

ACQUISITION OF GOVERNMENT PROPERTY BY DEFENSE CONTRACTORS

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This is the second article that I have written in regard to the Acquisition of Government property by Defense Contractors – but it seems to be a timely topic and one that has seen a number of changes since the first iteration (More than twenty years ago) – the most significant of these changes, the publication of the 2007 iteration of the Federal Acquisition Regulations (FAR) regarding Government property.

The issue of acquisition has been discussed in many forums under many different circumstances. And those discussions will probably go on for many years to come. Why? Because it is a most interesting subject, because it can be discussed from many different aspects and it may be discussed by so many different people. It is an interesting subject because it has a degree a complexity that goes beyond superficial analysis and requires one to dig into the meat of the subject. It is an interesting subject because it can be discussed from many different aspects such as title versus lien, collateral interest versus security interest, ownership versus right to title, property versus intellectual data, when is it Government property versus when is it not Government property and more. Lastly, it is an interesting subject because it may be discussed by so many different people - cost and pricing folks, Defense Contract Audit Agency (DCAA) folks, overhead folks, contracts folks, lawyers and yes, even Government property folks. Whether you, as a property person, are employed by the Government or by industry it is a critical aspect of your education to understand and comprehend, and to be able to apply that knowledge, what the Government has title to versus what the Government does not have title to.

For private industry or the commercial world there exists a wealth of literature surrounding the acquisition of their own assets. A veritable storehouse of information is available if one has to buy for a corporation supporting commercial products.

Some of the “OLD” Literature that I cited in previous writings:

- "Purchasing and Materials Management" by Dobler, Burt and Lee, Jr. (1990)
- "Materials Management and Purchasing" by Ammer (1980)
- "Purchasing and the Management of Materials" by Zenz (1987)
- "Proactive Procurement: The Key to Increased Profits, Productivity, and Quality" by Burt (1984)

Some of the more contemporary literature:

- "Introduction to Materials Management" by Arnold, Chapman, and Clive (2011)
- "Purchasing and Supply Management" by Johnson and Leenders (2010)

“Purchasing and Supply Chain Management” by Monczka and Handfield (2011)
“The Procurement and Supply Manager's Desk Reference” by Sollish and Semanik (2012)

In addition there are numerous professional associations that have been created to support these efforts. These include the Institute for Supply Management™ (ISM)¹ and the American Production and Inventory Control Society (APICS)², to name just a few.

Yet, when it comes to the acquisition of property for the Government, or under Government contracts (And this short paper will deal primarily with acquisitions under Department of Defense (DoD) contracts) the literature to support any knowledgeable or definitive discussions is sorely limited. There exists a void, an abyss into which the unwary may fall. In an attempt to fill that void and provide a bridge to cross that chasm this article will discuss some of those concepts that impact a contractor's acquisition of property, more importantly, the acquisition of Government property or property for the Government. Such concepts as entitlement to be reimbursed for a cost, the issues of reasonable, allocable, and allowable will be discussed; The impact of Cost Accounting Standards and the Disclosure statement as it applies to acquisitions under cost reimbursement type contracts.

ORIGINS OF GOVERNMENT PROPERTY

Let's establish some common ground. We know that the definition of Government Property as cited in the Federal Acquisition Regulations (FAR) states,

"Government property means all property owned or leased by the Government. Government property includes both Government-furnished property and contractor-acquired property. Government property includes material, equipment, special tooling, special test equipment, and real property. Government property does not include intellectual property and software." (FAR 45.101)

We must look even further at two subdivisions of the definition of Government Property: Government-furnished property and contractor-acquired property.

"Government-furnished property, means property in the possession of, or directly acquired by, the Government and subsequently furnished to the contractor for performance of a contract. Government-furnished property includes, but is not limited to, spares and property furnished for repair, maintenance, overhaul, or modification. Government-furnished property also includes contractor-acquired property if the contractor-acquired property is a

¹ ISM use to be called the National Association for Purchasing Management. Current website - <https://www.instituteforsupplymanagement.org/About/?navItemNumber=22327>

² <http://www.apics.org/pe-home>

deliverable under a cost contract when accepted by the Government for continued use under the contract." (FAR 45.101)

"Contractor-acquired property, means property acquired, fabricated, or otherwise provided by the contractor for performing a contract and to which the Government has title." (FAR 45.101)

Seeing these 3 definitions and clearly understanding that regardless of whether we call the property Government property, Government-furnished property, or Contractor-acquired property, in the context of federal contracting, it is property whose **TITLE** vests in the **Government**. Yet, even with these definitions the question presents itself – to **WHAT** exactly does the Government take title and **WHEN** (Do to what action or at what point in time) does the Government take title? To answer this question let us look at types of contracts for a moment.

