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A Business Manager's Guide to the Bona Fide Needs Rule

By Catherine Poole

The *bona fide needs rule* is a fundamental principle of appropriations law, widely applicable to acquisitions of goods and services and the associated obligation of funds. Yet, it is among the least understood of the myriad of rules that pertain to a contract award. The rule often becomes the focus of increased attention during the last quarter of a fiscal year.

This Advisory explores the rule and its application, and shares lessons learned from GAO Comptroller General decisions.

What is the bona fide needs rule?

The *bona fide needs rule* is a rule of appropriations law. It mandates that a fiscal year's appropriations *only* be obligated to meet a legitimate—or *bona fide*—need arising in (or sometimes before) the fiscal year for which the appropriation was made. It restricts *this year's* appropriated funds from being used to fund *next fiscal year's* requirements. Annual funds appropriated for Fiscal Year 2003 (FY2003) are to be used to fund a legitimate or genuine FY2003 need ... and are *not* to be used to fund a need the agency won't genuinely have until FY2004.

What is the applicability of the rule?

The rule applies not only to contracts, but to all federal government activities carried out with appropriated funds, including contract, grant, and cooperative agreement transactions. It is applicable to both *annual* and *multi-year* funds. Annual funds are funds appropriated for a specific fiscal year, while multi-year funds are available for obligation for a definite period of time that exceeds one fiscal year.

What is the origin of the rule?

The *bona fide needs rule* has a statutory origin. The first general appropriation act in 1789 made appropriations "for the service of the present year," and this concept continues to this day. The concept is codified in 31 U.S.C. 1502(a), often referred to as the bona fide needs statute. The General Accounting Office's *Principles of Federal Appropriations Law*¹ provides a legal background and discussion of the rule, including analysis of associated Comptroller General decisions through 1991.

How is the rule applied?

The rule *sounds* simple enough and *can be* simple to apply ... *when* the entire transaction—contract award, performance or delivery, and payment—occurs during the same fiscal year. For example, if an agency has a requirement for ten desktop computers for new employees and is able to award a contract (or order) obligating funds, take delivery, and make final payment during the same fiscal year, compliance with the bona fide needs rule is clear.

Proper adherence to and implementation of the rule, however, become more challenging as requirements overlap fiscal years. Even more challenging is the proper application of the rule for services.

Can service contracts cross fiscal years?

Yes, contracts for services may be awarded in one fiscal year with performance continuing into the next fiscal year. However, agencies must properly determine which fiscal year's funds will cover the cost of the services when those services are performed in a fiscal year subsequent to contract award.

How does the bona fide need rule apply to services that cross fiscal years?

It depends upon whether the services are considered “severable” or “non-severable.”

- **Severable services** are services that are continuing and recurring in nature—such as lawn maintenance, janitorial services, or security services—where an agency realizes a benefit at the time that services are provided even if the contract has not been performed to completion. Services are considered severable if they can be separated into components that independently provide value to meet an agency's needs.
- **Non-severable (or “entire”) services** represent a single undertaking that cannot be feasibly subdivided. If the services produce a single or unified outcome, product, or report, the services are considered non-severable. An example would be a consulting study, conducted over several months, but culminating in the delivery of a final report.

For a non-severable service (think “consulting study”), agencies may obligate the funds of this fiscal year to cover the services to be performed under the full contract ... even that portion of the services that will be performed next year. The entire non-severable service is considered a *bona fide need* of the fiscal year in which the agency entered into the contract.²

For severable services, agencies may enter into a contract that crosses fiscal years and that obligates

Proper adherence to and implementation of the rule ... become more challenging as requirements overlap fiscal years.

funds of the fiscal year in which the contract was awarded *for the entire period of performance...* as long as the basic contract, option, or order does not exceed one year each. In other words, agencies may enter into a “severable service” contract this fiscal year—which is a bona fide need of *this* year—and the services may cross fiscal years to *continue performance* into the following fiscal year, with all services chargeable to the award year's appropriation.

Has this always been the rule for severable services?

No ... and this is why there is often confusion in this area. Prior to 1995, severable services were required to be paid out of appropriations for the fiscal year in which the services were *actually performed*. Before that time, contracts for services funded by *annual* appropriations were precluded from extending beyond the end of the fiscal year of the appropriation except when authorized by law. This is the reason that we often saw awards for services—even awards made in July or August—established with initial periods of performance for “date of award through September 30th.” The first “option” year would often start on October 1st ... although it was only a month or two after the date of contract award. This led to an overwhelming workload in the last month of the fiscal year, as acquisition officials worked to exercise options and award new contracts that corresponded to the fiscal year.

