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## Uniform article for the termination of government fixed-price war supply contracts and Statement of principles for determination of costs upon termination of government fixed-price supply contracts, released January 8, 1944

United States. Office of War Mobilization

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UNIFORM ARTICLE FOR THE TERMINATION OF GOVERNMENT  
FIXED-PRICE WAR SUPPLY CONTRACTS

and

STATEMENT OF PRINCIPLES FOR DETERMINATION  
OF COSTS UPON TERMINATION OF GOVERNMENT  
FIXED-PRICE SUPPLY CONTRACTS

RELEASED JANUARY 8, 1944

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## Baruch Uniform Termination Clause and Cost Formula

Following is complete text of Bernard M. Baruch's directive setting forth a uniform article for the termination of Government fixed-price war supply contracts. It is effective immediately. It also contains a "Statement of Principles on the Determination of Costs."

Reproduced here is the official announcement, prepared by the Office of War Mobilization, text of the directive, the termination clause, and instructions as to allowable costs: (OFFICIAL TEXT)

### ANNOUNCEMENT

The Director of War Mobilization today issued a directive to all procurement agencies making immediately effective a uniform Article for the termination of government fixed-price war supply contracts and a Statement of Principles to be followed by such departments in determining costs.

The directive was based upon a recommendation by Mr. B. M. Baruch and Mr. John Hancock. Mr. Baruch is in charge of the Special Unit in the Office of War Mobilization established by Director Byrnes to deal with War and Post War Adjustment problems. Mr. Hancock is associated with Mr. Baruch in that work and is Chairman of the Joint Contract Termination Board composed of representatives of the various departments, which Board has agreed to the Article and the Statement of Principles today made effective for all departments.

In releasing the recommendation of Mr. Baruch and Mr. Hancock, Director Byrnes stated that the Office of War Mobilization would keep in touch with the various departments in order to see that the policies adopted were made effective. He said that the Unit headed by Mr. Baruch had made great progress in considering other phases of contract termination, and in the development of policies to govern the disposition of surplus property.

Director Byrnes said it was an important step toward eliminating the delay in a contractor getting his money and delay in the employee getting a job.

Following is a letter from Mr. Baruch and Mr. Hancock to Director Byrnes transmitting the uniform termination article and statement of principles:

Herewith we are transmitting with our approval and the recommendation that they be made effective, a Uniform Termination Article for Government fixed-price war supply contracts and a Statement of Principles on the Determination of Costs, which have been drafted and unanimously agreed upon by the Joint Contract Termination Board, established at your direction on November 12, with representatives of the major war pro-

urement agencies—War and Navy, Treasury, Maritime Commission, the RFC subsidiaries and the Foreign Economic Administration.

To facilitate war procurement and because of the need to insert this Termination Article into new war contracts, and to give contractors the earliest opportunity to have this Article included in their existing contracts, the Joint Board has asked that the Termination Article and Cost Statement be announced immediately, in advance of the broader program of contract termination policies on which we are working and which we will recommend to you.

This Termination Article and Cost Statement deal with only two of the many aspects of contract termination policies. They fill a long-felt need for a clear definition of what are the rights of the Government and contractors when war contracts are terminated—a definition that will be fair to contractors while protecting the Government, and the same definition to bind all of the war procurement agencies.

The Termination Article and Cost Statement are not intended to cover and should not be confused with the many other aspects of contract termination policies including such questions as payments and loans, settlement procedures, the keeping of adequate records and protection of the public interest, the special problems of subcontractors, appeals, company-wide settlements, the disposal of property and the need for legislation. All of these problems are enmeshed in many difficulties which are being cut through and will be reported on to you.

The fact that the termination provisions in Government war supply contracts are to be simplified and made uniform is an important contribution to and can be described as the first step in developing a full set of clearcut, workable policies on contract termination; but it is only the first step.

We trust there will be no speculation that our release of this Termination Article reflects a belief in an early end of the war. Contracts are being terminated and settled regularly as the needs of war change. The unifying and simplifying of the Government's contracts is a war measure, as well as a preliminary step in preparing for demobilization.

To clarify some of the questions that are not covered in this Termination Article and Cost Statement, our objectives on some of the unsettled problems might be stated:

1. How to apply the principles of this Uniform Termination Article to subcontractors, is under careful consideration. A number of serious administrative problems are involved that require further study. Our objective is to have the same principles of contract settlement apply to subcontractors as well as prime contractors.

2. As to payment, our objective is quick payment of what the Government owes so that our great productive capacity can be fully utilized for war and peace—destroying the dangers of unemployment and inflation.