TYPES OF CONTRACTS

To cover this topic thoroughly we must also discuss some of the various types of Government contracts that we may run across in our daily lives. Generally, we may see two groupings of competitive contracts driven by their pricing arrangements: fixed-price and cost-reimbursement. Under these two broad, general headings we have many permutations of these contracts. Under fixed-price type contracts we have firm-fixed-price, firm-fixed-price with an Economic Price Adjustment (EPA), fixed-price Incentive (FPI) and fixed-price-redeterminable. Under Cost-reimbursement type contracts we also have various permutations, e.g., Cost contract, Cost-plus-fixed-fee (CPFF), Cost-plus-incentive-fee, and Cost-plus-award-fee. Of course there are numerous other types of contracts that the Government has the option of using, e.g., time and materials, labor hours, letter contracts, and basic ordering agreements.

It is important to understand these various types of contracts and their underlying principles so as to properly frame the issue of title or more appropriately who owns what when.

TITLE TO PROPERTY UNDER FIXED-PRICE CONTRACTS

Consider for a moment a plain fixed price contract. There are no special clauses or provisions or options such as the Progress Payments Clause (FAR 52.232-16), or even agency specific clauses. It is lacking even a Government Property Clause (FAR 52.245-2). This contract is for the supply of 100 Fleurbels (I hate widgets.). Who has title to all property acquired by the contractor for this contract?

The **Contractor** has title to all property acquired.

The Government has no interest in the property. The Government is only concerned with the deliverable end items.

“Under fixed-price type contracts, in the absence of financing provisions or other specific requirements for passage of title in the contract, the contractor retains title to all property acquired by the contractor for use on the contract, except for property identified as a deliverable end item.”³

When does the Government take title to the deliverable end items? Generally, the Government takes title upon the inspection and acceptance and delivery of the Fleurbels by the Government representative on the appropriate form, say a DD Form 250.⁴

True, there are other factors and clauses that affect the title provisions which we will discuss later, but I am trying to keep this, initially, at a very simplistic level. I'll dig deeper later. Keep this "plain fixed price contract" in mind as it is a very important basis from which we will build; The **Contractor has title** to material acquired under this fixed price contract with no special clauses, until inspection, acceptance and delivery, as applicable.

TITLE TO PROPERTY UNDER COST REIMBURSEMENT TYPE CONTRACTS

But here we get to the good stuff!!! In light of the previous questions, one must also ask, “Who has title to property acquired under a cost reimbursement type contract?” Well, the old adage is that the **Government has title to all property** acquired by the Contractor.

I am here to tell you --**THAT IS NOT A TOTALLY TRUE NOR CORRECT NOR COMPLETE STATEMENT!!!**

One has to properly PARSE – break down into smaller segments -- both the Policy statement by the Government and the Government Property Clause.⁵ There are NUMEROUS conditions that must be met. Let’s analyze a few of these! And to do this we need to look at two FAR references

³ FAR 45.505(a)

⁴ It confuses many folks that the Government property clause would speak to the issue of “Financing provisions.” Though this is a nice reference to Progress Payments (FAR 52.232-16) and Performance Based Payments (FAR 52.232-32) they are out of place here. In the Progress and Performance based payments clauses we do not address title to Government property – so why should they address financing title under the Government Property clause? It only muddies the waters – confusing TWO DIFFERENT title vesting provisions.

⁵ FAR 52.245-1(e)

GOVERNMENT POLICY

The first is a policy statement, “(b) Under cost type and time-and material contracts, the Government acquires title to all property to which the contractor is entitled to reimbursement, in accordance with paragraph (e)(3) of clause 52.245-1.”⁶

Well, that sorta’ says the Government has title to all property – but it adds this comment “**To which the contractor is entitled to reimbursement.**” Those eight words are CRITICAL!!! And we will define that statement a little later.

