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Federal CFO Insights
Leveraging Share-in-Savings contracts to improve outcomes and save money

As Federal CFOs have adjusted to the reality of tighter budgets, many have pushed forward with innovative initiatives that allow their agencies to improve operational service delivery, streamline procurement and reduce spending on non-core services. Trends such as the migration of operational functions to shared services centers, or procurement strategies such as category management, are evidence of these innovative approaches. With no foreseeable end to the fiscal belt-tightening, CFOs will need to continue to leverage their position as strategic advisors, as well as their financial management acumen, to collaborate with program and operational leaders to identify similar new opportunities for efficiencies.

Many of these opportunities for innovation — such as the previously mentioned category management — fall within the purview of Chief Procurement Officers (CPOs). While Federal CFOs and CPOs have both complementary and complicated relationships, one thing they can universally agree upon is the need to maximize the value of their agency's contract spending. One approach to maximizing value that is frequently used in the private sector, but underutilized in the Federal government, is the Share-in-Savings (SiS) contract. With targeted application, agencies can add this approach to their toolkit to capitalize on savings opportunities and decrease upfront investment costs required to get savings-oriented projects off the ground.

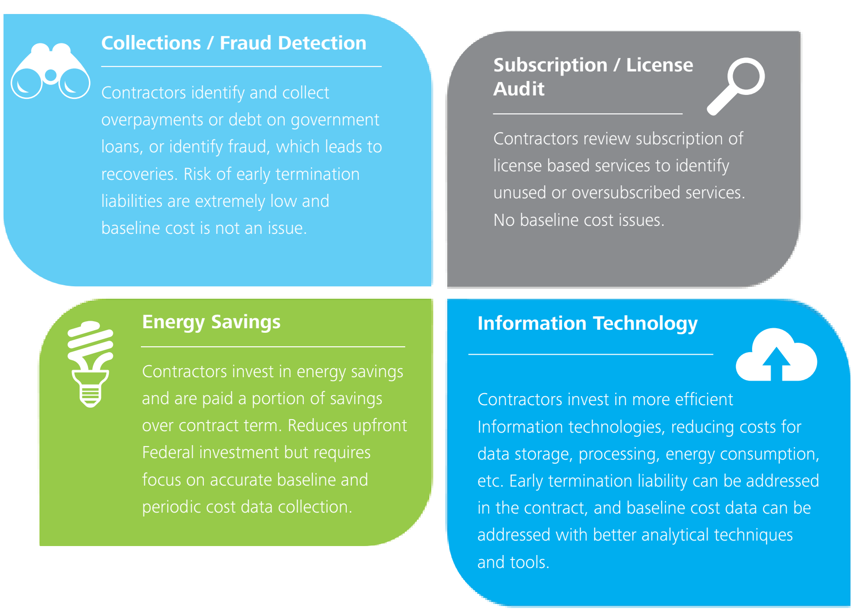
Share-in-Savings: The Federal experience

The Federal government's experience with the Share-in-Savings (SiS) approach started in the mid-1980s when energy savings performance contracts (ESPCs) were first awarded by the Department of Energy. The SiS idea is to work with contractors to implement cost savings initiatives, and incentivize performance by paying the contractor with a reasonable portion of realized savings. Similar to "value-based billing", a common private sector approach, SiS aligns client and contractor interests, as payments to contractors are directly tied to the amount of savings they produce. Additionally, SiS contracts reduce financial risk for buyers, as there are either no, or very low, upfront costs since the contractor bears the burden of investment needed to generate cost savings. This approach has been successful in multiple applications over the years, as illustrated by the following three examples:

- Energy Savings Performance Contracts (ESPCs) — The National Energy Conservation Policy Act of 1978 provided authority for agencies to enter into contracts for the purpose of achieving energy savings that pays contractors "… a share of the energy savings directly resulting from implementation of such measures..."[1] Using ESPCs, the Federal government has saved more than $7.3 billion on investments of $2.78 billion, illustrating the magnitude of the potential payoff of SiS contracts.[2]

- **Information Technology (IT) at the Department of Education** — The Clinger-Cohen Act of 1996 included a pilot program that authorized the use of SiS contracts for information technology projects. Using this authority, the Department of Education used the SiS approach to consolidate legacy information systems for the Student Financial Aid program. The Department issued a zero-dollar SiS contract to perform the consolidation, agreeing to pay the vendor from the delivered savings. The result was a realized savings of over $40 million, with the consolidated system delivered ahead of schedule. The contractor covered its costs and earned a reasonable profit, all while bearing the majority of the financial risk for non-performance.[3] Unfortunately, this has been the only example of the use of SiS for technology projects to date.
- **Improper Payment Recovery** — The Improper Payments Elimination and Recovery Act (IPERA) of 2010 expanded the requirement for Federal Agencies to address the estimated $125 billion in improper payments made annually at the time. The legislation allowed for a portion of recovered funds to be used to pay contractors, with OMB implementation guidance clearly encouraging the use of SiS contracts. To date, SiS related recoveries have been significant, totally almost $100 million. However, that number is dwarfed by the savings left on the table, with over $22 billion in 2013 in identified overpayments left unrecovered.

