A Taxonomy for Services: Tying Contract Type to Risk and Requirements

The federal acquisition system is a complex entity with vast capabilities and countless interdependent parts. Used correctly, it can effectively and efficiently achieve the government's mission objectives. As the attributes and desired outcomes of acquisitions can vary significantly, optimal use of the acquisition system requires a thorough understanding of the tools and techniques available to its users. However, certain parts of this system are more fundamental to its proper functioning than others, and getting these elements right goes a long way toward ensuring the best possible acquisition outcomes. Among these key components is the contract type selected, and the proper pairing of an acquisition strategy with the requirements to be fulfilled. With the rapidly increasing complexity of acquisitions, the growing demands placed on the system and the workforce that supports it, and the heightened focus on compliance rather than outcomes, this basic premise is increasingly overlooked. These challenges are further exacerbated for services acquisition, where the pace of change continues to grow exponentially, and where successful outcomes are often more difficult to quantify than for delivery of services.

To this end, in 2013, the Professional Services Council's (PSC) Leadership Commission proffered a prototype of a "Risked-based Acquisition Strategy Decision Matrix," or "Taxonomy," that matched the level and type of risk presented by various services acquisition requirements with appropriate contract types, along with obligations and incentives for contractors performing the contracted work.[1] The intent of this taxonomy was to provide a resource for the federal acquisition workforce "to drive business and acquisition strategies based on the acquisition's requirements [and] help translate and coalesce the often complex mix of mission requirements, business models, and government 'rules' in a way to help inform the road forward and provide insight that can help drive smart business and acquisition strategies."

To its credit, the Department of Defense's Defense Acquisition University (DAU) has also created a chart on "Comparison of Major Contract Types," most recently updated in January of 2014.[2] The chart provides a high-level overview of a spectrum of ten different common contract

[1] Available on the PSC website at: https://www.pscouncil.org/c/p/2013_Commission_Report/The_2013_PSC_Leadership_Commission_Report.aspx; see pp. 20-24.

[2] Available on the DAU Acquisition Community Connection website at: https://acc.dau.mil/CommunityBrowser.aspx?id=214513

types (e.g. Firm-Fixed-Price, Cost-Plus-Award-Fee, Time & Materials, etc.) and offering general guidance on when to use—and when not to use—each type based on various attributes of the requirements to be fulfilled, and on statutory and regulatory requirements tied to particular contract types. DoD is to be commended for providing this resource to its workforce to help ensure the proper alignment between requirements and acquisition strategies, streamlining the acquisition process and helping ensure outcomes that are beneficial both to the government and to industry.

However, the DAU chart is oriented primarily to the department's acquisition of major weapons systems. In PSC's view, because of the growing spending on and complexity of services acquisitions within the federal arena generally, and DoD specifically, we found it necessary to tailor the DAU chart and prepare a taxonomy that is better focused on the unique characteristics of services (see attached).[i]

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[i] The Taxonomy for Services Contracts was primarily developed by the Improving Pre-Award Acquisition Planning Working Group of the Acquisition and Business Policy Council (ABPC)

A Taxonomy for Services Contracts – Risk-Based Acquisition Strategy Decision Matrix

