ASI GOVERNMENT

VIRTUAL ACQUISITION OFFICE™ ADVISORY

September 2014

The Bona Fide Needs Rule in 2014

An Updated Look at This Fundamental Rule of Federal Acquisition

By Patrick Shields

This Advisory *updates our periodic review of the bona fide needs rule and its application, details guidance from OFPP and DoD, shares lessons learned from GAO decisions, and incorporates insights from the findings of our acquisition research team.*

With the end of another fiscal year approaching, questions concerning the bona fide needs rule become more prevalent, as delivery or performance requirements typically extend into the next fiscal year. 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. To avoid violations of this rule and the Antideficiency Act, clear communication is essential regarding the type and availability of funds, as well as the underlying need being satisfied by the acquisition.

This *Advisory* updates our periodic review of the bona fide needs rule and its application, details guidance from the Office of Federal Procurement Policy (OFPP) and the Department of Defense (DoD), shares lessons learned from a range of Government Accountability Office (GAO) decisions, and incorporates insights from the research findings of our acquisition research team.

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 be obligated *only* 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. For example, annual funds (such as operations and maintenance funding) appropriated for fiscal year (FY) 2014 are to be used to fund legitimate or genuine FY2014 needs and are *not* to be used to fund a need the agency won't actually have until FY2015.

What is the applicability of the rule?

The bona fide needs rule applies not only to contracts but also to all federal government activities carried out with appropriated funds, including contract, grant, and cooperative agreement transactions. It also applies to funds transferred between agencies, as we describe in more detail later.

The bona fide needs rule applies to appropriations that are limited to a definite period of availability—which includes both *annual* and *multiple year* appropriations—but does not apply to no-year appropriations.[1] Annual appropriations provide funds that are available for obligation during a specific fiscal year, while multiple year appropriations designate funds

that are available for obligation over a defined period of time that exceeds one fiscal year.[2]

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. Code (U.S.C.) 1502(a), often referred to as the bona fide needs statute. This section reads:

> The balance of an appropriation or fund limited for obligation to a definite period is available only for payment of expenses properly incurred during the period of availability or to complete contracts properly made within that period of availability and obligated consistent with section 1501 of this title. However, the appropriation or fund is not available for expenditure for a period beyond the period otherwise authorized by law.[3]

Volume 1 of the Government Accountability Office's (GAO's) "Principles of Federal Appropriations Law" and its annual supplements provide in chapter 5, section B, a good discussion of the rule, including its legal background and an analysis of associated comptroller general decisions.[4]

Key Terms Used in This *Advisory*

Appropriation – A form of budget authority given to federal agencies to incur obligations and to make payments from Treasury for specified purposes.

Annual appropriation – An appropriation that is available for obligation only during a specified fiscal year. All appropriations are assumed annual unless expressly provided otherwise. Also referred to as fiscal year or one-year appropriation. Appropriation includes funds made available by statute under section 9104 of title 31 to government-owned corporations.

Multiple year appropriations – Funds that are available for obligation for a definite period in excess of one fiscal year.

No-year appropriation – Funding that is available for obligation without fiscal year limitation. The standard language used to make a no-year appropriation is "to remain available until expended.

Obligation – An "action that creates a legal liability or definite commitment on the part of the government, or creates a legal duty that could mature into a legal liability by virtue of an action that is beyond the control of the government. Contracts entered into pursuant to contract authority constitute obligations binding on the United States."

Period of Availability – The period of time during which an appropriation is available for incurring new obligations to pay for satisfying a bona fide need of the government.

Requesting agency – As it pertains to an interagency agreement, the agency with a requirement that is seeking services from another agency to meet its need.

Servicing agency – As it pertains to an interagency agreement, the organization that provides to a requesting agency acquisition support, administers contracts for other agencies' direct use, or both.

Sources: GAO's Principles of Federal Appropriations Law, 3d ed.
"Improving the Management and Use of Interagency Acquisitions,"
OFPP memorandum, June 6, 2008

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, say an agency has a requirement for ten desktop computers that must be available for new employees in a given fiscal year. If it 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 become more challenging, however, as requirements overlap fiscal years. Even more challenging is proper application of the rule for services. These challenges are compounded when one agency transfers its funds to another.

Let's explore these challenges one at a time.

Can service contracts cross fiscal years?

Yes, contracts for services may be awarded in one fiscal year with performance continuing into the next. However, the way the bona fide needs rule is applied depends on the nature and duration of the services being acquired, as well as the period of availability of the appropriation being used.

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

It depends on whether the services are considered "severable" or "nonseverable."

Severable services are services that are continuing and recurring in nature—such as lawn maintenance, janitorial services, or security services—and from which the agency realizes a benefit at the time the 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.[5]

Nonseverable (or "entire") services represent a single undertaking that cannot feasibly be separated into components, but must be performed as a single task to meet a need of the government.[6] If the services produce a single or unified outcome, product, or report, the services are considered nonseverable. An example would be a consulting study, conducted over several months or even years, but culminating in the delivery of a final report. Without the final report, the agency would realize little or no benefit from the study.

