



REPLY TO
ATTENTION OF

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY OF THE ARMY
FINANCIAL MANAGEMENT AND COMPTROLLER
100 ARMY PENTAGON
WASHINGTON DC 20310-0109

MAR 28 2007

MEMORANDUM FOR LIEUTENANT GENERAL R. STEVEN WHITCOMB
COMMANDER , THIRD ARMY / US ARMY CENTRAL
1881 HARDEE AVENUE SW
FORT MCPHERSON, GA 30330-1064

SUBJECT: Funding Guidance for Contracts Involving Capital Assets

1. References:

- a. Commander, Third Army/ARCENT memo, subject: Request Exception to Policy for Capital Leases Under OMB Circular No. A-11, undated
- b. Commander, Multi-National Corps-Iraq memo, subject: Request for Guidance on and/or Relief from Fiscal and Budgetary Procedures in Support of Operation Iraqi Freedom, dated 12 January 2007
- c. OMB Circular A-11, Preparation, Submission and Execution of the Budget, Appendix B - Budgetary Treatment of Lease-Purchases and Leases of Capital Assets, 30 June 2006
- d. Defense Financial Management Regulation (FMR) 7000.14, Volume 2A - Budget Formulation and Presentation, June 2006
- e. Defense Financial Management Regulation (FMR) 7000.14, Volume 4 - Accounting Policy and Procedures, January 2007
- f. DoD Office of General Counsel memo, subject: Logistics Civil Augmentation Program (LOGCAP) Funding, dated 7 March 2006 (Enclosure 3)

2. This memo offers guidance to ARCENT activities to determine the type of funding used for specified in-theater service contracts that involve capital assets. It is provided in response to ARCENT and MNC-I requests for assistance to resolve funding dilemmas associated with the lease of capital assets in theater. Two major leasing actions are addressed: Prime Power Generation Equipment and Dining Facilities. The review of the Non-Tactical Vehicles (NTV) leasing situation continues.

3. As a preamble to the specific discussion and guidance on the two leasing actions, the following clarification on regulatory guidance is provided:

- a. FMR, Vol. 2A, Chap. 1, Section 010201 sets forth the historical funding policy for leases, defining "rental charges for equipment and facilities" as an expense, and thus properly funded in Operation & Maintenance (or RDT&E, when appropriate). Note that Section 010201 makes no distinction between operating and capital leases. Therefore, where a true leasing arrangement has been entered into under proper authority (either an annual lease with options to renew or a multi-year lease where statutory authority for such a lease exists), the O&M appropriation (or RDT&E, when appropriate) will normally be the proper funding source. Annual lease payments should be obligated and expended against current year funds, and neither the funding source nor the obligational requirements will change simply because lease payments may ultimately "exceed the 90 percent threshold" of OMB Circular A-11, Appendix B, or the criteria in the FMR Vol. 4, Chap. 7, Section 070207. As part of entering into any lease, funds must be committed in amounts sufficient to cover potential termination liabilities.
- b. There appears to be a broad-based misunderstanding of OMB Circular A-11 scoring rules and their application to the lease of capital assets. In the ARCENT and MNF-I correspondence provided thus far on the operating/capital lease matter, there is an assumption that an operating lease will turn into a capital lease once lease payments exceed 90 percent of the fair market value of the asset. Whether a lease entered into under an agency's general authority is considered an operating lease or a capital lease for scorekeeping purposes under Appendix B is determined at the time the lease is signed.
- c. In fact, under Appendix B, if the total lease payments under the full term of the lease (assuming the exercise of all options) will exceed the 90 percent threshold, the lease will be considered a capital lease for scorekeeping purposes upon signing. The same rule applies for a lease that contains a bargain-price purchase option. Whether lease payments under the lease ever actually exceed the 90 percent point, or whether the purchase option is ever exercised, is irrelevant for scorekeeping purposes. However, as discussed above, whether a lease would be characterized as a capital lease under Appendix B should have little practical impact on operations in the field.
- d. There also appears to be another common misconception, likely based in part on a Defense Federal Acquisition Regulation Supplement (DFARS) provision, DFARS 207.471, that all leases that qualify as capital leases under criteria set out in the FMR, Vol. 4, Chap. 7, Section 070207, must be funded with procurement or military construction funds, as applicable. The FMR provision is based on OMB Circular A-11, Appendix B, which addresses the treatment of capital leases for scorekeeping and accounting purposes. The DFARS provision is part of a contracting regulation. Neither is a primary source of guidance for recording obligations or identifying proper funding sources.

