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I've been writing about Performance-Based Payments (PBPs) for a long time. My first article on the topic was published in Contract Management magazine in 2005. (You can find it on this site under "Knowledge Articles" if you're a member.) In that nearly 15 year-old article, I wrote –

Performance-based payments offer a method of contract financing that can reduce administrative oversight and streamline the payment process. By tying financing payments to technical or programmatic accomplishment, rather than to incurred costs, PBPs offer the ability to reduce administrative costs associated with cost-based billing systems and, perhaps, the intrusion of accountants and auditors into the payment process.

Since those days of innocence, so long ago, things have changed a bit—particularly for DoD contractors. The Department of Defense has, seemingly, tried to impede usage of the FAR's "preferred method" of contract financing payments. In 2014—five years ago—we told readers that PBPs "were done" in **this article** . We said what we said based on a final DFARS rule in that redefined use of PBPs in ways not intended by Congress. For example, that new rule required contractors using PBPs to have an adequate accounting system because they would have to report cumulative incurred costs to their contracting officers.

So much for "reduced administrative costs."

Anyway, others noticed what we noticed. Some of those others were in Congress. The 2017 National Defense Authorization Act (NDAA) (Section 831) to amend the United States Code "to establish a preference for performance-based payments to contractors and would re-establish the policy objective laid out in Federal Acquisition Regulation 32.1001, which established performance-based payments as the preferred Government financing mechanism." In particular, the USC was revised as follows:

"(2) Performance-based payments shall not be conditioned upon costs incurred in contract performance but on the achievement of performance outcomes listed in paragraph (1).

"(3) The Secretary of Defense shall ensure that nontraditional defense contractors and other private sector companies are eligible for performance-based payments, consistent with best commercial practices.

"(4) (A) In order to receive performance-based payments, a contractor's accounting system shall be in compliance with Generally Accepted Accounting Principles, and there shall be no requirement for a contractor to develop Government-unique accounting systems or practices as a prerequisite for agreeing to receive performance-based payments."

In response to the Congressional direction, quoted above, the DAR Council opened a DFARS Case to—once again—revise the DFARS. In this case, DoD was walking back from its stance on PBPs, which at that point was contrary to the original intent of Congress, the "re-established" intent of Congress, and the Federal Acquisition Regulation as well. DoD needed to realign with the rest of the government contracting world.

You'd think that would be quick and easy, but you'd be wrong about that. In the words of one commenter, the DAR Council was "taking its sweet time" to make the required changes. Finally, on April 30, 2019, a proposed rule **was issued** .

Generally speaking, the proposed rule implements Congressional intent. Specifically, it (finally!) removes the illegal DFARS requirement that limit PBP payment values to amounts not greater than costs incurred up to the time of payment. That requirement resulted in absurd results, such as contractors not being able to invoice for the full negotiated amount of the PBP "trigger" events because they hadn't yet spent enough money.

(That result is even more absurd when you take into account the historical context of PBPs and why Congress was so dissatisfied with cost-based progress payments. At the time, the A-12 "train wreck" was still fresh in everybody's minds. We had all learned that "progress payments" didn't equate with making progress; they equated with spending money.)

So the proposed rule is better than the illegal and absurd current regulatory language, for sure.

But it's not perfect. It has one flaw that perverts Congressional intent.

In the words of the proposed rule, "the requirement for contractors to report costs incurred when requesting performance-based payments is retained, in order to have the data necessary for

negotiation of performance-based payments on future contracts."

Yeah, that's not going to work.

In order to report costs incurred, contractors will need to have a "job cost" accounting system. That's not a GAAP-compliant accounting system; that's a government-unique requirement that is expressly contrary to the requirements in the U.S. Code we quoted above. So that's a flaw.

Remember, PBPs are only used on firm, fixed-price contracts where the price "is not subject to any adjustment on the basis of the contractor's cost experience in performing the contract." (FAR 16.202-1.) Once the price is negotiated, nobody cares about the contractor's costs (absent some kind of change). Thus, contractors do not need to have a job-cost accounting system to received a FFP contract, and imposing that requirement on them is forcing them to have one simply to receive PBPs.

Which Congress expressly said cannot be the case.

If you want to submit comments to the DAR Council, the link to the proposed rule, above, has lots of details regarding how to do so.