3. The development of the necessary safeguards to protect the Government's interest in both the settlement of contracts and the disposal of property; including not only adequate records but also protective methods for the prevention and detection of fraud.

4. On the clearance of Government-owned materials and equipment from the plants of both prime and subcontractors, we have set for ourselves the objective of assuring prompt clearance with a deadline of not later than 60 days after the filing of inventory lists, and with manufacturers having the right to remove and store this property at an earlier date at their own risk.

Manufacturers will benefit from having this Termination Article in their contracts. It will assure uniform handling of their claims by all of the agencies with which they have contracts, eliminating possible conflict and confusion over varying contract provisions; it will make for swifter and more equitable settlement, give manufacturers a clear definition of their rights; reduce litigation.

The desirability of having a standard Termination Article for all agencies has been generally recognized. It has been advocated by business groups; independent organizations; the procurement agencies themselves as well as several important committees of Congress including those headed by Senators George and Murray.

Efforts to develop such a uniform termination clause have been going on within the Government for more than a year and a half. The fact that agreement has been obtained in these last weeks is a tribute to the fine, cooperative spirit with which the Joint Contract Termination Board and its staff has functioned and to the preparatory work that has been done by other agencies, particularly that done under the auspices of the War Production Board.

The Article applies only to domestic contracts, not foreign. Consideration is being given to certain other exceptions and an approved list of such exceptions will be issued soon. Obviously, where the sums involved are so small or the time of the contract is short, the Termination Article is not needed.

In drawing up this Article, the Joint Board was under instructions to protect the Government's interests fully, not giving contractors more than they are entitled to under existing contracts, but to assure them their just and fair rights. The Termination Article necessarily is a merging of the many types of contract termination provisions that have been used by the agencies and will not fit all cases

perfectly. Differences between this Article and existing contracts will be outweighed by the advantages of the unified, simpler and speedier procedure for settling contracts which this Uniform Termination Article makes possible.

Both the Termination Article and Cost Statement are confined to broad, workable principles, with details left to be covered in administrative regulations, manuals and instructions. Many points were not included because they were questions of detail which will require constant refinement in the light of experience and could be handled best by regulations which can be revised readily and which are more easily adjusted to special cases.

Briefly summarized, the Termination Article provides that the Government may terminate a prime contract at any time by giving notice, which is the common provision in existing contracts. What the contractor must do on receiving his termination notice is set forth. Contractors will be paid for all completed articles at the contract price.

Two types of settlement are provided for: one, for the contractor and the Government to agree upon a fair and reasonable settlement through negotiation; the second if such negotiations prove unsuccessful, for settlement through the application of a specified formula.

Of particular interest, is the margin of profit allowed on work which the contractor has begun but has not completed. Clearly, the simplicity of a flat, uniform rate of profit would yield enormous administrative benefits in easing the problems of settlement for both contractors and the Government. However, under certain conditions, a single flat rate might give excessive profits, as where a manufacturer's costs consisted largely of assembling an inventory of raw materials.

Accordingly, a profit formula was devised which (a) limits the aggregate profit in all cases to a maximum of 6 percent; and (b) further limits to a maximum of 2 percent the profit on unprocessed inventory, and only to the extent that this inventory is properly allocable to the contract. Both these rates of profit are maximums and there will be instances where only a fraction of a percent profit will be allowed on raw materials. Obviously no profit will be allowed except on work done or costs incurred.

We have felt that it would contribute to fair and speedy settlement, with protection for both the Government and the contractor, to set forth a specified, though not too rigid, yardstick for measuring profit.

The Cost Statement is based upon the recognition only of those costs that are properly allocable to the contract and only to the extent that they are quantitatively reasonable for the performance of the whole contract. In determining these costs, recognized accounting practices are to be used. The

Cost Statement goes further to clarify some of the uncertainties that have arisen in the minds of contractors as to which costs are properly allocable to the contract and which are definitely excluded.

In bringing the drafting of this Termination Article and Cost Statement to decision and conclusion, our thinking has been that the interests of both contractors and the Government will be best served by a clear definition of their mutual rights and obligations and by preparing the ground for prompt settlement on the basis of those rights and obligations.