The Federal Acquisition Streamlining Act of 1994 (FASA), implemented in 1995, provided the legal authority for services to extend beyond the end of the fiscal year of the appropriation ... for agencies other than the Department of Defense, United States Coast Guard, and the National Aeronautics and Space Administration (NASA). The authority (codified in 41 USC 2531) allowed agencies *to write service contracts that cross fiscal years, and to fund those contracts with one fiscal year's funds*. This new authority allowed most agencies to simplify the contracting for, and administration of, service

contracts by allowing single, fully funded contract actions, in lieu of multiple contracts or complex obligation arrangements. This new authority significantly simplified and streamlined the contracting process in this area.

The Federal Acquisition Regulations were revised³ in July 1995, to read in part as follows:

A contract that is funded by annual appropriations may not cross fiscal years, except in accordance with statutory authorization ... or when the contract calls for an end product that cannot feasibly be subdivided for separate performance in each fiscal year (e.g., contracts for expert or consultant services).

Federal Acquisition Streamlining Act of 1994 ... authorizes heads of executive agencies other than the Department of Defense, United States Coast Guard, and the National Aeronautics and Space Administration ... to enter into a basic contract, options, or orders under that contract for procurement of severable services for a period that begins in one fiscal year and ends in the next fiscal year if the period of the basic contract, options or orders under that contract does not exceed one year each. Funds made available for a fiscal year may be obligated for the total amount of an action entered into under this authority ...

To illustrate, agencies can now write a contract for performance beginning on August 1, 2003 and ending on July 31, 2004 (a one-year period), and fund all work under the contract out of a fiscal year 2003 appropriation.

Did DoD, Coast Guard, and NASA finally get the same authority?

In 1998, with the regulations implementing Section 801 of the National Defense Authorization Act for Fiscal Year 1998 (10 USC 2410a), the *Coast Guard and DoD* were authorized to enter into contracts for severable services for a period that begins in one fiscal year and ends in the next one, obligating funds of the first fiscal year, as long as the period of the contract (or order) does not exceed one year. As of this writing, the FAR continues to allow this authority for the heads of executive agencies, “except NASA.”⁴

For a non-severable service whose performance will cross fiscal years, are we *permitted* to fund the contract with funds from both fiscal years?

No. The Adequacy of Appropriations Act (41 USC 11) requires that “No contract or purchase on behalf of the United States shall be made, unless the same is

authorized by law or is under an appropriation adequate to its fulfillment...”⁵ Appropriations must be adequate to fully fund the contract at award. The Act prevents incremental funding of a non-severable task. A non-severable consulting study, for example, must be fully funded at award.

Can we award an indefinite delivery contract or blanket purchase agreement this year in anticipation of issuing orders next year?

Yes and no. If *any* funds will be obligated this fiscal year, the requirement must represent a bona fide need of *this* fiscal year. Keep in mind that the bona fide need rule applies specifically to the obligation of appropriated funds ... whether they are obligated via a contract, task order, or order under a blanket purchase agreement (BPA).

An agency could feasibly award a BPA this year for anticipated needs of next year, within the confines of the bona fide needs rule. This is possible because BPAs do not obligate funds ... they are simply charge accounts establishing the terms and conditions for future orders. Task orders placed under the BPA obligate the funding. As long as the order—hence, obligation—is placed during a year for which there is a bona fide need, this strategy is workable.

An indefinite delivery, indefinite quantity (ID/IQ) contract, on the other hand, obligates the government to expend funds to cover the guaranteed minimum quantity. FAR Part 16 *requires* that ID/IQ contracts specify a guaranteed minimum quantity that the government will order under the contract. Because an ID/IQ contract obligates the government to spend the guaranteed minimum amount, the contract itself must represent a bona fide need of the fiscal year in which it is awarded.

(The) bona fide need rule applies specifically to the obligation of appropriated funds ... whether they are obligated via a contract, task order, or order under a blanket purchase agreement (BPA).

How does an agency determine if a requirement is a bona fide need?

