

6.4 DELIVERY, ACCEPTANCE, PAYMENT AND OWNERSHIP

INTRODUCTION

- 1 This chapter applies to all procurement undertaken in Defence and Defence Materiel Organisation (DMO).
- 2 This chapter provides policy and guidance on contractual issues associated with delivery, acceptance, payment and ownership in Defence contracts.
- 3 Terminology and concepts described in this chapter are based on the ASDEFCON suite of tendering and contracting templates. Non ASDEFCON contracts, for example the Infrastructure Division suite of contracts, may not use this terminology and may contain alternative delivery, acceptance, payment and ownership provisions. Procurement officers using Infrastructure contracts should refer to the [Infrastructure Management homepage](#) for further guidance.

MANDATORY POLICY

- **All mobilisation payments must be secured by a financial guarantee from a suitable financial institution (refer to chapter 6.2 for further detail).**
- **All claims for payment must be in the form of a valid tax invoice that details the amount and calculation of any Australian Goods and Services Tax applicable to the supplies as a separate line item.**
- **Written contracts with small businesses for payments valued up to and including \$5 million (GST inclusive) must adopt maximum payment terms not exceeding 30 days from the date of receipt of a correctly rendered invoice.**
- **All written procurement contracts with small businesses for a value of up to A\$1 million (GST inclusive) must include provisions which provide that where payment has not been made within 30 days of receipt of a correctly rendered invoice, simple interest is payable by Defence on the unpaid amount.**

OPERATIONAL GUIDANCE

OVERVIEW

- 4 All Defence contracts should clearly detail the delivery, acceptance, payment and ownership requirements of the contract. The Commonwealth Representative is required to ensure that all of the contract requirements relating to delivery, acceptance, payment and ownership are met by both parties.

DELIVERY

- 5 All Defence contracts should specify the time and place for delivery of supplies. In most standard Defence contracts the delivery requirements may also be set out in the payment schedule and delivery schedule.
- 6 A number of different delivery options are available under Defence contracting templates. The Commonwealth Representative should ensure that the delivery requirements of the contract are monitored and managed in accordance with the terms of the contract. The checklist at Annex 6C provides general guidance on the problem scenarios and options for Defence where the supplier has not met its delivery obligations under the contract.

- 7 Any failure by the contractor to deliver supplies by the delivery dates or to the delivery points specified in the contract may place the contractor in breach of the contract and should be managed in accordance with the contract provisions. Chapter 6.5 provides general guidance on the problems that may be encountered and options for Defence where the contractor has not met its delivery obligations under the contract.

Risk of loss of or damage to the supplies

- 8 All Defence contracts should specify the time at which risk of loss or damage to the supplies will pass from the contractor to Defence. In accordance with Commonwealth policy, standard Defence templates have been drafted to allocate risk to the party best able to manage the risk, that is, risks should not generally be accepted which another party is better placed to manage.
- 9 Prior to supplies being delivered, the Commonwealth Representative must ensure that appropriate risk management measures are in place, for example in relation to security and storage of the supplies. Where required, the Commonwealth Representative should ensure that appropriate insurance coverage for the supplies has been arranged through the Comcover insurance scheme (see Chapter 3.15).

ACCEPTANCE

- 10 All Defence contracts should include a clause detailing the acceptance procedures for supplies delivered under the contract where Defence determines that the supplies meet the requirements of the contract.
- 11 Failure by Defence to accept or reject the supplies within the timeframes specified in the contract may place Defence in breach of the contract and may entitle the contractor to make a claim in accordance with the contract provisions. Failure to accept or reject the supplies within the specified timeframe may also automatically constitute acceptance, depending on the terms of the contract. If this is the case, Defence may have lost its opportunity to object to any deficiencies and will be legally bound to pay for the supplies in accordance with the contract. Use of the supplies prior to acceptance may also limit Defence's ability to object to any deficiencies in the supplies.
- 12 If supplies are accepted but subsequently turn out to be defective, Defence's remedies may be limited to relying on the warranties in the contract to have any defects remedied during the warranty period, rather than being able to sue the contractor for providing defective supplies. Therefore it is critical that the Commonwealth Representative ensures that the supplies meet the requirements of the contract prior to accepting them.