For a nonseverable 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 the portion of the services that will be performed during or even beyond the next fiscal year. The entire nonseverable service is considered a bona fide need of the fiscal year in which the agency entered into the contract.[7]

For a severable service, agencies may use one-year funds to enter into a contract that crosses fiscal years and that obligates 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. In other words, agencies may enter into a contract this fiscal year for a severable service that is a bona fide need of this year and the service may continue performance into the following fiscal year, with all services chargeable to the award year's appropriation.

Further, an agency using a multiple year appropriation would not violate the bona fide needs rule if it entered into a severable services contract for more than one year as long as the period of contract performance did not exceed the funds' period of availability.[8] Note, however, that the GAO interpretation is that the statutory authority that allows the flexibility for severable services contract requirements funded by annual appropriations does not extend to requirements funded by multiple year appropriations. If a severable services requirement is funded by a multiple year appropriation, performance may not cross into the following fiscal year.

Has this always been the rule for severable services?

No, and this is why there often is 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 actually were *performed*. 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 why 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 30." The first "option" year often would start on October 1, even if that 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) (41 U.S.C. 3902), 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 DoD, the U.S. Coast Guard, and the National Aeronautics and Space Administration (NASA). The authority allowed agencies to write service contracts that cross fiscal years, and to fund those contracts with one fiscal year's funds.[9] Three years later, DoD and the Coast Guard also were extended the authority through regulations implementing section 801 of the National Defense Authorization Act (NDAA) for Fiscal Year 1998 (10 U.S.C. 2410a).

FASA authorizes 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 and is captured in Federal Acquisition Regulation (FAR) 32.703-3, which currently reads:

> (a) A contract that is funded by annual appropriations may not cross fiscal years, except in accordance with statutory authorization (e.g., 41 U.S.C. 11a, 31 U.S.C. 1308, 42 U.S.C. 2459a, 42 U.S.C. 3515, and paragraph (b) of this subsection), 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).
>
> (b) The head of an executive agency, except NASA, may enter into a contract, exercise an option, or place an order under a contract for severable services for a period that begins in one fiscal year and ends in the next fiscal year if the period of the contract awarded, option exercised, or order placed does not exceed one year (10 U.S.C. 2410a and 41 U.S.C. 253l). 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 of severable services and funded by an annual appropriation that begins on August 1, 2015, and ends on

July 31, 2016 (a one-year period), and fund all work under the contract out of a fiscal year 2015 appropriation.

Can a contract for a nonseverable service whose performance will cross fiscal years be funded with funds from both years?

No. The Adequacy of Appropriations Act (41 U.S.C. 6301) states, "A contract or purchase on behalf of the Federal Government shall not be made, unless the contract or purchase is authorized by law or is under an appropriation adequate to its fulfillment."[10] Appropriations must be adequate to fully fund the contract at award. The act prevents incremental funding of a nonseverable task with annual funds. A nonseverable consulting study, for example, must be fully funded at award.[11]

Can I 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 be a bona fide need of *this* fiscal year. Keep in mind that the bona fide needs rule applies specifically to the obligation of appropriated funds, whether they are obligated via contract, task order, delivery order, or order under a blanket purchase agreement (BPA).

An agency could 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 simply offer a method for filling anticipated repetitive needs for supplies or services. 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 (IDIQ) contract, on the other hand, obligates the government to expend funds. FAR part 16 requires that IDIQ contracts specify a guaranteed minimum quantity that the government will order under the contract. The minimum quantity must be more than a nominal quantity, but should not exceed the amount the government is fairly certain to order. Because an IDIQ contract obligates the government to spend that guaranteed minimum amount, the basic contract's award must represent a bona fide need of the fiscal year in which it is awarded. Compliance with the bona fide needs rule is determined at the time the agency incurs an obligation.

Statutory Exceptions Other than FASA That Allow Annual Appropriations to Cross Fiscal Years

41 USC 11A: Contracts for fuel by the secretary of the Army may be made without regard to current fiscal year.

31 USC 1308: Charges for telephone and metered services (such as gas, electricity, water, and steam) for a time period beginning in one fiscal year or allotment period and ending in another fiscal year or allotment period may be charged against the appropriation or allotment current at the end of the time period covered by the service.

42 USC 2459a: Appropriations authorized for "research and development," "space flight, control, and data communications," or "construction of facilities" may remain available until expended. Contracts may be entered into under "inspector general" and "research and program management" for training, investigations, and costs associated with personnel relocation and for other services provided during the fiscal year following the fiscal year in which funds are appropriated.

42 USC 3515: Funds provided in this act (i.e., Public Law 102-394) or subsequent Departments of Labor, Health and Human Services, and Education, and Related Agencies Appropriations Acts (and used to employ experts and consultants, temporary or intermittent) may be used for one- year contracts that are to be performed in two fiscal years, so long as the total amount for such contracts is obligated in the year for which the funds are appropriated.

Source: Office of the Law Revision Counsel, U.S. House of Representatives, http://uscode.house.gov

However, an agency does not need to order the guaranteed minimum at the time of award. For example, it may award an IDIQ contract in June 2014 and not issue its first order until August 2014. As long as the guaranteed minimum is ordered in the same fiscal year, the agency has complied with the bona fide need rule.