Figure 1. Potential opportunities for SiS contracts



The Share-in-Savings Opportunity

Given the proven efficacy of SiS contracts, a reasonable idea would be to expand its application — when the approach makes sense. While SiS is not a panacea, it can be effectively used to better align contractor and Federal buyer incentives, replacing more traditional contract vehicles in many situations, several of which are shown in Figure 1.

The resulting potential for realized savings through SiS contracts is truly staggering. With regards to improper payments alone, the Federal government could save an estimated $1 billion annually by increasing the current recovery rate for overpayments by just 2.2%. The SiS contract would be ideal for this task, and would come at little to no initial cost for the Federal government.

Federal challenges with Share-in-Savings

While opportunities to leverage SiS contracts abound, several hurdles stand in the way of widespread Federal adoption of this leading commercial practice. CFOs, however, are uniquely positioned to help address the challenges, which include:

- **Cost Baseline Calculations** — An often-cited roadblock for SiS contracts is the ability to identify an accurate and reliable cost baseline against which savings-based payments can be calculated. With fraud and overpayment recoveries, this is a non-issue as the recovered amounts are the baseline. This is one of the biggest challenges, however, with using SiS for technology projects. CFOs are well-positioned to support CXOs and program area leaders in assessing whether cost data from CFO business systems is accurate and reliable. Additionally, CFOs, as financial analysis experts, can provide the expertise and analytical tools needed to develop an accurate and reliable cost baseline.
- **Legislation and Guidance** — Agency acquisitions professionals require clear authority and guidance to pursue new or unfamiliar contracting approaches. More specifically, technical guidance is needed to address the twin challenges of termination liabilities and potential Anti-deficiency Act (ADA) violations. In the case of SiS contracts, legal authority is provided through the multi-year contracting authority in the FAR.[4] However, outside of IPERA and the National Energy Conservation Policy Act (for ESPCs), many acquisitions professionals do not feel this authority is adequate legal cover given their general unfamiliarity with the approach. In order to address these concerns, CFOs can request more explicit guidance from OMB and the Office of Federal Procurement policy to address the reasonable and prudent concerns of acquisition professionals regarding ADA and termination liabilities.

- **Acquisition Training and Support** — The Federal acquisition workforce needs adequate SiS training and dedicated support to help them create, manage and problem solve SiS challenges. Dedicated resources should be set aside — such as those set aside in 2008 for the Defense Acquisition Workforce Development Fund (DAWDF) – to provide for training. Similarly, the creation of a SiS Center of Excellence (COE) could provide outreach, training and on-the-ground technical expertise to help expedite the adoption of these contract vehicles. CFOs could help address these challenges by championing these training and educational efforts.

Share-in-Savings – An idea whose time has come

Commercial leading practice approaches such as SiS offer demonstrated paths to achieving better overall value for contract dollars spent — and in this particular case at significantly reduced risk for the Federal government. While this approach is not the universal panacea, it does offer a lower-risk alternative to achieving desired outcomes than traditional fixed price vehicles across a broad range of applications. If key stakeholders across the Federal government — including CFOs, CPOs and Congress — desire to use every tool available to successfully adapt to the new normal of fiscal belt-tightening, they should start with what is known to work, namely the Share-in-Savings approach.

Endnotes

1. http://www.gpo.gov/fdsys/pkg/STATUTE-92/pdf/STATUTE-92-Pg3206.pdf
2. http://energy.gov/node/782456/financing/espcs_regulations.html
3. K. J. Buck, (2005), "Overcoming Resistance to a Paradigm Shifting Change in the Federal Sector: Share-in-Savings Contracting—From Concept to Application," Chapter 13 of *Challenges in Public Procurement: An International Perspective*, p. 249, at p. 255
4. http://fcw.com/articles/2009/10/19/comment-kelman-share-in-savings.aspxService Line/Industry

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