



DEPARTMENT OF THE AIR FORCE
WASHINGTON, DC

Office Of The Under Secretary

02 JUN 2000

MEMORANDUM FOR SEE DISTRIBUTION

FROM: SAF/IAX
1080 Air Force
Washington DC, 20330-1080

SUBJECT: Inclusion of Offset Costs in Letters of Offer and Acceptance (LOAs) (IAX 0015)
(DSCA Memo I-012655/99, Subject: Inclusion of Offset Costs in Letters of Offer
and Acceptance (LOAs), dated 19 Jan 2000)

The referenced DSCA policy letter published revised procedures for inclusion of offset costs in pricing Foreign Military Sales (FMS) contracts, expanded Congressional Notification requirements and changed the Security Assistance Management Manual (SAMM) addressing offsets. These changes are effective immediately and may be found in the Defense Acquisition Deskbook. A copy is attached for appropriate action (Atch 1).

On 13 July 1999, the Director, Defense Procurement (ASD/A& T (DDP)) provided clarification of DFARS offset policy. DDP directed contracting officers to comply with DFARS 225.7303-2(a) (3) which allows an U.S. defense contractor to recover all costs incurred for offset agreements. Offset cost is allowed if the LOA is financed wholly with customer cash or repayable foreign military finance credits.

As a result of the revised DoD policy, contracting officers must evaluate proposed offset costs as part of determining the total contract price is fair and reasonable prior to award of the contract. To satisfy this requirement, contractors may be required to provide cost or price data/information at a level of detail to support the reasonableness of the proposed offset costs. Failure to provide adequate information to support proposed offset costs may result in delays in awarding the contract, exclusion of the offset costs from the contract, or setting aside the offset cost in a saving clause that recognizes the need to negotiate a fixed price when adequate details are available.

The Omnibus Appropriation Act (PL 106-113) signed 29 Nov 99 incorporated offset policy changes contained in H.R. 3427. The new law requires that 36(b)(1) notifications include a "description of any offset agreement with respect to such sale" and establishes a review commission to study the use of offsets in international defense trade. The contractor must provide the FMS Case Manager, through the appropriate Program Office, information required to facilitate statutory disclosure requirements of the 36(b)(1) process (a general description of the performance required for the offset agreement). Should the contractor refuse to provide information on its offset costs, or provide insufficient information for the USAF to fulfill its 36(b)(1) notification requirements, a statement will be inserted in the appropriate section of the

notification that "The U.S. Defense Contractor declined to provide sufficient information to complete this section of the Congressional Notification". The Case Manager will notify the contractor that the congressional notification will contain this statement.

Offset details required to satisfy reporting obligations outlined above must be obtained from the contractor. It is inappropriate for USG personnel to discuss with the FMS customer the nature or details of an offset arrangement. However, should the FMS customer request details of offset costs included in the LOA, international affairs personnel may confirm that offset costs have been included in the P&A or LOA price estimate if known. The Purchaser should be directed to the US contractor for answers to all questions regarding its offset arrangement, including cost (SAMM para 80106.D.).

At DSCA's direction (SAMM para 80106) all LOAs will contain the following Note:

"Offset costs may be included in this LOA if it is financed wholly by Purchaser cash or repayable credit. The DoD 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 and assumes no obligation to administer or satisfy any offset requirements or bear any of the associated costs."

The DSAM Offset Note has been revised to reflect the above new language.

Offset issues remain a sensitive topic and will continue to demand our attention for the foreseeable future. You are requested to work closely with your counterparts within the acquisition community and with U.S. defense contractors to ensure compliance with these legislative and policy changes.

Request you ensure wide dissemination of this policy within your command and provide SAF/IAX a copy of implementing policy. If you have any question concerning these issues please contact Lewis Witt, SAF/IAX, (703) 588-8960, DSN 425-8960 or e-mail: lewis.witt@pentagon.af.mil or JP McCusker, SAF/AQC (703) 588-7031, DSN 425-7031 or e-mail james.mccusker@pentagon.af.mil.



