The phrase “authority to acquire” is not particularly well-known to most government contracting, accounting, and compliance professionals. You really can’t find it in a solicitation provision or in a contract clause. There’s no particular FAR section or subsection that addresses it. Yet the more we work with government contractors, the more we think it’s a phrase that everybody should have familiarity with. It’s a concept that crosses functions and impacts the adequacy of multiple business systems.

So let’s start with the basics. What the heck does it mean?

We’ll start by quoting from the DoD Guidebook for Contract Property Administration (Draft, dated July 28, 2011) –

Contractors acquire property through various means, including purchase, transfer, and fabrication. A contract might call for new property to be purchased by the contractor for use under the contract. The Government might transfer its own property to the contractor for use under the contract. Or, the contract might call for the contractor to produce—or fabricate—property for the Government. The contractor’s acquisition of property is regulated by FAR 52.245-1, Government Property; the applicable Cost Accounting Standards; and FAR 52.216-7, Allowable Cost and Payment.

Most contractors acquire property through an established purchasing system. Material control organizations initiate purchase requisitions (PRs), which are then submitted to the contractor’s purchasing function. Source documents include Military Standard Requisitioning and Issue Procedures (MILSTRIP) requisitions, purchase orders, transfer documents, petty cash documents, and fabrication orders. Supporting documents include purchase requisitions and engineering change proposals (ECPs).

In that Guidebook, the Government Property Administrator (PA) is told to “examine requisition and fabrication procedures,” and is directed to test to ensure that the contractor “has contractual authority for the acquisition of property, including property obtained from Government supply sources.” Thus, we will henceforth call that contractual authority for acquisition of property the “authority to acquire,” meaning that the terms of the prime contract (or higher tier subcontract) gives the entity performing the contract the authority to procure the stuff necessary to execute the contract’s (or subcontract’s) Statement of Work (SOW).

In other words, “authority to acquire” means that what is acquired—and what is charged as a direct contract cost—is within the ambit of the contract’s SOW. Goods and services charged to a contract as direct contract costs must be related to the SOW, as it is the contract SOW that gives the receiving contractor the authority to acquire those goods and services. There must be a clear nexus between the requirements of the contract SOW and the goods or services being acquired and direct-charged to that contract. Conversely, direct-charged goods and services that are unrelated to the SOW thus have been obtained without the requisite “authority to acquire” and, as such, are probably unallowable costs. At least, that’s what we suspect a DCAA auditor would assert.

Goods and services obtained without the authority to acquire are problematic from several different viewpoints. First, they are likely unnecessary costs (in terms of executing the SOW) and drive up costs that might be used as the basis for estimating future costs. In that sense, costs charged to a contract without the authority to acquire could lead to Estimating System deficiencies and/or allegations of defective pricing.

From a financial viewpoint, direct costs that lack authority to acquire can cause significant problems. On fixed-price contracts, such costs erode margin. On cost-type contracts, such costs may (in extreme cases) constitute the basis for an allegation that the False Claims Act has been violated. For either contract type, inappropriately charging direct costs to a government contract creates certain property tax concerns. And we are not even going to mention the cash flow problems.

Acquisitions of goods and services without requisite authority to acquire can also impact other DFARS business systems, including Purchasing and Property Control. For contractors subject to Earned Value Management System requirements, such costs can impact cost and schedule variances as well as estimates-at-complete. To the extent such items were not included in the original program Bill of Materials (BOM), they may create a deficiency in the Material Management and Accounting System.

In sum, goods and services obtained and direct-charged without the requisite authority to acquire can impact every one of the six DFARS business systems. They can impact financial results. They can impact tax reporting. They can, in extreme cases, lead to disputes and litigation. So we think this is kind of a big deal.

Despite the known problems and risks associated with obtaining goods and services without the requisite authority to acquire them, contractors (and their program managers) keep right on doing it. The rationale for continuing the poor behavior ranges from “it’s my program and I’ll buy what I want” to “the customer told me to buy it.” With respect to that latter reason, it’s truly amazing to see the wide variety of items that the customer “told” the contractor to buy. (The direction is rarely, if ever, committed to writing.)

