In August, 2009, we **reported** on a proposed FAR rule that looked very much as if it would have required Contracting Officers to exclude from profit consideration "all contractor-acquired property, unless an item is expressly called-out as a contract deliverable," when establishing pre-negotiation profit objectives. Well, the **final rule** was published on July 2, 2010 and, while it contained some changes from the proposed rule, it still contained some troubling language.

First, as we noted in our article, the location of the proposed profit language seemed illogical. We were pleased to note that the FAR Councils relocated the profit language from 15.404-4(a)(3) to 15.404-4(c)(3).

Several commenters disagreed with the elimination of profit on contractor-acquired property. The FAR Councils heard the objections and modified some aspects of the proposed rule. But they left intact the elimination of profit/fee on items that the contractor acquires, where those items are not part of a deliverable.

The final rule now states—

15.404-4 Profit.

* * * * *

(c) * * *

(3) * * * Before applying profit or fee factors, the contracting officer shall exclude from the pre-negotiation cost objective amounts the purchase cost of contractor-acquired property that is categorized as equipment, as defined in FAR 45.101, and where such equipment is to be charged directly to the contract. * * *

The term "equipment" is defined as—

Equipment means a tangible item that is functionally complete for its intended purpose, durable, nonexpendable, and needed for the performance of a contract. Equipment is not intended for sale, and does not ordinarily lose its identity or become a component part of another article when put into use. Equipment does not include material, real property, special test equipment or special tooling.

Why did the FAR Councils take this approach? As they wrote in the promulgating comments—

While the application of this policy tended to be obfuscated by the term ‘facilities,’ the underlying principle was clear--that when the contractor buys equipment or acquires real property on a ‘pass through’ basis, i.e., when not part of a deliverable, it is the Government--not the contractor--who assumes the risk. Moreover, it is generally held that upon contract award, contractors are required to furnish all property necessary to perform Government contracts (FAR Part 45.102) as well as all the necessary resources needed for contract performance (FAR 9.104-1(f), General standards).

Accordingly, it is not appropriate for the Government to include the cost of contractor acquired property (equipment) when calculating the Government's pre-negotiation profit or fee objective. Including such costs would unduly compensate the contractor for obtaining equipment it should already have; and for risks it did not incur. This is a long held view; however, up until the publication of the proposed rule FAR Case 2008-011, it had not been adequately addressed in the

FAR.

This policy does not exclude the otherwise allowable cost of depreciation under FAR 31.205-11.

Accordingly, contractors now have a clear disincentive to direct-charge costs of purchasing equipment to their Government contracts. Instead, we should expect them to include such costs in their overhead rates, as depreciation. However, given DOD's recent **emphasis** on curbing contractor overhead, this strategy has its own pitfalls.

The new rule contains much more than the policy statement noted above. But this is the one that caught our eye. Interested readers should follow the link above and review the multi-faceted rule in its entirety.