completion Criteria: Delivery of JS Engine to prime contractor facility. The engine must be delivered and accepted defect free.
(Severable)
 - ▶ (Excellent)

PBP Example 6

- ▶ Event: Completed 50% of software coding
- ▶ Completion Criteria: Completion of 10,000 lines of code based on initial estimate of 20,000.

PBP Example 6, cont.

- ▶ Event: Completed 50% of software coding
- ▶ Completion Criteria: Completion of 10,000 lines of code based on initial estimate of 20,000.
 - ▶ (Bad, the original estimate of 20,000 was an estimate. What is the real software requirement?)

PBP Example 7

- ▶ Event: Installation Complete
- ▶ Completion Criteria: Successful completion of site Installation and Acceptance as evidenced by the submittal of CDRL A067 and site acceptance certificate.

PBP Example 7, cont.

- ▶ Event: Installation Complete
- ▶ Completion Criteria: Successful completion of site Installation and Acceptance as evidenced by the submittal of CDRL A067 and site acceptance certificate.
 - ▶ *(Excellent, contractor submits CDRL and Govt signs certificate)*

PBP Example 8

- ▶ Event: Receipt of all Production Materials
- ▶ Completion Criteria: Long Lead Item No. X7843, Frame, has been received but reported as late on weekly Material Action/Inspection Report

PBP Example 8, cont.

- ▶ Event: Receipt of all Production Materials
- ▶ Completion Criteria: Long Lead Item No. X7843, Frame, has been received but reported as late on weekly Material Action/Inspection Report
 - ▶ (Bad, is part delivered or late?)

Questions

References

- ▶ All FAR references

- ▶ <https://www.acquisition.gov/?q=browsefar>

- ▶ DAU, Progress Payments

- ▶ <https://dap.dau.mil/acquimedia/Pages/ArticleDetails.aspx?aid=6357ed4f-b92b-49c5-b146-9d05db49fdb8>

- ▶ DAU, Performance Based Payments (including memo and guide)

- ▶ <https://acc.dau.mil/CommunityBrowser.aspx?id=420492>

- ▶ http://www.acq.osd.mil/dpap/cpic/cp/Performance_based_payments.html

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