Typically, the customer asks the contractor to buy goods and deliver them because the customer lacks the funding to otherwise acquire them. Or the paperwork is too bureaucratic and the easier solution is to just ask the contractor to take care of it. Computers and cell phones are two items that come immediately come to mind. The customer can’t get the computer he wants when he needs it, so he specs it and tells the contractor to buy it and deliver it. Problem solved! And really, when one is looking at a $10 million (or $100 million) contract, what’s a couple of thousands of dollars more? It’s barely a drop in the bucket; it probably won’t even show up in the variance analysis. So: no harm, no foul. That’s the normal way of such things – even though many rules and regulations exist to prevent just that type of transaction from taking place.

From the contractor’s perspective, the number one job is to keep the customer happy. Is there a contract clause that expressly prohibits providing an extra computer or cell phone? Is there a statute? Does doing so constitute a false claim? If nobody can point to a statute or rule that expressly prohibits doing what the customer requests, the contractor is almost certainly going to say “yes” and acquire the requested computer or cell phone, even though the goods are not strictly required in order to perform the SOW. Again: no harm, no foul. And it may even lead to a better CPARS rating!

But sometimes things go wrong.

We want to tell you an illustrative story of what happens when the contractor goes too far in trying to make the customer happy, when the customer goes too far in requesting goods that never should have been requested. In this particular case, there was harm so there was a foul.

We know there was harm because the Department of Justice **told us** so.

The DoJ announcement told us that “Two Men Plead Guilty in U.S. Department of State Contracting Fraud Scheme and Contractor Cover-Up.” Now, that headline is not particularly unusual these days; we got so tired of writing about procurement fraud that we stopped doing so, except for the very few instances were there may be a lesson to be learned. This is one of those rare instances.

According to the DoJ press release, Tony was a Department of State Contracting Officer’s Representative (COR). In addition to his day job of being a COR, Tony was also an authorized representative for a nutritional supplement company—one of those multi-level marketing companies where people can earn commissions from their sales as well as the sales of others they have enrolled into the pyramid. That wasn’t necessarily a problem for Tony, but he created a problem for himself when he involved one of the Department of State contractors in his sales pyramid. That situation created a prohibited conflict of interest for Tony.

With respect to the contractor, Marvin was a supervisor whose employees purchased the nutritional supplement. Marvin’s problem was that he got his employees reimbursed by his company for the cost they incurred in purchasing the nutritional supplement. The employees were reimbursed and the reimbursed costs were claimed as being allowable direct costs of the Department of State contract, even though there was no authority to acquire and even though the nutritional supplements were obviously unallowable personal expenses. To make matters worse, Marvin “caused false invoices to be made and submitted to the State Department for the cost of the nutritional supplements.” That created a problem for the company.

Getting back to Tony, his conflict of interest became a bigger problem when he “approved the majority of the false invoices” in his official capacity as COR. The value of the false invoices was more than $170,000. Tony “earned commissions in excess of $25,000“ from the purchases made by Marvin’s employees.

To the contractor’s credit, an internal investigation uncovered the foregoing scheme and the company reported it pursuant to the Mandatory Disclosure Program. However, a further problem arose when the company (former) President, Curtis, allegedly decided to edit the disclosure made to the State Department so as to “omit facts related to the fraud,” such as Tony’s role in approving the false invoices. Allegedly, Curtis did not timely disclose all relevant facts and that created a problem for him.

To sum this story up, the COR requested that the contractor obtain goods for which there was

no authority to acquire. Indeed, these goods were not only unnecessary for contract performance, they were unallowable personal items. The company supervisor approved reimbursement for the employees' expenses and direct-charged the costs to the contract, and then submitting invoices to the Government that included the unallowable costs. The Government COR approved the invoices, knowing they included the unallowable costs, and personally profited by doing so. When the company discovered the scheme, the company President allegedly edited the disclosure letter to omit facts that would have pointed to the COR's role, presumably in the name of maintaining good customer relationships.

What happened to Tony, Curtis and Marvin?

Tony pleaded guilty to one count of conspiracy to commit wire fraud and a conflict of interest. He is facing a maximum of 25 years in Federal prison.

Curtis also pleaded guilty and faces a maximum of 5 years in Federal prison.

Marvin pleaded not guilty to charges of wire fraud and conspiracy to commit wire fraud, and is awaiting trial.

Any charges and/or settlements pertaining to the contractor were not disclosed in the DoJ press release.

This is not a good story. But it is an illustrative story. It's an extreme example of the slippery slope a contractor is on, when it elects to obtain goods and/or services, and treat the costs of those goods and/or services as direct contract costs, when the contractor (or subcontractor) lacks "authority to acquire."