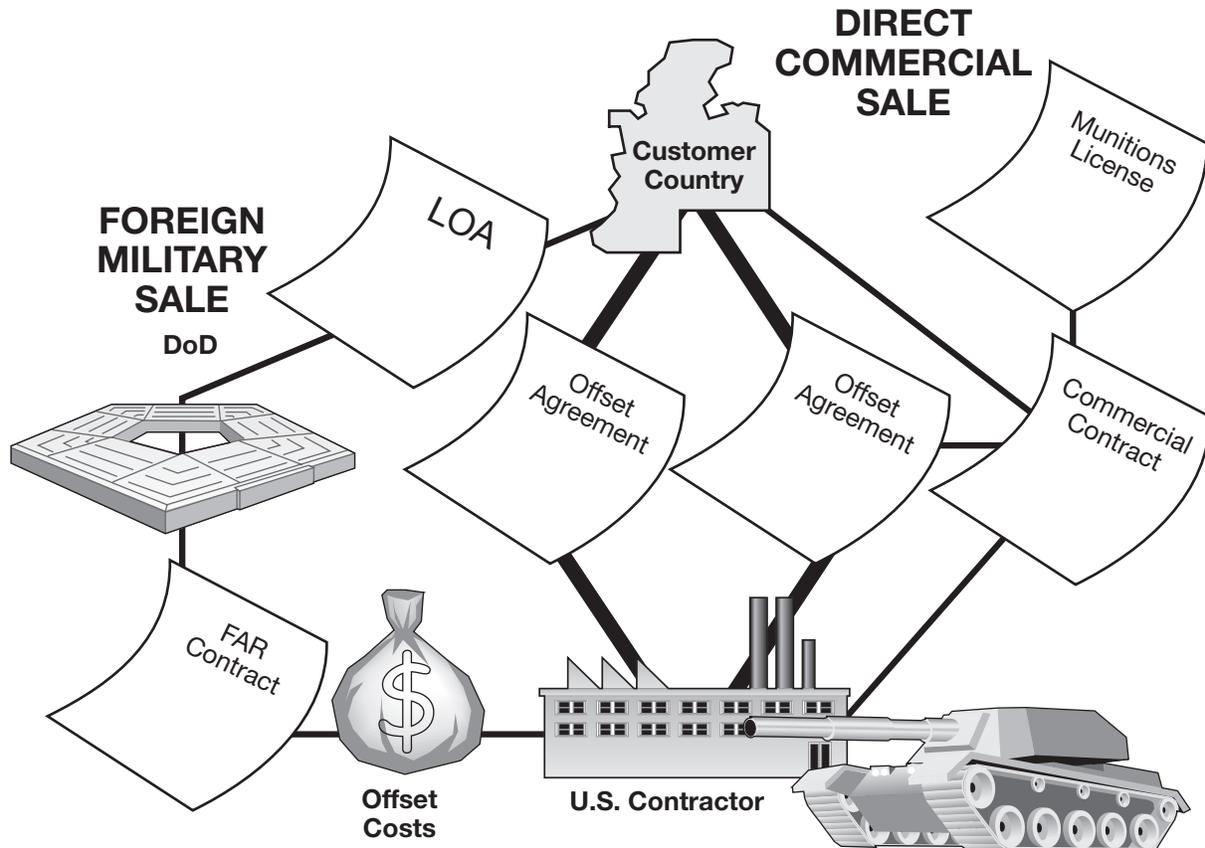


- No USG agency shall encourage, enter directly into, or commit US firms to any offset arrangement related to the sale of US defense articles or services
- USG funds shall not be used to finance offsets
- Negotiations or decisions regarding offset commitments reside with the companies involved
- Exceptions require Presidential approval through the National Security Council (NSC)

Figure 9-2
Offset Relationships



Offset Costs

When a customer requires an offset in association with a major procurement, do they actually obtain the offset benefit at no cost? The fundamental principle of business dictates that any enduring enterprise cannot incur expenses that exceed revenue. This extends to defense sales involving offsets. Firms may agree to perform an offset to win an acquisition competition, but they must recover the cost to perform the offset through the price charged in the primary system contract. In a direct commercial contract, the contractor must build the anticipated cost for performing the offset into its contract prices.