In a 2011 decision, GAO found the agency violated the bona fide needs rule because it did not have a bona fide need for the guaranteed-minimum quantities specified in the IDIQ contract. GAO explains:

> From an appropriations law standpoint, the recording statute, 31 U.S.C. § 1501(a), requires an agency to record an obligation against its appropriation at the time that it incurs a legal liability, such as when the agency signs a contract committing the government to purchase a specified amount of goods or services. As noted above, an IDIQ contract must include a guaranteed minimum in order to create a binding contract. Therefore, upon execution of an IDIQ contract, the agency must record an obligation in the amount of the guaranteed minimum at the time the con-

> tract is executed because, at that point, the government has committed itself to a fixed liability for the minimum amount. Further, the bona fide needs rule establishes that an agency may obligate its fiscal year appropriation only to meet a legitimate, or bona fide, need arising in the fiscal year for which the appropriation was made.[12]

Once the guaranteed minimum is satisfied, orders—hence, obligations—can be made throughout the life of the IDIQ contract using appropriated funds applicable to the term and bona fide need of each order.

To comply with the bona fide need rule for a multiple award IDIQ, must each awardee get an order that year?

To use those fiscal year funds, the government must order the minimum guarantee from each awardee. If several task orders are issued throughout the same fiscal year, it may be that all awardees will receive an order by the end of the fiscal year. If that is not the case, however, then the agency must deobligate the funds on the basic contract for those awardees from whom the minimum guarantee was not ordered and reobligate using the current fiscal year funds. The deobligated funds will not be available for agency reuse on other contracts.

If I don't have a bona fide need at the time of award, do I need to hold off awarding the IDIQ contract until such need arises?

As long as you have a bona fide need before the end of the fiscal year, you do not need to hold up award of the IDIQ contract(s).

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

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."[13] For services, whether they are severable or nonseverable is a factor, as discussed previously. But other factors come into play, as well. What if a service or product is needed this year but cannot be performed or delivered 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.[14]

GAO's Redbook tests bona fide need decisions on "whether an obligation bears a sufficient relationship to the legitimate needs of the time period of availability of the appropriation charged or sought to be charged."[15] Accordingly, 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, which we capture herein and use to support our explanation of how the bona fide needs rule applies to specific situations. Read on.

How does the bona fide needs rule apply to training?

GAO has put some additional caveats on how it applies the bona fide needs rule to training. GAO has determined that "training tends to be nonseverable."[16] And when a training obligation is incurred in one fiscal year, the entire cost is chargeable to that year, even if the training may not be completed until the following year.[17] But, as GAO affirmed in a July 2011 decision, "if an agency decides to enroll its staff for training that is delivered during the succeeding fiscal year, the training is a bona fide need of the expiring fiscal year *only if the training provider requires the agency to register during the expiring fiscal year, the date offered is the only one available, and the time between registration and the training is not excessive*" [emphasis added].[18] An excerpt from that case—

> The obligation at issue is for training that two NLRB employees received from OPM in January 2011. NLRB officials state that they obligated fiscal year 2010 funds for the training in part because they identified the training as a need during fiscal year 2010. However, as a general matter, the relevant date to ascertain whether the training is a bona fide need of a particular fiscal year is the date that the training is delivered, not the date upon which the agency made the decision to enroll its staff in the training. This is because generally, when an agency enters into a contract in one fiscal year for services that will not be performed until the succeeding fiscal year, the agency may not charge the first fiscal year's appropriation with the cost of the contract. . . . If an agency decides to enroll its staff for training that is delivered during the succeeding fiscal year, the training is a bona fide need of the expiring fiscal year only if the training provider requires the agency to register during the expiring fiscal year, the date offered is the only one available, and the time between registration and the training is not excessive.

GAO pointed to a 1984 GAO memorandum as the foundation for its decision.[19] That memo set forth three scenarios regarding the purchase of training near the end of a fiscal year:

1. **Approval is given near the end of a fiscal year for training that begins in that fiscal year.** GAO cases have held that "when a nonseverable services contract is entered into during one fiscal year, and performance of the contract also begins in that fiscal year, the contract fulfills a bona fide need of that fiscal year only." The training must be charged to the fiscal year in which the training is approved and begins.
2. **Approval is given near the end of the fiscal year for training that begins in the next fiscal year, but the appropriation for the next fiscal year has not been enacted.** In this case, training may be charged to the appropriation for the expiring fiscal year "only if registration for the course is required before the end of that fiscal year."
3. **Approval is given near the end of a fiscal year for training that begins in the next fiscal year, and the appropriation for the next fiscal year has been enacted.** "In this situation, the agency may properly charge the training to appropriations for the expiring fiscal year if . . . registration is required before the end of that fiscal year. Alternatively, if registration is not required until after the start of the new fiscal year, (whether or not the student actually registers before the new fiscal year), the training is a bona fide need of the new fiscal year only and may be charged only to appropriations of that year." GAO noted that in this situation, however, the student could register prior to the new fiscal year without violating the Antideficiency Act, because funds already had been appropriated for the succeeding fiscal year.

How is the bona fide need rule applied to subscriptions?

Agencies may use annual funds to pay for subscriptions; however, annual funds may not be used to pay for new subscriptions that will start in the next fiscal year, and the agency cannot use current-year funds to renew subscriptions that don't expire until after the start of a next fiscal year. However, GAO has determined that annual funds may properly be obligated to extend a subscription that expires on the last day of the current fiscal year, even though the new subscription period won't commence until the next fiscal year.

