

STATE AUDITOR'S OFFICE



Performance-Based Contracting Review of Current State Practices

June 30, 2011

Report No. 1004877



WASHINGTON
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STATE AUDITOR

EXECUTIVE SUMMARY

Background

Washington state contracts for goods and services valued at more than \$10 billion annually. That's nearly one-third of all state spending. Many leaders and contracting specialists believe state government can give citizens more value for their money by using a process called performance-based contracting. When used correctly, it can deliver a positive return on investment.

Washington is not starting from scratch on this issue. More than 90 percent of the contracts we reviewed for this project met the state's basic performance-based contracting standard, and about 50 percent included performance measures or outcomes. However, only 15 percent tied payment to contractors' attainment of those measures or outcomes. Overall, the state has a significant opportunity to adopt more advanced levels of performance-based contracting.

What do we mean by "**performance-based**" contracts? Traditionally, governments have used *time-and-materials contracts* that compensate vendors based on how much time they spent and the quantity of materials they used. Under performance-based contracts, businesses are paid based on providing *deliverables* or meeting pre-established *outcomes* or *results*. Government buys results instead of efforts.

For example, a team of educators might be contracted to help 500 job-seekers who never finished high school win general education diplomas (GEDs). A traditional contract might simply require the contractor to conduct the required classes. A performance-based contract might tie contractor pay to the number of people who actually received GEDs. A more advanced performance-based contract might tie compensation to the number who found jobs because they had GEDs.

We distinguish between two types of performance-based contracts:

- **Deliverables-based contracts** that link payment to specific products or project milestones.
- **Outcomes-based contracts** that tie payment to results, connecting performance measures and/or outcomes to payment.

Performance-based contracting is not a one-size-fits-all solution. Deliverables, performance measures and outcomes must be tailored to the purpose of the contract and the goals of the program it supports. Writing performance-based contracts is challenging, but some agencies are using promising techniques, such as tying payments to contractors' timely completion of deliverables and withholding payments if they do not meet contract requirements.

Washington's contracting systems are in transition, and contract oversight is divided among a number of agencies. For instance, the Office of Financial Management (OFM) provides guidance and oversees client services and personal services contracts, while the Department of General Administration oversees contracts for goods and purchased services. The Department of Enterprise Services, to be created later this year, will be structured in part to consolidate the oversight of most state contracts to ensure agencies and citizens receive maximum value. This transition period presents an ideal opportunity for agencies to expand their performance-based contracting.

Deliverables-based or outcomes-based?

A **deliverables-based contract** links payment to specific products or milestones.

A **outcome-based** or **results-based contract** ties payment to results, connecting performance measures or outcome to payment.

The Office of Financial Management defines a **performance-based contract** as a contract that identifies "expected deliverables, performance measures or outcomes; and payment is contingent on their successful delivery. Performance-based contracts also use appropriate techniques, which may include but are not limited to, consequences and/or incentives to ensure that agreed upon value to the state is received."

Why we did this review

In November 2010, the Governor asked the State Auditor's Office to evaluate statewide performance-based contracting and to assist OFM in providing training on performance-based contracting to state employees. At that time, the Governor issued **Executive Order 10-07**, requiring cabinet agencies to use performance-based contracting for new and renewed contracts.

The Governor's request included the following questions:

- Do current performance-based contracts include appropriate and effective performance measures for assessing contractor performance? If not, why not?
- Do current performance-based contracts provide incentives for excellent performance or consequences for inadequate performance? If not, why not?
- How are agencies managing performance-based contracts? For example, if a vendor is not performing, what corrective actions are agencies taking? Are contractors and vendors being held accountable? Given limited resources, what options are available to improve management if needed?
- What are leading practices around performance-based contracting? How could we apply these practices to Washington State?

To examine these questions, the State Auditor's Office worked with the FCS Group, a management consulting firm, to survey 34 state agencies and to conduct detailed reviews of more than 450 contracts for services. We also interviewed more than 100 agency contract and program managers. To learn about leading practices, the firm reviewed academic studies, congressional reports and research by national organizations.

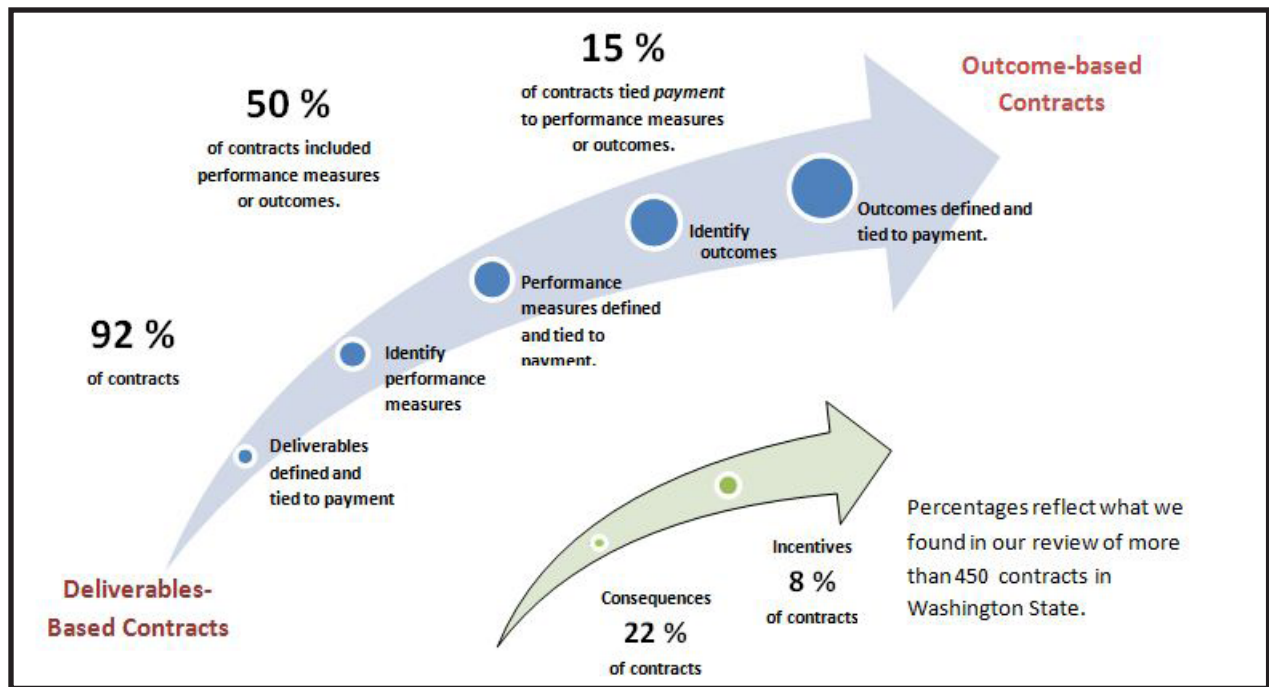
The Auditor's Office, in conjunction with OFM, offered two training sessions in May 2011 for state employees, which were developed and presented by FCS. More than 60 program and contract managers attended each session. Attendees gave the training high marks overall and said they would like to see more examples of good performance-based contracts and to receive help in identifying good performance measures.

What we found

Overall, Washington State has built a solid foundation from which to improve its contracting processes and possibly to reduce costs. We identified the following specific issues:

Most agencies use a basic form of performance-based contracting. Agencies are in various stages of transition to performance-based contracting, as shown in the following chart. Of the contracts we examined:

- **Some 92 percent** met OFM's basic standard by identifying deliverables and tying payment to successful completion or delivery.
- **About 50 percent** identified performance measures or outcomes.



However, relatively few contracts tied payment to the attainment of performance measures or outcomes. Likewise, few included incentives for good performance or penalties for poor performance beyond standard remedies and termination provisions. For example:

- **About 15 percent** of contracts we reviewed – slightly more than one in six – tied payment to the achievement of performance measures or outcomes.
- **About 8 percent** included performance incentives; 22 percent included penalties.

Most public works contracts included penalties, such as liquidated damages for specific project deficiencies. Penalties used in other types of contracts included reduced payment for late deliverables and “use it or lose it” provisions that cut funding for client service providers if they didn’t fully spend budgeted amounts.

Developing performance measures can be challenging for certain types of contracts – especially client services contracts – but we found examples of successful strategies. For instance, one program manager had developed client services performance measures by applying recommendations from evidence-based research.

Another example, one easily understood by anybody stuck for hours on the freeway after a large truck rollover: A few years ago the state tested a program that awarded tow truck companies a bonus if they cleared freeway collisions involving hard-to-move trucks in fewer than 90 minutes. Citizens saw dramatic results. About nine in 10 major incidents were cleared in 90 minutes and citizens saved time and money by not sitting in traffic.

Active monitoring of performance-based contractors is key to success

- Overall, at least three-quarters of interview respondents told us they monitor contracts by reviewing invoices and reports from contractors or by meeting with contractors. Nearly all agency contract managers said they review invoices.
- On-site monitoring is especially important for construction contracts, and all of the staff we interviewed who monitored capital contracts said they visit project sites to monitor progress.
- About half the agencies we talked with said they have quality assurance plans, an important element for strengthening a performance-based contract.

What stands in the way of more widespread use of performance-based contracting?

Many program managers told us they did not face challenges, but among those who did, several issues stood out:

- Internal challenges included staff limitations, the belief that performance-based contracting is inappropriate in certain situations, budget constraints and agency processes.
- Contract managers also felt challenged to develop performance measures without clear guidance from OFM, and some felt incentives were not necessary because contractors are naturally motivated to perform well.
- External challenges included the difficulty of using performance-based contracting in some industries, a need for training among vendors, and resistance from the vendor community. In some important contracting areas, effective performance measures are hard to develop and incentives are inappropriate.
- Incentives are often hard to use in contracts for federal grant funds. Federal guidelines often do not allow incentive payments, and the grantors and grant recipients decide the shape of the contracts, not the state.

Leading practices

We identified several effective approaches to address commonly cited challenges:

- Recognize that performance-based contracting is not a one-size-fits-all solution, especially when agencies must closely oversee contractors' work processes or meet strict federal requirements.
- Use risk assessments to inform contract development and to set priorities for monitoring.
- Use standard terms and templates when possible.
- Ensure that performance and outcome measures are relevant, attainable and practical.
- Active monitoring, including performance-improvement plans for contractors whose performance is sub-par.

Highlights of recommendations

We recommend state agencies:

Increase the use of performance or outcome measures for payment

- To help agencies better understand what is required by performance-based contracting, oversight agencies should explicitly define *deliverable*, *performance measure* and *outcome*.
- To help agencies develop performance measures, the state should revise OFM's *Performance Measure Guide* to include more strategies for developing and selecting performance measures and outcomes.
- To use staff expertise across agencies for similar types of services, create committees by major service type to explore appropriate and feasible performance and outcome measures to include in specific types of contracts. Based on our review, medical services might be the first opportunity to create such a committee to identify and create a set of common performance and outcome measures.

Improve contract management and contracting processes

- To reduce staff time needed to develop contracts, agencies should use more standardized language in contract documents. Agencies using standardized language should conduct assessments to make sure it supports performance-based contracting requirements.
- To help contract managers develop monitoring plans, each agency should use a "risk assessment and monitoring plan" (RAMP) as part of contract development. Agencies may be able to use elements of the RAMP already in place at the Department of Social and Health Services.
- To add more performance-based elements to contracts with federal grant recipients, agencies should develop incentives that are aligned with federal guidelines and use contract language allowing them to withhold payment.

Increase staff expertise and capacity

- To increase staff expertise, contract oversight agencies should offer more training for program managers and senior executives on the basics of performance-based contracting. Contract staffers who know the basics would benefit from advanced-level training.
- To inform employees about agency-specific contract procedures, each agency should provide staff training for employees who administer contracts.
- Update staff on how the agency is complying with the Governor's executive order.

Educate and collaborate with contractors

- To overcome contractor resistance to performance measures and outcomes, agencies should work with the vendor community to develop measures.

What's next?

We have presented this report to the Governor at her request. This information can support ongoing training efforts and help the state continue to improve contracting processes. As the state works to reform contracting through the new Department of Enterprise Services, it has a timely opportunity to expand the use and consistency of performance-based contracts.

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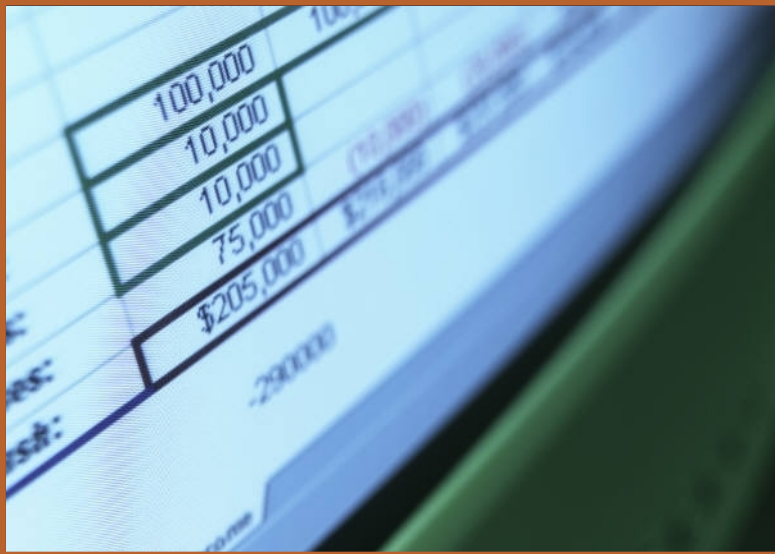
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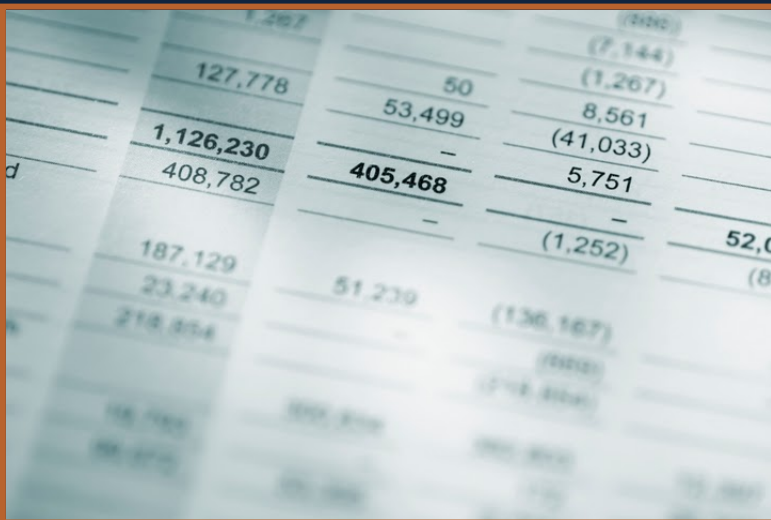
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The State Auditor's Office independently serves the citizens of Washington by promoting accountability, fiscal integrity and openness in state and local government. Working with these governments and with citizens, we strive to ensure the efficient and effective use of public resources.



Review of Performance-Based Contracting by State Cabinet Agencies

Final Report



Washington State
Auditor's Office



June 23, 2011



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June 23, 2011

Kevin Greene
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Dear Mr. Greene:

Enclosed is our final report on our review of performance-based contracting by State cabinet agencies. We want to thank you and the rest of the SAO staff for all the efforts made to assist us in working with the thirty-four State agencies that participated in the review. We received timely responses from all the agencies and they were able to accommodate the challenging schedule for the review. With the SAO's and the agencies' support we were able to review 461 contracts and conduct over 100 interview sessions with contract and program managers.

Although State agencies have been using performance-based contracting prior to the Governor's Executive Order, the Executive Order will provide more focus on the key elements that make performance-based contracting a tool to improve the accountability and effectiveness of using contracted services. Our report recommendations are oriented toward improving the State's use of performance measures and outcomes in conjunction with better contract management.

If you have any questions concerning the report or need additional assistance as the State moves forward with its performance-based contracting initiative, please feel free to contact us.

Sincerely,

A handwritten signature in black ink that reads "Peter Moy". The signature is written in a cursive, flowing style.

Peter Moy
Principal

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Introduction

On November 29, 2010, Washington's Governor issued Executive Order 10-7 concerning performance-based contracting. The Governor's Executive Order requires all state cabinet agencies to institute performance-based contracting (PBC) for new contracts and renewals of existing contracts and to ensure that such contracts are actively managed to meet performance-based standards. The Governor had several reasons for issuing the Executive Order, but three key reasons were the following:

- To be more diligent than ever in ensuring public funds are used appropriately and effectively.
- To hold not only government agencies accountable, but also individuals and businesses contracting with the state.
- To take additional steps to strengthen state agency contract monitoring and management practices.

When the Governor issued the Executive Order, she also requested assistance from the State Auditor to conduct a management review of current performance contract practices and to provide training in partnership with the Office of Financial Management (OFM) and with the Governor's Government Management Accountability and Performance (GMAP) staff. As part of her request, the Governor requested that the State Auditor answer three major questions by June 1, 2011:

- Are there provisions in current performance-based contracts that provide incentives for excellent performance and/or consequences for inadequate performance? If not, why not?
- How are agencies actively managing their contracts, for example if a vendor is not performing, what kind of corrective actions are being taken? Are contractors/vendors being held accountable? Given limited resources, what options are available to improve management if needed?
- What are the best practices around performance-based contracting? How could we apply these best practices to Washington State?

Based on the Governor's request, the State Auditor prepared a scope of work and objectives for the performance-based contracting review. In addition to the Governor's questions, the State Auditor also included the following additional questions:

- Do current performance-based contracts include appropriate and effective performance measures for assessing contractor performance? If not, why not?
- What are the internal challenges and obstacles to successful implementation of performance-based contracting?
- What are the external challenges and obstacles to successful implementation of performance-based contracting?

The State Auditor's Office (the Office) selected FCS GROUP, Inc. to conduct the review and held an initial kick-off meeting with FCS GROUP on March 10, 2011. Another kick-off meeting was held with the participating state agencies on March 31, 2011. The scope and methodologies used for the review are in Appendix B.

Background

When the Governor issued Executive Order 10-7, many cabinet agencies were already using performance-based contracting. Agency efforts to comply with the Executive Order are in various stages. According to the agency survey conducted as part of this review, when the Governor issued her Executive Order concerning performance-based contracting, thirty one or 91 percent of the 34 agencies responsible for reporting to the Governor on performance-based contracting had already started using such contracts before 2010. Slightly more than half of the 34 agencies indicated that they use performance-based contracting for most or all of their contracts. Only one agency indicated that it had not yet started using performance-based contracts.