Conditional acceptance

- 13 Subject to the acceptance regime detailed in the contract, the Commonwealth Representative may be able to give a conditional acceptance (e.g. accept the supplies subject to the contractor fixing particular defects). Any such conditions must be expressly stated on the Supplies Acceptance Certificate. Where Defence agrees to conditional acceptance, the contractor will be required to remedy the defects identified in the acceptance process within a specified period of time (as provided for under the contract). If the contractor fails to do this, Defence will usually be entitled to have the remedial work performed at the contractor's expense. Extreme care should be exercised if the Commonwealth Representative elects to conditionally accept supplies and specialist contracting advice should be sought.

Acceptance of over/under supplies

- 14 If flexibility is required in quantities supplied under a contract, this should be specified in specially drafted provisions of the contract, rather than by ad-hoc arrangements with the contractor.
- 15 If an over or under supply occurs, and is not provided for in the contract, the Commonwealth Representative should notify the contractor and reserve Defence's right to reject the supplies

until a decision is made as to whether to accept the over or under supply. Notification of Defence's final decision to accept or reject the supplies is subject to the exercise of delegations required by paragraph 16 below.

- 16 Where the Commonwealth Representative makes a determination to accept an over or under supply, a formal contract amendment should be prepared and delegations exercised in accordance with the Delegations Requirements outlined in Chapter 6.7.

MILESTONES

- 17 In addition to dates for delivery of supplies, Defence contracts may also provide for 'milestones' that must be met by the contractor. Where milestones are included in a Defence contract, an attachment to the contract should list all the milestones that must be met by the contractor, the requirements that must be met for each milestone to be achieved and, if met, the amount that will be paid to the contractor for achievement of each milestone.
- 18 As with dates for the delivery of supplies, where the contractor fails to achieve a milestone by the date specified in the contract, the contractor may be in breach of the contract and should be managed in accordance with the contract provisions (see Chapter 5.6).

Progress Certification Milestones

- 19 In standard Defence contracts for higher value Complex and Strategic procurements, milestones may be subject to formal acceptance processes or progress certification. Progress certification permits the Commonwealth Representative to provide feedback to the contractor on progress of a particular milestone, make payment to the contractor and transfer ownership of the supplies to Defence. It is important to note that progress certification does not constitute acceptance of the supplies and when the supplies are delivered to Defence for acceptance at a later date, Defence may reject the supplies if they do not meet the requirements of the contract.

Final Acceptance Milestones

- 20 In standard Defence contracts for higher value Complex and Strategic procurements, the final milestone of the contract may be referred to as the Final Acceptance Milestone. The final acceptance process provides a mechanism by which the Commonwealth Representative notifies the contractor that it has fulfilled all of its obligations under the contract and will make the final payment to the contractor. If allowed for in the contract provisions, the Commonwealth Representative can also withhold payment of the Final Acceptance Milestone until the contractor has satisfactorily completed all of the contracted requirements.
- 21 Given that one of the main purposes of the final acceptance milestone is to provide incentive for the contractor to fully perform the contract, it is critical that an appropriate payment be tied to achievement of the final acceptance milestone. Even where the final milestone under a contract is not nominated as a final acceptance milestone it is important that a significant payment be tied to achievement of the milestone to provide incentive for the contractor to fully perform the contract. The final acceptance (or last) milestone payment should be 20-30% of the contract price depending upon the complexity of the supplies being delivered and the other types of payments paid to the contractor under the contract.

POSTPONEMENT

- 22 Circumstances may arise which delay the contractor in delivering the required supplies. Defence contracts for higher value Complex and Strategic procurements should contain a clause that:
- places an obligation on the contractor to advise Defence in writing where it is likely to be delayed in delivering the supplies or achieving a milestone; and

- enables the contractor to claim a postponement of the delivery date for the supplies and/or the milestone date where the contractor's performance under the contract has been delayed by an event that is beyond the contractor's or its subcontractor's reasonable control, and the delay could not have been reasonably contemplated or mitigated by the contractor.