GAO explained this distinction when it ruled that an agency did not violate the bona fide needs rule when, in September 2006, it obligated FY2006 funds for five database subscription renewals that it needed to have in place on October 1, 2006, the first day of FY2007. GAO reasoned that even though delivery of the renewed subscriptions would occur entirely in FY2007, the agency reasonably determined that the renewal orders needed to be placed in FY2006, before the expiration of the existing subscriptions on September 30, 2006, to ensure continued receipt. GAO did note that the agency violated the bona fide needs rule when it obligated FY2006 funds to renew two subscriptions that were not due to expire until October 31, 2006. These renewals were a bona fide need of FY2007 and the agency should have purchased these subscriptions using its FY2007 appropriation.[20]

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

The government may obligate a fiscal year's funds for supplies only if those supplies are a bona fide need of the current fiscal year. But it is not unusual for orders placed near the end of the fiscal year to be delivered after the next fiscal year has started. In determining the fiscal year funds from which obligation and, ultimately, 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:

- Necessary order lead time
- Extent to which the supplies are consumable
- 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 are needed but, due to the long 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 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 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 of gasoline likely would not be considered a bona fide need of this fiscal year, with only a few days remaining, unless it was common procedure for the agency to keep such a stock on hand. It is reasonable for agencies to purchase supplies necessary to maintain normal, reasonable stock levels. "The bona fide needs rule does not prevent maintaining a legitimate inventory at reasonable and

historical levels, the 'need' being to maintain the inventory level so as to avoid disruption of operations."[21]

Accordingly, 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.

How is the rule applied to grants?

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 from 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 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.[22]

How does the rule apply to contract modifications?

According to GAO, it depends on the contract type and whether the modification is within or outside the scope of the original contract. For fixed-price contracts, GAO has stated that for contract modifications within the contract's statement of work, the agency should charge the cost of the modification to the original appropriation used at the time of award, since such a modification is part of the bona fide need established at time of contract award. For modifications outside the contract's statement of work (and, thus, outside the scope of the contract), agencies should charge the appropriation current at the time of modification, since these modifications are considered to meet a new bona fide need.

For cost-reimbursement contracts, modifications that increase the original contract ceiling (total estimated cost) should be charged to appropriations current at the time of modification. GAO opines, "Modifications increasing the ceiling are discretionary in nature and therefore are considered to reflect a new need. As such, the modifications should be charged to funds available when the modification is signed by the contracting officer."[23] This even applies to cost overruns, where the original work is not changed. As stated by GAO: "For cost-reimbursement contracts, because the agency, at time of contract award, cannot necessarily anticipate the need for and amount of increases in the contract ceiling, a modification that increases the ceiling is considered a bona fide need at the time of the modification."

Does the bona fide needs rule apply to interagency transactions?

Yes, the bona fide needs rule applies even when transferring funds between federal agencies. As with a contract, an agency's funds are considered obligated when they are transferred from one agency to another, which means there must be a bona fide 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.

GAO has explained this concept:

> An interagency transaction that permits the transfer of funds between the two agencies is, in some ways, not unlike a contractual transaction. Similar to a contractual transaction, at the time the agencies involved in the trans- action enter into an interagency agreement, the ordering agency incurs an obligation for the costs of the work to be performed, and the amount obligated remains available to pay these costs once the work is completed.[24]

So the bona fide needs rule applies regardless of the authority used to transfer funds to another agency?

Yes. There are three commonly used authorities for interagency agreements: the Economy Act, the Government Management and Results Act (GMRA)—governing franchise fund organizations—and revolving fund authorities. DoD's Financial Management Regulation (FMR) pools these into two simple categories: Economy Act orders and non-Economy Act orders.

The DoD FMR addresses the bona fide needs rule nearly identically in both the Economy Act orders and the non-Economy Act orders chapters.[25] Volume 11A, chapter 3, "Economy Act Orders" (updated March 2012), provides:

> Economy Act orders citing an annual or multiyear appropriation must serve a bona fide need arising, or existing, in the fiscal year (or years) for which the appropriation is available for obligation. Otherwise, a valid obligation is not accomplished. Bona fide need generally is a determination of the requesting activity and not that of the servicing activity. A servicing activity should, however, refuse to accept an Economy Act order if it is obvious that the order does not serve a need existing in the fiscal year for which the appropriation is made.

Volume 11A, chapter 18, "Non-Economy Act Orders" (updated March 2102), provides:

> Non-Economy Act orders citing an annual or multiyear appropriation must serve a bona fide need arising, or existing, in the fiscal year (or years) for which the appropriation is available for new obligations. Otherwise, a valid obligation is not accomplished. An interagency agreement may not be used in the last days of the fiscal year solely to prevent funds from expiring or to keep them available for a requirement arising in the following fiscal year. Bona fide need generally is a determination of the requesting activity and not that of the servicing activity. A servicing activity can, however, refuse to accept a non-Economy Act order if it is obvious that the order does not serve a need existing in the fiscal year for which the appropriation is available.

The two descriptions of the bona fide needs requirement are nearly identical, with the exception of this statement in the non-Economy Act chapter, which seeks to curb some past improprieties related to "parking" funds: "An interagency agreement may not be used in the last days of the fiscal year solely to prevent funds from expiring or to keep them available for a requirement arising in the following fiscal year." Enough said.