Under FMS, the offset cost recovery process is awkward. The USG wants US firms to successfully compete for international business and permits offset arrangements as a legal business activity. Likewise, the USG wants international customers to have the option to purchase military systems using either the FMS process or the DCS process. Under FMS, the contractor is actually working directly for

DOD, but the USG permits this same contractor to concurrently enter into an offset agreement directly with the FMS purchaser. Although DOD is clearly not a party to the offset agreement, the DFARS, subpart 225.7303-2 recognizes that contractors performing business in support of foreign governments or international organizations may incur certain additional legitimate business costs. Offset costs are one type of cost the DFARS considers as allowable. Contractors are permitted to build the cost of performing the offset into the contract price it charges the USG. Under FMS pricing policy, the USG must recover all the costs of conducting FMS; as a result, if offsets are required by the purchasing country, the LOA price will be incrementally higher in order to cover the cost of the offset. So, on the surface, it may appear that the customer is receiving the offset at no cost, but offset expenses are actually included as a part of the applicable line item unit cost in estimated prices quoted in the LOAs. It is the contractor's responsibility to inform the implementing agency when estimated offset costs have been included in FMS pricing.

The additional cost to perform the offset generally results in a higher contract cost which, in turn, results in a higher FMS cost under the LOA. Although not a party to the offset agreement, the USG serves as the banker for the offset. Although the DFARS states offset costs will be considered allowable, it does not mean the contractor does not have to exercise fiscal responsibility in offset performance. The DFARS requires the CO to review and determine that the contract costs, to include offset costs claimed by the contractor, are both allocable and reasonable. A recent change to DFARS 225.7303-2 directs that all indirect offset costs are to be deemed reasonable with no further analysis necessary by the CO if the contractor provides the CO a signed offset agreement or other documentation showing that the FMS customer made the indirect offset of a certain dollar value a condition of the FMS acquisition. LOA standard term and condition 2.8 reflects this change by referring to the DFARS but does not make specific reference itself to indirect offsets.

It is important to note that the DFARS provision permits offset costs to be included in the costs billed to the USG under the procurement contract only if the LOA is funded with customer funds or repayable credits. If the LOA is funded with non-repayable FMFP funds, offset costs are not allowable.

It is inappropriate for USG personnel to discuss with the foreign government the nature or details of an offset arrangement with a US contractor. However, the fact that offset costs have been included in the P&A or LOA price estimates will be confirmed, should the customer inquire. The customer should be directed to the US contractor for answers to all questions regarding its offset arrangement, including the offset costs.

Offset LOA Standard Term and Condition

LOA standard term and condition 2.8 addresses offsets. This condition summarizes the USG policy regarding offsets in association with FMS.

The USG is not a party to any offset agreements/arrangements which may be required by the Purchaser in relation to the sales made in this LOA. The USG assumes no obligation to administer or satisfy any offset requirements or bear any of the associated costs. To the extent that the Purchaser requires offsets in conjunction with this sale, offset costs may be included in the price of contracts negotiated under this LOA. Such costs shall be determined or deemed to be reasonable in accordance with SUBPART 225.73 of the Defense Federal Acquisition Regulation Supplement (DFARS). If the Purchaser desires visibility into these costs, the Purchaser should raise this with the contractor during negotiation of offset arrangements.

SUMMARY

The fundamental principle regarding contracting for FMS requirements is that the USG essentially treats the FMS customer's requirements as if they were USG requirements. In contracting for FMS, the same contracting regulations, policies and procedures are applied. Per the SAMM, this is one of the principal reasons customers select the FMS system rather than contracting themselves using direct commercial processes.

