

APTAC Body of Knowledge Competency Guide

C. Basics of Contracting with Government Entities

C.3.1 Supply Chain Management

Description

The “Supply Chain” consists of purchases made to inventory and other indirect costs, and purchases made to support specific projects. Of the latter, some projects are government funded and some are private sector business. Depending on the company's accounting system, purchases made to inventory are typically costed out when the materials are drawn from inventory and supplied to the point of use, and the value of residual inventory is an asset. Thus, purchases made for inventory replenishment are purchases of assets, not expenses. These matters should be clearly defined and clarified by the company's accounting resource. This section is limited to supply chain as it relates to the government contracting market. Body of Knowledge sections, C.14, Subcontracting B.3.2 Manufacturing and B.3.3 Quality Systems may also provide information related to the Supply Chain function. Companies should have written purchasing procedures. SBA's Small Business Development Centers (SBDC) can help setting them up.

PTAC Counselors should clearly understand the Supply Chain as it pertains to Government procurement and counsel clients accordingly, specifically the following requirements that are unique to federal and some state or local government contracts:

- **DPAS Rating.** "The Defense Priorities & Allocations System Program is used to prioritize national defense-related contracts/orders throughout the U.S. supply chain in order to support military, energy, homeland security, emergency preparedness, and critical infrastructure requirements. The DPAS can also be used to provide military or critical infrastructure assistance to foreign nations." Further explanation is at FAR 11.6 and agency supplements. Federal contractors and subcontractors at any tier, including suppliers, must comply with the DPAS rating if one is specified. For example, on SF1449, if Block #13a is checked, the rating will have been filled in at Block #13b. The rating will be either DO or DX followed by a number. DO means the order has the same priority as all other DO orders and has preference over unrated orders. DX means the order has the same priority as all other DX orders and has preference over DO orders and unrated orders. The customer should be asked to specifically interpret the rating, especially on flow-down orders, since penalties for violation can be severe and lack of knowledge is not forgiven.
- **Socio-economic policy.** In federal procurements, when receiving an order that is set-aside to a specific group, it must be determined whether it is a partial or total set-aside, and if it applies when placing orders to suppliers further down the chain. See FAR clause references to 52.125-22, 52.215-23, 52.219-14, 52.219-6(d), 52.219-7(c). A total set-aside that flows to all tiers may mean that even commercial manufactured products must be produced by the socio-economic group specified in the set-aside, or permission must be requested in advance when no such source is available or acceptable, and

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“exceptions” must be carefully documented. Other considerations include Limitations on Pass-Through Charges, Limitations on Subcontracting, and the Non-Manufacturer Rule.

- **Competition.** Some customers require their suppliers to adhere to competitive procurement practices. This means prospective government contractors need to know how to properly document deviations, such as "Justification For Non-Competitive Procurement" which should be accompanied by two supporting documents, "Justification of Non-Competitive Source" and "Justification of Non-Competitive Price". The terms "sole source", "selected source" and "single source" are often used interchangeably, which is not correct. "Non-competitive" is the correct generic term, and the justification must explain whether other sources are available but not technically capable, or other sources are available but not in the socio-economic set-aside group, or no other sources can provide the product at all, or no other source can meet an expedited schedule required by the customer. Note that failure to plan ahead is not an emergency and does not justify lack of competition based on schedule. All contractors & subcontractors should have a written procurement policy that describes the process of qualifying sources and established threshold(s) at which formal competitive purchasing processes are invoked, and what those practices are.
- **Flow-down clauses.** Government contractors often fail to notice that their order from the government customer contains clauses (often incorporated by reference and not provided in full text) that are required to be included in the client's purchase orders to lower tier suppliers. If the company is a subcontractor, their prime contractor may have flowed down FAR clauses improperly that the client must flow down to its supplier even if they don't apply. Such practices increase the cost of doing business, and clients should be educated in how to negotiate with their customer to remove unnecessary flow-down requirements.
- **Shipping terms.** The FOB point is not just about paying the freight, it is also about transfer of title and responsibility for risk of loss in transit. Government usually prefers FOB Destination, which means the shipping company is responsible for cost of whatever method of shipping is needed to ensure delivery by the required date, and the contractor is responsible for loss or damage in transit, including filing the claim with the carrier. For example, on SF1449, the delivery date is in Block #11 which assumes the FOB point is destination unless "see schedule" is checked to indicate a different FOB point is specified elsewhere in the order, and the delivery location is in Block #15.
- **Payment terms.** On SF1449, Block #12 contains the prompt payment discount, which means that the supplier offers to reduce the price by the specified percentage if paid within the specified days. Small businesses need to be paid within 30 days from delivery and acceptance, so this discount should not be offered to the government unless they

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really need the money sooner. Some suppliers may demand payment sooner, which means cash flow could become troublesome unless better payment terms are negotiated in both directions.

- **Inspection.** Hold points may be specified in the contract from the government, which means production must stop until the government inspector approves the work done so far, and if production did not stop at the "hold point", the supplier has to pay any costs associated with undoing the work to be inspected. When this requirement affects work to be performed by a supplier, the purchasing company must maintain control and ensure the government representative and the sub-supplier's representative communicate only through channels of contracting authority. Sometimes the purchasing company fails to recognize this responsibility, and the other parties incur costs that the purchasing company has to pay for.
- **Inventory.** Employees of companies within the supply chain must be trained in material handling procedures and documentation. Purchases made to inventory that are intended to be used on government sales should be kept separate from inventory intended for private-sector sales. Purchases made specifically in support of one government contract but held in storage until needed must be segregated in a designated enclosure. If these latter purchases are billed to the government upon receipt into storage, the client must determine when title passes which is usually when responsibility for risk of loss or damage passes. Items paid for by the government are usually subject to government property regulations. Note: This may only apply in a cost-reimbursable type contracts – fixed price contracts should not require these measures.

The above are some examples of Supply Chain Management issues that are unique to the federal government marketplace, which may increase the cost of doing business due to unfamiliar documentation and material handling procedures. PTAC Counselors should advise clients to adjust their price list or profit margin accordingly.

References and resources

Uniform Commercial Code

Federal Acquisition Regulation and agency supplements

Clauses and provisions in individual contracts and solicitations

Terms and conditions of purchase orders from government contractors

DPAS: <http://www.bis.doc.gov/index.php/other-areas/strategic-industries-and-economic-security-sies/defense-priorities-a-allocations-system-program-dpas>