TERRY BATES
Chief, Policy Division
Office of the Deputy Under Secretary of the Air
Force International Affairs

Attachment:
DSCA Memo 19 Jan 00

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DEFENSE SECURITY COOPERATION AGENCY

WASHINGTON, DC 20301-2800

19 JAN 2000

In reply refer to:
I-012655/99

MEMORANDUM FOR DEPUTY UNDER SECRETARY OF THE ARMY
(INTERNATIONAL AFFAIRS)
ATTN: SAUS-IA-DSZ
DEPARTMENT OF THE ARMY

DIRECTOR, NAVY INTERNATIONAL PROGRAMS OFFICE
DEPARTMENT OF THE NAVY

DEPUTY UNDER SECRETARY OF THE AIR FORCE
(INTERNATIONAL AFFAIRS)
DEPARTMENT OF THE AIR FORCE

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DIRECTOR, DEFENSE LOGISTICS INFORMATION SERVICE

DEPUTY DIRECTOR FOR SECURITY ASSISTANCE,
DEFENSE FINANCE AND ACCOUNTING SERVICE -
DENVER CENTER

SUBJECT: Inclusion of Offset Costs in Letters of Offer and Acceptance (LOAs) (DSCA 00-01)

REFERENCE: OUSD (A&T) Memorandum, "Pricing Issues in Foreign Military Sales
Contracts," July 13, 1999

The referenced memorandum (attached) provided clarification of the requirements for including offset costs in pricing of Foreign Military Sales (FMS) contracts financed wholly with customer cash or repayable Foreign Military Financing (FMF) credits. Per this memorandum, contracting officers were advised to treat all offset costs as allowable FMS contract costs. Effective 14 Sep 99, the Defense Federal Acquisition Regulation Supplement (DFARS) was changed to reflect this policy. The DFARS, section 225.7303-2(a)(3) now states that "A U.S.

defense contractor may recover all costs incurred for offset agreements with a foreign government or international organization if the LOA is financed wholly with customer cash or repayable foreign military finance credits." Nonrepayable FMF funds may not be used to pay offsets. The Omnibus Appropriation Act (P.L. 106-113) which incorporated H.R. 3427, signed 29 Nov 99, also made some changes to offset policy. The new law requires that 36(b)(1) notifications include a "description of any offset agreement with respect to such sale" and establishes a review commission to study the use of offsets in international defense trade.

In order to ensure our guidance is consistent with the DFARS and new legal requirements, the Security Assistance Management Manual (SAMM) must be revised. The following changes are effective immediately:

- a. Paragraph 80106 is deleted in its entirety and is replaced as follows:

"80106 OFFSET COSTS DFARS 225.7303-2(a)(3) allows US contractors to recover, under FMS contracts based on LOAs financed wholly by Purchaser cash or repayable FMF credits, costs of any offsets which are associated with those contracts. USG agencies may not enter into or commit US firms to any offset agreement. Any Purchaser requesting offset arrangements in conjunction with FMS should be informed that the responsibility for negotiating offset arrangements and satisfying all related commitments resides with the US firm involved. It is the responsibility of the implementing agency to specify to DSCA, in the transmittal of any Congressional Notification, LOA and any subsequent LOA modification or amendment, that offset costs have been included, if known. Information regarding offset costs and their recoupment through FMS follows:

A. Offset costs should be included as part of the line item(s) unit cost in P&A data and in estimated prices quoted in the LOAs.

B. For procurements where adequate price competition exists or it is anticipated, whether conducted by the Purchaser or by the USG, the USG will normally not have visibility as to whether offset costs are included in the price or the amount of such costs.

C. When the USG anticipates a noncompetitive procurement, it is the contractor's responsibility to inform the implementing agency when estimated offset costs have been included in the FMS pricing information provided. The costs should be included as early as possible but before submittal of the LOA. Requests to include these costs after LOA acceptance will require an LOA modification or amendment.