#### DIRECTIVE

The following is the text of the Directive Order to All Procurement Agencies issued by Director Byrnes:

### UNIFORM TERMINATION ARTICLE FOR FIXED PRICE SUPPLY CONTRACTS

Article Termination at the Option of the Government. (a) The performance of work under this contract may be terminated by the Government in accordance with this Article in whole, or from time to time in part, whenever the contracting officer shall determine any such termination is for the best interests of the Government. Termination of work hereunder shall be effected by delivery to the contractor of a Notice of Termination specifying the extent to which performance of work under the contract shall be terminated, and the date upon which such termination shall become effective. If termination of work under this contract is simultaneous with, a part of, or in connection with, a general termination (1) of all or substantially all of a group or class of contracts made by the \_\_\_\_\_ Department for the same product or for closely related products, or (2) of war contracts at, about the time of, or following, the cessation of the present hostilities, or any major part thereof, such termination shall only be made in accordance with the provisions of this Article, unless the contracting officer finds that the contractor is then in gross or wilful default under this contract.

(b) After receipt of a Notice of Termination and except as otherwise directed by the contracting officer, the contractor shall (1) terminate work under the contract on the date and to the extent specified in the Notice of Termination; (2) place no further orders or subcontracts for materials, services or facilities except as may be necessary for completion of such portions of the work under the contract as may not be terminated; (3) terminate all orders and subcontracts to the extent that they relate to the performance of any work terminated by the Notice of Termination; (4) assign to the Government, in the manner and to the extent directed by

The Uniform Termination Article for Government fixed price war supply contracts and the Statement of Principles on the Determinations, adopted by the Joint Contract Termination Board and approved by the War and Post War Adjustment Unit of the Office of War Mobilization, are hereby made effective.

The Termination Article shall be used to the fullest extent practicable in all new war contracts and contractors shall be given the earliest practicable opportunity to have the Article included in existing contracts.

Situations in which it is deemed impracticable to use the Termination Article should be promptly reported to this Office for further instructions.

the contracting officer, all of the right, title and interest of the contractor under the orders or subcontracts so terminated; (5) settle all claims arising out of such termination of orders and subcontracts with the approval or ratification of the contracting officer to the extent that he may require, which approval or ratification shall be final for all the purposes of this Article; (6) transfer title and deliver to the Government in the manner, to the extent and at the times directed by the contracting officer (i) the fabricated or unfabricated parts, work in process, completed work, supplies and other material produced as a part of, or acquired in respect of the performance of, the work terminated in the Notice of Termination, and (ii) the plans, drawings, information and other property which, if the contract had been completed, would be required to be furnished to the Government; (7) use his best efforts to sell in the manner, to the extent, at the time, and at the price or prices directed or authorized by the contracting officer, any property of the types referred to in subdivision (6) of this paragraph provided, however, that the contractor (i) shall not be required to extend credit to any purchaser and (ii) may retain any such property at a price or prices approved by the contracting officer; (8) complete performance of such part of the work as shall not have been terminated by the Notice of Termination; and (9) take such action as may be necessary or as the contracting officer may direct for protection and preservation of the property, which is in the possession of the contractor and in which the Government has or may acquire an interest.

(c) The contractor and the contracting officer may agree upon the whole or any part of the amount or amounts to be paid to the contractor by reason of the total or partial termination of work pursuant to this Article, which amount or

amounts may include a reasonable allowance for profit, and the Government shall pay the agreed amount or amounts. Nothing in paragraph (d) of this Article prescribing the amount to be paid to the contractor in the event of failure of the contractor and the contracting officer to agree upon the whole amount to be paid to the contractor by reason of the termination of work pursuant to this Article shall be deemed to limit, restrict or otherwise determine or affect the amount or amounts which may be agreed upon to be paid to the contractor pursuant to this paragraph (c).

(d) In the event of the failure of the contractor and contracting officer to agree as provided in paragraph (c) upon the whole amount to be paid to the contractor by reason of the termination of work pursuant to this Article, the Government, but without duplication of any amounts agreed upon in accordance with paragraph (c), shall pay to the contractor the following amounts:

(1) For completed articles delivered to and accepted by the Government (or sold or retained as provided in paragraph (b) (7) above) and not, theretofore, paid for, forthwith a sum equivalent to the aggregate price for such articles computed in accordance with the price or prices specified in the contract;

(2) In respect of the contract work terminated as permitted by this Article, the total (without duplication of any items) of (i) the cost of such work exclusive of any cost attributable to articles paid or to be paid for under paragraph (d) (1) hereof; (ii) the cost of settling and paying claims arising out of the termination of work under subcontracts or orders as provided in paragraph (b) (5) above, exclusive of the amounts paid or payable on account of supplies or materials delivered or services furnished by the subcontractor prior to the effective date of the notice of termination of work under this contract, which amounts shall be included in the cost on account of which payment is made under subdivision (i) above; and (iii) a sum equal to \_\_\_\_\_%<sup>1</sup> of the part of the amount determined under subdivision (i) which represents the cost of articles or materials not processed by the contractor, plus a sum equal to \_\_\_\_\_%<sup>2</sup> of the remainder of such amount, but the aggregate of such sums shall not exceed 6% of the whole of the amount determined under subdivision (i), which for the purpose of this subdivision (iii) shall exclude any charges for interest on borrowings;

(3) The reasonable cost of the preservation and protection of property incurred pursuant to paragraph (b) (9) hereof; and any other reasonable cost incidental to termination of work under this

contract, including expense incidental to the determination of the amount due to the contractor as the result of the termination of work under this contract.