If the servicing agency intends to apply annual funds to a third-party contract, do the funds have to be obligated on a contract before the end of the appropriation's period of availability?

It depends on the authority under which the funds were transferred. If the funds were transferred under authority of the Economy Act, they must be obligated under a third-party contract by the end of the appropriation's period availability (fiscal year for an annual appropriation) or returned to the requesting agency (further explanation of this follows). If the funds were transferred under another authority, such as the GMRA or revolving fund authority, GAO has advised that they must be obligated to the third party contract within a "reasonable" amount of time, noting that "there is no hard and fast rule in this regard."[26]

Because funds are considered obligated when the requesting agency sends the funds to the servicing agency, the funds do not have to be further obligated on a third-party contract by the servicing agency by the end of the fiscal year—unless they were transferred under the authority of the Economy Act—but they must be awarded within a reasonable amount of time thereafter. This is assuming—and this is important—that the requiring agency was "specific" enough about its requirement to clearly establish that there was a bona fide need within the fiscal year of the appropriation. Describing the need with sufficient specificity for the servicing agency to take action is required to establish a bona fide need and thus to create a legitimate obligation.

A good example that shows where GAO is likely to draw the line on the question of timing and the specificity required to create an obligation is a case in which it was determined that an order for automobiles placed during the summer before the specifications for the new model year were available was insufficient to create an obligation.[27] In this case, the orders were to be placed with the General Services Administration (GSA) during the summer using funds available in that fiscal year, and finalized in October. GAO concluded that the orders, when placed, were "tentative and incomplete," and therefore insufficient. Citing 31 U.S.C. section 1501(a)(1) (the so-called Recording Statute), GAO determined that an order needs to be specific and complete, with a definite description of the goods or services to be provided, to be a valid obligation.

So a servicing agency can retain annual funds provided via an interagency agreement and award them on a contract in the following fiscal year?

Yes, as long as (1) the interagency agreement provides a sufficiently specific description of the bona fide need such that the servicing agency can take action; (2) the servicing agency's actions to further obligate the transferred funds are taken in a reasonable amount of time; and (3) the Economy Act is not the underlying authority used to transfer the funds to the servicing agency. (Note that the Economy Act applies only when there is not a more specific authority for transferring funds.) The following excerpt from a July 2007 GAO decision adds clarity:

> Distinguishing Economy Act orders from non-Economy Act orders, the Comptroller explained that with some fed-

eral agencies, such as GovWorks, who have legal authority separate from the Economy Act, DoD need not retrieve DoD funds advanced to the servicing agency but not yet used by the servicing agency. . . . The Comptroller noted, however, that "an interagency agreement must be based upon a legitimate, specific and adequately documented requirement representing a bona fide need of the year in which the order is made." The Comptroller advised, "If these basic conditions are met, these servicing agencies may retain . . . the funds in the following fiscal year." The Comptroller admonished DoD officials to "resist the misguided desire to bank government funds through improper use of interagency agreements," and warned that "[m]isuse of interagency agreements may result in disciplinary action, adverse media attention and additional congressional limitations and oversight Department-wide."[28]

Funds obligated to another agency under the authority of the Economy Act, however, must be obligated against a third-party contract by the time the appropriation expires. Once that period of availability expires, any funds that have not been expended by servicing agency personnel performing the work or further obligated against a third-party contract must be deobligated and returned to the transferring agency. The performing agency cannot retain the expired funds and must be provided new funds for work it performs in a subsequent fiscal year. According to GAO, "Where the work performed or service rendered covers more than one fiscal year, the ordering agency must pay the performing agency from its respective annual appropriations for the particular fiscal years in which the work was performed or services were rendered."[29]

GAO has noted that the Economy Act's requirement to deobligate unspent funds once the appropriation's period of availability expires is the most significant difference between it and other more specific fund transfer authorities such as revolving or franchise fund transactions.[30] This means that an agency entering into an interagency transaction using annual appropriations and the Economy Act as its transfer authority must, at the end of the fiscal year, deobligate any funds not already spent by the servicing agency's personnel performing the service or obligated against a third-party contract.

How does the bona fide needs rule apply to supplies purchased via interagency agreements?

All supplies acquired on behalf of the requesting agency must be delivered before the end of the year or within the vendor's normal production lead time. DoD clarified its policy, as follows:

HHS Reference Tool for Contract Funding, Formation, and Appropriations Law Compliance

The Department of Health and Human Services (HHS) has developed an interactive reference tool to aid its staff in complying with federal appropriations law and Federal Acquisition Regulation and departmental requirements with regard to the availability of and use of appropriations.

The HHS Reference Tool focuses on the time element of appropriations law, providing an overview of fundamental concepts such as the bona fide needs rule and the Antideficiency Act. Decision factors (presented in a logical progression of questions) help users assess how a contract action might be funded or whether a proposed course of action may be appropriate based on the requirement, its duration, and the type of appropriation involved. For example, the tool can help determine whether a proposed acquisition is for severable or nonseverable services and then determine applicable requirements. Help notes included with each decision factor explain key concepts and point users to relevant Government Accountability Office decisions.