As part of the Executive Order, the Governor directed the Office of Financial Management (OFM) to issue minimum performance contracting standards for client and personal services contracts. Other contract oversight agencies such as the Department of General Administration were also asked to revise their policies and procedures to make them consistent with OFM’s standards. In response to the Governor’s Executive Order, 13 agencies already have developed and use revised policies and procedures. Four agencies have not started working on the issue. **Exhibit 1** shows the number and percentage of agencies that are taking specific actions to comply with the Executive Order. In the survey an agency could select more than one action.

Exhibit 1
Agency Actions on Executive Order 10-7

Agency Action Taken	Number of Agencies	Percent of Agencies
Have not started yet	4	12%
Established a task force/work group to determine how to initiate performance-based contracting in the agency	12	35%
Established a task force/work group to review agency policies and procedures and make recommendations on changes	16	47%
Have already developed and implemented revised policies and procedures	13	38%

As part of the agency survey, several agencies made additional comments about what actions they were taking to comply with the Governor’s Executive Order. Some examples include the following:

- Notifying agency staff about the requirement to use performance-based contracting,
- Waiting for final recommendations to update agency policies and procedures,
- Working to strengthen performance language in new contracts, and
- Investigating best practices.

Performance-Based Contracting Standards and Reporting

In the Governor's Executive Order, the Governor noted that OFM has already provided guidelines on using performance-based contracts for personal and client services contracts. The guidelines are incorporated as part of the State Administrative & Accounting Manual (SAAM). Performance-based contracting is defined in SAAM sections 15.40.20.a for personal services contracts and 16.20.20.a for client services contracts. These sections define performance-based contracting as follows:

“At a minimum, performance-based contracts must identify expected deliverables, performance measures or outcomes; and **payment is contingent on their successful delivery** (Emphasis added). Performance-based contracts also use appropriate techniques, which may include but are not limited to, consequences and/or incentives to ensure that agreed upon value to the state is received. Performance-based contracts:

- Emphasize results related to output, quality and outcomes rather than how the work is performed;
- Specify deliverables, performance standards and/or an outcome orientation and clearly defined objectives and timeframes;
- Use quality assurance plans, measurable performance standards and/or outcomes;
- Provide performance incentives and/or consequences for non-performance; and
- Tie payment to deliverables, performance measures and/or outcomes.

Performance-based contracting must be carefully considered since deliverables, performance measures and/or outcomes need to be clearly identified in the contract, so that achievement of those deliverables, performance measures and/or outcomes is apparent to all.”

According to the SAAM 15.40.25 and 16.20.25, the purpose of including expected deliverables, performance measures or outcomes within a contract is to provide a standard or measure for performance of the contracted services. These may also be used to determine if, and when, the contractor has successfully completed performance, and when and how much the contractor should be paid. OFM previously has issued information on performance measures. In 2009 OFM published a Performance Measure Guide that defines a performance measure as a quantifiable expression of the amount, cost, or result of activities that indicate how much, how well, and at what level, products or services are provided to customers during a given time period. Types of performance measures identified in the guide include the following:

- Output measures are tangible, specific products produced by the business process or activity.
- Process measures describe aspects of the business process, such as completion rate, processing time, etc.
- Outcome measures are the purpose or result that customers want from the product or service. A measure of the ultimate benefits associated with a program and service. Ultimate outcomes or results are broad social goals that the work is supposed to affect or accomplish (e.g. improved health, reliable transportation).

To monitor the use of performance-based contracting by agencies, the Governor's Office developed a Performance-Based Contracting Reporting Plan to establish reporting requirements on agency use of performance-based contracts.

Agency Survey Summary

In addition to questions about what actions agencies have taken to comply with the Governor's Executive Order, the survey, which included 34 agencies, also asked a number of other questions about what elements of performance-based contracting agencies were using in their contract management (see Appendix C). As previously mentioned, most agencies believe that they are already doing performance-based contracting. Twenty-seven agencies or 79 percent use performance-based contracts in at least a majority (over 50 percent) of the contracts. Four agencies said all their contracts are performance-based. From an overall agency-wide perspective, the survey indicated that the agencies believed the following about agency use and issues concerning performance-based contracts:

- Timeframes and deliverables were the most commonly specified items in performance-based contracts. Ninety-seven percent and 94 percent of the agencies, respectively, included them in at least a majority of the contracts.
- Performance standards and outcomes were included by 77 percent and 63 percent of the agencies, respectively, in at least a majority of the contracts.
- Payment tied to a deliverable was identified by 82 percent of the agencies in a majority or more of the contracts, while payment tied to performance measures or outcomes was identified by 53 percent of the agencies in at least a majority of the contracts.
- The primary monitoring activities were invoice reviews, periodic contract reporting, and other periodic contacts where 91 percent, 87 percent, 78 percent of the agencies, respectively, included them in at least a majority of the contracts.
- Only 15 percent of the agencies included positive incentives in a majority or more of the contracts, but 65 percent included negative consequences in at least a majority of the contracts.
- Staff training, limited staffing and resources, developing PBC contracts, monitoring, and reporting were identified by agencies as the most common internal challenges.
- Working with contractors, contractor resistance, contracts that may not translate well to performance-based, incompatibility between performance-based contracting and federal requirements, and providing training to contractors were identified by agencies as the most common external challenges.

The following sections discuss the results of our contract review and agency interviews based on a sample of contracts from 14 of the 34 agencies. These sections reflect similar results as those cited above from the survey, but provide more detail and represent a larger number of agency staff.

Issues

Issue 1: Most contracts in our sample met OFM’s criteria for a performance-based contract by at least identifying expected deliverables and making payment contingent on the receipt of those deliverables.

To determine how performance-based contracting is used and managed in the 14 sample state agencies, a sample of contracts was selected to evaluate whether the contracts were performance-based. If the contracts met OFM’s criteria, a sample of the program managers for those contracts was selected for interviews about their contracts. Our sample included 461 contracts in the areas of client services, capital outlay, personal services, and purchased services. Specifically, we reviewed 69 contracts for capital outlay, 193 contracts for client services, 102 contracts for personal services, and 97 contracts for purchased services. Based on a review of the contracts in our sample, most contracts met OFM’s criteria for performance-based contracts by at least identifying expected deliverables and making payment contingent on the receipt of these deliverables.

Of the total 461 contracts we sampled, 97 percent defined deliverable expectations in the contract. A total of 421 contracts, or 92 percent of all contracts, tied these deliverables to the contract’s payment conditions. These results are consistent with our survey of 34 state agencies. When agencies were asked, “To what extent do your performance-based contracts specify deliverables,” 94 percent of the respondents indicated that either “all,” “most,” or a “majority” of their contracts specified deliverables. Further, 28 of the 34 respondents, or 82 percent indicated that either “all,” “most,” or a “majority” of their contracts tied payment to their deliverables.

In addition to determining how contracts met the definition of a performance-based contract, we also made additional observations from our contract review and discussions with program staff. Although some of our observations are more applicable to certain departments than others, all departments may find value in their discussion. These observations include:

- OFM’s performance-based contract definition could be improved,
- The type of contract affects the deliverables,
- Defining deliverables can be challenging, and
- Linking payment to deliverables can be improved.

OFM’s Performance-Based Contract Definition Could Be Improved

In November 2010, the State Administrative & Accounting Manual (SAAM) was updated to state that all cabinet agency personal and client service contracts must be performance-based. The SAAM indicates that “non-cabinet agencies are encouraged to use performance-based contracting.” Although the SAAM provides a definition of performance-based contracting, the manual does not provide guidance on the intended meaning of terms critical to the definition: “deliverables,” “performance measures,” and “outcomes.” Our review of literature providing definitions for these terms suggest that there is variability in their meaning depending on how they are applied to different types of services. In interviews with staff, some agency and program staff indicated that guidance has not always been clear or standardized. Other staff indicated that training is needed to better understand OFM’s expectations. As noted earlier, the SAAM defines performance-based contracts as:

“At a minimum, performance-based contracts must identify expected deliverables, performance measures or outcomes; and payment is contingent on their successful delivery. Performance-based contracts also use appropriate techniques, which may include but are not limited to, consequences and/or incentives to ensure that agreed upon value to the state is received.” (State Administrative & Accounting Manual, Sections 15.40.20 and 16.20.20)

• **Performance-Based Contracting**

Using this definition of performance-based contracts as our criteria for reviewing our contract sample, we identified contracts as being performance-based if at least one of the following three conditions were met:

1. Deliverables were identified and tied to payment.
2. Performance measures were identified and tied to payment.
3. Outcomes were identified and tied to payment.

Given that the SAAM does not provide specific definitions, we used the definitions noted in **Exhibit 2** to guide our assessment of contracts in meeting the SAAM criteria related to performance-based contracts. These definitions are intentionally broad to account for the variation in meaning across agencies and contract types.

Exhibit 2
Definitions Used to Determine Performance-Based Contracts

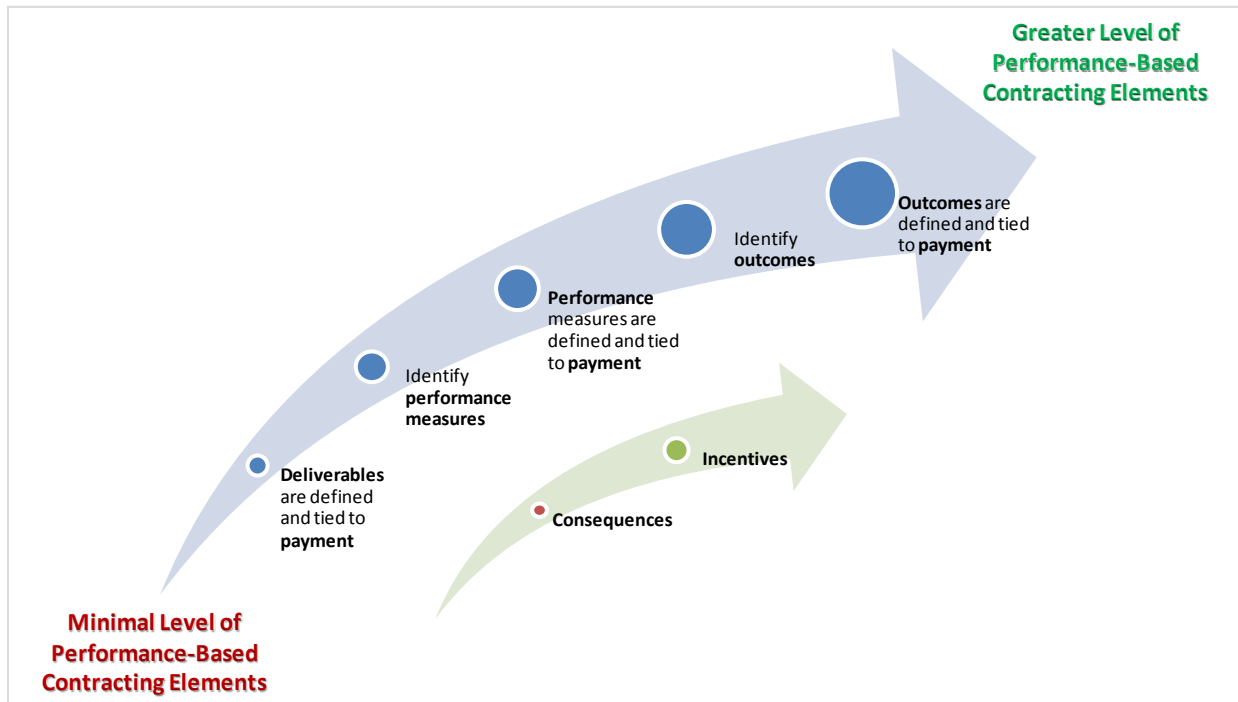
SAAM Term	Definition*
Deliverables	A deliverable is an item, duty or service, or project task that must be completed or delivered under the terms of the contract.
Performance Measures / Outcomes	Performance measures and outcomes are specific, quantifiable expectations for service delivery, and can describe the degree to which the desired result (goal) of the contract is achieved. Depending on the program or service, these could include output goals, accessibility, availability, timeliness, quality, compliance, measurable changes in client behavior, health or well-being, attainment of sustained employment at a particular wage level, an average satisfaction rating of good or better by citizens or customers as measured by a survey, changes in student test scores.

*Sources: Government Accounting Standards Board (GASB), GASB Service Efforts and Accomplishments Project (SEA) and SAAM

Although the use of performance-based techniques, such as positive incentives and negative consequences, was also considered in our review, the sole use of one of these two elements would not necessarily mean that a contract was performance-based. Instead, the use of these elements enhances the performance-oriented nature of a contract by expecting a greater level of performance and accountability from its contractors. The actual use of incentives and consequences in our contract sample is described in Issue 2 of this report.

As previously mentioned, most of the contracts reviewed were performance-based contracts because payment was linked specifically to a deliverable. If the goal of performance-based contracting is to achieve better performance and outcomes from the services received, just providing a deliverable might not achieve that goal. **Exhibit 3** illustrates this concept.

Exhibit 3
Elements of Performance-Based Contracting Per the State
Administrative & Accounting Manual (SAAM)*



*Based on the State Administrative & Accounting Manual, Sections 15.40.20 and 16.20.20

The Type of Contract Affects the Deliverables

For many of the contracts we reviewed, deliverable expectations were stated in the sections identified as “Scope of Work,” “Statement of Work,” or in some cases a specific “Deliverable” section. Our review revealed that the types of deliverables in our sample varied based on the type of contract. Generally, contracts related to capital outlay and purchased services identified tangible deliverable items. Examples of deliverables for these types of contracts included facility construction, infrastructure upgrades, information technology software, and equipment.

Conversely, contracts for personal and client services did not always define tangible products for delivery. Instead, these contracts generally focused on contracting for labor with a specific expertise, such as information technology support, medical services, referrals and outreach, and trainings.

In addition to the variability in the types of deliverables requested across contracts, our review also indicated that the level of detail used to describe expected services can vary. Some contracts provide a general list of requested services – sometimes in minimal bullet form – without a clear delineation of categories or service types. Other contracts provide detailed deliverable expectations, segregating deliverables into numbered tasks or providing categories for the type of service being requested. These contracts generally provide a clearer scope of work with deliberate communication of expected services. The importance of a clear scope of work was noted in our interviews with program staff, and was the second most common response when asked “are there any contract terms or monitoring process and procedures that you believe are really critical to have in performance-based contracts?”

• Performance-Based Contracting

The following figures provide examples of the variability in the detail sometimes provided as part of the scopes of work. **Exhibit 4** shows an information technology support contract that identifies a general list of tasks and provides little detail about the expectations for each of the tasks. Conversely, **Exhibit 5** provides a detailed description of expected mental health services. Within one task, “Mental Health Intake, Evaluation and Treatment Plan,” the contract provides a description of expectations and the level of information to be included in each deliverable item.

Exhibit 4 Example of Less Specific Deliverable Contract Language

The SCS/Field Services Core Team Manager or his designee will assign the specific tasks performed under the Work Contract(s) resulting from this Work Request. The tasks include, but are not limited to, the following:

- Estimating hours required to complete tasks
 - Working with and assisting other SCS/Field Services Core Team staff on projects/assignments
 - Interviewing customers to determine and specify detailed requirements
 - Analyzing requirements and evaluating alternatives to meet them
 - Performing maintenance support as needed
 - Designing programs or applications
 - Programming
 - Testing application changes completed - both themselves and assisting the client with testing, verifying, and correcting issues that are identified
 - Trouble-shooting and problem resolution
 - Coaching, mentoring, and training (when applicable) ■■■ staff
 - Complete development tasks and assignments on scheduled due dates.
 - Related tasks as required
 - Documenting the above
-

Exhibit 5 Example of More Detailed Deliverable Contract Language

CONTRACTOR RESPONSIBILITIES

The Contractor shall provide professionally trained and registered mental health or licensed counselors to provide services included in a-c below:

- a. **Mental Health Intake, Evaluation and Treatment Plan**-This service includes screening, assessing, providing diagnosis and developing an individualized Intake/Evaluation and Treatment Plan for all participants receiving counseling. These pre-counseling services must be provided in person.

The **Intake/ evaluation** must be dated and include:

- (1) Biographic information;
- (2) Evaluation of the participant's mental health needs;
- (3) Diagnosis using the Diagnostic Statistical Manual of Mental Disorders (DSM) IV; and
- (4) Other planned services in addition to counseling services

The **Treatment plan** must be dated and signed by the Contractor and identify the following:

- (1) Prescribed service goals;
- (2) Type of services to be provided;
- (3) Time frames; and
- (4) Anticipated results from treatment

• Performance-Based Contracting

From our review of sample contracts, we found that the level of detailed language related to deliverables can vary within the same type of service. One example is our review of medical service contracts. At one agency, we found instances where medical contracts only included general references to the expected work, even though the medical contractor provides specialty services. The program officer stated that this is due to her use of a template for medical service contracts. Therefore, even though a provider specializes in a service such as vision, the contract's scope of work used the following general terminology:

“The Provider will deliver basic medical services to [department clients] in a cost-effective setting off-site (not in a [department site]). Basic medical services are those health care services that are identified by [the department] as medically necessary. Medically necessary as used herein is defined as that care that is determined by the [the department] to:

- Be consistent with applicable [department] policies and procedures;
- Be ordered by an authorized [department] health care provider;
- Be required to prevent significant deterioration in the [client's] health or permanent functional impairment if not rendered during the period of [service];
- Not be considered experimental or be lacking in medically recognized professional documentation of efficacy; and
- Not be administered solely for the convenience of the recipient or the Provider.”

These contracts tie deliverables to payment through a reimbursement schedule that is referenced in the contract and provides detail on the allowable medical services for the department through a website link.

More detailed language for medical service contracts were found at other departments. For instance, one sampled contract for medical anesthesia specified the need for compliance with accepted protocols for office-based anesthesia, participation in the most demanding aspects of the anesthesia plan, monitoring expectations, and specific documentation expectations. When a contract does not elaborate on the expected services within a specialty, contractors may have varying interpretations of service delivery expectations. This can result in inconsistent performance across similar contracts.

Defining Deliverables Can Be Challenging

For some contract types, our interviews with program staff indicated that deliverable language can be challenging to write since the exact needs are not always known at the time of contracting, or are likely to change during the course of the contract. This was specifically the case for certain types of information technology (IT) contracts. One program manager stated that he struggles with how to develop a scope of work for these contracts because the needs anticipated at the beginning of a contract are often changed or revised once the software is being developed. These changes are often a result of changing needs identified during user experience groups, software testing, or business processes updates. In these cases, software specifications listed in the contract's scope of work can quickly become out of date.

We found one instance where a program manager used an industry approach for allowing flexibility in software development. Specifically, the contract included an IT process that emphasizes communication, collaboration, functioning software, and the flexibility to adapt to emerging business realities – all attributes that suffer under more rigid methodologies. The program manager stated that this process addresses the concern of changing needs by allowing for specific software requirements to be developed and changed during the course of development. However, the program manager also noted a challenge in sufficiently crafting contract language that incorporates this process into the contract in a way that still holds the contractor formally accountable for the department's needs. Our conversation with the program manager explored the potential of using memoranda of understanding to account for changes in service. The program manager stated that this could be a possibility.