The total sum to be paid to the contractor under subdivisions (1) and (2) of this paragraph (d) shall not exceed the total contract price reduced by the amount of payments otherwise made and by the Contract price of work not terminated. Except for normal spoilage and to the extent that the Government shall have otherwise expressly assumed the risk of loss, there shall be excluded from the amounts payable to the contractor as provided in paragraph (d) (1) and paragraph (d) (2) (i), all amounts allocable to or payable in respect of property, which is destroyed, lost, stolen or damaged so as to become undeliverable prior to the transfer of title to the Government or to a buyer pursuant to paragraph (b) (7) or prior to the 60th day after delivery to the Government of an inventory covering such property, whichever shall first occur.

(e) The obligation of the Government to make any payments under this article: (1) shall be subject to deductions in respect of (i) all unliquidated partial or progress payments, payments on account theretofore made to the contractor and unliquidated advance payments, (ii) any claim which the Government may have against the contractor in connection with this contract, and (iii) the price agreed upon or the proceeds of sale of any materials, supplies or other things retained by the contractor or sold, and not otherwise recovered by or credited to the Government, and (2) in the discretion of the contracting officer shall be subject to deduction in respect of the amount of any claim of any subcontractor or supplier whose subcontract or order shall have been terminated as provided in paragraph (b) (3) except to the extent that such claim covers (i) property or materials delivered to the contractor or (ii) services furnished to the contractor in connection with the production of completed articles under this contract.

(f) In the event that, prior to the determination of the final amount to be paid to the contractor as in this article provided, the contractor shall file with the contracting officer a request in writing that an equitable adjustment should be made in the price or prices specified in the contract for the work not terminated by the Notice of Termination, the appropriate fair and reasonable adjustment shall be made in such price or prices.

(g) The Government shall make partial payments and payments on account, from time to time, of the amounts to which the contractor shall be entitled under this Article, whether determined by agreement or otherwise, whenever in the opinion of the contracting officer the aggregate of such pay-

<sup>1</sup>Not to exceed 2%.

<sup>2</sup>To be established at a figure which is fair and reasonable under the circumstances.

ments shall be within the amount to which the contractor will be entitled hereunder.

(h) For the purposes of paragraphs (d) (2) and (d) (3) hereof, the amounts of the payments to be made by the Government to the contractor shall be determined in accordance with the Statement of Principles for Determination of Costs upon Termination of Government Fixed Price Supply Con-

tracts approved by the Joint Contract Termination Board, December 31, 1943. The contractor for a period of three years after final settlement under the contract shall make available to the Government at all reasonable times at the office of the contractor all of its books, records, documents, and other evidence bearing on the costs and expenses of the contractor under the contract and in respect of the termination of work thereunder.

#### STATEMENT OF PRINCIPLES FOR DETERMINATION OF COSTS UPON TERMINATION OF GOVERNMENT FIXED PRICE SUPPLY CONTRACTS

The following is the "Statement of Principles for Determination of Costs upon Termination of Government Fixed Price Supply Contracts approved by the Joint Contract Termination Board, December 31, 1943" referred to in paragraph (h) of the Uniform Termination Article applicable to the termination of fixed price supply contracts at the option of the Government.

1. General Principles. The costs contemplated by this Statement of Principles are those sanctioned by recognized commercial accounting practices and are intended to include the direct and indirect manufacturing, selling and distribution, administrative and other costs incurred which are reasonably necessary for the performance of the contract, and are properly allocable or apportionable, under such practices, to the contract (or the part thereof under consideration). The general principles set out in this Statement are subject to the application of any special provisions of the contract. Certain costs are specifically described below because of their particular significance, and, as in the case of other costs, should be included to the extent that they are allocable to or should be apportioned to the contract or the part thereof under consideration.

(a) Common Inventory. The costs of items of inventory which are common to the contract and to other work of the contractor.

(b) Common Claims of Subcontractors. The claims of subcontractors which are common to the contract and to other work of the contractor.