	Firm-Fixed-Price (FFP)	**Fixed-Price Economic Price Adjustment (FPEPA)**	**Fixed-Price Incentive Firm Target (FPIF)**	**Fixed-Price Award-Fee (FPAF)**	**Fixed-Price Prospective Price Redetermination (FP^3R)**	**Cost-Plus-Incentive-Fee (CPIF)**	**Cost-Plus-Award-Fee (CPAF)**	**Cost-Plus-Fixed-Fee (CPFF)**	**Cost or Cost-Sharing (C or CS)**	**Time & Materials (T&M)**
Principal Risk to be Mitigated	None. Thus, the contractor assumes all cost risk.	Unstable market prices for labor or material over the life of the contract.	Moderately uncertain contract labor or material requirements.	Risk that the user will not be fully satisfied because of judgmental acceptance criteria.	Performance cost after the first year due to difficulty with estimating costs.	Highly uncertain and speculative labor hours, labor mix, and/or material requirements (and other things) necessary to perform the contract. The Government assumes the risks inherent in the contract, benefiting if the actual cost is lower than the expected cost, or losing if the work cannot be completed within the expected cost of performance.				
Use When . . .	The requirements, measurements and objectives are well-defined. •Contractors are experienced •Market conditions are stable. •Financial risks are otherwise insignificant.	The market prices at risk are severable and significant. The risk stems from industry-wide contingencies beyond the contractor's control. The dollars at risk outweigh the administrative burdens of an FPEPA.	A ceiling price can be established that covers the most probable risks inherent in the nature of the work. The proposed profit sharing formula would motivate the contractor to control costs and to meet other objectives.	Judgmental standards can be fairly applied by the fee determining official. The potential fee is large enough to both: •Provide a meaningful incentive. [1] •Justify related administrative burdens.	The Government needs a firm commitment from the contractor to deliver the supplies or services during subsequent years. The dollars at risk outweigh the administrative burdens of an FPRP.	An objective relationship can be established between the fee and such measures of performance as actual costs, delivery dates, performance benchmarks, etc.	Objective incentive targets are not feasible for critical aspects of performance. Judgmental standards can be fairly applied. Potential fee would provide a meaningful incentive.	Relating fee to performance (e.g., to actual costs) would be unworkable or of marginal utility.	The contractor expects substantial compensating benefits for absorbing part of the costs and/or foregoing fee or the vendor is a non-profit entity.	No other type of contract is suitable (e.g., because costs are too low to justify an audit of the contractor's indirect expenses).
Elements	A firm-fixed-price for each line item or one or more groupings of line items.	•A fixed-price, ceiling on upward adjustment, and a formula for adjusting the price up or down based on: •Established prices. •Actual labor or material costs. •Labor or material indices.	•Ceiling price •Target cost •Target profit •Delivery, quality, or other performance targets (optional) •Profit sharing formula •120 % ceiling and 50/50 share are points of departure	•Fixed-price. •Award amount •Award fee evaluation criteria and procedures for measuring performance against the criteria	•Fixed-price for the first period. •Proposed subsequent periods (at least 12 months apart). •Timetable for pricing the next period(s).	•Target cost •A minimum, maximum, and target fee •A formula for adjusting fee based on actual costs and/or performance •Performance targets (optional)	•Target cost •Base amount, if applicable, and an award amount •Award fee evaluation criteria and procedures for measuring performance against the criteria	•Target cost •Fixed fee	•Target cost •No fee •If CS, an agreement on the Government's share of the cost.	•Ceiling price •A per-hour labor rate that also covers overhead and profit •Provisions for reimbursing direct material costs
Contractor is Obliged to:	Provide an acceptable deliverable at the time, place and price specified in the contract.	Provide an acceptable deliverable at the time and place specified in the contract at the adjusted price.	Provide an acceptable deliverable at the time and place specified in the contract at or below the ceiling price.	Perform at the time, place, and the price fixed in the contract.	Provide acceptable deliverables at the time /place specified in the contract at established price for the period.	Make a good faith effort to meet the Government's needs within the estimated cost in the Contract, Part I the Schedule, Section B Supplies or services and prices/costs.				Make a good faith effort to meet the Government's needs within the ceiling price.
Contractor Incentive *(other than maximizing goodwill)* [1]	Generally realizes an additional dollar of profit for every dollar that costs are reduced.	Generally realizes an additional dollar of profit for every dollar that costs are reduced.	Realizes profit on cost by completing work below the ceiling price. May earn higher profit by incurring costs below the target cost or by meeting objective performance targets.	Generally realizes an additional dollar of profit for every dollar that costs are reduced; earns an additional fee for satisfying the performance standards.	For the period of performance, realizes an additional dollar of profit for every dollar that costs are reduced.	Realizes a higher fee by completing the work at a lower cost and/or by meeting other objective performance targets.	Realizes a higher fee by meeting judgmental performance standards.	Realizes a higher rate of return (i.e., fee divided by total cost) as total cost decreases.	If CS, shares in the cost of providing a deliverable of mutual benefit.	
Typical Application	Commercial supplies and services (e.g. grounds keeping, facilities maintenance, building security)	Long-term services contracts whose cost elements can be impacted by volatile market conditions. (e.g. fuels, silver in batteries (UUV's), or titanium)	Production of a major system based on a prototype. Atypical for services, but could be applied for variable level of effort; surge or contract (e.g. mobilization services)	Performance-based contracts including services contracts, (e.g., HR Services)	Long term maintenance contracts. Applies where tong-term agency or customer requirements are volatile from year to year.	Research and development of the prototype for a major system. Services that require a level of effort that is expected to be variable (e.g., software development).	Performance based services contacts, where deliverables are well defined but level of effort remains speculative (e.g. research modernization)	Level of effort services contracts (e.g. government directed acquisition program management)	R&D type contracts conducted jointly with FFRDC's or other non profits such as educational institutions (e.g. shared user rights, patents, revenue generating IT systems)	Emergency repairs to heating plants and aircraft engines.
Principal Limitations in FAR/DFARS Parts 16, 32, 35, and 52[2]	Generally NOT appropriate for R&D.	Must be justified.	Must be justified. Must be negotiated. Contractor must have an adequate accounting system. Cost data must support targets.	Must be negotiated.	MUST be negotiated. Contractor must have adequate accounting system that supports pricing periods.	The contractor must have an adequate accounting system. The Government must exercise surveillance during performance to ensure use of efficient methods and cost controls. Must be negotiated. Must be justified. Statutory and regulatory limits on the fees that may be negotiated. Must include the applicable Limitation of Cost clause at FAR 52.232-20 through 23.				D&F required (w/ HCA if over 3 years). Government MUST exercise surveillance to ensure efficiency. Document ceiling increases.
Variants	Firm-Fixed-Price Level-of-Effort.		Successive Targets (FPIS)		Retroactive Redetermination			Completion or Term.		Labor Hour (LH)

[1] Goodwill is the value of the name, reputation, location, and intangible assets of the firm.

[2] Comply with any USD(AT&L), DPAP or other memoranda that have not been incorporated into the DFARS or DoD Directives or Instructions.