• Performance-Based Contracting

A contract in our sample at another department incorporated the concept of using memoranda of understanding (MOU) to address unforeseeable needs and changes during the course of the contract period. For this contract, the department noted that specific tasks for a given area would “be determined and executed through an MOU.” The contract elaborated that MOU “tasks performed and the timing will be determined by [the department] and the contractor, but will fall under the following categories...” The contract then provided general areas that the tasks should address – consistent with the overall purpose of the contract. The concept of using an MOU was tied to the contract’s payment conditions by stating, “Deliverables, including fee, shall be documented in a memorandum of understanding (MOU) signed by each party’s Contract Manager prior to initiating work.” In stating this language, the contract not only established a mechanism for providing service flexibility, but also established a method of maintaining contractor accountability for unforeseeable needs.

Linking Payment to Deliverables Can Be Improved

As noted earlier, a total of 421 of the contracts in our sample, or 92 percent, tied deliverables to the contract’s payment conditions. However, we also found that some of the payment language can be improved by specifically showing the relationship between deliverables and payments. In a number of cases, we determined that contracts had deliverables linked to payment **only** because the department’s standard “boilerplate” language created the linkage. This was the case with contracts for at least a few departments that we reviewed. In several cases in these departments, this standard contract language was present in the contract’s billing or invoicing procedures. Examples of such language included:

- “Payment for work performed shall be made in accordance with satisfactory acceptance of each of the deliverables outlined in the PAYMENT SCHEDULE section. A signed, written statement by the contract manager will indicate satisfactory acceptance of all deliverables for each phase.”
- “Payment for work shall be made in accordance with the satisfactory completion and acceptance of deliverables for each task as outlined in the Statement of Work.”
- “Invoices shall include such information as is necessary for [the department] to determine the date and exact nature of all expenditures...Payment shall be made after acceptance by [the department’s] Contract Manager of each deliverable as described in the Statement of Work.”
- “[Invoice] vouchers shall include such information as is necessary for the Department to determine the exact nature of all expenditures and shall identify all personnel for whom compensation is sought, the amount of hours each individual worked, and the rate of compensation.”

While the relationship between deliverables and payment was sometimes vague, some contracts clearly tied deliverables to payment by specifying task numbers, the quantity of service, and other measures in budget sections. More clearly written contracts used a numbering scheme in the scope of work and repeated this numbering scheme in the compensation and budget sections of the contract to create a clear connection between the deliverables and payments. A contract for the Department of Early Learning provides an example of a written scope of work (or deliverable section) with compensation conditions that clearly link payment to specific work phases and tangible work products. **Exhibits 6 and 7** show the deliverables and payment sections.

Exhibit 6
Department of Early Learning – Example Deliverable Language

<p>3. <u>Deliverables and Compensation</u> Compensation for services is itemized in Exhibit B Budget and payment is subject to receipt and approval by DEL of all deliverables.</p> <p>The Contractor shall provide to DEL the following deliverables:</p> <ul style="list-style-type: none"> a. Phase I: In collaboration with DEL staff and stakeholders, develop and submit a written draft Outcome Map and Theory of Change Development Plan to DEL for review and revision that includes at a minimum: <ul style="list-style-type: none"> i. First draft – “starter dough” -- outcome map graphic and narrative that incorporates and summarizes notes and ideas gained from the Theory of Change work session of the December 17th Infant Toddler Think Tank. ii. A process and participation plan that describes planned “next steps” for further development of the outcome map and a theory of change. b. Phase II: Conduct, facilitate and provide follow-up for advisory group and larger stakeholder members conversations (up to four meetings) to inform and develop a second draft outcome Map, background, context and assumptions. Submit the following written documents to DEL for review and revision: <ul style="list-style-type: none"> i. Second draft outcome map graphic and narrative describing background, context and assumptions; ii. Revised and finalized outcome map and narrative describing background, context and assumptions. c. Phase III: Provide additional follow up activities as requested and approved in advance by DEL. Compensation for Phase III will be based on an hourly rate, not to exceed 37 hours, at the rate set forth in Exhibit B Budget Phase III. <ul style="list-style-type: none"> i. Communicate with DEL staff and stakeholders to identify next steps. ii. Develop written materials and/or work processes to help DEL staff and stakeholders begin that work.
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Exhibit 7
Department of Early Learning – Example Compensation Language
Linking Deliverables in Figure X to Payment

State Fiscal Year 2010 (July 1 2009 - June 30 2010):						
Payment Point	Qty	Unit	Unit Cost	Budget	Limit	Note
Phase I	1	Lump Sum	\$5,500.00	\$5,500.00	Yes	
Phase II, i	1	Lump Sum	\$6,900.00	\$6,900.00	Yes	
Phase II,ii	1	Lump Sum	\$6,000.00	\$6,000.00	Yes	
Phase III	37	Hourly	\$180.00	\$6,660.00	Yes	
			Total:	\$25,060.00		
			Contract Maximum:	\$25,060.00		

Based on our review of contracts, establishing a linkage between the scope of work and payment conditions can be easier for contracts that result in a tangible product, or are tied to an established service delivery process that includes the delivery of defined items such as intakes, applications, and referrals. We found that establishing a link between deliverables and payment was more challenging when the intent of the contract was to purchase labor hours related to a service or expertise. However, despite these challenges, we found evidence that suggests opportunities for addressing this challenge already exist within some of these contracts. For example, there were instances where contracts established status reporting requirements for contractors. In these cases, a department could improve its payment language to incorporate receipt and approval of these status reports as a condition of payment.

Performance-Based Contracting Might Not Be Appropriate for Some Services

Given some of the challenges in identifying deliverables and linking payment to those deliverables, there might be situations where performance-based contracting cannot be used. A few articles in our literature review discussed how PBC might not be applicable to all types of service contracts because of factors related to risk or the difficulty of measuring outcomes.

- In a review of federal contracts that did not adhere to federal guidelines related to PBC, the Government Accountability Office found that many of these contracts entailed “unique and complex services which entailed such safety, cost and/or technical risks that the agencies appropriately concluded that they needed to be more prescriptive as to how the work was to be done, and exercise more oversight as to methods for achievement of objectives.”
- Another article argued that PBCs were most appropriate for situations where the outcomes of services were measurable and could be attributed to the service provider. Otherwise, how could one know that the outcome was the result of the service provider’s efforts or why would it be fair to hold them responsible for an outcome they had little or no control over?
- This article also argued that if outcomes cannot be attributed to the service, “PBC’s should not be implemented with coping and procedural agencies. Instead, contracts should focus on outputs.”

Issue 2: Relatively few performance-based contracts reviewed included incentives for good performance or penalties for poor performance.

Performance-based contracts can include incentives and consequences to encourage better performance and accountability for the value received by the State. For the performance-based contracts sampled for this review, only about 8 percent of the contracts had incentives, but 22 percent had consequences or performance penalties beyond the standard remedy or termination provisions. The use of incentives or consequences to manage contractor performance varies depending on the type of contract. Overall, incentives are found more often in contracts related to capital projects, and consequences are usually found in capital and purchased services contracts. Incentives or consequences are rarely used for personal services contracts. **Exhibit 8** shows the types of contracts and their use of incentives and consequences.

**Exhibit 8
Use of Incentives and Consequences by Contract Type**

Type of Contract	Percentage with Incentives	Percentage with Consequences
Client Service	4%	5%
Capital	34%	78%
Personal Services	0%	4%
Purchased Services	6%	30%
All Sample PBC Contracts	8%	22%

The above discussion and results about the use of these contract elements was based on the contract reviews for the participating agencies. Questions in the all agency survey also asked about the use of incentives and consequences. For those agencies that only participated in the survey, the results are similar to what was found in the more detailed contract review; little use of incentives but greater use of consequences. The survey-only participants, however, indicated a greater percentage use of consequences. The survey results showed the following:

- Fourteen of the 20 agencies, 70 percent, responded that incentives were used in few or no contracts, and
- Thirteen agencies, 65 percent, responded that consequences were used in either a majority, most, or all contracts.

Use of Incentives

Agency staff provided a number of reasons why incentives are not used more often. Reasons include the following:

- Incentives are not consistent with industry standards,
- Prices for purchased services already reflect the true cost of doing business,
- Incentives are difficult to include in federal contracts where only actual allowable costs can be reimbursed,

• Performance-Based Contracting

- There is no room in the budget for incentives,
- Incentives are not appropriate in the current economic environment,
- There is a risk that project or service quality will be compromised, and
- There is a natural incentive for the contractor to perform well in order to receive future work.

Depending on the type of services provided, the type of incentives can vary. One type of incentive occurs when the contractor saves the State money or exceeds the timeline or performance standard established by the contract. A second type of incentive might offer the contractor an incentive to provide or complete a specific type of service or provide more services. Examples of incentives include the following:

- The standard specifications for the Washington State Department of Transportation (WSDOT) road public works contracts include incentives that provide contractors with additional payment for delivering materials or test results that are higher than those specified in the contract.
- One Department of Transportation public works contract included an incentive of \$10,000 per day (up to \$100,000 maximum) for early completion.
- The Department of Transportation also has a Cost Reduction Incentive Proposal (CRIP) program that allows contractors to submit proposals that would reduce contract costs. If WSDOT accepts the proposal the cost savings are shared between the contractor and WSDOT.
- The Liquor Control Board's contract liquor stores receive additional commissions depending on the amount of their liquor sales. With higher sales, a store owner can earn more from commissions.
- In three managed care contracts at Department of Social and Health Services, there is a performance-based element built into the rate structure. Providers are paid a higher rate for enrollees that are chronically ill and potentially more costly to serve.
- A "Healthy Options" contract included a quality incentive payment for hospitals and providers for excellent performance against federal measures. (Measures included number of well-child visits, immunizations and other indicators of overall child health.) The Legislature, however, eliminated funding for these incentives, and they have been removed from the contract.
- The Lottery pays two contractors a percentage of the lottery sales that are related to their services.
- A program manager for the Department of Corrections (working with chemical dependency contracts) has recently considered the use of surplus contract money not used during a contract period to establish resources for incentive payments. These incentive payments would not exceed the total surplus amount for the contract period.
- At DSHS' Economic Services Administration, basic food outreach contracts include incentives for contractors tied to the benefit application approvals. If a contractor achieves an application approval rate above 60 percent for a payment period, the contractor receives additional payment.

In the above examples, a key part in establishing an incentive is having a performance standard or measure that enables the agency to determine whether an incentive is cost effective and whether the contractor has earned an incentive.

Use of Consequences

As shown above in **Exhibit 8**, agencies use consequences more often than incentives. Contracts usually have a termination clause, which is the ultimate consequence for a contractor. However, our review of consequences was more oriented toward contract terms besides termination that are used during the monitoring or execution of the contract when a contractor does not provide the services or poorly performs in meeting the contract's terms. There are a variety of methods that are used to hold the contractor accountable for non-performance before the situation reaches the point of termination. A commonly used mechanism is retainage (i.e. holding a portion of the payment until the contractor successfully fulfills the terms of the contract). Consequences can involve withholding payment or having the contractor pay the State, such as retainage, penalties, or liquidated damages.

“Liquidated damages” is a legal term used in contracts that refers to a situation when the terms of a contract are broken and the harm from the broken terms is uncertain or difficult to quantify. The damage amount is agreed to in advance and considers the actual or anticipated harm, the difficulty of proving loss, and the difficulty of finding another adequate remedy. These types of contract consequences have very specific amounts and conditions when they apply. Like some incentives, consequences that are penalties or liquidated damages have established performance standards that must be met as part of the contract. In contrast, a contract just giving the agency the discretion to withhold payment is not a well defined consequence.

Some examples of how agencies have used consequences for poor performance are the following:

- All of WSDOT's public works contracts included liquidated damages for project completion.
- Several of the WSDOT's public works contracts included liquidated damages for specific project activities – most typically delays in ending lane closures.
- Three of WSDOT purchased services contracts examined included consequences. Two included liquidated damages for late delivery and one included credits to WSDOT for interruption of service that lasted a certain length of time.
- Department of Information Services contracts include liquidated damages of \$100 per day for failure to make required delivery dates.
- One Department of Health contract included a penalty of 10 percent of the contract amount for each deliverable between one to ten days late, with an additional 10 percent penalty each for deliverables 11-30 days late and over 30 days late. This penalty was used to ensure the timeliness of required reports.
- Employment Security included a 50 percent reduction in the monthly maintenance fee for poor performance.
- The Lottery contract includes liquidated damages at \$1,000 per minute for downtime for its gaming system when it is not near any game drawing. If the problem occurs near a game drawing, the amount increases to \$2,500 per minute.
- At the Department of Ecology, one contract provided the department a 10 percent discount if certain project deliverables did not meet expected project timelines.
- The Department of Commerce includes language in its contracts that provide the “threat” of financial reductions for not meeting requirements. For instance, energy assistance contracts state "failure of the Contractor to meet performance standards, production projections, or comply with federal or state requirements may result in reduction of funds." Employment support contracts sometimes indicate that performance will be reviewed after nine months and if contractor has not achieved 75% of expenditure projections then funds may be reduced.
- The Liquor Control Board contract for contract liquor stores has penalties for late reporting.

Issue 3: Performance-based contracts do not always establish performance or outcome measures. Even when such measures are included, contractor payment is not always based on the measures.

The SAAM notes that “the purpose of including expected deliverables, performance measures or outcomes within a contract is to provide a standard or measure for performance of the contracted services. These may also be used to determine if, and when, the contractor has successfully completed performance, and when and how much the contractor should be paid” (SAAM, Section 15.40.25 and 16.20.25). As noted earlier, 92 percent of the contracts in our sample tied payment to deliverables and therefore met the SAAM definition of performance-based contracts. Further, about 50 percent of all contracts examined included some form of performance measure or outcome expectations, but **only** 15 percent of all contracts examined based payment contingent on achieving these measures. Given that about half of the contractors in our sample were already expected to satisfy or report on some type of performance metric as part of their scope of work, agencies might be able to move toward increasing the use of performance and outcome measures as a basis for payment instead of deliverables.

Based on our review of contracts, we identified several observations that were applicable to some departments concerning the use of performance and outcome measures. These observations included the following:

- There are opportunities to link payment with existing performance and outcome measure expectations,
- The nature of performance and outcome measures varied across contract types, and
- There are various challenges that exist in identifying and monitoring performance and outcome measures.

Opportunities to Link Payment with Performance and Outcome Measures

Based on our survey of 34 state agencies, respondents indicated there is a relatively high level of performance and outcome measures included in their contracts. Seventy-six (76) percent of respondents indicated that “all,” “most,” or a “majority” of their contracts include performance standards in contracts. Sixty-two (62) percent of respondents indicated that “all,” “most,” or a “majority” of their contracts included outcome measures. However, our review of 461 contracts showed that 50 percent of contracts included some form of performance or outcome measure expectations. Further, although 53 percent of survey respondents reported that “all,” “most,” or a “majority” of contracts tied payment to performance measures or outcomes, we found that only 15 percent of all sampled contracts met this criteria. Despite these differences, the results indicate that there is room for possible improvement in linking performance and outcome measures with contractor payment.

For example, one contract included a comprehensive set of measures that the contractor was responsible for collecting and reporting to the department. These measures included output measures such as the number of unduplicated clients served and the number of visits made. The contract also included program outcome indicators of success, such as the number of verified hires and the number of employers using the system. Although this contract is monitored for the achievement of these performance and outcome measures, the contract does not formally tie them with payment. The contract could reinforce the expectation and provide a stronger mechanism for holding the contractor accountable if the payment was tied to the performance and outcome measures.

Performance and Outcome Measures Vary by Contract Type

Like the variation in the types of deliverables, there is wide variability in the types of performance measures and outcomes that were identified in our contract review. Measures ranged from being related to the number of outputs, such as service quantity, to timeliness metrics, such as expected service completion. **Exhibit 9** provides categories of measures and outcomes found through our review.

Exhibit 9

Example Performance and Outcome Measure Categories

• Service outputs	• Response time
• Availability of services	• Minimum technical specifications
• Timeliness of service or product completion	• Acceptance and performance testing
• Quality of service / product	• Client benefits

Our contract review and interviews with program managers indicated that some contract types lend themselves to including performance measures more than other types of contracts. For instance, 96 percent of all capital outlay contracts included evidence of performance or outcome measures. The high percentage of these types of contracts meeting this criterion might be due to the nature of the industry and requirements tied to inspections and other health and safety requirements. Other contract types, such as those related to human services, can be more challenging to incorporate performance or outcome measures. At least one program manager working in this area indicated that service output measures are reasonable to include in contracts; however, outcome measures can be more difficult. These measures often require expertise in the specialty area, an understanding of appropriate types of outcomes to expect, and a sufficient amount of data. Further, staff indicated that some performance or outcome expectations are longitudinal in nature and would likely not be realized within a contract period, or a contract’s payment intervals. In these cases, measures and outcomes could not be tied to a contract’s payment, therefore not meeting one criterion of “performance-based” under the SAAM definition.

As noted, some program staff indicated the establishment of performance metrics depends on their knowledge of appropriate measures and goals to set. In this regard, one program manager stated that it is an objective in some contracts to collect performance and outcome information as part of its required reporting. In doing so, the department sometimes collects “baseline” information so that it can later use the data to set quantitative goals and expectations for its contractors. The program manager indicated that this is important when considering negotiations with contractors and establishing a sound basis for future requirements. Further, the same department is involved in a specific study that will help identify appropriate and expected outcomes for one of its programs. Specifically, the study will “identify short and long-term outcomes and strategies and create an outcome map and theory of change narrative for improving the quality of” the department’s services and systems in Washington State.

Challenges in Establishing Performance Measure and Outcome Expectations

Our interviews with agency and program staff indicated that there are many challenges related to including performance and outcome measures in contracts. These challenges may be contributing factors as to why only 50 and 15 percent of contracts in our sample identified performance and outcome measures and tied them to payment, respectively. These comments included:

- Staff does not always have the understanding or expertise of the specific service area to determine appropriate measures,
- Contractors may resist performance or outcome measures,
- Program staff needs training on how to establish measures and outcomes, and
- Some performance and outcome measures may be outside of a contractor’s control.