There is no cut-and-dried answer to this question. What constitutes a bona fide need of a particular fiscal year, in GAO's words, "depends largely on the facts and circumstances of the particular case." For services, whether they are severable or non-severable is a factor, as discussed above. But other factors come into play, as well. What if a service is needed this year, but cannot be performed by the contractor until next year? In one scenario, an agency issued a purchase order for a doctor's examination to establish an individual's eligibility for a disability benefit, but the doctor could not provide the services for several weeks ... into the next fiscal year. In such a case, the need for the service arose when the individual presented his claim for disability benefits, and the charge was considered a bona fide need of the fiscal year in which the order was placed.⁶

The determination of what constitutes a bona fide need of the agency for the fiscal year ultimately requires the application of business judgment and is the responsibility of the contracting agency. However, some case precedent has been set. Read on.

How does the bona fide need rule apply to training?

GAO has determined that "training tends to be nonseverable (or entire)." Where a training obligation is incurred in one fiscal year, the entire cost is chargeable to that year, regardless of the fact that the training may not be completed until the following year.⁷ GAO has held that even if a training class does not begin until "early in the next fiscal year," an agency may charge funds current at the time it enters into the training obligation so long as it has a valid need for the training at that time and the delay between the obligation and the start of the training is not excessive.

As an example, an agency requested GAO's advance decision on whether it could obligate its fiscal year funds in advance for the full cost of the two-year training program administered by the Office of Personnel Management (OPM) for the Presidential Management Intern (PMI) program. GAO ruled that

the OPM training may be viewed as an entire, nonseverable undertaking, and thus, a bona fide need of the fiscal year in which the agency appointed the intern to the program.⁸

How is the rule applied to supplies delivered in a subsequent fiscal year?

The government may only obligate a fiscal year's funds for supplies if they are a bona fide need of the current fiscal year. But quite often the supplies are not delivered until the next fiscal year has started. In determining the fiscal year from which payment should be made—in other words, the year for which there was a bona fide need for the supplies—it is appropriate to consider three things:

- (1) the necessary order lead-time,
- (2) the extent to which the supplies are consumable, and,
- (3) the appropriate stock level.

It is appropriate and reasonable to place an order in one fiscal year when supplies will not be delivered until the following fiscal year *if* the items were genuinely needed, but due to lead time, could not be delivered until the following fiscal year. Similarly, if supplies will be needed in the beginning of the next fiscal year, but the normal lead time for production requires order placement in the current fiscal year, the appropriation of the current fiscal year may be charged.

Consumables ordered late in the fiscal year in quantities beyond what can be consumed in the remainder of the fiscal year would likely violate the bona fide needs rule. An example would be the purchase of gasoline to be delivered in monthly installments over the next six months. Six months worth of gasoline would not be considered a bona fide need of the current fiscal year, with only a few days remaining ... unless it was common procedure for your agency to keep a large stock on hand. It is reasonable for agencies to purchase supplies that are necessary to maintain normal, reasonable stock levels. Such purchases for "stock" may be considered a bona fide need of the current fiscal year, even if the supplies are not actually used until the following fiscal year.

The determination of what constitutes a bona fide need of the agency for the fiscal year ultimately requires the application of business judgment and is the responsibility of the contracting agency.

How is the rule applied when purchasing from a government franchise fund organization?

The *bona fide need rule* applies even if obligating funds to another government agency, including the six agencies designated as “franchise fund” organizations under the authority of the Government Management and Results Act (GMRA). There must be a genuine need for the supplies or services during the fiscal year for which the funds are obligated, even if they are obligated to another government organization. Franchise funds were authorized under the GMRA to provide common administrative support services to other government agencies.

An agency’s funds, including the cost of the requirement and the service fee, are considered obligated once they are transferred to the franchise fund organization. Funds obligated to a franchise fund organization for a bona fide need will remain available until spent by the franchise fund. Funds obligated under the authority of GMRA are not required to be deobligated if they remain unspent at the end of the fiscal year, as they would be if the funds were transferred under the authority of the Economy Act. Note that the Economy Act authorizes acquisitions from other agencies *when more specific authority does not exist*. In this situation, GMRA provides the more specific authority.

An example of a franchise fund organization is GovWorks,⁹ also known as the Minerals Management Service of the Department of Interior. GovWorks provides service-for-fee acquisition and assistance services for agencies looking for better, more efficient procurement alternatives.