- e. Finally, if the contractual arrangement is, in reality, a purchase (i.e., an installment purchase or lease-to-buy), procurement funds, military construction funds or Contingency Construction Authority, as applicable, will be required. In any of these cases, the full amount of the government's liability under the contract must be obligated upon execution.

4. **Prime Power Generation Equipment**: Enclosure 1 provides a digest, decision, detailed discussion (Background, Management Issues, Technical Issues and Legal Issues) and required command actions. In summary:

- a. Digest: ARCENT requests an operating/capital lease funding determination for a contract for prime power generation equipment at forward operating bases in the theater or an exemption from the capital leasing rules.
- b. Decision: These contracts are for the provision of electrical service, vice lease of specific power generating equipment, and as such should be paid with Operation and Maintenance funding.

5. **Dining Facilities (DFAC)**: Enclosure 2 provides a digest, decision, detailed discussion (Background, Management Issues, Technical Issues and Legal Issues) and required command actions. In summary:

- a. Digest: ARCENT requests an operating - capital lease determination for contracts for dining facilities used in the theater or an exemption from the capital leasing rules.
- b. Decision: These contracts are for the provision of food services, vice the lease of specific facilities, and as such should be paid with Operation and Maintenance funding.

6. Additional Guidance.

- a. If there is a command determination that the U.S. Government's intent is to purchase, own or take permanent possession of the equipment currently under lease, then actions will be initiated to obtain the proper procurement funding. ARCENT G-8 should contact the Army Budget Office to request procurement funding.
- b. If there is a command determination that the U.S. Government's intent is to acquire a facility, and if there are no military construction funds available, then current guidance for the use of Contingency Construction Authority (CCA) should be followed. ARCENT G-8 should coordinate with the Army Budget Office to obtain such authority for the specified facility.

- c. The guidance provided for these three cases necessitates a reemphasis of the careful construction of contracts for the provision of services in the theater. The legal guidelines established by the DoD General Counsel memo at enclosure 4, along with the reasoning and guidance provided in this memo, should be transmitted to the supporting contracting, staff judge advocate and resource management staffs responsible for formulating, reviewing, executing and managing similar contract efforts in theater.

7. This guidance memo has been coordinated with the Army Office of the General Counsel, the Office of the Assistant Secretary of the Army (Acquisition, Logistics and Technology), the G-4, the G-3 and the Army Budget Office. We also consulted with selected officials in the Office of the Under Secretary of Defense (Comptroller) and DoD General Counsel's Office to ensure that this memo's guidance conforms to OSD policy and guidance.

8. The following HQDA functional staff points of contact are available:

- a. Office of the Assistant Secretary of the Army (Financial Management and Comptroller):

- (1) Mr. Joe Hemphill, Army Budget Office - Budget Execution Policy Division, DSN 222-7497, CM 703-692-7497, joseph.hemphill@hqda.army.mil

- (2) Mr. Dave Atherton, Army Budget Office - Investment Division (Other Procurement), DSN 222-4780, CM 703-692-4780, david.atherton@hqda.army.mil

- (3) Ms. Erica Ellis, Army Budget Office - Investment Division (Military Construction), DSN 224-9719, CM 703-614-9719, erica.ellis@hqda.army.mil

- (4) Mr. Brooke Allen, ODASA(Resource Analysis & Business Practices), DSN 222-7871, CM 703-692-7871, brooke.allen@hqda.army.mil

- b. Office of the General Counsel (Ethics and Fiscal Law Section): Mr. Paul Hancq, DSN 225-4296, CM 703-695-4296, paul.hancq@hqda.army.mil
- c. Office of the Assistant Secretary of the Army (Acquisition, Logistics and Technology): Mr. David Mabee, DSN 664-7104, CM 703-604-7104, david.mabee@hqda.army.mil



Nelson M. Ford
Assistant Secretary of the Army
(Financial Management and Comptroller)

3 Enclosures:

1. Digest, Decision, Discussion, Command Action Detail for Prime Power Generation Equipment:
2. Digest, Decision, Discussion, Command Action Detail for Dining Facilities
3. DoD Office of General Counsel memo, subject: Logistics Civil Augmentation Program (LOGCAP) Funding, dated 7 March 2006

Copy Furnished:

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G4

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MNC-I:

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C4

Enclosure 1 – Prime Power Generation Equipment:

1. **Digest:** ARCENT requests an operating/capital lease funding determination for a contract for prime power generation equipment at forward operating bases in the theater or an exemption from the capital leasing rules.
2. **Decision:** These contracts were awarded for the provision of electrical service, vice lease of specific power generating equipment, and as such should be paid with Operation and Maintenance funding.
3. **Discussion:**
 - a. **Background.** Early in the Iraq operation, theater contracting officials processed contracts for the provision of electrical power generation equipment at forward operating bases. At that time it was the command's intent that U.S. forces would temporarily occupy these bases as units conducted their assigned military missions and then vacate the said forward operating bases. Based on the perception that it is leasing a capital asset, the command contends that it is approaching the OMB Circular A-11, Appendix B, capital lease thresholds, and as such requires Procurement funding vice Operation and Maintenance funding for the lease, or an exemption from the OMB capital lease "funding" rules. The command also cites the capital lease guidance laid out in DoD Financial Management Regulation 7000.14, Volume 4 (Accounting Policy and Procedures) to further support its request for either specified procurement funding or an exemption.
 - b. **Technical Factors.** Review of the submitted ARCENT contract documents (e.g., Contract W912BU-04-D-002 issued 12 May 2004 by U.S. Army Engineer District, Philadelphia, to IAP Worldwide Services) indicates that the contracts were awarded for electrical power services and are all-inclusive for the services rendered. The contract stipulates that the contractor is responsible for providing all labor, transportation, equipment and internal logistical support for the provision of electrical power service.
 - c. **Management Factors.** Though the original intent of the contract was to provide electrical service for an undetermined "short" period of time while U.S. forces occupied the forward operating base, the subsequent in-theater strategy for the deployment and basing of U.S. forces has resulted in the continuing use of the designated forward operating bases and thus the electrical power generating service for a longer period than originally envisioned. Nevertheless, there is still uncertainty at this point in time as to usage of the forward operating bases in the future and, as such, it can be concluded that base tenancy remains contingent in nature.

d. Legal Factors.

- (1) ARCENT and MNC-I correspondence on this matter cites the provisions of OMB Circular A-11, Appendix B. This scorekeeping guidance does not control the selection of the proper appropriation (Procurement or Operation and Maintenance) as discussed in paragraph 3 of the base memo.
- (2) Additionally, the ARCENT and MNC-I correspondence cite the Defense Financial Management Regulations (FMR) 7000.14, Volume 4 (Accounting Policy and Procedures) for further provision of regulatory guidance in this matter. Volume 4 provides specific regulatory guidance on the proper accounting treatment for leases. However, Volume 4 does not control the selection of the proper appropriation (Procurement or Operation and Maintenance) as discussed in paragraph 3 of the base memo.
- (3) The 7 March 2006 legal opinion rendered by the DoD Office of the General Counsel (enclosure 3 of base memo) provides the Department's most recent legal guidance for this matter. Though it addresses the fiscal execution for the Logistics Civilian Augmentation Program (LOGCAP) contract, the fiscal principles expounded upon in the opinion, in addition to the guidance provided in the paragraph 3 of the base memo, provide appropriate guidance for resolving this matter. Specifically in the opinion's fifth paragraph:

“Whether a particular...task order in fact constitutes an order for services will depend upon the intent of the government, as evidenced primarily by the task order's terms in context of the contract under which it is issued, including the manner in which the contract allocates business risk between the government and the contractor...Thus where the government intends to acquire logistics or engineering services or supplies, the task order must be funded with O&M appropriations, unless the task order requires the contractor to deliver investment end items that [then] must be funded from procurement appropriations...”

4. Required Command Actions:

- a. Command will continue to use O&M funding for payment of this service contract.
- b. To ensure that there is no confusion concerning the nature of the current contract and the Army's intentions, command, through the appropriate contracting officer(s), will modify the current contract(s) to clarify that the U.S. Government (ARCENT and/or MNF-I) will not purchase the power generating equipment

identified in the contract for the provision of the services rendered, nor will it take possession of the power generating equipment upon completion of the contract.

Enclosure 2 – Dining Facilities:

1. **Digest:** ARCENT requests an operating - capital lease determination for contracts for dining facilities used in the theater or an exemption from the capital leasing rules.
2. **Decision:** These contracts were awarded for the provision of food services, vice the lease of specific facilities, and as such should be paid with Operation and Maintenance funding.
3. **Discussion:**
 - a. **Background.** Early in the Iraq operation, theater contracting officials processed contracts for the provision of dining facilities throughout the AOR. Based on the perception that it is leasing a capital asset, the command contends that it is approaching the OMB Circular A-11, Appendix B, capital lease thresholds, and as such requires military construction funding vice Operation and Maintenance funding for the lease, or an exemption from the OMB capital lease “funding” rules. The command also cites the capital lease guidance laid out in DoD Financial Management Regulation 7000.14, Volume 4 (Accounting Policy and Procedures) to further support its request for either specified procurement funding or an exemption.
 - b. **Technical Factors.** Review of the ARCENT submitted contract documents (e.g., Subcontract Number 02HU-VC-SDF0768 let to subcontractor Tamimi Global Co, Ltd, by prime contractor Kellogg Brown and Root under its LOGCAP III contract DAAA09-02-D0007) indicates that the contracts were awarded for food services and are all-inclusive for the services rendered. According to the contract, the vendor is responsible for providing (where necessary) facilities to render the food services to military forces at various locations in the AOR. The contract stipulates that the contractor is responsible for providing all labor, transportation, equipment and internal logistical support for the provision of food services. The lease does not have a purchase option nor is there an implied intent to purchase. The DFAC lease is actually part of a larger contract for food services. In other words, intent of the contract, and therefore of the Army, was to procure food services and not facilities. This is clearly evident in the cost schedules contained in the contract, with only a fraction of the total overall costs going to actual lease costs.
 - c. **Management Factors.** The intent of the contract was to provide meal services for an undetermined period of time while U.S. forces and their supporting logistical operations conducted in-country operations.
 - d. **Legal Factors.**

- (1) ARCENT and MNC-I correspondence on this matter cites the provisions of OMB Circular A-11, Appendix B. This scorekeeping guidance does not control the selection of the proper appropriation (Procurement or Operation and Maintenance) as discussed in paragraph 3 of the base memo.
- (2) Additionally the ARCENT and MNC-I correspondence cite the Defense Financial Management Regulations (FMR) 7000.14, Volume 4 (Accounting Policy and Procedures) for further provision of regulatory guidance in this matter. Volume 4 provides specific regulatory guidance for the proper accounting treatment of leases, but it does not control the selection of the proper appropriation (procurement or Operation and Maintenance) as discussed in paragraph 3 of the base memo.
- (3) The 7 March 2006 legal opinion rendered by the DoD Office of the General Counsel (enclosure 3 of base memo) provides the Department's most recent legal guidance for this matter. Though it addresses the fiscal execution for the Logistics Civilian Augmentation Program (LOGCAP) contract, the fiscal principles expounded upon in the opinion, in addition to the guidance provided in paragraph 3 of the base memo, provide appropriate guidance for resolving this matter. Specifically, in the opinion's fifth paragraph:

“Whether a particular...task order in fact constitutes an order for services will depend upon the intent of the government, as evidenced primarily by the task order's terms in context of the contract under which it is issued, including the manner in which the contract allocates business risk between the government and the contractor...Thus where the government intends to acquire logistics or engineering services or supplies, the task order must be funded with O&M appropriations, unless the task order requires the contractor to deliver investment end items that [then] must be funded from procurement appropriations...”

4. Required Command Actions:

- a. Command will continue to use O&M funding for payment of this service contract.
- b. Contingency Contracting Authority. If there is a subsequent determination to acquire a facility, a properly documented request for Contingency Contracting Authority should be forwarded through channels to the Army Budget Office.

Enclosure 3 – DoD Office of General Counsel memo, subject: Logistics Civil Augmentation Program (L



DEPARTMENT OF DEFENSE
OFFICE OF GENERAL COUNSEL
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WASHINGTON, DC 20301-1600



MAR 07 2006

MEMORANDUM FOR OFFICE OF THE LEGAL COUNSEL TO THE CHAIRMAN,
JOINT CHIEFS OF STAFF (ATTN: COL T. AYRES)

SUBJECT: Logistics Civil Augmentation Program (LOGCAP) Funding

This responds to your memorandum, subject as above, dated 1 November 2005, requesting this office's opinion regarding the proper funding source for LOGCAP contracts under which the contractor's performance entails (1) military construction costing more than the statutory ceiling on the use of operation and maintenance (O&M) funds for unspecified minor military construction projects; or (2) the expense-investment threshold applicable to the purchase of items. We recognize the uncertainty surrounding this complex issue, as commanders and contracting officers strive to support soldiers executing ongoing military operations in two active combat zones. This opinion clarifies relevant fiscal and contract law principles and establishes a common understanding of how these principles should be applied in administering the LOGCAP.