One program manager addresses the challenge of how to best define expected performance and outcome measures by using evidence-based research. Her work includes contracting for chemical dependency services. In doing so, she noted that she uses treatment practices and expectations defined by research performed by federal departments such as the Substance Abuse and Mental Health Services Administration (SAMHSA). In our review of this contract, the scope of work not only includes performance expectations related to client treatment duration and

- **Performance-Based Contracting**

completion, but also requires the contractor to “work directly with the [department’s chemical dependency unit] to analyze the existing assessment process and documents and develop a plan for improvements consistent with the use of a comprehensive assessment using research-validated instruments.” The department and contractor can reassess the approach to redirect expectations, as necessary.

In addition to these challenges, staff also noted challenges such as staff time and resources needed to develop appropriate performance measures or outcomes, and the resources needed to monitor and enforce performance expectations. One program manager stated that a time study should be performed along with implementation of performance-based contracting expectations. These types of studies could provide insight into the additional administrative time required of staff for executing and monitoring such contracts, as well as the added value in doing so for certain contract types.

Issue 4: State agencies are managing and monitoring performance-based contracts using a variety of methods, but the primary methods involve reviewing invoices and periodic contract reporting. Improvements, however, can be made to contract management practices.

One of the reasons given for the executive order requiring performance-based contracting was to take additional steps to strengthen state agency contract monitoring and management practices. The SAAM defines contract monitoring as planned, ongoing or periodic activity that measures and ensures contractor compliance with the terms, conditions, and requirements of a contract. As a result, the terms of a performance-based contract play an important part in understanding what the contract is for, what is required, what needs to be monitored, and what actions can be taken if performance is not what was expected.

The SAAM states that the purpose of monitoring is to ensure that the contractor is complying with the terms, conditions, and applicable laws, adhering to the project schedule and making appropriate progress toward the expected results, providing the quality of services expected, identifying and resolving potential problems, and providing constructive, timely feedback. Besides the monitoring activities, the SAAM guidelines also mention that performance-based contracts use quality assurance plans, measurable performance standards, and/or outcomes. The SAAM also identifies the following monitoring activities:

- **Invoice reviews.** Comparing billings/invoices with contract terms ensures the costs being charged are accurate, consistent with the contract requirements, and within the compensation limits set by the contract. Also, verifying that funds are tracked by fund source will help prevent over-payments by fund.
- **Periodic contractor reporting.** Contractors submit progress reports or other appropriate data or deliverables to report on services being provided, adherence to the contract, and progress being made. Sub-standard performance can also be determined.
- **On-site reviews and observations.** Contract managers may conduct on-site reviews, interview contractor staff to ascertain their understanding of program goals, review key systems and service documentation, review personnel records to ensure staff has appropriate credentials, review fiscal records, and observe operations whenever possible. The results of these reviews should be documented in writing and compared with contract requirements.
- **Other periodic contact with contractor.** Meetings and other periodic contact with the contractor to review progress facilitates continuous dialog and mitigates problems.
- **Audit report reviews.** Contract managers review any required audit reports and audit work papers and ensure the contractor takes appropriate and timely corrective action, if required.

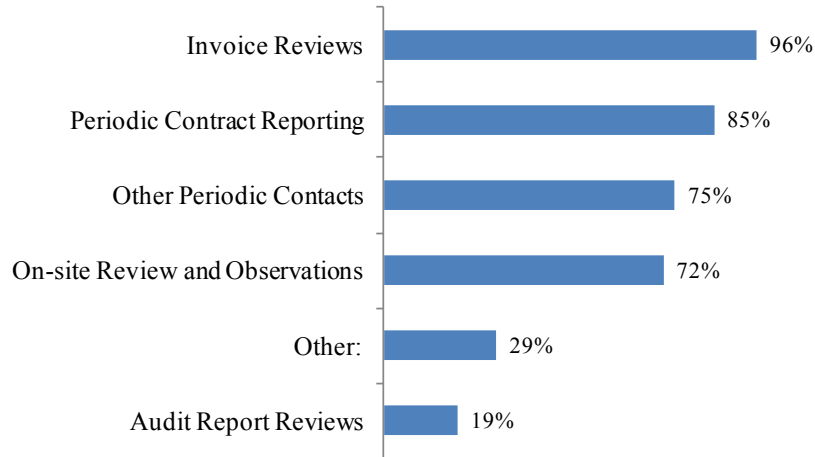
State Agency Contract Management Efforts

The state agencies participating in this review are managing and monitoring their contracts by using a variety of methods depending on the type of contract. Based on interview sessions with over 100 program managers, invoice review was the most commonly mentioned monitoring method at 96 percent followed by periodic contract reporting at 85 percent. Other periodic reviews and on-site reviews and observations were mentioned 75 and 72 percent, respectively. Other methods were mentioned in 29 percent of the interviews. According to the program managers, more than half (57 percent), review contractor progress monthly, while another 36 percent identified other monitoring frequencies such as daily, weekly, or biweekly to as long as until the contract ends.

• Performance-Based Contracting

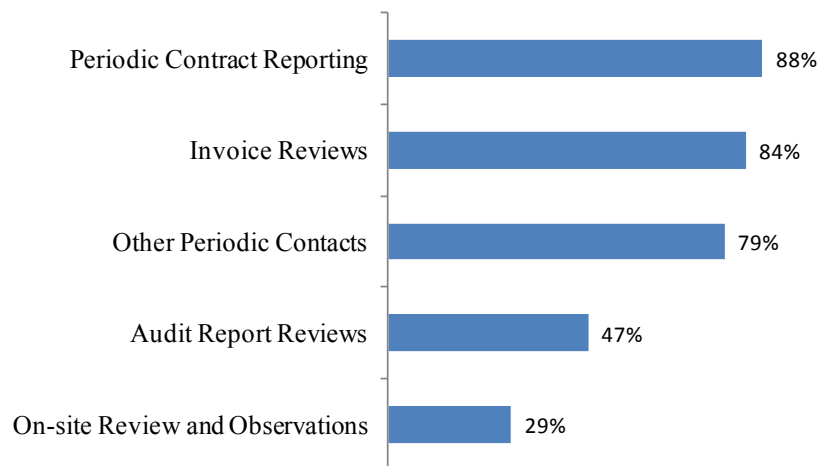
Exhibit 10 shows the percentage of interview responses for each type of monitoring activity.

Exhibit 10
Monitoring Methods Used by Program Managers Interviewed



For the agencies that only participated in the survey, their survey responses are similar to the responses from the program manager interviews. The agency only survey responses in Exhibit 11 show that for the combined percentage responses for the majority, most, and all contracts categories, the most commonly used monitoring activities were still invoice reviews and periodic contract reporting. Compared to the program manager interview data, the remaining methods are different for the survey-only agencies, which rely more on audit report reviews than on on-site review and observations.

Exhibit 11
Monitoring Methods Used by Survey-Only Agencies



• **Performance-Based Contracting**

For the different types of contracts, the type of monitoring varies. **Exhibit 12** shows the type of reviews by type of contract. The percentages represent the percent of interview sessions in which the monitoring method was mentioned. More than one method could be mentioned. Each type of contract has its own set of management tools.

- Client service program managers rely on a combination of invoice reviews, periodic contract reporting and contacts, and other methods.
- All capital program managers rely on invoice reviews, periodic contract reporting, and on-site review and observations.
- Personal services program managers all rely on invoice reviews and primarily on periodic contract reporting. On-site reviews and other periodic contacts also were also used frequently.
- Purchased services program managers use invoice review slightly more often, but periodic contract reporting, on-site reviews, and other periodic contacts are almost equally used as often.

Exhibit 12
Percentage of Responses by Type of Contract and Monitoring Method

Type of Contract	Periodic Contract Reporting	On-site Reviews & Observations	Invoice Reviews	Audit Report Reviews	Other Periodic Contacts	Other
Client Services	77%	52%	98%	18%	68%	41%
Capital	100%	100%	100%	14%	86%	29%
Personal Services	97%	80%	100%	23%	77%	13%
Purchased Services	65%	76%	82%	12%	65%	24%

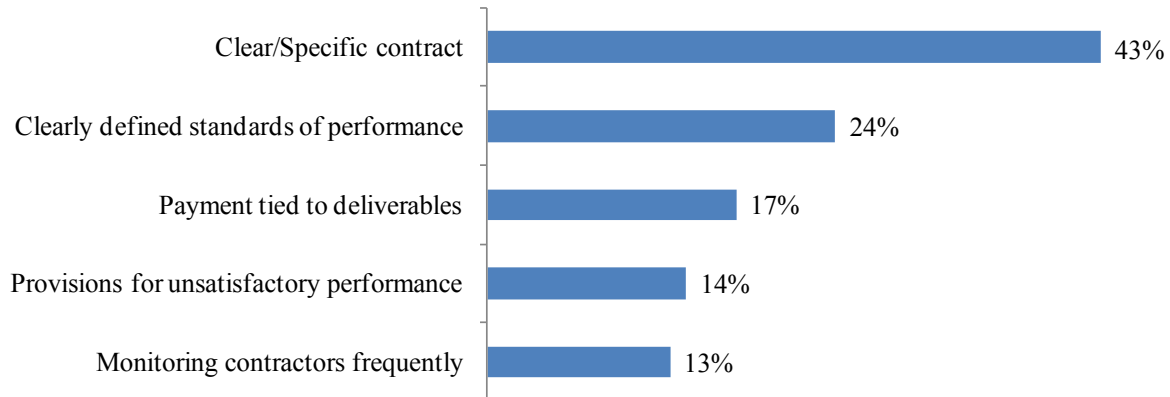
Contract monitoring can also involve more than just the program manager. For some contracts, a program manager handles all aspects of ensuring that the contractor fulfills the contract terms and provides the deliverables or meets the performance standards and measures. In other contracts, the program manager might be the contact point and manage the contract, but other agency personnel also might be involved. For example, DSHS might contract with an organization to provide a certain type of care. DSHS might have separate licensing and certification personnel that review the contractor’s qualifications and operations, quality assurance units that randomly audit the quality of care, and regular visits from case workers that work with the clients using the contractor’s services.

Critical Contracting Practices and Improvements

The contract terms provide the basis and the framework for managing and monitoring a contractor’s performance, and for ensuring the quality and quantity of services received. When program managers were asked what contract terms or monitoring processes were critical to have in a performance-based contract, their answers covered a broad range of items that related to performance-based contracting and specific agency contracting issues. In categorizing the numerous comments, many of them were unrelated to each other, but we have identified some that appeared to have a common theme. Having a clear and specific contract was mentioned the most in the interviews. **Exhibit 13** shows the response categories that had the most responses.

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Exhibit 13
Critical Contracting Practices



Some of the miscellaneous comments on critical contracting processes included having clearly defined processes, flexibility and adaptability, good communication, good relationships with the contractor, on-site monitoring and inspections, and quality plans and specifications. To help contract and program managers identify the elements of performance-based contracts, DSHS has developed a checklist that assists the managers define how their contract meets the definition of a performance-based contract. DSHS' form has the following seven questions.

- Does the contract identify expected deliverables?
- Does the contract identify performance measures?
- Does the contract identify outcomes?
- Is the payment contingent on successful delivery?
- Does the contract include incentives provided to the contractor for performance?
- Does the contract include consequences for non-performance (other than termination of the contract or default)?
- Does the contract include techniques or methods, other than incentives or consequences, to ensure that agreed upon value to DSHS is received?

As previously discussed, contract descriptions, performance standards and measures, and payments for deliverables can be improved. For handling a poorly performing contractor, contract provisions might not be uniform throughout state agencies and could be improved. At one agency, the general contract terms have a specific clause that accommodates problem resolution as well as disputes. The contract clause reads as follows:

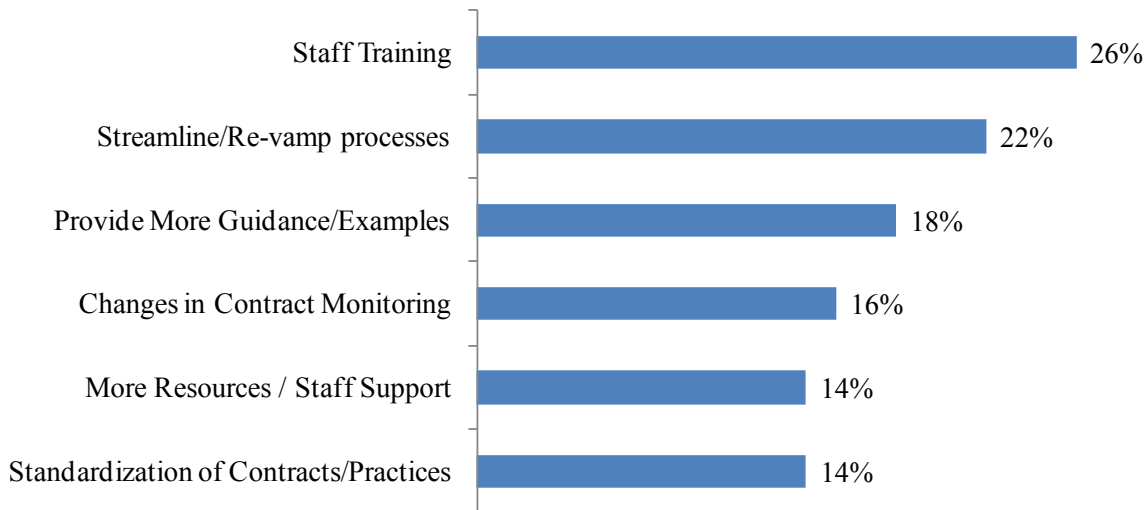
“Problems arising out of the performance of this Contract shall be resolved in a timely manner at the lowest possible level with authority to resolve such problem. If a problem persists and cannot be resolved, it may be escalated within each organization.

In the event a bona fide dispute concerning a question of fact arises between the WSLCB and Contractor and it cannot be resolved between the parties through the normal escalation processes, either party may initiate the dispute resolution procedure provided herein.”

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The program managers were also asked what they would improve to make their contract management more effective and efficient. Like the other questions there was a variety of answers, but **Exhibit 14** shows the following categories that represented the most responses from the interview sessions.

Exhibit 14
Improvements Identified by Program Managers



Besides the monitoring methods used and above comments, slightly less than half of the interview sessions (47 percent) indicated that there was a formal quality assurance plan. Quality assurance is defined as a program for the systematic monitoring and evaluation of various aspects of a project, service, or facility to ensure that standards of quality are being met. The SAAM identifies an approach that might assist program managers in developing a quality assurance plan for a contract. SAAM sections 15.40.45 and 16.20.45 discuss a risk-assessment approach to contracting. This approach is intended to assist contract managers in analyzing the contract services and the contractor’s qualifications in order to focus their oversight efforts on higher risk contracts. According to the SAAM, a risk assessment evaluates risk factors to determine how much monitoring and/or auditing should be done to protect the agency’s interests. The risk assessment can be conducted informally or formally depending on the dollar value of the contract, complexity of the services, experience of the contractor, etc. Risk is evaluated based on the type of service provided and on the contractor’s qualifications.

Based on a risk assessment, the contract manager can identify the scope, frequency, and methods for monitoring or auditing to use to ensure sufficient oversight given the risks involved. The SAAM notes that risk assessment results may also be used to devise more stringent controls and tighter contract language, when appropriate, to adequately monitor or audit the use of public funds. According to the SAAM, risk assessments, linked to a monitoring plan, should be documented. As agencies progress from performance-based contracts that rely on deliverables to ones that emphasize performance and outcome measures, monitoring might play a more important role in determining whether the contractor is fulfilling the contract terms and achieving measures.

At the Department of Social and Health Services, risk assessment and monitoring are closely linked. When a contract is requested, completing forms for a risk assessment and monitoring plan are required as part of the process. The risk assessment form requires that the contract or program manager rate both the program’s and the contractor’s risk on several factors. The program risk factors include client health and safety, program or service history, complexity of service, financial and funding requirements, data sharing, and insurance requirements. The contractor’s risk factors include contractor experience, performance history, multiple contracts, and subcontracting of services. Based on the risk assessment, the monitoring plan identifies the monitoring activities

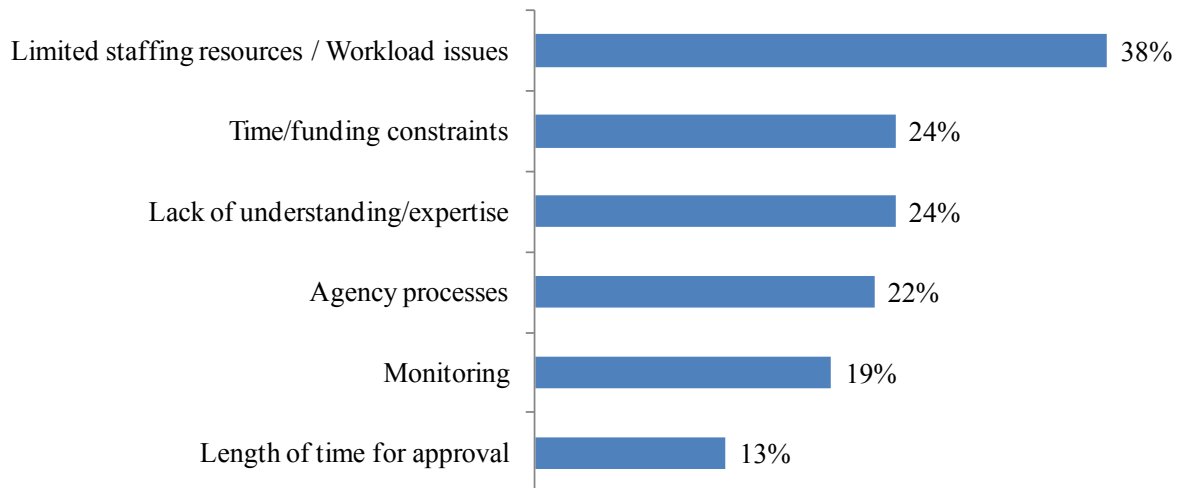
- **Performance-Based Contracting**

based on the risk factors considered and describes the frequency and method of monitoring activities. Also, any mandatory monitoring activities must be identified based on the program requirements. As a result of this process, contract and program managers must at least assess risks and develop an appropriate monitoring plan based on those risks before a contract can be approved. Such plans can provide a means to assess the contractor's performance. Labor and Industries conducts a post-contract performance evaluation of the contractor through a "Performance Measurement" form that is referenced and documented in most of its contracts. This form is used to assess the performance of the contractor for future contracting opportunities. In some cases, these forms are used during the course of the project or study to assess existing performance.