(c) Depreciation. An allowance for depreciation at appropriate rates on buildings, machinery and equipment and other facilities, including such amounts for obsolescence due to progress in the arts and other factors as are ordinarily given consideration in determining depreciation rates. Depreciation as defined herein shall not include loss of useful value of the type covered by subparagraph (f).

(d) Experimental and Research Expense. General experimental and research expense to the extent consistent with an established pre-war program, or to the extent related to war purposes.

(e) Engineering and Development and Special Tooling. Costs of engineering and development and of special tooling; provided that the contractor protects any interests of the Government by transfer of title or by other means deemed appropriate by the Government.

(f) Loss on facilities—Conditions on Allowance. In the case of any special facility acquired by the contractor solely for the performance of the contract, or the contract and other war production contracts, if upon termination of the contract such facility is not reasonably capable of use in the other business of the contractor having regard to the then condition and location of such facility, an amount which bears the same proportion to the loss of useful value as the deliveries not made under the contract bear to the total of the deliveries which have been made and would have been made had the contract and the other contracts been completed, provided that the amount to be allowed under this paragraph shall not exceed the adjusted basis of the facility for Federal income tax purposes immediately prior to the date of the termination of the contract, and provided further that no amount shall be allowed under this paragraph unless upon termination of the contract title to the facility is transferred to the Government, except where the Government elects to take other appropriate means to protect its interests.

(g) Special Leases. (1) Rentals under leases clearly shown to have been made for the performance of the contract, or the contract and other war production contracts, covering the period necessary for complete performance of the contract and such further period as may have been reasonably necessary; (2) costs of reasonable alteration of such leased property made for the same purpose; and (3) costs of restoring the premises, to the extent required by reasonable provisions of the lease; less (4) the residual value of the lease; provided that the contractor shall have made reasonable efforts to terminate, assign, or settle such leases or otherwise reduce the cost thereof.

(h) Advertising. Advertising expense to the ex-

tent consistent with a pre-war program or to the extent reasonable under the circumstances.

(i) Limitation on Costs Described in Subparagraphs (d), (e), (f), (g), and (h). In no event shall the aggregate of the amounts allowed under subparagraphs (d), (e), (f), (g), and (h) exceed the amount which would have been available from the contract price to cover these items, if the contract had been completed, after considering all other costs which would have been required to complete it.

(j) Interest. Interest on borrowings.

(k) Settlement expenses. Reasonable accounting, legal, clerical and other expenses necessary in connection with the termination and settlement of the contract and subcontracts and purchase orders thereunder, including expenses incurred for the purpose of obtaining payment from the Government only to the extent reasonably necessary for the preparation and presentation of settlement proposals and cost evidence in connection therewith.

(l) Protection and Disposition of Property.

Storage, transportation and other costs incurred for the protection of property acquired or produced for the contract or in connection with the disposition of such property.

2. Initial Costs. Costs of a non-recurring nature which arise from unfamiliarity with the product in the initial stages of production should be appropriately apportioned between the completed and the terminated portions of the contract. In this category would be included high direct labor and overhead costs, including training, costs of excessive rejections and similar items.

3. Excluded Costs. Without affecting the generality of the foregoing provisions in other respects, amounts representing the following should not be included as elements of cost:

(a) Losses on other contracts, or from sales or

exchanges of capital assets; fees and other expenses in connection with reorganization or recapitalization, anti-trust or federal income-tax litigation, or prosecution of federal income tax claims or other claims against the Government (except as provided in paragraph 1 (k)); losses on investments; provisions for contingencies; and premiums on life insurance where the contractor is the beneficiary.

(b) The expense of conversion of the contractor's facilities to uses other than the performance of the contract.

(c) Expenses due to the negligence or wilful failure of the contractor to discontinue with reasonable promptness the incurring of expenses after the effective date of the termination notice.

(d) Costs incurred in respect to facilities, materials, or services purchased or work done in excess of the reasonable quantitative requirements of the entire contract.

(e) Costs which, as evidenced by accounting statements submitted in renegotiation under Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, were charged off during a period covered by a previous renegotiation, may not be subsequently included in the termination settlement if a refund was made for such period, or to the extent that such charging off is shown to have avoided such refund.

4. To the extent that they conform to recognized commercial accounting practices and the foregoing Statement of Principles, the established accounting practices of the contractor as indicated by his books of account and financial reports will be given due consideration in the preparation of statements of cost for the purposes of this article.

5. The failure specifically to mention in this statement any item of cost is not intended to imply that it should be included or excluded.