TITLE UNDER THE GOVERNMENT PROPERTY CLAUSE

The second is from the Government property clause. It states under (e), “(3) Title under Cost-Reimbursement or Time-and-Material Contracts or Cost-Reimbursable contract line items under Fixed-Price contracts.

(i) Title to all property purchased by the Contractor for which the Contractor is entitled to be reimbursed as a direct item of cost under this contract shall pass to and vest in the Government upon the vendor's delivery of such property.

(ii) Title to all other property, the cost of which is reimbursable to the Contractor, shall pass to and vest in the Government upon—

(A) Issuance of the property for use in contract performance;

(B) Commencement of processing of the property for use in contract performance; or

(C) Reimbursement of the cost of the property by the Government, whichever occurs first.”⁷

The clause makes the statement "Title to **ALL PROPERTY**...vests in the Government." This is not to say that the contractor may go out and buy anything he or she wants. Such is not the case. Notice that I specifically LEFT OUT THOSE EIGHT WORDS!!! “For which the Contractor is entitled to be reimbursed!!!”

What does ENTITLED TO BE REIMBURSED MEAN???

Well, that takes us to another clause.

“Wait Doug, we are talking about Government Property here – why do we have to go to another clause?”

Because this other clause addresses the issue of ENTITLEMENT – property for which the Contractor is entitled to be reimbursed!

⁶ FAR 45.402(b)

⁷ FAR 52.245-1(e)(3)

We have to go the “Allowable Cost and Payment Clause.” FAR 52.216-7
In that clause we have to go to Paragraph (a) Invoicing. And under Paragraph (a) we have to read (1). It states, “(1) The Government will make payments ... in amounts determined to be ALLOWABLE by the Contracting Officer in accordance with Federal Acquisition Regulation (FAR) Subpart 31.2 in effect on the date of this contract and the terms of this contract.”

So under this clause there is answered for us the issue of entitlement. But wait – there’s more!!! Notice that the clause has a reference to allowability. But it also directs us to ANOTHER FAR Part – in this case a FAR Subpart – FAR Subpart 31.2.⁸ So we now have to go to FAR Part 31 and Subpart 31.2 entitled respectively, FAR 31, **Contract Cost Principles and Procedures** and FAR Subpart 31.2, **Contracts with Commercial Organizations**.

COST PRINCIPLES

So many things may impact the acquisition of property and the various cost principles are one of them. The terms used in this area are complex and convoluted. So let's start with operationalizing some terms and definitions. Numerous terms are bandied about in Government contracting, especially when dealing with DCAA folks as well as property folks, that it is important to understand their meaning and origins. Federal Acquisition Regulation (FAR) Subpart 31.201-2 discusses the concept of allowability and provides the following guidance:

Determining allowability.

(a) The factors to be considered in determining whether a cost is allowable include the following:

(1) Reasonableness.

(2) Allocability.

(3) Standards promulgated by the CAS Board, if applicable; otherwise, generally accepted accounting principles and practices appropriate to the particular circumstances

(4) Terms of the contract.

(5) Any limitations set forth in this subpart.

Essentially, the requirement for determining allowability of Government contract costs list five factors. The five factors consist of:

Reasonableness,

Allocability,

STANDARDS -- Cost Accounting Board Standards/Generally Accepted

Accounting Principles (GAAP) where appropriate,

Terms of the Contract and

⁸ Technical note. Some of the “old guard” may remember that pre-2007 there was a FAR Subpart – 45.5 – that was binding upon the Contractor through the Government Property clauses FAR 52.245-2 and -5 as well as others. This was referred to as incorporation by reference. Well, technically, the better way is to have ALL of the contractor requirements in a Clause. In the situation we are discussing here FAR Subpart 31.2 is rather voluminous and therefore the clause (IF it were to be created) would be gigantic!

Any limitations set forth in this subpart.

REASONABLENESS

Let's look at each of these terms for a minute. The term "reasonable" can take on numerous meanings. For instance, some people shop only once a month. They make one great big shopping trip once a month to accomplish their major produce acquisitions, and then make quick stops, periodically, for perishable items. Other families shop every week for their groceries. Who is to say what is reasonable? More importantly who is to say **HOW MUCH** is reasonable. FAR 31.201-3 defines reasonable in terms of cost principles as

(a) A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business. Reasonableness of specific costs must be examined with particular care in connection with firms or their separate divisions that may not be subject to effective competitive restraints. No presumption of reasonableness shall be attached to the incurrence of costs by a contractor. If an initial review of the facts results in a challenge of a specific cost by the contracting officer or the contracting officer's representative, the burden of proof shall be upon the contractor to establish that such cost is reasonable.