Clauses to this effect can be found in the ASDEFCON major capital equipment templates.

- 23 In order to be able to claim postponement of the delivery date and/or milestone date the contractor must follow the process and timeframes detailed in the contract. Where the contractor fails to comply with the process and timeframes detailed in the contract, specialist contracting advice should be sought.
- 24 The contractor is under an obligation to minimise delay and mitigate its losses due to delay. Hence, Defence can challenge claims for postponement of the delivery date of supplies and/or milestone date where the contractor could absorb the delay in its schedule or reschedule so that the delay does not impact upon the delivery or milestone date. It is important to note that any rescheduling should be reasonable having regard to the contract price, the conditions of contract and any other relevant circumstances.
- 25 Where the delay affects any contract provision, for example, the delivery schedule and schedule of payments, the contract should be amended via a Contract Change Proposal. Where the effect of a delay is not appropriately taken into account and reflected in the contract, Defence's right to terminate the contract could be adversely affected.

Postponement Costs

- 26 Some contracts for higher value Complex and Strategic procurements also entitle the contractor to claim postponement costs from Defence where the delay occurs as a result of Defence action or a failure to perform an activity required by the contract. As with postponement claims, the contractor must follow the process detailed in the contract, substantiate all claims for costs and meet the specified timeframes in order to be entitled to claim postponement costs.

OWNERSHIP

- 27 All Defence contracts should include a provision that details when ownership of the supplies will pass to Defence. Standard Defence practice in Simple procurement is for ownership of supplies to pass to Defence following acceptance of the supplies. In Complex and Strategic procurements, ownership of supplies usually passes to Defence following payment for the supplies.

Title to supplies

- 28 In order to transfer ownership to Defence, the contractor must own the supplies or have appropriate rights to deal with the supplies. The Commonwealth Representative should carefully check the evidence put forward by the contractor in support of its ownership of the supplies. Contracts for Complex and Strategic procurements should include a clause which notifies the contractor that at the time ownership of the supplies pass to Defence, the supplies must be free of any registered or unregistered charge, lien, mortgage or other encumbrance.

Re-passing of Ownership in Rejected Supplies

- 29 Defence may elect to repass ownership of supplies back to the contractor where supplies vested in Defence following payment for a progress certification milestone are subsequently rejected when submitted for acceptance.
- 30 The election to repass ownership should be made at the time of notifying the contractor of the rejection of the supplies or as soon as possible after that. Unreasonable delay in notification of an election to repass ownership by Defence may result in Defence losing the right to do so.

PAYMENT POLICY

- 31 In accordance with Defence CEI 2.4 and DMO CEI 2.4, all contracts should include payment terms not exceeding 30 days from receipt of the specified goods and services and a correctly rendered tax invoice. This policy is reflected in all standard contracting templates used within Defence. A correctly rendered invoice means an invoice that has no discrepancies, and is in accordance with all of the requirements of the contract. In addition, payment remains subject to goods or services having been accepted or satisfactorily performed.
- 32 *Finance Circular 2008/10 Procurement 30 Day Payment Policy for Small Business* provides that for procurement from small businesses for payments valued up to and including A\$5 million (GST inclusive), agencies must adopt maximum payment terms not exceeding 30 days from the date of receipt of acceptable supplies and a correctly rendered invoice. Defence and DMO policy exceeds these requirements by applying this aspect of the policy to all its standard contracting templates whether the contractor is a Small Business or not. However, for *ASDEFCON (Strategic Materiel)*, *ASDEFCON (Support)* and *ASDEFCON (Complex Materiel) Volume 2*, the payment terms require completion of the acceptance or progress certification process before a correctly rendered invoice can be submitted, while for all other standard contracting templates the acceptance or approval process runs concurrently with the 30 day payment period (i.e. from the date of invoice receipt).
- 33 For the purposes of this policy, small business means an enterprise that employs less than the fulltime equivalent of 20 persons on the day that the written contract under which the payment is made is entered into ('full time equivalent' is as defined by the Australian Bureau of Statistics). If the enterprise forms part of a group, this test is applied to the overall group as a whole.
- 34 Contracts for high value Complex and Strategic procurements within Defence contain a wide range of price bases (see Chapter 2.2) and payment options including:
- payment upon delivery and acceptance;
 - progress payments;
 - milestone payments;
 - mobilisation (or advance) payments;
 - price variation payment claims;
 - earned value payments;
 - incentive payments; and
 - cost reimbursement payments.