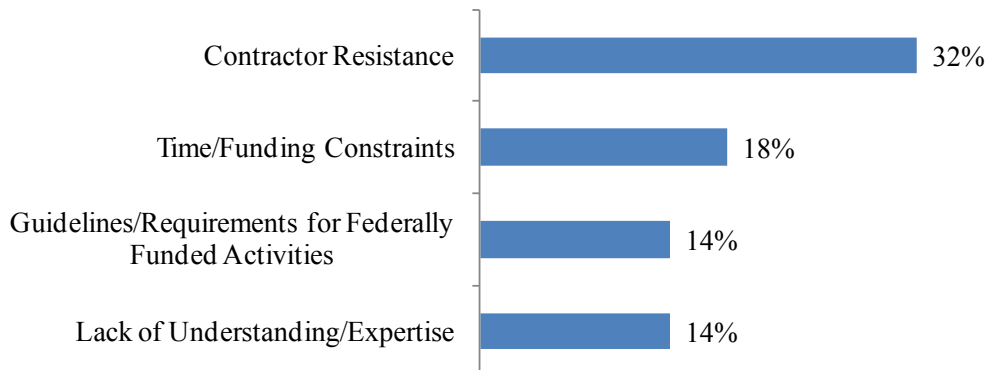
Issue 5: Although state agencies have previous experience using performance-based contracts, the internal and external challenges identified by agencies and program managers are similar to other organizations that have previously used performance-based contracting. Federal grants also present some challenges to using performance-based contracts.

Although state agencies have previous experience using performance-based contracts, the internal and external challenges identified by agencies and program managers are similar to other organizations that have started performance-based contracting. As part of our agency survey and interviews with program managers in the participating agencies, agency staff were asked to identify internal and external challenges to successful performance-based contracting. In 32 percent of the interviews, no internal challenges were identified, and in 31 percent no external challenges were identified. Some of these challenges shown in **Exhibits 15** and **16** have been previously mentioned as part of other issues.

**Exhibit 15
Internal Challenges for Program Managers Interviewed**



**Exhibit 16
External Challenges for Program Managers Interviewed**



For those agencies that only participated in the survey, **Exhibits 17** and **18** show what they identified as internal and external challenges. Only a few agencies did not identify internal or external challenges, 15 percent and 20 percent, respectively. Several of the challenges are similar to the ones identified by the program managers in the participating agencies.

• Performance-Based Contracting

Exhibit 17
Internal Challenges for Survey Only Agencies

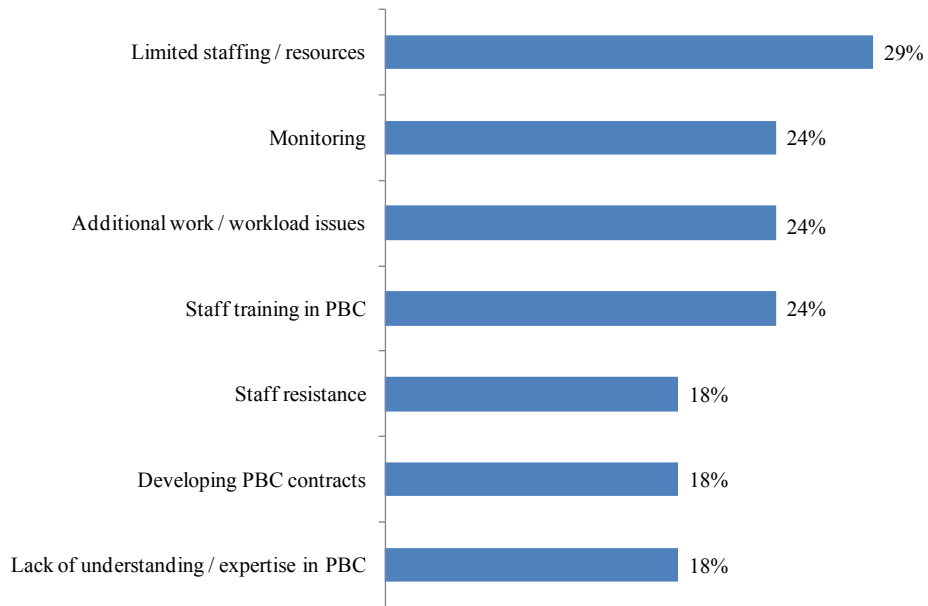
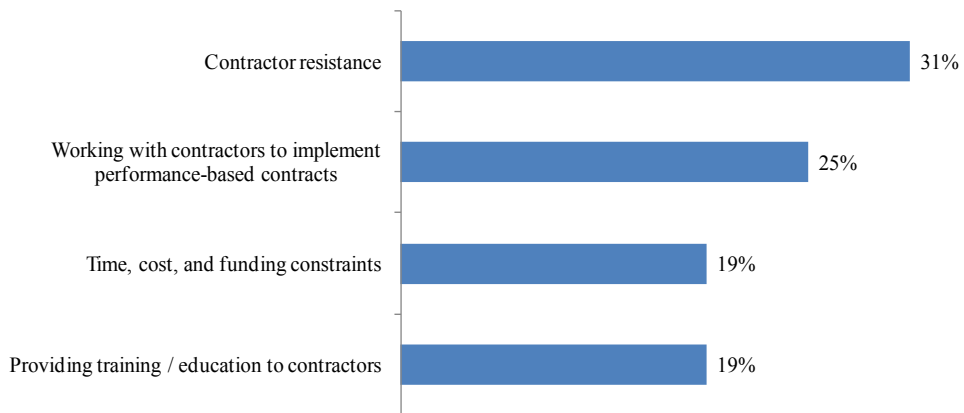


Exhibit 18
External Challenges for Survey Only Agencies



Federal Grant Funding Presents Challenges in Using Performance-Based Contracts

The Governor's Executive Order directed OFM to evaluate ways to apply performance-based standards to federal and state pass-through funding and other grants. Our sample of performance-based contracts included a number of federal pass-through contracts to sub-recipients. Washington State agencies can act as pass-through entities for federal grants. They determine which sub grantees or sub-recipients will receive federal money and then contract with them. A *sub-recipient* is defined as "a non-federal entity that expends federal awards received from a pass-through entity to carry out a federal program."

We reviewed sub-recipient contracts at multiple departments and found that many of the sub-recipient contracts in our sample were performance-based because payment was contingent on the receipt of deliverables. A typical sub-recipient contract identified project tasks and activities, one or more simple deliverables (e.g. a State invoice, a status report) and specified that the sub-recipient would be paid upon contract manager approval of an invoice describing allowable expenses. Contracts typically linked completion or partial completion of activities to payment, but offered little or no ability to withhold payment for non-performance.

Based on our contract review, interviews with contract managers, and using the State Administrative & Accounting Manual (SAAM) and the federal Office of Management and Budget's (OMB) Circular A-133 we identified several characteristics that make performance-based contracting more difficult. These characteristics include the following:

- **Cost-reimbursement pricing.** Sub-recipients are reimbursed only for allowable costs that they have incurred. No increment above allowable costs (profit) is allowed. This requirement was frequently cited in our interviews as a primary barrier to performance-based contracting. Contract managers pointed out that sub-recipients must be reimbursed for any costs allowed under the federal grant (salaries, supplies, equipment) they have incurred, even if performance goals or objectives are not met. Consequences or penalties for non-performance are difficult to impose. Incentives, to the extent that they represent a profit to the agency, are not allowed. Contract managers told us that they may take corrective action or provide technical assistance in lieu of a penalty. The only way to avoid paying a contractor is to terminate the contract for cause.

Because sub-recipients are reimbursed by allowable expenses, they are accustomed to preparing line-item project budgets and track and report expenditures against these line-items. Contract managers disagreed as to whether it would be more work for sub-recipients to also structure, collect, and report data by activity or deliverable.

- **Sub-recipient-determined scope of work and project objectives.** In a typical vendor procurement, the purchasing agency specifies the required scope of work and may also define deliverables and required performance as part of the procurement. In contrast, sub-recipients create the scope of work by identifying the program details of the activity for which they are seeking support. By accepting a sub-recipient proposal, agencies are accepting the sub-recipient's version of what the program and related activities should look like. The sub-recipient has the flexibility to perform the work of the program or grant and retains control over how to do the work. The contract manager has the ability to review the work to make sure that the sub-recipient is making progress against program objectives and is not spending all of its time on one or two activities.
- **Accountability for performance.** Generally, sub-grants are treated as "best effort" awards. The sub-recipient assumes little risk if performance does not meet goals. This is in recognition that the grant is often used to fix difficult problems that may or may not respond to the sub-recipient's activities. Contract managers find it hard to hold sub-recipients accountable for client outcomes that are viewed as being out of the sub-recipient's direct control.

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While sub-recipients are not directly accountable for client outcomes, they are responsible for reporting performance to federal and state agencies and are carefully scrutinized. Federal OMB Circular A-133 states that a sub-recipient “has its performance measured against whether the objectives of the Federal program are met.” Our limited contract reviews revealed that sub-recipient contractors were required to collect and report a variety of performance-related data. Program goals, objectives, and required performance are defined in federal grants.

According to the SAAM, pass-through agencies have a responsibility to “monitor the activities of sub-recipients as necessary to ensure that federal awards are used for authorized purposes...and that performance goals are met.

- Property may be purchased with award money. The sub-recipient may be allowed to purchase real property, equipment, or supplies with federal funds and typically retains a residual interest in the property. These purchases within client services sub-recipient contracts appear to fall outside of the Governor’s current requirements for performance-based contracting.
- Advance payments. Federal assistance payments to sub-recipients may be made before or at the time that work is performed. One department administers an energy assistance program that allows for advanced payments to its sub-recipients, at the department’s discretion. Even though the department periodically reconciles planned performance to actual expenditures, and can move a contractor to a reimbursement basis for any reason, the advance payment clause does not meet the SAAM’s definition of performance-based contracts. The SAAM states that for a performance-based contract payment must be “contingent on the successful delivery of deliverables, performance measures, or outcomes.” Therefore, eight of the energy assistance contracts we reviewed were not considered performance-based. Discussions with the department’s contract staff indicated that advance payments are provided to sub-recipients to meet their cash flow needs. Further, these contracts state, “advance payments under this contract are not a right and are completely within the discretion of [the department].”

Opportunities for More Federally Funded Performance-Based Contracts

According to our review, agencies are using several techniques to make sub-recipient contracts more performance-based and to hold contractors more accountable for performance. These were combined in some contracts and include:

- Identify deliverables for contract tasks and activities. Many sub-recipient contracts identified reporting deliverables (expenditure reports, status reports, quarterly reports, for example) for each primary task. These were used to describe or document sub-recipient progress or performance against the contract tasks and activities. A few contracts included deliverables more directly related to the work performed (education plan, client data reports, and client visit records). We believe there are opportunities to improve the identification of deliverables in many sub-recipient contracts. For example, a contract that developed field staff training could have identified the resulting training sessions as deliverables.
- Attach due dates to work (deliverables or key tasks and activities) and link invoices to completion of work. Some contracts included a provision that failure to submit deliverables timely may result in non-payment. According to contract managers, this technique allows greater visibility to sub-recipient progress against tasks and activities than the more traditional approach, which allows the sub-recipient to bill monthly for any expenses incurred. If cash flow is a problem for a sub-recipient, deliverables can be crafted to occur more frequently.

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- Distribute the project budget by deliverable. A few contracts divided the overall grant amount into budgets by deliverables (groups of tasks and activities, or discrete services). Some contract managers recommended that the federally-allowable, line-item costs be identified for each deliverable, acknowledging that this makes it easier to hold contractors accountable for performance.
- Incorporate program objectives, outcomes and performance targets into the contract. As mentioned earlier, sub-recipients are accountable for program goals and objectives and must report these to state and federal authorities. Several contracts in our sample included performance measures related to caseload or number of clients served as part of the contract. There are opportunities to use the goals, objectives and measures that are identified in federal grants to strengthen sub-recipient contracts.
- Include performance-based boilerplate language in sub-recipient contracts. Some sub-recipient contracts we reviewed used performance-based language. Contracts referred to “deliverables” and “outcomes” and included language that required deliverables to meet with the approval of the project manager or his/her designee prior to payment. Weaker contracts retained more traditional language such as “compensation for services shall be in accordance with the Line Item Budget...” Simply including performance-based language in a contract does not make it strongly performance-based, however. One contract specified that the agency reserved the right to withhold payment of any deliverable contingent upon acceptance of the deliverable. “Deliverables,” however, were quarterly progress reports, not completed work activities.
- Include payment withholding language. Department of Health includes the following language in its Termination Procedure: “DOH may withhold from any amounts due the Contractor for such completed work or services such sum as the Contracting Officer determines to be necessary to protect DOH against potential loss or liability.”
- Use incentives that are inherent within the federal funding process. Contract managers noted that providers who are able to serve the most clients or serve more difficult populations during the year will be in line for additional money should it become available.
- Apply federal acceptance criteria. One contract manager noted that each of his federal grants had acceptance criteria that could be used to evaluate deliverables. These could be included in the contract.

Issue 6: The use of standardized contracting language, master contracts, and templates can facilitate the use of performance-based contracts across state agencies while also providing uniform contracting formats and practices.

The use of standardized contracting language, master contracts, or templates can provide uniform contracting formats and facilitate the standardization of contracting practices to improve contracting compliance and efficiency. Based on our review of contracts, we found that the use of such tools can facilitate the extent of performance-based contracting when they are developed to meet State requirements and performance-based contracting guidance. At one department, about 99 percent of contracts use template formats. Our review of one program area within this department found that 91 percent of contracts we reviewed were performance-based, primarily due to the use of a standardized format.

Information Technology Master Contracts Can Provide a Good Foundation

Our limited review of the Information Technology Purchased Services (ITPS) and other master contracts at the Department of Information Services (DIS) indicates that these can provide a good foundation for performance-based contracting.

“The term ‘master’ personal service contracts, as used in this policy, refers to personal service contracts competitively solicited [via a formal competitive solicitation] and awarded by the Department of General Administration, the Department of Personnel, the Department of Information Services, and the Department of Printing for use by other state agencies. To access the services from the contractors available under the master contracts, the agency conducts a second-tier competition for the specific scope of services needed. The second-tier contracts are not filed with OFM, as the master personal service contracts were filed at time of award. Agencies are encouraged to use master contracts as a way to improve procurement efficiency, maintain quality and reduce costs.” (State Administrative & Accounting Manual, Sections 15.20.40)

We found that the DIS master contracts contain key terms and conditions to enforce the linkage between deliverable and payment and may contain performance criteria and deliverable acceptance criteria. These contracts allow customer agencies to request professional and purchased services from a pool of pre-qualified vendors. Each customer agency conducts a second-tier procurement process with these vendors by completing an ITPS Work Order between the purchaser and the contractor that provides detail on the specific services and deliverables expected of the work.

From our review of sample contracts, we found evidence that ITPS work orders do not always include elements suggested by each master contract template in at least three departments selected in our sample. For instance, one ITPS work order was entered for an expert to provide web-design consulting services. The work order generally described elements that might be subject to the expert’s review but offered no description of deliverables to be offered for the hourly compensation.

Our review of the payment conditions of the ITPS forms suggests that there are opportunities for improvement or clarification to the forms themselves. These forms include a compensation section that provides two compensation options for the agreement. These two options are:

- “Compensation for work associated with this work will be based on completion or percentage completion of deliverables.”
- “The deliverables associated with this work cannot be clearly defined in advance. The Vendor will be compensated based on hourly rate(s) for work actually performed.”

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When applying the statements in the second option to the criteria for performance-based contracts in the SAAM, one could deduce that a contract (or work order) would not be performance-based if this compensation type was selected. Specifically, the statement suggests that payment is **not** contingent on deliverables. However, interviews with staff indicate that the term “deliverable” in these work orders is meant to represent tangible work products, rather than the broader “item, duty, or project” our review uses as the definition. Staff further noted that the contractor’s actual service is considered the deliverable. The compensation option is used to indicate payment that is based on labor hours, rather than the delivery of a tangible item.

One department attaches their own boilerplate language to the ITPS work orders to provide further detail on payment expectations. This department uses the following contract language to establish a linkage between payment and deliverables:

- “Invoices shall include information as is necessary for [the department] to determine the date and exact nature of all expenditures.”
- “Payment shall be made after acceptance by [the department’s] Work Order Manager of the services described in the *Statement of Work*.”

In at least one contract we reviewed, this department also linked payment to expected services in the contract’s statement of work language. This contract stated, “Keep a detailed timesheet showing all work performed broken down to the quarter hour. Invoices based on hours worked which will be accurately reflected in corresponding timesheets for each pay period.”

Templates and Standardized Contracting Formats Can Facilitate the Use of Performance-Based Contracts

The use of contract templates or standardized contracting formats occurred in our contract sample for multiple departments and administrations. The decision to use templates or standard formats was generally determined based on the volume of contracts initiated for a particular type of service. For instance, the Liquor Control Board uses a standard contracting format for its “contract stores” because it enters agreements with more than 100 of these stores. The Department of Social and Health Services (DSHS) also relies heavily on the use of template contracts. This is primarily due to its large number of contracts – over 39,000 during a period of a year and nine months. This large volume is partly attributable to the size and scope of the agency’s mission, but is also due to the fact that contracting is the primary form of service delivery for many of the DSHS’s programs.

Based on our review, DSHS used template contracts for 39,285 of the 39,797 contracts (99 percent) in the listing we used to select our sample of contracts. From our review, there were 168 different templates used in this population. Of those, six templates were for Individual Provider (IP) contracts, which account for 33,503 of the 39,285 template contracts, or about 85 percent. Our review of the Aging and Disability Services Administration revealed that 67 of 74 contracts we reviewed in our sample, or 91 percent, were considered performance-based. Because of the use of templates – and in particular, the IP templates – the 67 contracts in the sample considered to be performance-based represent 32,500 performance-based individual contracts. This represents almost 100 percent of the total population of 32,556 contracts in this service type. Due to the use of templates, our review indicated that the department maintains a high degree of uniformity in contract language and practices, as well as the consistent use of terms and conditions that are conducive to performance-based contracting.

Using Contracts Solicited by Other Agencies

In a few instances during our contract review, we found contracts in different agencies that provided the same or similar services. For example the DSHS, Department of Corrections, Department of Health, and Labor and Industries all contract for a variety of medical and health services. In another instance, both the Liquor Control Board and the Lottery contracted for installation of security equipment. One agency staff member also commented that another state agency approached him to find out if that agency could use his contracted freight transportation services, but the contract did not allow for such a use.

Based on these few instances, there may be opportunities to reduce the number of separate procurements that each agency conducts to obtain services. If agencies have the same service needs, the State's procurement process might include a provision that notifies agencies about the procurement and notifies the potential contractors that other agencies might use the services at the same terms. A similar phrase should also be added to the contract. This process would be different from master contracts in that the services are already specified and might not need a new work request or task order to describe the services provided.

Leading Practices

As previously mentioned, the Governor’s request to the State Auditor included research on what the leading practices are for performance-based contracting. FCS GROUP reviewed about 30 articles and documents related to performance-based contracting and leading practices. These included academic studies, official congressional reports, research studies for national organizations, and other reports. FCS GROUP previously conducted research for the Office of Financial Management on performance-based contracting trends in 2005. Our research for this review identified more recent articles, research, and documents on performance-based contracting. Performance-based contracting has been instituted previously by a variety of federal and state agencies. Research shows that agencies have encountered a number of problems and issues with performance-based contracting and that there are a number of leading practices that can help agencies successfully navigate through these issues.