The HHS Reference Tool also contains 12 case studies designed to show the application of specific appropriations law-related principles to hypothetical contract formation and funding scenarios. Some of the topics covered include advance funding of options, extending the performance period for severable services, and contracting in advance of a bona fide need.

Funds provided to a performing agency for ordered goods where the funds' period of availability thereafter has expired shall be deobligated and returned by the performing agency unless the request for goods was made during the period of availability of the funds and the item(s) could not be delivered within the funds' period of avail- ability because of delivery, production or manufacturing lead time, or unforeseen delays that are out of the control and not previously contemplated by the contracting par- ties at the time of contracting.

Where materials cannot be obtained in the same fiscal year in which they are needed and contracted for, provisions for delivery in the subsequent fiscal year do not violate the bona fide need rule as long as the time intervening between contracting and delivery is not excessive and the procurement is not for standard commercial off the shelf (COTS) items readily available from other sources.

The delivery of goods may not be specified to occur in the year subsequent to funds availability unless delivery meets the exceptions cited above and a justifiable bona fide need exists in the year funds area available for obligation.[31]

The last paragraph above stresses that delivery of goods must occur within the same fiscal year unless a legitimate exception applies.

Are there examples that illustrate these points?

Yes, there are several. One is the July 2009 Natural Resources Conservation Service case mentioned previously, in which the funds transferred to GSA were not to be used until the following fiscal year when the order was to be finalized. Since the exact specifications were not to be available until the next fiscal year, GAO determined there was no bona fide need established during the fiscal year of the appropriation. GAO considered the requirement to be a bona fide need of the next fiscal year, when the orders were to be finalized.[32]

In another case, the Library of Congress FEDLINK program, a revolving fund organization, asked GAO whether fixed-year funds—transferred to FEDLINK from customer agencies and left over from a particular order—retained their fixed-year identity or assumed the no-year identity of the revolving fund. In other words, could FEDLINK use those funds to fulfill an alternate requirement of the customer agency? GAO determined, "consistent with the bona fide needs rule," that "unearned amounts transferred from a fiscal year appropriation to FEDLINK are available only to cover obligations properly incurred during the appropriation's period of availability."[33] Accordingly, FEDLINK could not use excess funds to satisfy new requirements not attributed to a bona fide need established during the appropriation's period of availability.

What actions can be taken to avoid violations of the bona fide needs rule in interagency transactions?

It is critical for the interagency agreement to specify (1) a description of the requirement sufficient to establish that a bona fide need exists; (2) the authority used to transfer the funds; and (3) the type and extent of funds obligated, along with any constraints on the use of the funding.

OFPP published substantial guidance in June 2008 on interagency transactions and the bona fide needs rule, including a checklist of roles and responsibilities and elements of a model interagency agreement.[34] Specific to the bona fide needs rule, OFPP noted in its guide that—

> Requesting and servicing agencies need to develop clear and complete interagency agreements that:
>
> - establish general terms and conditions to govern the relationship between the agencies, including each party's role in carrying out responsibilities in the acquisition lifecycle; and
> - provide information required to demonstrate a bona fide need and authorize the transfer and obligation of funds.

In the guidance, OFPP recommended that the requirements and funding information section of the agreement provide "specific information on the requesting agency's requirements sufficient to demonstrate a bona fide need."

Similar guidance was released shortly thereafter by GSA. Recognizing the need for clarity when accepting funds through an interagency agreement (IA), in a June 10, 2008, acquisition letter GSA outlined steps it will take prior to accepting funds from another agency. Among them: "Ensure that each IA clearly identifies . . . type of funds to be used (i.e., annual/multiple-year/no-year) . . . type of requirements (i.e., supplies, severable services, non-severable services) . . . and specific, definite, and concise description of requirements sufficient to demonstrate the bona fide needs at the time of GSA's IA acceptance."[35]

Is there anything else I should consider when evaluating the application of appropriated funds?

Yes. In addition to the bona fide needs rule, comptrollers or other entities responsible for certifying the availability of funds should consider the purpose statute, to ensure the product or service to be acquired is consistent with the stated purpose of the appropriation. Codified in 31 U.S.C. 1301(a), the purpose statute states that "appropriations shall be applied only to the objects for which the appropriations were made except as otherwise provided by law." In its April 2008 report, the DoD inspector general observed that "violations of the purpose statute generally occur when purchases are funded with the wrong type of appropriation. For example, if a DoD organization were to use operations and maintenance funds instead of military construction funds to build a new building."[36]

What is the impact of misapplying the bona fide needs rule or purpose statute?

The bona fide needs rule and purpose statute should always be considered to ensure funds are used in a manner consistent with the intent of the appropriation. When funds are obligated inconsistent with their appropriation authority, there is risk of a potential violation of the Antideficiency Act. The Antideficiency Act enforces Congress's constitutional powers of the purse with respect to the purpose,

time, and amount of expenditures made by the federal government.[37] To this end, potential Antideficiency Act violations specifically refer to 31 U.S.C. 1341(a)(1), which states that a U.S. government officer or employee "may not (A) make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation" or "(B) involve . . . Government in a contract or obligation for the payment of money before an appropriation is made unless authorized by law."[38]

Are bona fide needs rule violations correctable?