(b) What is reasonable depends upon a variety of considerations and circumstances, including--

(1) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance

(2) Generally accepted sound business practices, arm's-length bargaining, and Federal and State laws and regulations;

(3) The contractor's responsibilities to the Government, other customers, the owners of the business, employees, and the public at large; and

(4) Any significant deviations from the contractor's established practices.

The Contractor has an IMPORTANT role in determining reasonableness!!! In the acquisition process contractors should be reviewing their acquisition and purchasing processes and procedures to ensure that this variable is met!!! That the test of REASONABLENESS is clearly defined AND MET!!!

The Government Property Administrator is also tasked to review the concept of "reasonableness" at a number of different times during the Contract Property System Analysis of the contractor's Property Management System. One instance of this review would be during the review/audit/analysis of the process of Acquisition.⁹ One of the

⁹ FAR 52.245-1(f)(1)(i) Acquisition of Property and the DoD Guidebook, http://www.acq.osd.mil/dpap/ccap/cc/jcchb/Files/Topical/Property/guides/Guidebook%20for%20Contract%20Property%20Administration_April%202012.pdf Section on Acquisition.

criteria deals with the "reasonableness" of the quantities of property that has been acquired by the contractor for the Government. A second instance would be under the review/audit/analysis of the process of Consumption.¹⁰

ALLOCABILITY

The next element is that of allocability. FAR 31.201-4 provides this definition, *A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it--*

- (a) Is incurred specifically for the contract;*
- (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or*
- (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.*

We could spend hours discussing allocability. So, let's try and make this simple:

"Allocate" means to assign an item of cost, or a group of items of cost, to one or more cost objectives. This term includes both direct assignment of cost and the reassignment of a share from an indirect cost pool.¹¹ Allocability is defined as "Characteristic of a cost that can be assigned or charged to one or more activities or items (cost objects) on the basis of benefits received...."¹² I believe the simplest explanation of allocability – You bought it for Contract X, it is to be used for Contract X. Yes, there is much more to allocability than this simple explanation – but we will leave it at this for now.

CAS/GAAP

The fourth element requiring discussion and impacting the acquisition of Government property is that of the Cost Accounting Board and the standards as well as Generally Accepted Accounting Principles (GAAP). There is a long and vivid history to the Cost Accounting Standards Board (CASB). The CASB was created to establish cost accounting standards "which would achieve uniformity and consistency in cost accounting practices followed by prime contractors and subcontractors in estimating, accumulating, and reporting of costs under certain negotiated prime and subcontract procurements" (Arnavas and Ruberry, 1987). The CASB established a number of standards which have become known as the Cost Accounting Standards (CAS). It should be noted that these standards do not apply to every Government or Defense contractor. Rather, they are applied to those contractors that do a substantial business with the Government. See FAR 30.201 for the specific applicability of CAS. GAAP have also evolved over a goodly number of years. The GAAP aren't a rigid set of rules but rather are a set of guidelines that have been adopted by the accounting profession

¹⁰ FAR 52.245-1(f)(1)(viii) Utilizing Government property.

¹¹ FAR 31.001 Definitions

¹² <http://www.businessdictionary.com/definition/allocability.html>

to ensure uniformity in reporting business transactions. The most authoritative source of GAAP developed by Federal Accounting Standards Advisory Board (FASAB) for federal entities is contained in The FASAB Handbook of Accounting Standards and Other Pronouncements, As Amended (FASAB Handbook).¹³

It is essential that every PROPERTY PROFESSIONAL have some familiarity with CAS and GAAP.¹⁴

Contractor's Disclosure Statement

One critical item covered under the CAS is that of the contractor's Disclosure Statement. If a contractor is covered by the CAS it is required to file a Disclosure Statement¹⁵. Essentially, this Disclosure statement is a written description of how the contractor is going to handle the accounting practices. As property professionals are familiar with the contractor's Property Management System as required by the FAR, auditors are intimately involved with the contractor's Disclosure Statement. Property professionals should avail themselves of the information contained within the Disclosure statement especially as it pertains to Government property acquired by the contractor.