The Army established the LOGCAP in 1985, as a means to "preplan for the use of civilian contractors to perform selected services in wartime to augment Army forces." Army Reg. (AR) 700-137, *Logistics Civil Augmentation Program (LOGCAP)*, para. 1-1 (1985). Importantly, contracts for obtaining logistics and engineering services and supplies under LOGCAP are not subject to special treatment under the law: they must be formed, funded, and executed in accordance with the laws and regulations governing government contracts generally. Thus, the Army's implementing policies and procedures provide that LOGCAP contracts shall be planned and executed under the authority of the Federal Acquisition Regulation (FAR), Defense Federal Acquisition Regulation Supplement (DFARS), and the Army Federal Acquisition Regulation Supplement (AFARS). *Id.*, at paras. 1-4k.(2) and 3-1d. Further, guidance promulgated by the U.S. Army Corps of Engineers notes that "[t]here are no special fiscal rules when using LOGCAP" and that "[f]unds used to finance work ordered and accomplished under the LOGCAP contract must comply with all normal fiscal rules and restrictions associated with the appropriation(s)" as it is "important that the correct 'color' of money be provided to finance work." EP 500-1-7. This guidance is accurate, and should be followed.

As a general proposition, an agency's operating appropriations are legally available for the acquisition of services and supplies that are necessary to carry out its day-to-day operations, and for which funds are not otherwise provided. *See, e.g., Ms. Comp. Gen. B-303170* (Apr. 22, 2005). Therefore, the Operation and Maintenance, Army (OMA) appropriation is the proper source of funding for task orders issued under LOGCAP contracts, provided the task order under the contract is for logistics or engineering services or supplies in support of military operations, rather than investment end items or



construction. A contractor's election, for its own account, to purchase what in government practice would be investment end items or engage in construction, in order to perform under a proper LOGCAP services task order, is not subject to the monetary limits prescribed by section 8036 of the DoD Appropriations Act, 2006, or title 10, United States Code, section 2805(c). These restrictions are not intended to constrain private contractors in exercising their judgment as to the best means of providing services to the government.

Several Government Accountability Office (GAO) reports describe the construction activities and purchase of high-value material that contractors routinely undertake in performing services under O&M-funded LOGCAP contracts. *See, e.g.,* GAO/NSIAD-97-63, *Contingency Operations: Opportunities to Improve the Logistics Civil Augmentation Program* (February 1997); GAO-04-854, *Military Operations: DoD's Extensive Use of Logistics Support Contracts Requires Strengthened Oversight* (July 2004); GAO-05-328, *Defense Logistics: High-Level DoD Coordination is Needed to Further Improve the Management of the Army's LOGCAP Contract* (March 2005). Congress' continued appropriation of funds that are obligated for LOGCAP, presumably with knowledge of these reports, does not amount to ratification by appropriation, however; the government still must abide by statutory restrictions related to the obligation of appropriated funds, and may not accomplish indirectly through LOGCAP contracts a purpose it could not accomplish by direct expenditure. *See, e.g.,* 1 Government Accountability Office (GAO), *Principles of Federal Appropriations Law*, 4-9 (3d ed. 2004).

Whether a particular LOGCAP task order in fact constitutes an order for services will depend upon the intent of the government, as evidenced primarily by the task order's terms in the context of the contract under which it is issued, including the manner in which the contract allocates business risks between the government and the contractor. The proper funding for the order should be determined at the time funds are obligated. Thus, task orders "must be carefully drafted to specify the services required and the conditions under which they will be required." AR 700-137, para. 3-1d. In preparing task orders for services to be funded with O&M appropriations, contracting officers should consider Federal Acquisition Regulation (FAR) Clause 52.245-5, and the implications of cost provisions that vest in the government title to contractor-purchased property. Whether title to such property vests in the government, however, is only one factor that must be considered in determining proper funding. Other factors include the government's intent, the type of performance required under the task order, and the manner in which business risks are allocated between the government and the contractor. Thus, where the government intends to acquire logistics or engineering services or supplies, the task order must be funded with O&M appropriations, unless the task order requires the contractor to deliver investment end items that must be funded from procurement appropriations, or construct facilities that exceed statutory ceilings on O&M-funded construction, or the contractor is entitled to be reimbursed for the costs of such items or construction as direct items of cost. Consequently, task orders for tactical, support, and non-tracked combat vehicles must be funded with Other Procurement, Army (OPA) funds.

Similarly, task orders that require the construction of base facilities at a cost that will exceed the threshold for O&M-funded minor military construction normally will require military construction (MILCON) appropriations or exercise of the Department's temporary, limited authority under section 2809 of the National Defense Authorization Act for Fiscal Year 2006 to use O&M funds for construction projects outside the United States.



Douglas P. Larsen
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