How is the rule applied when purchasing from a government revolving fund organization?

Much the same as with franchise funds, as discussed above. “Revolving fund” authority is provided via specific authority granted to the federal organization, usually via a statute specific to each fund. The authority to operate a revolving fund, or to obligate funds to a revolving fund organization, does not negate the need to adhere to the bona fide needs rule. Again, there must be a genuine need for the supplies or services during the fiscal year for which the funds are obligated, *even if they are obligated to another government organization*.

Funds obligated to a revolving fund organization for a bona fide need will remain available until spent by the revolving fund organization. Funds obligated under the revolving fund’s authority are not required to be deobligated if they remain unspent at the end of

... the bona fide needs rule applies to all federal government activities carried out with appropriated funds ... including grants.

the fiscal year, as they would be if the funds were transferred under the authority of the Economy Act.

An example of an agency with revolving fund authority is the General Services Administration (GSA). Under the authority of the Clinger-Cohen Act, OMB designated GSA as an “executive agent” for the acquisition of government-wide IT resources. Agencies may transfer—thus, obligate—funds with GSA under the authority of the Clinger-Cohen Act, for requirements that are bona fide needs of the current fiscal year. The funds will remain with GSA until they are spent.

Another example of a revolving fund organization is the Library of Congress, which administers the Federal Library and Information Network (FEDLINK) program.¹⁰ The program is operated under the authority of the Library of Congress Fiscal Operations Improvement Act of 2000 (Public Law 106-481).

How is the rule applied to grants?

Again, the bona fide needs rule applies to all federal government activities carried out with appropriated funds ... including grants. However, GAO has acknowledged that grants are significantly different than contracts, as they are awarded specifically “to provide financial assistance,” not to acquire goods and services for the agency. The bona fide need for the agency with grant authority is to “provide financial assistance.” Once a grant is awarded, even if awarded on the last day of the fiscal year, the bona fide need of the agency is complete. It has met its need to “provide assistance.” Therefore, for grants, GAO has concluded that the principle of severability is irrelevant to a bona fide need determination. Further, a bona fide need analysis in the context of grants focuses on whether the grants are made during the period of availability of the appropriation charged and whether they further the authorized purposes of program legislation. This decision was communicated in late 2002 when GAO was asked for its opinion regarding the Department of Education’s use of appropriations available for only one fiscal year to fund grant awards for multiple years.¹¹

Why is there confusion surrounding the application of these rules?

In part because there has been no single current point of reference applicable to all agencies. For appropriations guidance, the federal community often refers to GAO's *Principles of Federal Appropriations Law*, also known as "The Redbook." It is self-proclaimed to be "essentially expository in nature, and should not be regarded as an independent source of legal authority ... The material in this publication is, of course, subject to change by statute or through the decision-making process." Volume I, which includes Chapter 5 addressing the bona fide needs rule, was last updated in 1991—well before the FASA statute allowed a severable contract to overlap fiscal years and remain chargeable to the fiscal year in which it was awarded.

To add to the confusion, we have noted that GAO decisions issued since the passing of FASA in 1995 have relied on case precedence and include specific quotes that, "generally,"¹² contracts for severable services are chargeable to the appropriation current at the time services are rendered. That is true, *unless* there is specific statute that authorizes agencies to cross fiscal years with severable services, and charge them to the fiscal year in which the award was made. Such a statute exists: FASA, applicable to executive agencies, except DoD, Coast Guard, and NASA. Statutory authority for DoD and the Coast Guard is provided via Section 801 of the National Defense Authorization Act for Fiscal Year 1998 (Public Law 105-85).

What is the significance of this rule to the end of the fiscal year?

Year-end spending is often the subject of scrutiny, as fingers are pointed at the significant obligations that are incurred in the last quarter—or last month—of the government's fiscal year ... particularly as compared to the rest of the fiscal year. Of course, one good reason for the significant number of end-of-year obligations is that in many years—including this one—many agencies do not receive their funding until approximately halfway through the fiscal year. By default then, agencies obligate the majority of their funds during the second half of the year.