The payment terms require completion of the acceptance or progress certification process before a correctly rendered invoice can be submitted.

Timing of Payments

- 35 Defence policy and contracting templates provide for payment within 30 days from receipt of a correctly rendered invoice. Where the supplies have been approved or accepted in accordance with the timeframes in the contract, Defence should ensure that payments to suppliers are processed and paid in a timely manner. This is especially important in circumstances where the supplier is a small business (see para 48). For strategic and high value complex procurements that contain early and late payment clauses, payment of a correctly rendered invoice before 30 days has elapsed can amount to a significant amount of interest foregone by the Commonwealth. Accordingly, in such clauses, early payment occurs prior to 30 days from receipt of a correctly rendered invoice and late payment occurs after 30 days from receipt of a correctly rendered invoice.

Mobilisation payments

- 36 A mobilisation (or advance) payment is a payment made to the contractor early in the contract period prior to the delivery of any supplies or achievement of any milestones. A mobilisation payment provides the contractor with funding to assist it to procure items required in order for it to fulfil obligations under the contract.
- 37 A mobilisation payment should only be paid under a contract where the contractor or its subcontractors will incur significant non-recurring ramp-up costs, including the cost of procuring plant, machinery, materials and facilities for use in the production of the supplies. A mobilisation payment will not usually be required for commercial-of-the-shelf acquisitions or procurements off a well established production line where only minor modifications to the products are required. The cost of money with the required ramp-up costs should be considered when determining the need for and amount of any mobilisation payment.
- 38 Only one mobilisation payment should be paid to the contractor under a contract. Mobilisation payments will usually be for between 5-15% of the contract price. Consideration should be given to the entire payment regime for the contract when determining an appropriate amount for the mobilisation payment. Where the contractor will be paid earned value payments, the contractor will be able to progressively claim a percentage of the cost of the upfront materials and labour required by the contractor and therefore a mobilisation payment may not be required or the amount required may be less.
- 39 Where a mobilisation payment is paid it must be secured by a financial guarantee from a suitable financial institution (see Chapter 6.2). Depending upon the value of the contract and the financial viability of the contractor, the mobilisation payment security may be for between 50% and 100% of the value of the mobilisation payment.
- 40 Suitable clauses for mobilisation payments and mobilisation payment securities can be found in the draft conditions of contract of *ASDEFCON (Strategic Materiel)*.

Price variation payment claims

- 41 Defence contracts may include provisions that enable the contractor to claim variations in the contract price resulting from:
- fluctuations in the cost of labour and materials during the contract period; and/or
 - fluctuations in exchange rates.
- 42 Guidance on Defence policy in relation to price variation and the standard price variation clauses used in Defence contracts is contained in Chapter 2.2.

Incentive payments

- 43 Defence contracts for high value Complex and Strategic procurements may contain provisions that entitle the contractor to be paid incentive payments for superior performance of the contract. Incentive payments are paid in addition to the contract price where the contractor's performance exceeds that required by the contract. The contractor's performance is usually measured against key performance indicators (see Chapter 6.2) that are detailed in the contract. A suitable clause for incentive payments can be found in the draft conditions of contract of *ASDEFCON (Strategic Materiel)*.

Cost reimbursement payments

- 44 Cost reimbursement payments enable the contractor to recover the costs of labour and materials incurred by the contractor in the performance of the contract. Cost reimbursement payments may be paid to a contractor in relation to high risk and/or developmental elements of Strategic procurement contracts. The elements of the contract for which payments will be made on a cost reimbursement basis should be clearly detailed in the contract. Cost reimbursement payments should generally not be made for more than 25% of the contract price.