D. It is inappropriate for USG personnel to discuss with the Purchaser the nature or details of an offset arrangement. However, if known, the fact that offset costs have been included in the P&A or LOA price estimate will be confirmed should the Purchaser inquire. The Purchaser should be directed

to the US contractor for answers to all questions regarding its offset arrangement, including questions dealing with cost. Implementing agency involvement in any discussion of offset costs (beyond confirmation of the inclusion of these costs in price estimates) with the Purchaser requires case-by-case review and approval by DSCA.

E. All LOAs will include the offset note provided in paragraph 70105.L.4.”

b. Paragraph 70105.L.4. requires the inclusion of an offset note on all LOAs. To ensure the customer is aware that offset costs may be included in the FMS case, this paragraph/note is revised to read as follows:

“4. **Offset Costs.** (See paragraph 80106) All LOAs will contain the following note:

Offset costs may be included in this LOA if it is financed wholly by Purchaser cash or repayable credit. The DoD 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 and assumes no obligation to administer or satisfy any offset requirements or bear any of the associated costs.”

This note must be included on any new LOAs written after the date of this memorandum. There is no requirement to add this revised note retroactively to any existing cases.

c. Paragraph 70302 is updated to eliminate the phrase “(if known on the date of certification submittal)” from line 26. This change makes the paragraph consistent with the changes in P.L. 106-113.

d. Paragraph 70302.A.3.c. is updated to eliminate the phrase “(if known on the date of transmittal of such statement)” from line 4. Again, this makes the paragraph consistent with new legal requirements.

e. Table 703-3, “Advance Notification Data” must be updated to reflect the requirement to include offset information as part of the advance notification. Paragraph p. is relabeled “q.” and a new p. is included as follows: “p. A description of any offset agreement with respect to this sale is included in the enclosed confidential attachment (if applicable). [NOTE: See Table 703-3B for the proper format.]”

f. Table 703-3B is added as shown in attachment 2 of this memorandum.

g. Table 703-5, “Statutory Notification Data,” must be updated to reflect the requirement to include offset information as part of the statutory notification. Paragraph o. is relabeled “p.” and a new o. is included as follows: “o. A description of any offset agreement with respect to this sale is included in the enclosed confidential attachment (if applicable). [NOTE: See Table 703-5B for the proper format.]”

h. Table 703-5B is added as shown in attachment 3 of this memorandum.

The revised paragraphs and tables are effective immediately and will be included in the automated version of the SAMM found in the Defense Acquisition Deskbook. If you have any questions concerning this change, please contact Beth Baker, DSCA/PSD-PMD, (703) 604-6612, DSN 664-6612 or e-mail: beth.baker@osd.pentagon.mil.



MICHAEL S. DAVISON, JR.
LIEUTENANT GENERAL, USA
DIRECTOR

Attachments:

1. OUSD(A&T) Memorandum, 13 Jul 99
2. New SAMM Table 703-3B
3. New SAMM Table 703-5B

cc: AMSAC-OL-MP



ACQUISITION AND
TECHNOLOGY

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

July 13, 1999

DP/CPF

MEMORANDUM FOR DIRECTORS OF DEFENSE AGENCIES
DEPUTY FOR ACQUISITION AND BUSINESS MANAGEMENT,
ASN(RD&A)/ABM
DEPUTY ASSISTANT SECRETARY OF AIR FORCE
(CONTRACTING)
DEPUTY ASSISTANT SECRETARY OF THE ARMY (PROCUREMENT)
EXECUTIVE DIRECTOR FOR PROCUREMENT MANAGEMENT
(DLSC/DLA)

Subject: Pricing Issues in Foreign Military Sales Contracts

I want to clarify the requirements for pricing foreign military sales (FMS) contracts, including the treatment of offset costs.