According to the DoD inspector general, bona fide needs violations are correctable by replacing the wrong year funds with correct year funds, as long as the funds are available.[39] This is consistent with the recommendation GAO made in the NRCS and GovWorks cases cited previously, in which the order was really a bona fide need of the next fiscal year. To replace the misapplied funds, DoD organizations used a process in which a funds manager certifies that the correct year's appropriated funds were available at the time of the obligation, the day the corrections were processed, and all time in between. Standard Form 1081 was then used to record the change and was forwarded to the Department of the Treasury to make the accounting adjustment.[40]

Why is there confusion surrounding application of the bona fide needs rule?

In part because there has been no single point of reference applicable to all agencies. For appropriations guidance, the federal community often refers to GAO's "Principles of Federal Appropriations Law" (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." For example, the flexibilities available under FASA resulted in major changes to GAO's previous statutory interpretations, and the impact appears to still be "taking hold" in the acquisition community.

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

Year-end spending often is the object of scrutiny, as significant obligations 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 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 the fiscal year is well under way. By default, then, they obligate the majority of their funds during the latter portion of the year.

In reality, the significance of the rule to end-of-year spending arises from the perception that an agency may be trying to spend any remaining appropriated funds before they expire, regardless of whether the spending is for a bona fide need of that fiscal year. In fact, while the end-of-year timing of an obligation may warrant a "further look," GAO says "the timing of the obligation does not, in and of itself, establish anything improper." Despite the perception that end-of- year spending is less likely to represent a bona fide need of the current fiscal year, in historical studies GAO has found that year-end spending is no more or less wasteful than spending at 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 Different terms are used to identify funds that have been appropriated with a statutory period of availability in excess of one fiscal year. For purposes of this *Advisory*, we use the term "multiple year," as used in the GAO Red Book. Other sources, including the DoD FMR use the term "multi-year" for the same type of appropriation.

2 "Severable Services Contracts" (B-317636), Government Accountability Office, April 21, 2009; http://www.gao.gov/decisions/appro/317636.htm.

3 Section 1502(a), title 31, U.S. Code; http://www.law.cornell.edu/uscode/text/31/1502.

4 "Principles of Federal Appropriations Law," 3d ed., vol. 1, Government Accountability Office, January 2004; http://www.gao.gov/assets/210/202437.pdf.

5 GAO's classic illustration of services severability is discussed within the section on the bona fide needs rule at page 5-28 of "Principles of Federal Appropriations Law," 3d ed., vol. 1, Government Accountability Office, January 2004; http://www.gao.gov/assets/210/202437.pdf.

6 B-235678, Government Accountability Office July 30, 1990; http://www.gao.gov/products/461176.

7 Matter of: Funding of Maintenance Contract Extending Beyond Fiscal Year (B-259274), Government Accountability Office, May 22, 1996; http://www.gao.gov/products/476343.

8 B-317636, Government Accountability Office, April 21, 2009; http://www.gao.gov/decisions/appro/317636.htm.

9 Federal Acquisition Streamlining Act of 1994 (S. 1587); http://www.gpo.gov/fdsys/pkg/BILLS-103s1587es/pdf/BILLS-103s1587es.pdf.

10 41 USC 6301; http://www.law.cornell.edu/uscode/text/41/6301. Exceptions to this rule may be made by DoD or the Coast Guard "for clothing, subsistence, forage, fuel, quarters, transportation, or medical and hospital supplies," which, "may not exceed the necessities of the current year."

11 Matter of: Incremental Funding of U.S. Fish and Wildlife Service Research Work Orders File (B-240264), Government Accountability Office, February 7, 1994; http://www.gao.gov/products/150750.

12 Matter of: U.S. Small Business Administration—Indefinite-Delivery Indefinite-Quantity Contract Guaranteed Minimum (B-321640), Government Accountability Office, September 19, 2011; http://www.gao.gov/assets/400/392952.pdf

13 "Principles of Federal Appropriations Law," 3d ed., vol. 1, page 5-13; http://gao.gov/special.pubs/d04261sp.pdf.

14 B-174226, Government Accountability Office, May 11, 1981; http://www.gao.gov/products/473979.

15 "Principles of Federal Appropriations Law," 3d ed., vol. 1, page 5-12; http://www.gao.gov/special.pubs/d04261sp.pdf.

16 Matter of: EEOC–Payment for Training of Management Interns File (B-257977), Government Accountability Office, November 15, 1995; http://archive.gao.gov/legald426p1/155651.pdf.

17 Decision No. B-233243, Government Accountability Office, August 3, 1989; http://www.gao.gov/products/437282; and B-213141- O.M., Government Accountability Office, March 29, 1984; http://www.gao.gov/products/402673.

18 Matter of: National Labor Relations Board—Recording Obligations for Training and Court Reporting (B-321296), General Accountability Office, July 13, 2011; http://www.gao.gov/decisions/appro/321296.htm.

19 "Fiscal Year to Be Charged for Training of GAO Employees" (B-213141-O.M.), Government Accountability Office, March 29, 1984; http://www.gao.gov/products/402673.

20 Matter of: National Labor Relations Board—Funding of Subscription Contracts (B-309530), Government Accountability Office, September 17, 2007; http://www.gao.gov/decisions/appro/309530.htm.