TERMS OF THE CONTRACT

The next to the last concept that affects the acquisition of property, from a cost principles perspective, is the terms of the Contract. The Government may specifically exclude certain costs or prohibit the contractor from charging certain items to the Government, or more specifically to the cost of the contract. We will see this clearly illustrated as we start to discuss the various types of property acquisitions.

LIMITATIONS SET FORTH IN SUBPART

And lastly, FAR 31.201-2 provides a blanket statement of "Any limitations set forth in this subpart." That being, the regulations covered in FAR 31.2 which cover a myriad of topics including those covering the property world,
Insurance and Indemnification under 31.205-19
Material costs under 31.205-26
Special Tooling and Special Test Equipment Costs under 31.205-40,
to list just a few.

¹³ <http://www.fasab.gov/accounting-standards/authoritative-source-of-gaap/index.html>

¹⁴ Robert McFarland did an excellent presentation on the Cost Accounting Standards at the 2011 NPMA NES. Link to his presentation
<http://www.npma.org/resource/resmgr/2011NES/2011NES326PPT.ppt?hhSearchTerms=%22%22Robert++McFarland%22+and+Cost+and+Accounting+and+Standards%22>

¹⁵ CASB-DS1 Form. http://www.whitehouse.gov/OMB/procurement/casb_ds-1.pdf

BACK TO ALLOWABLE

And to come back full circle – for a Cost to be ALLOWABLE – it must meet all five of the above discussed requirements:

- (1) Reasonableness.
- (2) Allocability.
- (3) Standards promulgated by the CAS Board, if applicable; otherwise, generally accepted accounting principles and practices appropriate to the circumstances.
- (4) Terms of the contract.
- (5) Any limitations set forth in this subpart.

POP QUIZ – For acquisitions under FAR based contracts -- are alcoholic beverages “allowable?”

ANSWER – NO!!! FAR 31.205-51. “Costs of alcoholic beverages are **unallowable.**” Though in my travels I have found a FEW instances where this may not ALWAYS be true!!! ☺ But THAT is fodder for another article!

BACK TO THE GOVERNMENT PROPERTY CLAUSE TITLE PARAGRAPH

O.k., so we read, “Title to all property purchased by the Contractor for which the Contractor is entitled to be reimbursed...” but now we need to parse it one step further and add the NEXT requirement, “...as a direct item of cost under this contract.”

I am going to say this – and put it in writing – In THIS clause -- the Government **ONLY** takes title to property that is **CHARGED** as a **DIRECT ITEM OF COST!!!**

I know, I know – the lawyers are screaming at me right now. If you study the history of the FAR rewrite prior to the publication of the 2007 iteration you will find numerous comments that state, “The Government takes title to property charged direct and indirect!!!” Government lawyers said this. Contractor Lawyers and representatives said this. All down in writing for the record.¹⁶ In addition, it appears that there is still some confusion by practitioners as a recent (2015) Defense Acquisition University Ask A Professor posed the question, “Is there clear and convincing evidence to support overhead or indirect funds not tracked as government property, or is there convincing evidence that overhead or indirect funds are accountable as government property and administered under the property clause?”¹⁷

If that was the case, i.e., where the Government took title to property acquired with INDIRECT or OVERHEAD monies – Well, there would be some interesting problems with EVERY contractor’s Property Management system and its compliance with the Government Property Clause. For an interesting article on THIS aspect see the reference for the National Contract Management Association’s Journal.¹⁸

¹⁶ <https://www.federalregister.gov/articles/2007/05/15/07-2256/federal-acquisition-regulation-far-case-2004-025-government-property> See comments sections of the website information.

¹⁷ <https://dap.dau.mil/aap/pages/qdetails.aspx?cgiSubjectAreaID=5&cgiQuestionID=122403>

¹⁸ <http://www.ncmahq.org/NewsPublications/JCMArticleDetail.cfm?ItemNumber=4236>

O.k., back on task – we can now see the VARIABLES that impact the Government taking title to property under a Cost Reimbursement Contract. Analyzing BOTH the GP CLAUSE, FAR 52.245-1, and the ALLOWABLE COST AND PAYMENT CLAUSE, FAR 52.216-7 we reach a conclusion.