In today's global marketplace, there is significant competition for sales of military equipment, with U.S. systems competing against foreign systems and other U.S. systems (for example, F-15 vs. F-16) to meet foreign governments' requirements. In these situations, competitions run by foreign governments should determine the price to be paid. This is true even if the sale to the foreign government is then processed as a foreign military sale and even if DoD is buying the same item sole source. The contracting officer should consult with the foreign government through security assistance personnel to determine whether adequate price competition occurred. If so, this meets the requirement of FAR 15.403-1(b)(1), which states that the submission of certified cost or pricing data shall not be required when the contract price is based on adequate price competition. No further data to support the price should be requested.

In pricing noncompetitive FMS contracts where cost or pricing data is obtained, DFARS 225.7303-2(a) instructs contracting officers to recognize the reasonable and allocable costs of doing business with a foreign government, including offset implementation costs, except when the purchase is financed with funds made available on a nonrepayable basis. In 1995, the language at DFARS 225.7303-2(a)(3) was changed to allow all costs of implementing an offset agreement. There appear to be differences in how this



language is being interpreted and implemented. Contracting officers should treat all offset costs as allowable FMS contract costs. To disallow such costs means that U.S. companies must absorb offset costs that are required by the foreign government as a condition of making the sale. It is only reasonable that foreign governments that require offsets should bear the costs of those offsets.

A handwritten signature in cursive script that reads "Eleanor R. Spector". The signature is written in dark ink and is positioned to the right of the typed name.

Eleanor R. Spector
Director, Defense Procurement

TABLE 703-3B
OFFSET INFORMATION – ADVANCE NOTIFICATION

(CLASSIFICATION)

Reporting of offset agreements in accordance with Section 36(b)(1) of the Arms Export Control Act (AECA), as amended by Section 1245 of H.R. 3427 enacted by P.L. 106-113 dated November 29, 1999, requires a description of any offset agreement with respect to this proposed sale. Section 36(b)(1)(g) of the AECA (as amended) provides that reported information related to offset agreements be treated as confidential information in accordance with section 12(c) of the Export Administration Act of 1979 (50 U.S.C. App. 2411(c)). Information about offsets for this proposed sale are described below:

-- general description of the performance required for the offset agreement.

Section 36(b)(1)(g) of the Arms Export Control Act (22 U.S.C. 2776) requires this information to be treated as "CONFIDENTIAL INFORMATION" in accordance with section 12(c) of the Export Administration Act of 1979 (50 U.S.C. App. 2411(c)). This information is exempt from disclosure under section 552 of title 5, United States Code, and shall not be published or disclosed without a determination that withholding is contrary to the national interest.

DERIVED FROM: SEC 12(C) OF THE EAA OF 1979 (50 U.S.C. APP. 2411(C))
DECLASSIFY ON: OADR

(CLASSIFICATION)

TABLE 703-5B
OFFSET INFORMATION – STATUTORY NOTIFICATION

(CLASSIFICATION)

Reporting of offset agreements in accordance with Section 36(b)(1) of the Arms Export Control Act (AECA), as amended by Section 1245 of H.R. 3427 enacted by P.L. 106-113 dated November 29, 1999, requires a description of any offset agreement with respect to this proposed sale. Section 36(b)(1)(g) of the AECA (as amended) provides that reported information related to offset agreements be treated as confidential information in accordance with section 12(c) of the Export Administration Act of 1979 (50 U.S.C. App. 2411(c)). Information about offsets for this proposed sale are described below:

-- general description of the performance required for the offset agreement.

Section 36(b)(1)(g) of the Arms Export Control Act (22 U.S.C. 2776) requires this information to be treated as "CONFIDENTIAL INFORMATION" in accordance with section 12(c) of the Export Administration Act of 1979 (50 U.S.C. App. 2411(c)). This information is exempt from disclosure under section 552 of title 5, United States Code, and shall not be published or disclosed without a determination that withholding is contrary to the national interest.

DERIVED FROM: SEC 12(C) OF THE EAA OF 1979 (50 U.S.C. APP. 2411(C))
DECLASSIFY ON: OADR

(CLASSIFICATION)