Various articles, research, and studies concerning performance-based contracting have identified and discussed a number of common issues that have occurred when organizations began using performance-based contracting. These issues include the following:

- General lack of knowledge, understanding, and training,
- Difficulty in preparing proposals/contracts,
- Contract performance not monitored,
- Performance-based contracting not appropriate for some services,
- Resistance to change, and
- Risk of contractor failure.

Leading Practices

Given the issues associated with performance-based contracting, the research identified several best practice areas that might help agencies improve the transition to and the effectiveness of performance-based contracting. The areas identified were the following:

- Providing staff training and other resources,
- Developing performance-based proposals and contracts,
- Developing effective performance measures and incentives,
- Using performance-based contracting in appropriate situations, and
- Monitoring contracts.

A. Providing Staff Training and Other Resources. There were many suggestions about staff training in the literature. The following highlights a few recommendations from different articles and reports about training.

- Training should be “cross-functional.” In other words, it should include senior management, program managers, subject matter experts, those involved in quality assurance, and the user community, in addition to those involved with developing the contracts.
- Training should emphasize the importance of “clearly articulating needs and requirements to contractors and the impact of change requests on schedule and cost.”
- Training should include how and when PBC should be used.

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- Training should include the guidance on working closely with contracting personnel, such as which contractors to invite to planning meetings, when to invite contractors to training, and what to do if contractors are involved in an incident that would be against human resources policies (e.g. sexual harassment).
- In order to be successful, the staff of nonprofits providing services will also need training, especially program and technical staff that need special training to adapt to new systems.
- In highway maintenance, the more an agency does PBC, “the more its role shifts from managing and performing maintenance work to planning, contract administration, and contractor oversight. The skills an agency requires must shift accordingly.”

In addition to staff training, other tools for helping organizations use PBC were discussed in a 2007 report to Congress and the Office of Federal Procurement Policy (OFPP). These recommended organizational tools included:

- Establishing a centralized office with a high degree of expertise to assist with PBC. This approach was used by the United States Coast Guard, which saw some degree of success in implementing PBC.
- Having the OFPP create a best practice measures guide on the development and selection of performance measures for PBC. This was included as one of the report’s main recommendations.
- Creating a self-assessment tool that would help evaluate whether services were appropriate for PBC. This was also included as one of the report’s main recommendations. This tool would include questions that would help:
 - Determine if a performance-related problem existed with a service,
 - Assess the risk associated if that service is not optimally provided,
 - Assess the level of confidence the organization has in its own solution for fixing the problem,
 - Assess the amount of risk the organization wants to assume for keeping the service in-house, vs. contracting it out to a vendor, and
 - Assess the readiness to measure the impact of the service on its program performance goals/mission, and the readiness of the organization’s staff to participate in a PBC.

The above 2007 report also emphasized the importance of having senior leadership’s support. Without this support, they found it was difficult to provide the necessary resources to PBC and to break through any cultural barriers against PBC in an organization.

B. Developing Performance-based Proposals and Contracts. Many articles discussed the importance in developing proposals and contracts in order for PBC to be successful. In the literature the OFPP’s “Seven Steps” is a common framework for developing performance-based contracts. The seven steps are the following:

- Establish an integrated solutions team,
- Describe the problem that needs solving,
- Examine private sector and public sector solutions,
- Develop a performance work statement, or statement of objectives,
- Decide how to measure and manage performance,
- Select the right contractor, and
- Manage performance.

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Many recommendations found in the literature review were related to the “Seven Steps.” A list describing a few highlights of the many recommendations is included below. This list includes selected recommendations on market research, working with contractors, suggested components of proposals/contracts, and the need to adjust contracts with time.

The 2007 report to Congress and the OFPP discussed the importance of doing market research. According to this report, doing market research would help ensure that “the agency has its finger on the pulse of market innovation in a particular service area” and would allow potential contractors to identify additional areas of innovation that the agency might have missed.

Several articles discussed the importance of meeting regularly with contractors to engage them in planning and problem solving when developing proposals. Potential benefits include generating buy-in by the potential service providers, promoting good relations, and preventing the government from developing an unworkable system. One article recommended that the discussions should include:

- Selecting outcomes and goals,
- Engaging contractors in planning and problem solving,
- Reviewing where performance is at the moment,
- Discussing barriers to improvements, and the steps that could be taken to overcome them, and
- Developing mutually agreed upon action plans.

A couple of articles identified suggested components of proposals and contracts. These components include the following:

- A description of the problem that needs to be solved,
- Answer the what, when, where, how many, and how well work will be performed,
- Plans for monitoring the contract,
- Outcome or performance measures,
- An assessment of the current level of performance (i.e. using the outcome or performance measures identified and establishing a performance baseline to let the potential contractors know where you are at),
- A description of the performance problems and needs,
- A description of the current way the service is being provided in general, based on market research,
- Reporting requirements,
- How information will be shared (through materials and meetings),
- Complaint procedures, and
- How the government will access client records.

C. Developing Effective Performance Measures and Performance Incentives. Several articles recommended that contractors should be involved in developing and/or proposing performance measures. The potential benefits include better performance measures, increased support for the new performance measurement system by contractors, and a better shared sense between the contractors and organization of what they are trying to achieve together. As mentioned in an article, “it would also prevent government from imposing an unworkable system on providers.”

Several articles emphasized the importance of keeping the number of measures small, in order to reduce the potential burdens of reporting and monitoring. One report suggested that instead of measuring everything across a process, organizations could instead take a sample of measures across certain points in the process to create a “basket of indicators” to assist with contract management and monitoring.

In the 2007 report to Congress and the OFPP, several recommendations were made concerning developing performance measures for PBCs, including:

- Performance measures should be defined using a structured framework that links the outcomes of the measures with the overall outcomes that the agency seeks to achieve.
- At least one measure should directly assess the agency’s need or problem that is related to the service being acquired. The results of this measure can be used to show improvements towards program goals, and help demonstrate any cost savings.
- Other performance measures should relate to the work being done, and measure things such as timeliness, accessibility, quality, workload levels, and economy. Agencies should only use a handful of these measures.

One broad recommendation on performance incentives was provided in the 2007 report to Congress and the OFPP. It stated that “performance incentives must be simple, clearly articulated, understood by all parties, and encourage overall program success. No one benefits from reward systems that result in burdensome processes or encourage the wrong things, or worse, perverse incentives that work to save the government money by promoting contractor failure.” One article recommends:

- Having a proportionally higher payment in situations where there was a proportionally higher risk of non-payment – In milestone contracting, those individuals with the highest risk of failing to successfully complete a program are often those who may need the program the most. Without the potential for higher payment, contractors may choose to not provide these individuals services to avoid the increased risk of not being paid. “Risk adjustment is absolutely necessary to uphold the equity principle.”

Considering how much of the overall payment to a contractor is at risk – In milestone contracting, there may be a disincentive to serve those who need substantial time and resources when the final payment for services is dependent on a client outcome and is a large portion of the cost (i.e. 50%). One article recommends:

- Guaranteeing a certain minimum level of payment – In milestone contracting, contractors depend on a regular flow of referrals into their programs. In light of the risk that there will not be enough referrals to cover a contractor’s costs for a particular program, some states guarantee a certain number of annual referrals and pay a reduced rate if that target is not met, such as 50% of a full regular referral rate.
- As mentioned earlier, the components of programs such as performance incentives/disincentives and performance measures might have to be changed over time as their impact on program outcomes becomes clearer. This was especially evident in several studies which reviewed the history of the development of PBC programs in human services over the past few years. The 2006 GAO report on grants management mentioned above also recommended phased implementation of performance accountability mechanisms to “allow time to design, test, and revise measurement systems before linking them to accountability mechanisms.”

D. Using Performance-based Contracting in Appropriate Situations. One article discussed the importance of using PBC selectively and not for every service contract. As mentioned above, the GAO also found that in some cases federal agencies “strived to build in performance-based attributes but they appropriately found that they still needed to be prescriptive and to exert strong oversight, because the services themselves presented safety, cost, and/or technical risks.”

One of the main recommendations in the 2007 report to Congress and the OFPP was to modify federal guidelines to create two main categories of PBC to help agencies “calibrate their investment in [PBC] to fit the level of benefit they seek.” These categories included:

- Transformational PBC – This type of PBC should be used when a government agency has identified a problem or need but is not in a position to specify how it should be solved. The government agency focuses on identifying the outcomes it desires in its scope of work, and leaves it up to the prospective contractors to develop potentially unique solutions for solving it. Once the contract has been awarded, performance is measured by the impact of the contractor’s solution on solving the problem or need, and not on the work actually being done. In this approach, the contractor assumes all of the risk that their solution may not work. In light of this, the government agency should be flexible enough to allow the contractor to adjust its approach after the contract has been awarded.
- Transactional PBC – This type of PBC should be used when a government agency has identified a problem or need and has largely determined the work that should be done to solve it. In this situation, the government agency is more concerned with meeting certain types of goals such as timeliness, quality, and cost. Performance is measured by how well these goals are being met, and does not focus on the overall impacts of the work on solving the need/problem. In this approach, the government agency assumes all of the risk that their solution may not work.

E. Monitoring Contracts - A Key to Success. Many studies referred to how monitoring was a key to the success of PBC. Some studies also provided general recommendations about how monitoring should be done.

Regarding the importance of monitoring to PBC, one article stated that “contract monitoring is a critical and essential element in the success of performance-based contracting. Absent contract monitoring, the performance of contractors and the success of services cannot be assessed.” As mentioned earlier, another report questioned the purpose of spending the extra effort to do PBC if the contractor’s level of success was not going to be measured.

One article recommended that when deciding what monitoring information should be collected and how it will be done, organizations should also “consider who is available and trained to analyze the data, and how the results will be disseminated.”

Another article recommended that governments should be clear in specifying the roles and responsibilities for monitoring and oversight of PBCs. They also recommended that there should be a clear separation of responsibilities between the contractor and those assigned to monitor the contractor.

To improve contract monitoring at the federal level, one of the main recommendations suggested in the 2007 study to Congress and the OFPP was to use a “performance improvement plan” with the contractor. This plan would require regular communication between the agency and the contractor and would:

- Include reporting of required performance standards,
- Identify and explain gaps in performance,
- Suggest changes to improve performance and reflect evolving circumstances, and
- Identify eligibility for any contract incentives.

Options and Recommendations

As part of the Governor's request to the State Auditor, she wanted to know, given limited resources, what options are available to improve contract management. The State Auditor also wanted to know how leading practices could be applied to Washington State. The previous issue discussions have identified a number of opportunities and needs for state agencies to improve their performance-based contracting. Agency contract and program managers identified a number of challenges and improvements that need to be addressed for them to be more effective in using performance-based contracts. Like the Governor, the agency contract and program managers also identified a concern about resource issues for performance-based contracting, such as time and funding constraints, limited staffing and resources, and additional workload. Making any improvements might require changing the use of existing resources to performance-based contracting or adding new resources for performance-based contracting.

Based on the challenges and improvements mentioned by the agency contract and program managers, there are a number of options and strategies that address their challenges and needs concerning performance-based contracting. Based on the issues identified, the Governor and the state cabinet agencies should focus their efforts on four major areas:

- Increase the use of performance/outcome measures for payment,
- Improve contract management and contracting processes,
- Increase staff expertise and capacity, and
- Educate and collaborate with contractors.

The following are recommendations for each major emphasis area, and recommendations that are associated with a leading practice from the previous section are identified. It should be noted that for the biennium starting July 1, 2011, the Governor will be reorganizing agencies that have responsibility for overseeing the State's procurement processes.

Increase the Use of Performance/Outcome Measures for Payment

Currently, most performance-based contracts are primarily oriented toward deliverables. The following recommendations are designed to help agencies increase the use of performance and outcome measures as the basis for their performance-based contracts. Depending on the reorganizations, the agency or agencies responsible for contracting and providing support on performance-based contracting should do the following:

- Provide more guidance by providing more explicit definitions for the terms "deliverable," "performance measures," and "outcomes."
- Create a best practice measures guide on developing and selecting performance measures and outcomes that could supplement and be more specific to performance-based contracting than the current Performance Measure Guide. (Leading Practice)
- To use staff expertise across agencies for similar types of services, create committees by major service type to explore appropriate and feasible performance and outcome measures to include in specific types of contracts. Based on our review, medical services might be the first opportunity to create such a committee to identify and create a set of common performance and outcome measures.
- Establish a centralized office or staff with a high degree of expertise in performance measurement and performance-based contracting to provide technical assistance to agencies in developing and improving their use of performance measures and outcomes. (Leading Practice)

• Performance-Based Contracting

- For agencies with federally funded sub-recipients, begin to do the following:
 - Identify deliverables for contract tasks, and activities,
 - Attach due dates and link invoices to completion of work,
 - Distribute the project budget by deliverable,
 - Begin to incorporate program objectives, outcomes, and performance targets into contracts,
 - Develop a phased implementation of performance accountability to allow time to design, test, and revise measurement systems (Leading Practice), and
 - Include specific performance-based language in sub-recipient contracts.
- When using master contracts for information technology services and when contract managers are not familiar with information technology, use agency IT resources or work with staff from DIS to help them identify deliverables and performance measures.

Improve Contract Management and Contracting Processes

Although agencies are using the tools available to them to monitor and manage performance-based contracts, additional improvements can be made in the contract language and the processes.

- Agencies should consider greater use of master contracts, templates, and standardized language to incorporate performance related language into future contracts. These contracting mechanisms also provide uniformity and can improve contract development efficiency. For departments already using such mechanisms, they should review them to ensure they sufficiently support performance-based contracting expectations. Some additions to current contract terms include the following:
 - Adding a section that deals with poor performance and that allows the agency to work with the contractor to resolve performance issues through a performance improvement plan before termination is necessary. (Leading Practice)
 - Adding a section that would allow other state agencies to use the same contract prices and terms for identical services. This concept should be reviewed by the Attorney General’s Office to determine if such a clause can be included as part of the terms in a scope of work or a Request for Proposal as well as the contract.
 - Adding a section that allows an agency to withhold payment for poor performance.
- To help contract managers determine the appropriate level of monitoring activities and develop a monitoring plan, agencies should develop their own or use DSHS’ risk assessment and monitoring plan (RAMP) forms as part of the contracting process. (Leading Practice)
- For agencies with federally funded sub-recipients, agencies should begin to do the following
 - Include payment withholding language in the contracts,
 - Use incentives that are inherent within the federal funding process, and
 - Apply federal acceptance criteria.
- Agencies should make payment clauses more specific and identify the specific deliverables or performance measures and payment terms related to each deliverable or performance measure.
- Agencies should review the deliverables and performance and outcome measures to determine whether incentives or consequences are appropriate and should be specified in a contract to encourage better contractor performance that yields savings or benefits to the agency and accountability for meeting contract terms. The Attorney General should review the issue of incentives and provide guidance on their use.

• Performance-Based Contracting

- When using master or convenience contracts for personal or purchased services, agencies should fully develop any related work orders to make sure that resulting contracts are performance-based. At a minimum, work orders should include well-defined statements of work or services to be purchased, deliverables and/or performance measures, due dates, and payment amounts. Information technology Personal Services (ITPS) master contracts for information technology services include samples that should be used to create ITPS supplemental work orders. The DIS web site also provides samples and forms that can assist agencies.

Increase Staff Expertise and Capacity

Several challenges to using performance-based contracting relate to the lack of knowledge and expertise of contract and program managers concerning performance-based contracting.

- Increase training on the basics of performance-based contracting and develop more advanced training.
- Provide training on agency contracting procedures and on how the agency will comply with the Governor's Executive Order.
- As previously recommended, provide training and technical assistance on linking payment to meeting performance and outcome measures.
- Where possible, include both subject matter experts and contracting experts in the agency contract development process.

Educate and Collaborate with Contractors

To use more performance and outcome measures as a basis for payment, agencies may have to overcome contractor resistance to such changes.

- Agencies that have encountered contractor resistance to using performance measures should determine the reasons for such resistance and work with contractors, where appropriate, to develop performance measures that are acceptable to both the agency and its contractors. The State's responsible contracting agency should provide guidance on how such collaboration can occur within the State's contracting rules. (Leading Practice)
- Agencies may want to survey contractors to better understand readiness for performance-based contracting. DSHS/JRA has developed a survey instrument.

Options and Recommendations Summary

The following recommendations summary in **Exhibit 19** divides the above recommendations into two categories: recommendations that require few or limited resources and those that require more resources. Many of the recommendations involve procedural and contract changes, better coordination and assistance, and some work to initially review agency contracts for deliverables, performance measures, and outcomes.

Exhibit 19
Options and Recommendations

Option/Strategy	Challenges/Issues Addressed	Short-Term Recommendations (Resource Limited)	Long-Term Recommendations (Resource Intensive)
<p>A. Increase the use of performance /outcome measures for payment</p>	<ul style="list-style-type: none"> ▪ Performance/outcome measures not always tied to payment 	<ul style="list-style-type: none"> ▪ Provide more guidance by having more explicit definitions for the terms “deliverable,” “performance measures,” and “outcomes.” ▪ Use staff from DIS to help identify deliverables and performance measures for ITPS contracts when agencies and contract managers are not familiar with information technology work. ▪ Establish a medical services committee to identify and create a set of common performance and outcome measures. ▪ Begin work to identify deliverables, link payments to completion of work, begin incorporating objectives and performance targets into contracts and develop phased implementation of performance accountability. (Leading Practice) 	<ul style="list-style-type: none"> ▪ Create a centralized office or staff with a high degree of expertise in performance measurement and performance-based contracting to provide technical assistance to agencies in developing and improving their use of performance measures and outcomes. (Leading Practice) ▪ Create a leading practices measures guide on developing and selecting performance measures and outcomes. ▪ Establish committees by major service type to explore appropriate and feasible performance and outcome measures to include in specific types of contracts.