For the Government to take TITLE to property ACQUIRED by the Contractor:

IT MUST BE CHARGED DIRECT

It must be a cost to which the Contractor is

ENTITLED TO BE REIMBURSED:

It must be REASONABLE

It must be ALLOCABLE and

It must be ALLOWABLE

It must be charged in a CONSISTENT FASHION in accordance with CAS (Which requires the application of a Disclosure Statement (CASB-DS1) or GAAP Applied.

POINTS OF DISCUSSION

The real concern, the real point of this exercise though was to provide some points for analysis and to poke and prod one's mind to further explore the realm of Government property and its delightfully detailed inner workings. So let me try to do that!

Generally speaking, the Government allows Contractors to acquire and DIRECT CHARGE:

Material – REASONABLE QUANTITIES that are going to be incorporated into the deliverable end item or is to be consumed or expended in the process of fabricating or manufacturing the end item or even repairing existing Government Property, e.g., Government property furnished for the purpose of being repaired!

Special Tooling – tooling that is TRULY SPECIAL, which is going to be used in assembling or manufacturing or producing the end items or used for repairing existing Government Property.

Special Test Equipment – items that are of a SPECIALIZED NATURE with LIMITED USE used to perform SPECIAL PURPOSE TESTING which is going to be used in TESTING components going into the end items or to test the end item itself or used for testing the repair of existing Government Property.¹⁹

Well, what about “Equipment?”

An Example of a Technical Issue under CAS -- Acquiring General Purpose Equipment

One issue that the Government and Industry has faced and still faces is the issue of the allowability of costs for the acquisition of General Purpose Equipment under Cost Type Contracts. In other words, under a cost reimbursement type contract can a contractor direct charge the Government for a piece of General Purpose Equipment?

¹⁹ SEE FAR 52.245-1(a) for these property classification definitions

Two Word Answer – “IT DEPENDS!!!”

In my experience I have seen contractors acquire cars, other commercial (NOT SPECIAL) vehicles, large wide screen High Def color TVs, various hand tools (some of which I would love to have in my garage), coffee brewers, photocopy machines and other “general purpose stuff.” Wait – can contractors charge this stuff direct? Again, that horrible TWO WORD ANSWER – “IT DEPENDS!!!”

It depends upon HOW the contractor specified it would acquire this property under its “Disclosure Statement” that we addressed earlier. Generally, for the mid-size and large contractors – they know what their disclosure statement says and what the CAN or CANNOT charge direct – such that the Government acquires title. And again GENERALLY those mid-size and large contractors disclose that these items will only be charged through amortization or depreciation charges – where the Government DOES NOT take title to the items. Why does the Government generally NOT want title to General Purpose Equipment? Because the Government does NOT want be in the property business – and the Government’s POLICY is that, “Contractors are ordinarily required to furnish all property necessary to perform Government contracts.”²⁰

Yes, the Government will allow the direct charging of Material, Special Tooling and Special Test Equipment as described above – but GENERAL PURPOSE EQUIPMENT??? The Government (Generally) does NOT want to “facilitize” contractors. Now, with that said – there are specific situations where contractors MAY charge General Purpose Equipment. Situations such as where there is only ONE contract being performed by this contractor – and they have “DISCLOSED” in their disclosure statement that this is there accounting practice.²¹

Contractors should be VERY careful about charging GENERAL PURPOSE EQUIPMENT as a direct item of cost and ensure that they are compliant and CONSISTENT with CAS 402 – the Consistency Standard.

Government Property Administrators should ensure, during their Property Management System Analysis (PMSA), that if contractors are acquiring general purpose equipment and treating it as a direct charge where it becomes Government property that this is being done in accordance with the contractor Disclosure Statement.

A SECOND Example of a Technical Issue under CAS -- Acquiring Office Supplies

In a number of instances we have run across contractors that charge OFFICE SUPPLIES as a direct charge to the contract. Based upon our previous discussion – is this an allowable appropriate methodology for charging things like pens and pencils, paper, and

²⁰ FAR 45.102(a)

²¹ Note – while performing one and only one contract under that corporate entity things are fine – but if they are awarded a SECOND contract under that corporate entity -- now things can get really interesting due to the cost principles and determining allocability to which contract or contracts.

let's go to the extreme... toilet paper, i.e., the contractor is direct charging ALL administrative and even custodial supplies. Is this allowable?

ONE LAST TIME – IT DEPENDS!!!