The unique aspects of the procurement process that pertain to FMS are few in number, but they have a major impact on the FMS process. Competitive source selection is the norm; however, the FMS customer has the option to use other than full and open competition if they desire the USG to contract with a specific firm. Under other than full and open competition procedures, the FMS customers need not provide a rationale for the request.

The USG also has established a comprehensive contract administration infrastructure that will be used to oversee the execution of contracts awarded in support of FMS requirements. Again, the USG uses the same contract administration, quality assurance and contract audit processes for FMS that it uses for normal DOD business.

Offsets are an international market reality. Offsets are permitted in association with FMS when the LOA funding the procurement contract is financed by customer cash or repayable credit. If the LOA is funded by USG grant funds, offset costs claimed by the contractor will be considered unallowable.

REFERENCES

DSCA Manual 5105.38-M, *Security Assistance Management Manual (SAMM)*, chapters 3, 5, 6, and 9. <http://www.samm.dscamilitary.com/>.

Federal Acquisition Regulation (FAR), parts 6, 14, 15, 16, 25, and 31. <https://www.acquisition.gov/far/>.

Defense Federal Acquisition Regulation Supplement (DFARS), part 225, Foreign Acquisition. <http://www.acq.osd.mil/dpap/dars/dfars/html/current/tochtml.htm>.

Department of Commerce. *Offsets in Defense Trade*, Eighteenth Report to Congress. <https://www.bis.doc.gov/index.php/other-areas/strategic-industries-and-economic-security-sies/offsets-in-defense-trade>.

ATTACHMENT 9-1
DSCA Policy MEMORANDUM 09-60, DATED 22 DECEMBER 2009



DEFENSE SECURITY COOPERATION AGENCY
201 12TH STREET SOUTH, STE 303
ARLINGTON, VA 22202-5408

DEC 22 2009

MEMORANDUM FOR DEPUTY UNDER SECRETARY OF THE AIR FORCE
INTERNATIONAL AFFAIRS
DEPUTY ASSISTANT SECRETARY OF THE ARMY FOR
DEFENSE EXPORTS AND COOPERATION
DEPUTY ASSISTANT SECRETARY OF THE NAVY FOR
INTERNATIONAL PROGRAMS
DIRECTOR, DEFENSE CONTRACT MANAGEMENT
AGENCY
DIRECTOR FOR SECURITY ASSISTANCE, DEFENSE
FINANCE AND ACCOUNTING SERVICE –
INDIANAPOLIS OPERATIONS
DIRECTOR, DEFENSE INFORMATION SYSTEMS
AGENCY
DIRECTOR, DEFENSE LOGISTIC AGENCY
DIRECTOR, DEFENSE INFORMATION SERVICE
DIRECTOR, DEFENSE REUTILIZATION AND
MARKETING SERVICE
DIRECTOR, DEFENSE THREAT REDUCTION AGENCY
DIRECTOR, NATIONAL GEOSPATIAL-INTELLIGENCE
AGENCY
DEPUTY DIRECTOR FOR INFORMATION ASSURANCE,
NATIONAL SECURITY AGENCY

SUBJECT: Foreign Military Sales (FMS) Customer Participation in the DoD Contracting
Process, DSCA Policy 09-60

In 2002, the Security Cooperation Community led the effort for customer participation and acquisition transparency in DoD contracts awarded on behalf of Foreign Military Sales (FMS) customers. We successfully sponsored the November 22, 2002, Defense Federal Acquisition Regulation Supplement (DFARS) amendment that provided authorization for FMS customers to participate in specifications development, delivery schedule development, identification of warranties, and other contractual requirements unique to the customer.

The DFARS change encourages customer participation in both the acquisition process and discussions with industry. Customers also are allowed to participate in the contract negotiation process within the limitations of the section, to the degree authorized