• Performance-Based Contracting

Option/Strategy	Challenges/Issues Addressed	Short-Term Recommendations (Resource Limited)	Long-Term Recommendations (Resource Intensive)
B. Improve contract management and contracting processes	<ul style="list-style-type: none"> ▪ Defining deliverables ▪ Linking payment to deliverables ▪ Agency processes ▪ Developing PBC contracts ▪ Provisions for unsatisfactory performance 	<ul style="list-style-type: none"> ▪ Consider greater use of standardized language, master contracts, and templates and add sections to contracts that deal with correcting poor performance, allow use by other agencies, and allow withholding of payments. ▪ Develop risk assessment and monitoring plan forms as part of finalizing contracts. ▪ Make payment clauses more specific and identify specific deliverables and performance measures and the payment terms related to each deliverable or performance measure. ▪ Review deliverables and performance measures to determine whether incentives or consequences are appropriate and have the Attorney General review the issue of using incentives. ▪ Include payment withholding clauses, use incentives inherent with federal funding, and apply federal acceptance criteria. 	
C. Increase staff expertise and capacity	<ul style="list-style-type: none"> ▪ Lack of understanding/expertise ▪ Staff training ▪ Staff resistance 	<ul style="list-style-type: none"> ▪ Increase training opportunities on the basics of performance-based contracting. ▪ Provide agency training on their contracting procedures and compliance with the Governor’s Executive Order. ▪ Include both subject matter experts and contracting experts in the contract development process. 	<ul style="list-style-type: none"> ▪ Provide more advanced training on specific aspects of performance-based contracting. ▪ Make available expert staff to provide technical assistance to contract and program managers.

• Performance-Based Contracting

Option/Strategy	Challenges/Issues Addressed	Short-Term Recommendations (Resource Limited)	Long-Term Recommendations (Resource Intensive)
D. Educate and collaborate with contractors	<ul style="list-style-type: none"> ▪ Contractor resistance 	<ul style="list-style-type: none"> ▪ Identify reasons for contractor resistance and work with resistant contractors to develop acceptable performance measures. ▪ Agencies may want to survey contractors to better understand readiness for performance-based contracting. DSHS/JRA has developed a survey instrument. 	

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Appendix B: Scope and Sampling Methodology

Scope and Methodology

The Governor’s request and the additional questions included by the State Auditor’s Office established the scope of this review on performance-based contracting. To answer the questions and to review a broad spectrum of state agency contracts, the Office and FCS GROUP developed a methodology that included the following:

- Thirty-four state agencies were selected to participate in the review based on the state agencies identified by the Governor’s Office in her performance-based contracting reporting plan.
- A general survey questionnaire on performance-based contracting was sent to and was received back from all 34 agencies.
- Fourteen of the 34 state agencies were selected for a more detailed contract review that selected a sample of contracts from each agency. The types of contracts included client services, capital outlay, personal services, and purchased services, and each agency’s sample included one or more of these types of contracts. The contract sample included only the new contracts issued since July 1, 2009. Overall, 461 contracts were reviewed. A kick-off meeting with the 14 agencies was held on March 31, 2011.
- Based on the number of performance-based contracts from each agency’s contract sample, a sample of agency contract managers was interviewed about their contract management, use of deliverables, performance measures or outcomes, use of incentives and consequences, and internal and external challenges. Over 100 interview sessions were conducted.

The following state agencies participated in the review. Those agencies with an “*” were selected for the more detailed contract review and interviews.

- | | |
|---|---|
| <ul style="list-style-type: none"> ▪ Office of Administrative Hearings ▪ Department of Agriculture ▪ Department of Commerce (COM)* ▪ State Board for Community and Technical Colleges ▪ Department of Corrections (DOC)* ▪ Department of Early Learning (DEL)* ▪ Department of Ecology (ECY)* ▪ Employment Security Department (ESD)* ▪ Department of Financial Institutions ▪ Office of Financial Management ▪ Department of Fish and Wildlife ▪ Department of General Administration (GA)* ▪ Department of Health (DOH)* ▪ Health Care Authority ▪ Board of Industrial Insurance Appeals ▪ Department of Information Services (DIS)* ▪ Department of Labor and Industries (L&I)* | <ul style="list-style-type: none"> ▪ Department of Licensing ▪ Liquor Control Board (LCB)* ▪ Military Department ▪ Department of Parks and Recreation (PARKS)* ▪ Department of Personnel ▪ Department of Printing ▪ Puget Sound Partnership ▪ Recreation and Conservation Office ▪ Department of Retirement Systems ▪ Department of Revenue ▪ Department of Services for the Blind ▪ Department of Social and Health Services (DSHS)* ▪ Washington State Lottery (LOT)* ▪ Department of Transportation (WSDOT)* ▪ Department of Veterans Affairs ▪ Washington State Patrol ▪ Workforce Training and Education Coordinating Board |
|---|---|

FCS GROUP received timely cooperation from all the participating state agencies and their staff in providing contract data and scheduling interviews. We would like to acknowledge and thank them for their cooperation.

Scope Limitations

Because the Governor requested a response from the State Auditor by June 1, 2011 and because the Office desired a broad review of the agencies, FCS GROUP's limited time frame for the work was very challenging. To accomplish the review within the given time period, the review relied primarily on the agency survey, interviews, and various document reviews. The review concentrated primarily on the Governor's key questions and the agency staff's responses. Detailed reviews of every aspect of a contract and all supporting materials were not performed. The results are limited only to the contracts reviewed and the participating agencies.

Agency Selection

Although the State Auditor's Office identified the number of contracts for some categories and services, the Office did not know how many or what percentage of contracts were performance-based. As a result, the contract samples could not be specifically targeted to performance-based contracts. To select a sample of contracts to review, a judgmental sample of contracts was developed primarily based on agency expenditures for the different types of contracts. The State Auditor's Office provided expenditure data for fiscal years 2010 and 2011 through February 8, 2011 from the State's AFRS database (Agency Financial Reporting System). The data identified the expenditure amounts by agency, object, and sub-object codes for the following expenditure types:

- Grants, Benefits & Client Services
- Capital Outlays
- Personal Services Contracts
- Goods and Services

The expenditure data was reviewed, and for some expenditure categories, certain types of expenditures were excluded because they did not appear to be related to contracts (e.g. lottery prizes, benefit payments). Based on the remaining expenditures, the agencies and their expenditure amounts for each expenditure type were sorted and ranked. Based on the ranking and expenditure amounts, a sample of agencies was selected by FCS GROUP and the Office for each expenditure type. The agencies selected for the various types of contracts represent the following percentage of expenditures, as a percentage of statewide spending in these categories:

- Client services contracts – 99 percent
- Capital contracts – 98 percent
- Personal services contracts – 72 percent
- Purchased services contracts – 68 percent

The following table shows the agencies selected and the types of contracts that were to be sampled.

• Performance-Based Contracting

Agencies/Departments	Client Services	Capital Outlay	Personal Services	Purchased Services
Commerce (COMM)	X			
Early Learning (DEL)			X	
Information Services (DIS)			X	X
Corrections (DOC)	X	X		
Health (DOH)	X		X	X
Transportation (WSDOT)		X	X	X
Social and Health Services (DSHS)	X		X	X
Ecology (ECY)				X
Employment Security (ESD)			X	X
General Administration (GA)		X		X
Liquor Control Board (LCB)				X
Labor and Industries (L&I)			X	X
Washington State Lottery (LOT)			X	X
Parks and Recreation (PARKS)		X		
State Board of Community and Technical Colleges (SBCTC)		X		

Sampling Process

Through the State Auditor’s Office, FCS GROUP requested and collected a listing of contracts started (initiated) within the current biennium (July 1, 2009 to present) for the contract types specified for each agency. From the contract listing, a judgmental sample of contracts was selected from the appropriate agency and applicable contract type. The information requested was provided in a format that consisted of the following information.

- Contract Number
- Contract Manager
- Start Date
- End Date
- Contract Vendor Name
- Service Type/Description
- Contract amount
- Contract type

• Performance-Based Contracting

With the exception of a few contracts such as those from the Lottery, the number of contracts sampled from each agency was based only on the new contracts issued since July 1, 2009. Selecting the sample of contracts from the agency’s list of contracts was based on several parameters. For personal service contracts, contracts that were \$20,000 or less were excluded, and for other types of contracts a threshold of \$10,000 was used. In some cases, exceptions were made because of the limited number of contracts available after the thresholds.

For each type of contract and agency, a judgmental sample of contracts was selected. The number of contracts selected for the sample varied between 2 and 63 depending on the number of contracts for each type of contract. The actual number of contracts reviewed for each agency could vary among the types of contracts, and considerations in selecting the sample included stratifying the population by type of contract, services provided, or agency. Other methods used to make the actual selection involved random number generation and other methodologies used as appropriate for a particular agency. Overall, the percentage of sample contracts for each agency represented between a low of less than one percent to a high of 63 percent of all contracts. The following table shows the number of contracts provided by each agency in each category and the number of contracts that were randomly selected.

Number of Contracts and Sample Size

Department/Agency	Client Services		Capital		Personal Services		Purchased Services		Totals for All Contract Types		
	Number of Contracts	Sample Number	Number of Contracts	Sample Number	Number of Contracts	Sample Number	Number of Contracts	Sample Number	Total Contracts	Total Samples	Sample Percent
Commerce	107	17							107	17	16%
Corrections	418	24							418	24	6%
Early Learning					158	25			158	25	16%
Ecology							63	12	63	12	19%
Employment Security					79	10	36	10	115	20	17%
General Administration			48	3			24	5	72	8	11%
Corrections			74	5					74	5	7%
SBCTC			438	16					438	16	4%
Other Agencies			149	11					149	11	7%
Health	200	10			473	25	51	10	724	45	6%
Information Services					4	3	54	10	58	13	22%
Labor and Industries					186	12	263	13	449	25	6%
Liquor Control Board							52	15	52	15	29%
Lottery					4	2	4	3	8	5	63%
Parks and Recreation			107	10					107	10	9%
Social and Health Services											
ESA	198	12			203	5	17	5	418	22	5%
CA	927	30			8	0	4	0	939	30	3%
ADSA	37,573	63			40	5	373	6	37,986	74	0%
MRA	60	8			11	6	1	0	72	14	19%
JRA	124	13			9	0	0	0	133	13	10%
Exec.	171	16			18	0	60	3	249	19	8%
Transportation			302	24	58	9	49	5	409	38	9%
Total	39,778	193	1,118	69	1,251	102	1,051	97	43,198	461	1%

Interview Selection Process

To pick contract or program managers to interview, we generally selected them randomly from the sample of contracts reviewed for an agency, primarily from the performance-based contracts in the agency sample. Depending on the number of performance-based contracts, the types of contracts, and the similarity of the contracts (e.g. same service or same contract template), we selected between one to nine contract or program managers to interview for each contract category (e.g. client service, capital outlay, personal service, or purchased services). In some cases, a contract or program manager was responsible for more than one contract. The interviews were based on a set of predetermined questions, and interviews were conducted individually and in groups. The data was collected by interview session and not by the individual participating. As a result, one interview session's data might represent responses from one or several contract or program managers. The interview session responses were input into a survey form and were compiled for analysis.

Appendix C: Agency Survey and Results

Scale for Responding to the Extent of Using Performance-based Contracts

- 1 = All Contracts – 100% of the time
- 2 = Most Contracts – 76% to 99% of the time
- 3 = A Majority of Contracts – 51% to 75% of the time
- 4 = Some Contracts – 11% to 50%
- 5 = Few/No Contracts – 0% to 10% of the time

Question 1: To what extent is your agency using performance-based contracts?

All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know
4 / 12%	14 / 41%	9 / 27%	6 / 18%	1 / 3%	0 / 0%

	All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know	Total
Survey Only	2 / 10%	8 / 40%	5 / 25%	4 / 20%	1 / 5%	0 / 0%	20 / 100%
Field Interviews	2 / 14%	6 / 43%	4 / 29%	2 / 14%	0 / 0%	0 / 0%	14 / 100%

• Performance-Based Contracting

1.a: When did your agency start using performance-based contracts?

- Before 2010 (31 / 91%)
[Survey Only (17 / 85%), Field Interviews (14 / 100%)]
- During 2010, but before the Governor’s Executive Order (1 / 3%)
[Survey Only (1 / 5%), Field Interviews (0 / 0%)]
- After the Governor’s Executive Order (0 / 0%)
[Survey Only (0 / 0%), Field Interviews (0 / 0%)]
- Have not started yet (1 / 3%)
[Survey Only (1 / 5%), Field Interviews (0 / 0%)]
- Do Not Know (1 / 3%)
[Survey Only (1 / 5%), Field Interviews (0 / 0%)]

1.b: To what extent do your performance-based contracts specify deliverables, performance standards, outcomes, and timeframes?

	All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know
Deliverables	10 / 29%	18 / 53%	4 / 12%	2 / 6%	0 / 0%	0 / 0%
Performance Standards	7 / 21%	12 / 35%	7 / 21%	5 / 15%	2 / 6%	1 / 3%
Outcomes	8 / 24%	7 / 21%	6 / 18%	10 / 29%	2 / 6%	1 / 3%
Timeframes	11 / 32%	18 / 53%	4 / 12%	1 / 3%	0 / 0%	0 / 0%

• Performance-Based Contracting

	All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know	Total
<u>Deliverables</u>							
Survey Only	6 / 30%	10 / 50%	3 / 15%	1 / 5%	0 / 0%	0 / 0%	20 / 100%
Field Interviews	4 / 29%	8 / 57%	1 / 7%	1 / 7%	0 / 0%	0 / 0%	14 / 100%
<u>Performance Standards</u>							
Survey Only	4 / 20%	9 / 45%	2 / 10%	3 / 15%	1 / 5%	1 / 5%	20 / 100%
Field Interviews	3 / 21%	3 / 21%	5 / 36%	2 / 14%	1 / 7%	0 / 0%	14 / 100%
<u>Outcomes</u>							
Survey Only	4 / 20%	6 / 30%	3 / 15%	5 / 25%	2 / 10%	0 / 0%	20 / 100%
Field Interviews	4 / 29%	1 / 7%	3 / 21%	5 / 36%	0 / 0%	1 / 7%	14 / 100%
<u>Timeframes</u>							
Survey Only	5 / 25%	10 / 50%	4 / 20%	1 / 5%	0 / 0%	0 / 0%	20 / 100%
Field Interviews	6 / 43%	8 / 57%	0 / 0%	0 / 0%	0 / 0%	0 / 0%	14 / 100%

1.c: Do your performance-based contracts have quality assurance plans that monitor the contractor's performance? (32 responses)

- No (Go to question 1.d) (2 / 6%)
[Survey Only (1 / 6%), Field Interviews (1 / 7%)]
- Yes (complete the following) (30 / 94%)
[Survey Only (17 / 94%), Field Interviews (13 / 93%)]

• Performance-Based Contracting

To what extent do your plans do the following?

	All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know
Periodic Contract Reporting (30 responses)	7 / 23%	17 / 57%	2 / 7%	3 / 10%	1 / 3%	0 / 0%
On-site Reviews and Observations (30 responses)	1 / 3%	8 / 27%	4 / 13%	11 / 37%	5 / 17%	1 / 3%
Invoice Reviews (32 responses)	22 / 69%	6 / 19%	1 / 3%	3 / 9%	0 / 0%	0 / 0%
Audit Report Reviews (32 responses)	4 / 13%	5 / 16%	4 / 13%	11 / 34%	5 / 16%	3 / 9%
Other Periodic Contacts with the Contractor (32 responses)	9 / 28%	14 / 44%	2 / 6%	7 / 22%	0 / 0%	0 / 0%
Other: - <hr/> (5 responses)	<ul style="list-style-type: none"> • For audit report reviews, we would address any audit issues immediately and thoroughly. (Office of Financial Management) • We also use desk audits, phones, email, to determine risk factor. (Military Department) • Review all invoices prior to payment. Maintain constant communications with contractors. (WDVA) • Client satisfaction surveys. (Department of Services for the Blind) • Many client service contracts require ongoing client case management, and the performance of Contractors' services is reviewed as part of that process. (Department of Social and Health Services) 					

• Performance-Based Contracting

	All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know	Total
<u>Periodic Contract Reporting (30 responses)</u>							
Survey Only	5 / 29%	8 / 47%	2 / 12%	1 / 6%	1 / 6%	0 / 0%	17 / 100%
Field Interviews	2 / 15%	9 / 69%	0 / 0%	2 / 15%	0 / 0%	0 / 0%	13 / 100%
<u>On-site Reviews and Observations (30 responses)</u>							
Survey Only	1 / 6%	3 / 18%	1 / 6%	6 / 35%	5 / 29%	1 / 6%	17 / 100%
Field Interviews	0 / 0%	5 / 38%	3 / 23%	5 / 38%	0 / 0%	0 / 0%	13 / 100%
<u>Invoice Reviews (32 responses)</u>							
Survey Only	12 / 63%	4 / 21%	0 / 0%	3 / 16%	0 / 0%	0 / 0%	19 / 100%
Field Interviews	10 / 77%	2 / 15%	1 / 8%	0 / 0%	0 / 0%	0 / 0%	13 / 100%
<u>Audit Report Reviews (32 responses)</u>							
Survey Only	3 / 16%	3 / 16%	3 / 16%	5 / 26%	5 / 26%	0 / 0%	19 / 100%
Field Interviews	1 / 8%	2 / 15%	1 / 8%	6 / 46%	0 / 0%	3 / 23%	13 / 100%
<u>Other Periodic Contacts with the Contractor (32 responses)</u>							
Survey Only	6 / 32%	9 / 47%	0 / 0%	4 / 21%	0 / 0%	0 / 0%	19 / 100%
Field Interviews	3 / 23%	5 / 38%	2 / 15%	3 / 23%	0 / 0%	0 / 0%	13 / 100%

• Performance-Based Contracting

1.d: To what extent do your performance-based contracts use the following to monitor the contractor's performance?

	All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know
Measurable Performance Standards (32 responses)	5 / 16%	11 / 34%	5 / 16%	7 / 22%	4 / 13%	0 / 0%
Outcome Measures (32 responses)	6 / 19%	5 / 16%	4 / 13%	9 / 28%	7 / 22%	1 / 3%

	All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know	Total
<u>Measurable Performance Standards (32 responses)</u>							
Survey Only	2 / 11%	7 / 39%	3 / 17%	4 / 22%	2 / 11%	0 / 0%	18 / 100%
Field Interviews	3 / 21%	4 / 29%	2 / 14%	3 / 21%	2 / 14%	0 / 0%	14 / 100%
<u>Outcome measures (32 responses)</u>							
Survey Only	3 / 17%	3 / 17%	3 / 17%	4 / 22%	5 / 28%	0 / 0%	18 / 100%
Field Interviews	3 / 21%	2 / 14%	1 / 7%	5 / 36%	2 / 14%	1 / 7%	14 / 100%

1.e: To what extent do your performance-based contracts provide positive incentives?

All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know
1 / 3%	1 / 3%	3 / 9%	5 / 15%	24 / 71%	0 / 0%

	All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know	Total
Survey Only	1 / 5%	0 / 0%	1 / 5%	4 / 20%	14 / 70%	0 / 0%	20 / 100%
Field Interviews	0 / 0%	1 / 7%	2 / 14%	1 / 7%	10 / 71%	0 / 0%	14 / 100%

• Performance-Based Contracting

1.f: To what extent do your performance-based contracts have negative consequences for non-performance?