If the contractor has DISCLOSED in its disclosure statement that this is the methodology that will be applied – yes, it is allowable – though always subject to Defense Contract Audit Agency (DCAA) review and determination and ultimate referral to the CO to make a determination. My problem with contractors acquiring and charging, DIRECT CHARGING this stuff to the contract is it now becomes Government property – and even though it is low value, VERY LOW VALUE property, they are still required to have a record for it. A record for its acquisition, its receiving, a record while it is in the stock room and a record to show it was issued (And even then potentially subject to a consumption analysis under the PMSA).

The contractors tell me, “Doug, wait, we don’t keep records of THAT stuff – there is no value to that action!”

And I would like to cut them some slack, but the FAR requirement establishes NO MINIMUM THRESHOLD for accounting for Government property. The FAR states, “(iii) Records of Government property. The Contractor shall create and maintain records of

ALL (Emphasis added) Government property accountable to the contract, including Government-furnished and Contractor-acquired property.”²² So, in the words of Phil Donahue, IRREGARDLESS of DOLLAR VALUE – a record must be created for this property.²³ The Property Administrator DOES NOT have the AUTHORITY to diminish this record keeping requirement!!!

“Wait Doug,” the contractor laments, “So you are telling us that we need to establish a record for Pens and pencils and even TOILET PAPER if it is direct charged to a cost reimbursement type contract?”

I do not mean to sound snide or condescending – but, I am not telling you to do anything. Rather, your CONTRACT with the Government Property clause of 52.245-1 is telling you that this is a requirement!

Now, I for one, running a business, believe that there are certain things BEST CHARGED TO OVERHEAD. In the NORMAL course of BUSINESS – these items are charged to overhead. Yet, there are a few companies that choose to charge them direct to their cost reimbursement type contract – and then are concerned when the Government asks for those records. MY OPINION is that this would be better charged to an INDIRECT account or OVERHEAD account that was charged indirect – such that these items were CONTRACTOR property.

²² FAR 52.245-1(f)(1)

²³ Sorry, a little bit of humor. Yes, I know that there is no such word as IRREGARDLESS!!! But I hear it ALL of the time. Phil Donahue Under the Air Force it is DISIRREGARDLESS – the DIS and the IR cancel out and therefore it is REGARDLESS!!!

Even worse (Though I do not recommend doing this) -- how, during a Government Property Administrator's Property Management System Analysis would the contractor show that this property was "consumed" for this instant contract? Yes, if the contractor has only ONE CONTRACT then the assumption is that this property was ONLY used/consumed under this one contract. Ahhhh, but if there are two contracts – how do you then treat this cost allocation as a direct charge – do you split the purchasing in half? And if this is a Department of Defense (DoD) Contract – it gets a little bit MORE COMPLEX. DoD has the Material Management Accounting System (the MMAS) – DFARS 252.242-7004. How is that "material" handled under THAT system? It gets really messy.

Once again, administrative materials – paper, pencils, pens and the horrible example of toilet paper – in my opinion are better charged INDIRECT to eliminate any argument as to the management of said items. Can I "FORCE" a contractor to handle these items in this way? NO!!! But if they choose to charge them direct I can, as a Government Property Administrator, require that they comply with the Government Property Clause!²⁴

And I always try to determine commercial practice – or in the current vernacular, "Customary Commercial Practice." In other words, I would ask, how do you charge these items in your commercial contracts/applications?

My discussion, so far, has focused on "To WHAT does the Government take title!" I would like to shift gears and for a time focus on the instant in time or the action that provides the trigger for the Government to take title!

WHEN DOES THE GOVERNMENT TAKE TITLE UNDER THE GOVERNMENT PROPERTY CLAUSE?

The Government Property clause provides us five (5) conditions, driven by ACTIONS – actions performed by others or even actions performed by the Contractor, or even an action performed by the Government. These are set forth in FAR 52.245-1(e) – and since we are focusing on Cost Reimbursement type contracts we need to look at paragraph (3). It states,

Title under Cost-Reimbursement or Time-and-Material Contracts or Cost-Reimbursable contract line items under Fixed-Price contracts.