21 "Principles of Federal Appropriations Law," 3d ed., vol. 1, page 5-13; http://www.gao.gov/special.pubs/d04261sp.pdf.

22 "U.S. Department of Education's Use of Fiscal Year Appropriations to Award Multiple Year Grants" (B-289801), Government Accountability Office, December 30, 2002; http://www.gao.gov/decisions/appro/289801.pdf.

23 Matter of: Financial Crimes Enforcement Network—Obligations under a Cost-Reimbursement, Nonseverable Services Contract (B-317139), Government Accountability Office, June 1, 2009; http://www.gao.gov/decisions/appro/317139.pdf.

24 "Interagency Transactions: Frequently Asked Questions Regarding Interagency Transactions," Government Acccountability Office, March 2005; http://www.gao.gov/special.pubs/appforum2005/transactions.pdf.

25 DoD Financial Management Regulations; http://comptroller.defense.gov/fmr.

26 "Interagency Transactions: Roles and Responsibilities; Frequently Asked Questions," Government Accountability Office, March 13, 2008; http://www.gao.gov/special.pubs/appforum2008/interagencytransactions.pdf.

27 Matter of: Natural Resources Conservation Service—Obligating Orders with GSA's AutoChoice Summer Program (B-317249), Government Accountability Office, July 1, 2009; http://www.gao.gov/decisions/appro/317249.htm.

28 Matter of: Expired Funds and Interagency Agreements between GovWorks and the Department of Defense (B-308944), Government Accountability Office, July 17, 2007; http://www.gao.gov/products/B-308944.

29 Interagency Agreement with the Department of Energy for Online Research and Education Information Service (B-301561), Government Accountability Office, June 14, 2004; http://www.gao.gov/decisions/appro/301561.htm.

30 "Interagency Transactions: Frequently Asked Questions Regarding Interagency Transactions," Government Acccountability Office, March 2005; http://www.gao.gov/special.pubs/appforum2005/transactions.pdf.

31 "Summary of Major Changes to DoD7000.14-R, vol. 11A, ch. 18, 'Non-Economy Act Orders,' March 2012; http://comptroller.defense.gov/Portals/45/documents/fmr/current/11a/11a_18.pdf.

32 Matter of: Natural Resources Conservation Service—Obligating Orders with GSA's AutoChoice Summer Program (B-317249), Government Accountability Office, July 1, 2009; http://www.gao.gov/decisions/appro/317249.htm.

33 Matter of: Implementation of the Library of Congress FEDLINK Revolving Fund (B-288142), Government Accountability Office, September 6, 2001 http://archive.gao.gov/legald425p10/a02227.pdf.

34 "Improving the Management and Use of Interagency Agreements," memorandum, Office of Federal Procurement Policy, June 6, 2008; http://www.whitehouse.gov/sites/default/files/omb/assets/procurement/iac_revised.pdf.

35 "Interagency Agreements—Acceptance and Obligation of Funds," GSA Acquisition Letter V-08-04, General Services Administration, June 10, 2008; http://www.gsa.gov/graphics/staffoffices/V-08-04.doc.

36 "Summary Report on Potential Antideficiency Act Violations Resulting from DoD Purchases Made Through Non-DoD Agencies (FY 2004-2007)" (Report No. D-2008-082), Department of Defense Inspector General, April 25, 2008, p. 9; http://www.dodig.mil/audit/reports/fy08/08-082.pdf.

37 The ADA is codified in a number of sections of title 31 of the United States Code (such as 31 U.S.C. 1341(a), 1342, 1349-1351, 1511(a), and 1512-1519); http://www.law.cornell.edu/uscode/text/31.

38 "Potential Antideficiency Act Violations on DoD Purchases Made Through Non-DoD Agencies" (Report No. D-2007-042), Department of Defense Inspector General, January 2, 2007, p. 7; http://www.dodig.mil/audit/reports/FY07/07-042.pdf.

39 "Summary Report on Potential Antideficiency Act Violations Resulting from DoD Purchases Made Through Non-DoD Agencies (FY 2004-2007)" (Report No. D-2008-082), Department of Defense Inspector General, April 25, 2008, p. 15; http://www.dodig.mil/audit/reports/fy08/08-082.pdf.

40 "Summary Report on Potential Antideficiency Act Violations Resulting from DoD Purchases Made Through Non-DoD Agencies (FY 2004-2007)" (Report No. D-2008-082), Department of Defense Inspector General, April 25, 2008, p. 15; http://www.dodig.mil/audit/reports/fy08/08-082.pdf.

This *Advisory* is an updated version of an *Advisory* originally published in August 2003 by Catherine Poole, updated in September 2008 by Catherine Poole and Bob Ransom, and updated in July 2011 and August 2013 by Catherine Poole.

Special thanks to Gladys Gines, Karen Moser, and Paul Cataldo for their assistance in updating this *Advisory*.

The *Advisory* is published as part of the Virtual Acquisition Office™ subscription service, made available by ASI Government, 1655 North Fort Myer Drive, Suite 1000, Arlington, VA 22209, 703-253-6300, fax 703-253-6301, www.GoToVAO.com. Information and opinions are based on best available information, but their accuracy and completeness cannot be guaranteed. Layout by Julie Olver. Contents ©2013 by ASI Government. All rights reserved.