All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know
9 / 27%	9 / 27%	4 / 12%	7 / 21%	5 / 15%	0 / 0%

	All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know	Total
Survey Only	6 / 30%	4 / 20%	3 / 15%	4 / 20%	3 / 15%	0 / 0%	20 / 100%
Field Interviews	3 / 21%	5 / 36%	1 / 7%	3 / 21%	2 / 14%	0 / 0%	14 / 100%

1.g: To what extent do your performance-based contracts tie payment to deliverables?

All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know
8 / 24%	14 / 41%	6 / 18%	5 / 15%	1 / 3%	0 / 0%

	All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know	Total
Survey Only	5 / 25%	7 / 35%	5 / 25%	2 / 10%	1 / 5%	0 / 0%	20 / 100%
Field Interviews	3 / 21%	7 / 50%	1 / 7%	3 / 21%	0 / 0%	0 / 0%	14 / 100%

1.h: To what extent do your performance-based contracts tie payment to achievement of performance measures or outcomes?

All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know
6 / 18%	8 / 24%	4 / 12%	9 / 27%	6 / 18%	1 / 3%

	All Contracts	Most Contracts	A Majority of Contracts	Some Contracts	Few/No Contracts	Do Not Know	Total
Survey Only	3 / 15%	4 / 20%	3 / 15%	6 / 30%	4 / 20%	0 / 0%	20 / 100%
Field Interviews	3 / 21%	4 / 29%	1 / 7%	3 / 21%	2 / 14%	1 / 7%	14 / 100%

• Performance-Based Contracting

Question 2: What progress has your agency made in implementing the Governor’s Executive Order? Check all that apply. (NOTE: Totals will be greater than 100% because respondents had the option to select more than one category)

- Haven’t started yet (4 / 12%)
[Survey Only (4 / 20%), Field Interviews (0 / 0%)]
- Established a task force/work group to determine how to implement performance-based contracting in the agency (12 / 35%)
[Survey Only (6 / 30%), Field Interviews (6 / 43%)]
- Established a task force/work group to review agency policies and procedures and make recommendations on changes (16 / 47%)
[Survey Only (6 / 30%), Field Interviews (10 / 71%)]
- Have already developed and implemented revised policies and procedures (13 / 38%)
[Survey Only (8 / 40%), Field Interviews (5 / 36%)]
- Do not know (0 / 0%)
[Survey Only (0 / 0%), Field Interviews (0 / 0%)]
- Other: _____

Not a workgroup, but as the Contracts administrator for the agency, notified agency staff involved in contracting of new requirements, developed exemption process and form, and reviewed policies and procedures. Currently, reviewing incoming contracts and advising on how to incorporate performance-based terms in contract.	Employment Security Department
Contracting is centrally managed. Most of our contracts, particularly all of the complex ones, were already performance-based. Agency managers have been notified of the new requirement. We are working on development of written policy to implement.	Washington State Patrol
Working with contract specialists on strengthening performance language in new contracts. As best practices develop/emerge, we'll develop agency-wide guidance.	Department of Ecology
As standard operating procedures, all renewals and new contracts are written in alignment with the executive order.	Department of Revenue, Washington State
Waiting for final recommendations to update Agency policies and procedures.	Military Department
Revised policies are in development but not yet implemented.	Department of Information Services
We are investigating best practices.	Department of Retirement Systems
Our goal is to be 100% compliant. We are reviewing ways to better engage contractors to perform consistently above requirements.	WDVA
OAH has a very small volume of contracts. Most contracts have concentrated on deliverables, not necessarily on outcomes and performance measures. Discussions have occurred with the Chief Administrative Law Judge, Deputy Chief ALJ, and Finance Director on implementing outcomes and performance measures for contracts in the future.	Office of Administrative Hearings

• **Performance-Based Contracting**

<p>The contracts office will be responsible for developing and implementing policies and procedures for performance-based contracting in the agency, including the increased use of the Contract Manager's portion of ECMS, etc. These will be reviewed and approved by the Senior Management Team. DOP uses performance-based contacting methods for most contracting activities, whenever it is to our best advantage and feasible, as well as the most economical.</p>	<p>Department of Personnel</p>
<p>Review of contracts, contract manager refresher training, sharing of the EO with all contract managers.</p>	<p>Washington's Lottery</p>
<p>Our agency has not yet created a new set of policies and procedures, but the contracting staff have experience with performance-based contracting and are using contract language and performance and payment monitoring.</p>	<p>State Board for Community & Technical Colleges</p>
<p>We have conducted 14 trainings of 64 staff on this since 11/29/11; trained 43 people on this before 11/29/11, and provided tools such as a menu of terms, examples, FAQ, checklist, exemption request form, technical assistance, etc.</p>	<p>Commerce</p>
<p>Most of our contracts are performance-based, plan to conduct in-house training to help divisions/programs better understand how to set up performance-based contracts.</p>	<p>Washington State Department of Agriculture</p>
<p>In some contract areas, already had policies and procedures in place prior to the Governor's Executive Order.</p>	<p>Washington State Department of Transportation</p>

• Performance-Based Contracting

Question 3: What are the internal challenges in implementing performance-based contracting in your agency?

Summary

Comment Category	# of respondents	% of respondents
Staff training in PBC	9	26%
Lack of understanding / expertise in PBC	4	12%
Developing PBC contracts	6	18%
Developing PBC policies & procedures	3	9%
Limited staffing / resources	8	24%
Additional work / workload issues	6	18%
Staff pushback	4	12%
Staff turnover	2	6%
Limited knowledge of our existing contracts	1	3%
Monitoring	6	18%
Reporting	6	18%
Our organization's structure	3	9%
Breadth of our services	2	6%
PBC does not apply to our contracts	1	3%
Philosophical shift to incentivized contracts	1	3%
No issues or agency has few contracts	3	9%
Unable to say	1	3%

Full Comments

Adequate Staffing	Workforce Training and Education Coordinating Board
Breadth of difference in work accomplished by the programs in the agency. There is no "one way" to approach. Program staff turnover makes training on contract management a challenge.	Department of Health
Existing agency contracts tracking/management systems were not specified or designed to track "performance-based" as a category or field for reporting purposes, which has resulted in some additional IT work.	General Administration
Competing priorities with limited staff. The broad brush of making every good or service contract performance-based whether it is for \$100 or \$100,000 takes additional staff time to cross the t's and dot the i's as well as additional time for collecting data and reporting.	Employment Security Department
Helping staff understand what performance-based contracting really means.	Office of Financial Management
Limited personnel. Limited knowledge of existing contracts. /// To establish methods that create consequences for poor performance and at the same time, inspire the contractor to achieve higher performance standards.	Department of Veterans Affairs
There are contracts within other divisions that are not managed by the contracts office. The level of oversight needed to effectively manage a performance-based contract may require training and potentially additional personnel.	Liquor Control Board
None	Board of Industrial Insurance Appeals
Not having a full understanding of what performance-based contracting is; how to write the statement of work; how to write performance standards and measurable outcomes. Contract Manager's monitoring of	DOL

• Performance-Based Contracting

the contractor performance – workload issue.	
1) Small agency staffing issues, particularly in fiscal and contracts unit, prevent implementation without further guidance and support from OFM. 2) Agency staff require training. 3) Inability to provide on-site monitoring with current staffing levels	Puget Sound Partnership
DEL has been implementing performance-based contracts, so there is no challenge to implement them, but it is a challenge to effectively consolidate and report this information to others. Finding time for staff to keep up on monitoring and reporting is very challenging in these times.	Department of Early Learning
We believe we are setting quite well and will continue to improve internally on implementing performance-based contracting. Short time frame on being able to communicate to the agency, write policies and procedures, reporting for GMAP, and prepare for a review all at the same time. Doing this in stages would help agencies prepare better.	Department of Labor & Industries
We have many very simple personal service contracts to perform a basic service (such as provide 4 hours of training in a particular subject), then we pay the vendor upon satisfactory delivery. The challenge is to make the simpler contracts performance-based without making the whole contractual instrument overly bureaucratic or burdensome.	Washington State Patrol
When we first implemented performance-based contracting in State Parks years ago, we experienced initial pushback from staff on performance disincentives (liquidated damages). It is no longer an issue.	State Parks & Recreation Commission
Resistance from staff (but we'll overcome); Workload (just making the transition); Lack of expertise and we don't understand how to implement Lack of clarity regarding scope of EO: what are included besides personal services contracts? We do grants, engineering contracts, some purchased services --- are these included? Modifications of systems to track pay points	Recreation and Conservation Office
Educating technical staff to put more thought into tying task completion to payment as they are drafting scopes of work.	Department of Ecology
Educating contract managers on what is performance-based contracting. Finding a way to incorporate the extra time required to develop good performance criteria for the contract into already full workload.	Department of Revenue, Washington State
All contracts are performance-based, in that our agency does not pay for a product that has not been delivered to the satisfaction of ourselves or our customer. Challenge may be with reporting the contracts.	Department of Printing
Conducting contractor on-site monitoring.	Military Department
Application of PBC principles to software licenses, telecom, master contracts, maintenance and other IT goods. Staff training for business owners will be important. Additionally, implementation of new procedures requires time for adapting, understanding and compliance.	Department of Information Services
The identification and tracking is a critical component. DOC uses ECMS as its database. This application was limited in that capability and has just now been modified to a limited extent. DOC also implemented a risk assessment and monitoring plan (RAMP) electronically through a SharePoint application. This was previously a paper process. Staff needs training in the use of the RAMP and encouragement to use rather than a paper note. Changing of staff in positions doing the monitoring creates challenges to keeping them trained as well as compliance with OFM training requirements. The most challenging is the application of outcome measures in certain areas such as medical.	Corrections
The Department is a small agency and implements very few contracts. We are still investigating best practices.	Department of Retirement Systems
Communicating to various divisions the importance of adding performance standards. Many divisions view this as an extra hurdle and feel it is unnecessary with contractors they have dealt with for a long time or haven't had problems with.	Washington Health Care Authority

• Performance-Based Contracting

Small number of contracts in size and frequency.	Office of Administrative Hearings
The agency has decentralized contracting procedures.	Department of Services for the Blind
DOP has used the performance-based contracting model whenever feasible and economical well before the executive order was issued. It is considered best business practice. The major internal challenges will now be to develop written procedures and processes to allow us to meet the new reporting requirements. Our major challenge is that we have very limited staff resources who are busy trying to keep up with the day to day work as well as meet the priority requirements that the possibility of a central services consolidation now poses. This is additional work that must be accomplished to portray what we have been doing all along. Another challenge is the new justification requirement when we don't write a contract under the performance-based model - drafting another justification in an already laborious state contracting process adds extra time and effort to acquire services.	Department of Personnel
Nature of contracts, training, decentralized contract management environment. Incentives for excellent performance and consequences for inadequate performance do not apply to types of contracts such as purchased services. Either they deliver or they don't - e.g. Lexis/Nexis background checks - either they did it or they didn't.	DFI
Already implemented. Challenge is annual training availability required of contract managers by OFM and full attendance at internal contract manager training.	Washington's Lottery
Educating internal staff - some staff members are not aware of performance-based contracting, but the contracts staff are educated about it and use it.	State Board for Community & Technical Colleges
Challenges internally are related to the high volume of contracts the Department administers and allocating staff time to revise existing contract templates, analyze new contracts, identify appropriate performance measures and outcomes, and draft and negotiate revised contract terms.	Department of Social and Health Services
The broad diversity of types of contracts was a challenge in responding to this survey. Our monitoring ranges from the very labor intensive for large federally funded client services contracts to simple for small purchases of services. And although the client services contracts are often large in dollar amounts there are a large number of smaller purchased services. The fact that they have different requirements because of different rules and different risk levels means that the process is different. So to make generalizations about all of them is difficult.	Commerce
We don't see much of a challenge since we have been doing performance-based contracts for some time now, however some people are used to doing it the way they always have.	Washington State Department of Agriculture
Time, staff and funding	Washington Department of Fish and Wildlife
* Limited resources due to budgetary constraints. * Additional reporting requirements for cabinet agencies. * Philosophical shift to incentivized contracts.	Washington State Department of Transportation

• Performance-Based Contracting

Question 4: What are the external challenges in implementing performance-based contracting in your agency?

Summary

Comment Category	# of respondents	% of respondents
Working with contractors to implement performance-based contracts	16	47%
Contractor resistance	4	12%
Providing training / education to contractors	4	12%
Requirements of clients / customers	2	6%
Monitoring contractors	2	6%
Variable expertise / experience of contractors and the number of contractors	1	3%
Contracts may not translate well to PBC	5	15%
Incompatibility between PBC and federal requirements	4	12%
PBC limited in some way by direction from Legislature, Governor, or State policy	2	6%
Services already regulated by other gov't agencies	1	3%
Time and funding constraints	3	9%
Using other agencies' master contracts	2	6%
Level of OFM support / training to agencies	2	6%
Enterprise Contract Management System providing required information	1	3%
Finding best practices	2	6%
Limited sharing of ideas and information between agencies	1	3%
Not all clients benefit from services, but contractors have earned compensation	1	3%
Outcomes of services are influenced by factors beyond vendor's control	1	3%
Measures and data drive up administrative costs for providers	1	3%
Developing PBC for interagency agreements	1	3%
Stakeholder support	1	3%
Convincing the public of the benefit of PBC	1	3%
No issues or agency has few contracts	4	12%

Full Comments

Multiplicity of contractors and variable contractor expertise and experience	Workforce Training and Education Coordinating Board
Incompatibility between incentive based performance contracts and reimbursement requirements of federal grants. Many federal grants have deliverables negotiated when federal grant applications are submitted. Many programs have been doing business a set way for a number of years, transition to incentive based is a challenge. Many programs have long term outcomes that are not easily or readily translated to outcomes in one or two year contract periods.	Department of Health
As most agency contracts already are performance-based, we do not anticipate significant external challenges.	General Administration

• Performance-Based Contracting

Trying to reconcile this requirement with Federal requirements for pass through grants. Also master contracts through DIS and GA (personal services) are all geared toward hourly rates. There needs to be some communication with vendors regarding what the state is expecting.	Employment Security Department
Some vendors feel constrained by performance-based contracting requirements.	Office of Financial Management
Limited sharing of ideas and information with other agencies. /// Once we develop creative performance standards, we will need to educate our contractors on these new standards and the consequences of poor performance and incentives for superior performance.	Department of Veterans Affairs
In some circumstances this is going to be new to the vendor community for certain commodities. This may impact the competitive process participation.	Liquor Control Board
None	Board of Industrial Insurance Appeals
Contractors not willing to enter into a performance-based contract. /// To some extent in using other agencies' master contracts.	DOL
1) Budget constraints that prevent financial incentives. 2) Finding ways to motivate contractors to change how they do business. 3) Providing training	Puget Sound Partnership
We haven't had many external challenges and feel we have implemented performance-based contracts for our agency, but there is always time and money that would assist in creating more outcome driven incentives. Measures and data always drive up administrative costs for providers.	Department of Early Learning
External challenges in implementing the performance-based contracts are getting vendors to agree to new performance-based measures. Both parties need to agree. All state agencies using the same system like OFM's Enterprise Contracts Management System (ECMS). This system will allow all agencies to track all contracts, including performance-based contracts, track invoices approved by contract managers. It could also be used to track performance measures electronically, if programmed. Currently this is done electronically in ECMS by the contract office staff at L&I. This could be added into ECMS to measure performance of contractors as well. This system will work for the Governor's reporting. Doing all of this would create a standard way for all agencies to monitor performance. All agencies must buy into and use it the same way. This is critical for accurate reporting.	Department of Labor & Industries
Will these requirements apply to interagency agreements? If so, a challenge will be to develop performance-based interagency agreements that both parties can agree to.	Washington State Patrol
When we first implemented performance-based contracting in State Parks years ago, we experienced initial pushback from design professionals (A/E) on performance disincentives (liquidated damages). It is no longer an issue.	State Parks & Recreation Commission
Lack of training from OFM. Culture change by our vendors. How will funding sources and the public react for paying someone more than it cost (feds like reimbursement models).	Recreation and Conservation Office
Sifting through examples to find the best practices that work for environmental contracts.	Department of Ecology
Educating vendors on the purpose of performance-based contracting, negotiating reasonable criteria into the contract and ensuring the vendor shows they have met the criteria within the contract before payment is processed.	Department of Revenue, Washington State
Customer requirements	Department of Printing
Having entities/contractors comply with sending a copy of their audit reports for review.	Military Department
Requesting modification of boilerplate vendor contracts to comply such as maintenance agreements when the structure of the transaction may not fit PBC.	Department of Information Services
A challenge for DOC is to acquire services for a client base that not all want any part of, that is litigious and potentially more expensive, and to which the outcomes of services are influenced by factors beyond the vendor's control. Avoiding the perception of vendors, particularly small businesses, that this is more	Corrections

• Performance-Based Contracting

bureaucratic red tape or cost to be absorbed in a contract may be challenging in professional services which are already regulated by federal, state or local agencies that have their own requirements and monitoring requirements. Recognizing these external relationships while developing DOC's requirements is important to maintain vendor interest.	
The Department is a small agency and implements very few contracts. We are still investigating best practices.	Department of Retirement Systems
Many contractors do not like adding criteria that they have not had to comply with before--they believe that, since there may not have been any problems with performance in the past, they should not need to meet new standards in their contracts with the agency.	Washington Health Care Authority
Small number of contracts in size and frequency.	Office of Administrative Hearings
The majority of our contracts are Client Services. Not all clients benefit from the services they receive, but contractors have earned compensation regardless.	Department of Services for the Blind
Our biggest external challenge will be with contract renewals and the requirement to attempt to modify contracts that are currently not performance-based into the performance-based model. The original contracts were based on the criteria set forth in the RFX document - some contractors may challenge this. Otherwise for the most part, the contractor community is used to performance-based contracting - as long as it is stated clearly in the acquisition document.	Department of Personnel
Shifting paradigm with contractors. History is based on deliverables, not necessarily outcomes and performance measures.	DFI
Availability of contract manager at OFM and contractors representative using the contract manager as their internal point of contact.	Washington's Lottery
The main external challenge we expect will be in negotiating and agreeing upon actual performance measures, outcomes and potential consequences for nonperformance with contractors.	Department of Social and Health Services
Federally funded contracts sometimes have their own restrictions that we must pass through to contractors. Those federal requirements may not always coincide with performance-based principles.	Commerce
The only challenge we see is providing incentives since state policy does not allow for this.	Washington State Department of Agriculture
Funding and stakeholder support	Washington Department of Fish and Wildlife
* Convincing the public of the benefit in performance-based contracting. * Constraints of Enterprise Contract Management System to provide required information. * Working with firms to implement performance-based contracts.	Washington State Department of Transportation