*(i) Title to all property purchased by the Contractor for which the Contractor is entitled to be reimbursed as a direct item of cost under this contract shall pass to and vest in the Government upon the **VENDOR'S DELIVERY** of such property.*

(ii) Title to all other property, the cost of which is reimbursable to the Contractor, shall pass to and vest in the Government upon—

²⁴ And I still want to know how the Government Property Administrator is going to do a consumption analysis of the toilet paper and ensure it was used ONLY for Government business!!! Forgive the scatological humor – it just struck me as funny!

(A) **ISSUANCE** of the property for use in contract performance;

(B) **COMMENCEMENT OF PROCESSING** of the property for use in contract performance; or

(C) **REIMBURSEMENT OF THE COST** of the property by the Government, **WHICHEVER OCCURS FIRST.**

The first instances where the Government takes title to property acquired by the contractor and meeting the Direct Charge issue and the issues of allowability -- **UPON THE VENDOR'S DELIVERY**

Simply put, if the Contractor acquires from one of its vendors or subcontractors – property – property that will be direct charged and is reasonable, allocable and allowable – that property, upon **VENDOR'S DELIVERY** becomes “Contractor acquired property” (CAP) to which the Government has title as Government property!

But, not all property comes from a vendor. The second situation is where Contractors may have their own Stockrooms, supply rooms of material.²⁵ It may have been acquired for the contractor's commercial work and was received, placed in their stockroom and then upon award of that government contract, issued from stock to the assembly or manufacturing or production floor. Under this scenario the contractor may have material on hand, in their company stock or storeroom, which will be issued for use on the Government contract. When that property – generally material – is **ISSUED** from the contractor's stores or stockroom, for use in contract performance – it becomes “Contractor acquired property” (CAP) to which the Government has title as Government property!²⁶

And property, again focusing on material, CONTRACTOR'S MATERIAL may already be out on the factory floor. As such, the third “action” takes place vesting title in the Government. That action -- **COMMENCEMENT OF PROCESSING** of said property. As an example, the shipping department has a rack of lumber. When an item is to be prepared for shipment, as a DIRECT CHARGE to the contract, the shop worker reaches over, grabs a piece of lumber and starts cutting and nailing. It was not received from a vendor accountable to a single contract. It was not formally issued from a stockroom. It was processed, though, and that is when the Government takes title upon the **COMMENCEMENT OF PROCESSING.**

This then takes us back to the issue of payment, in this case **REIMBURSEMENT.** Simply put, to cover the bases, the Government takes title upon reimbursement. When the

²⁵ The intent of the segregation of sentences (i) and (ii) are NOT dealing with the cost or price or charging (Direct or Indirect) as many lawyers have misconstrued. Rather, the parsing deals with WHERE the property is coming from for this use!

²⁶ NOTE – this is NOT the same in a DEPOT situation where the contractor is acting as a depot for the Government.

Government issues and the contractor receives payment for the specific item(s) title vests with the Government.

Lastly, the Government wants to protect its ownership interest in that property at the earliest possible time so it adds the caveat, **“WHICHEVER OCCURS FIRST.”** The

Quick summary -- Government takes title upon:

- Vendor's delivery,
- Issuance,
- Commencement of processing
- Reimbursement,
- Whichever comes first.

CLOSING

Each and every corporation and commercial entity is different and as such needs to establish procedures best suited for its organizational structure. Rather, the belief of the author is that "Good practice is based upon sound theory." One must learn the theoretical constructs before one starts application. "WHY?" is just as important as "HOW" if we are to do our jobs as anything more than automatons!

This paper has attempted to bring to light a number of concepts which are difficult to grasp. Some of them have been misunderstood, others have been misapplied and still others have been ignored, for whatever reason(s). It is always hoped that articles of this nature educate and inform as an encouragement for each of us to seek that continuous improvement in doing our jobs the best that we can ever do. An attribute of professionals is that they are always seeking education, education that is job related as well as education that is external to their field of employment. I encourage you to learn all that you can as it will help not only yourself but all those that you come in contact with.

From a distance, the world of Government property appears to be a smooth, seemingly glassy surface that no one should have a problem traversing. It has been referred to as a low, hanging fruit. I have heard comments such as "Anyone can do Government property. I beg to differ!!! Upon closer inspection that glassy surface has depth and detail to it; Those small fractures, upon closer viewing, become chasms waiting to swallow the unwitting who fall prey to the intricacies of that most delightful world of Government property. I hope that this paper has provided some additional analysis that will help you on your journey. Good luck and God bless in your quest for Holy Grail of Property!

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