- 45 Where the contractor will be paid on a cost reimbursement basis, the contract should include provisions that enable Defence to undertake a cost investigation to determine the actual costs incurred by the contractor in performing the contract (see Chapter 3.3). The contract should also include review points at which Defence may elect to terminate the contract where the cost reimbursement payments made to the contractor exceed the progress made by the contractor in performing the contract (as assessed by the relevant earned value management system) and the parties cannot agree to a contract change proposal to amend the contract.
- 46 A suitable clause for cost reimbursement payments can be found in the draft conditions of contract of *ASDEFCON (Strategic Materiel)*.

Claims for payment

- 47 The contract should clearly detail the requirements that must be met by the contractor when submitting a claim for payment, including any requirements that must be detailed on the invoice and any documentation that must be submitted with the invoice. The requirements to be met by the contractor will vary depending on the type of payment being claimed. However, in all cases the claim for payment submitted by the contractor must be in the form of a valid tax invoice that details the amount and calculation of any Australian Goods and Services Tax applicable to the supplies as a separate line item (see Chapter 3.7).

Early and Late Payments

- 48 In accordance with *Finance Circular 2008/10*, all written procurement contracts valued up to A\$1 million (GST inclusive) with small businesses must contain clauses which provide that Defence must pay interest on payments not made within 30 days (or shorter period as specified in the contract) following receipt of a separate correctly rendered invoice. Paragraph 33 contains a definition of small business. The interest is payable at the general interest charge rate, calculated in respect of each day from the day after payment was due up to and including the day that payment of the contract amount is made. Interest is not payable unless the amount of interest is more than A\$10 and the contractor has issued a correctly rendered invoice for the interest. The general interest charge rate means the interest charge determined under section 8AAD of the Taxation Administration Act 1953 on the day that payment is due. The general interest charge rate can be found at the following link - <http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/2832.htm>.
- 49 The requirement to pay interest on late payment to small businesses does not include:
- procurement of real property including leases and licences;
 - procurement from administered items (defined in *Estimates Memorandum 2007/29 – Criteria for Determining Departmental and Administered Classifications*);
 - where the nature of the goods and services or the structure of the procurement would make it impractical for the policy to be applied. This might be the case, for example, where the procurement occurs under standard terms and conditions put forward by the contractor rather than Defence; or
 - procurement where prior to 1 December 2008, a written contract or standing offer was already in place or in the process of being negotiated.
- 50 If a contract variation increases the value of a contract to above A\$1 million (GST inclusive), there is no obligation for the interest on late payment clause to be removed.
- 51 Other Defence contracts that do not fall within the criteria in paragraphs 48 and 49 may include provisions for early and late payment of invoices. Where a late payment clause is included in a contract, the Australian Taxation Office's General Interest Charge should be the rate used to calculate these payments. The General Interest Charge rate can be accessed on the Australian Taxation Office's web site: <http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/2832.htm>.

- 52 Where an early payment clause is included in a Defence contract, the Reserve Bank of Australia target cash rate should be used to calculate early payments. The target cash rate is the rate charged on overnight loans between financial intermediaries. The Department of Finance and Deregulation has assessed this rate as representing the opportunity cost to the Commonwealth of paying early. The applicable rate is reviewed monthly and published on the Reserve Bank of Australia web site: <http://www.rba.gov.au/>.
- 53 Financial approvals are required for the payment of interest on late payments. Government policy is for agencies to pay invoices on time. Accordingly, Defence should not anticipate facing late payment charges when arranging approvals for a procurement contract.

KEY REFERENCES

Commonwealth Procurement Guidelines 2008

Finance Circular No 2008/10 – Procurement 30 Day Payment Policy for Small Business

Defence CEI 2.4 Payment of Accounts

DMO CEI 2.4 Payment of Accounts

ASDEFCON (Strategic Materiel)

ASDEFCON (Complex Materiel)