The significance at the end of the fiscal year—in reality—is simply in the *perception* that an agency may be trying to spend any remaining appropriated funds for that fiscal year before they expire ... *regardless* of whether the spending is for a bona fide need of that fiscal year. The historical rationale is that an agency that doesn't spend all of its allotted funds this year will receive fewer funds next year. In reality, GAO has stressed that "an appropriation is just as much available to supply the needs of the [last day] of a particular year

as any other day or time in the year." While the end-of-year timing of an obligation may warrant a "further look," says GAO, "the timing of the obligation does not, in and of itself, establish anything improper." While the perception is that end-of-year spending is less likely to represent a bona fide need of the current fiscal year, GAO has not found that to be the reality. In historical studies of year-end spending, GAO has concluded that year-end spending is no more or less wasteful than spending any other time of the year.

Conclusion

The *bona fide needs rule* is a fundamental principle of appropriations law, widely applicable to acquisitions of goods and services and the associated obligation of funds, yet often misunderstood and misapplied. Knowledge and understanding of the rule—particularly heading into the fiscal year-end—can provide insight into both the limitations and opportunities surrounding the crafting of an effective and appropriate acquisition strategy for meeting the agency's needs. ♦

ENDNOTES

- ¹ GAO's Principles of Federal Appropriations Law, Volume I; <http://www.gao.gov/special.pubs/og91005.pdf> (See page 1.)
- ² B-259274 (May 22, 1996) (See page 2.)
- ³ Federal Acquisition Circular 90-30 (See page 3.)
- ⁴ FAR 32.703-3(b); http://www.arnet.gov/far/current/html/Subpart_32_7.html#998209 (See page 3.)
- ⁵ 41 USC 11; Exceptions to this rule may be made by DoD for "for clothing, subsistence, forage, fuel, quarters, transportation, or medical and hospital supplies, which, however, shall not exceed the necessities of the current year." (See page 3.)
- ⁶ 60 Comp. Gen. 452 (as indicated in GAO's Principles of Federal Appropriations Law) (See page 4.)
- ⁷ B-233243, August 3, 1989; B-213141-O.M., March 29, 1984 (See page 4.)
- ⁸ B-257977, EEOC-Payment for Training of Management Interns, November 15, 1995 (See page 4.)
- ⁹ GovWorks Federal Acquisition Center, <http://www.govworks.gov/index.asp> (See page 5.)
- ¹⁰ FEDLINK; <http://www.loc.gov/flicc/fedlink.html> (See page 5.)
- ¹¹ B-289801, December 30, 2002 (See page 5.)
- ¹² B-282601, National Park Service Soil Surveys, September 27, 1999, states "Generally, funds may be obligated for the provision of services beyond the fiscal year in which the appropriation is made only to the extent those services constitute a single nonseverable undertaking. B-259274, Funding of Maintenance Contract Extending Beyond Fiscal Year, May 22, 1996, states "Service contracts, where the services are continuing and recurring in nature ... are severable and are chargeable to the appropriation current at the time services are rendered." (See page 6.)

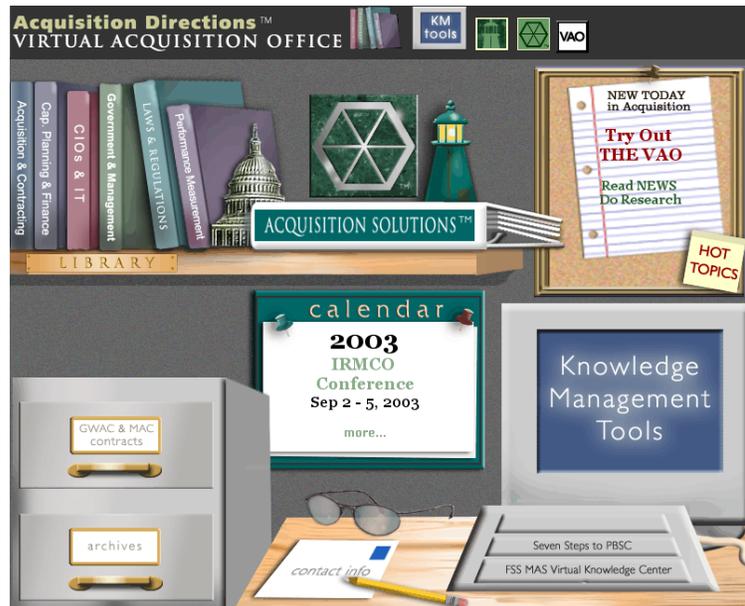
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