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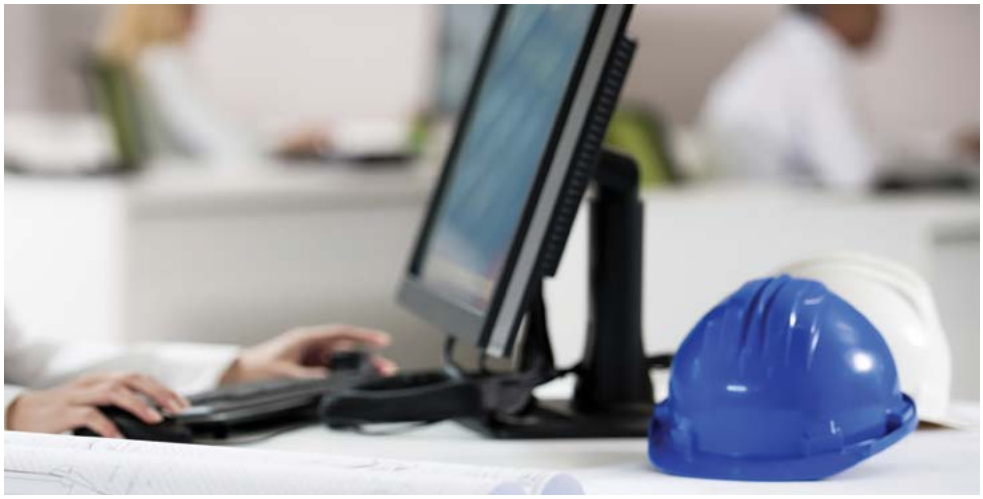
THE NEWSLETTER FROM THE BDO GOVERNMENT CONTRACTING PRACTICE

BDO KNOWS: GOVERNMENT CONTRACTING



PRACTICAL IMPLICATIONS OF THE PROPOSED DFARS BUSINESS SYSTEMS AUDIT RULE

By Kellye Jennings

The U.S. Department of Defense (DoD) has drafted a proposed amendment to the Defense Federal Acquisition Regulation Supplement (DFARS) that would require larger contractors to have their business systems audited by independent CPAs (IPAs), as well as self-report deficiencies uncovered in these audits or in internal reviews of their business systems (see the Regulatory Update for more information). This proposed rule is not a new concept. The Defense Contract Audit Agency (DCAA) and the Defense Contract Management Agency (DCMA) have historically been tasked with performing such audits.

The DCMA relies on these audits to determine whether a contractor's business systems are adequate. For a number of years, DCAA has faced increasing scrutiny from the U.S. General Accounting Office and other agencies for a growing backlog of audits. The proposed rule, however, will shift some of the burden from DCAA to the private sector. DCAA views this change as a natural offshoot of Sarbanes-Oxley and the financial statement audit work IPAs are already performing for most of the companies affected by this rule.

BDO professionals attended the Aug. 18, 2014, public hearing on the proposed DFARS rule. The conversation among the attendees, including DCAA and DCMA representatives, was – as expected – very robust. At the hearing and elsewhere, a number of issues were raised by contractors, industry trade associations, the legal community and other professionals that work with government contractors such as:

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According to ***Small Business Trends***, the federal government awarded 23.9 percent of prime contracts to small businesses in 2013, meeting its annual government contracting goal for small businesses.

President Obama signed an executive order on July 31 that would mandate federal contractors to report labor law violations, according to ***FierceGovernment***.

Government contract bid protests have risen 83 percent over the past seven years – from 1,327 in fiscal year (FY) 2006 to 2,429 in FY 2013 – reports the ***Government Accountability Office***.

According to ***CNBC***, the number of Small Business Administration loans of $150,000 or less declined from 25,485 in FY 2012 to 24,923 in FY 2013.

The federal government spent $273.5 billion on contracts so far in FY 2014, according to data from ***USASpending.gov***.

According to ***Onvia***, a U.S. government business intelligence company, government contracting opportunity volume increased 5 percent among state and local agencies from 2013 to 2014.

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DFARS BUSINESS SYSTEMS AUDIT RULE

- In the current LPTA (Lowest Price Technically Acceptable) environment, requiring companies to engage an IPA to perform an audit that DCAA historically has performed will generally result in a higher cost structure for companies subject to the proposed rule.

- DCAA plans to use the non-systems audits they already perform as a "checks and balances" approach to oversight. For example, if DCAA finds problems in an incurred cost audit for a contractor that received a clean systems audit report from its IPA, there will likely be a reconciliation of the two reports. It is unclear what this reconciliation will ultimately entail; however, it will most likely result in more time to be incurred by the IPA and thus even more costs charged to the contractor if the audits are ultimately challenged by DCAA.

- Given that DCAA will oversee the process by reviewing audit plans and findings while performing their own audits, this process could be time- and resource-intensive, and could result in additional costs to the contractor.

- The DCAA oversight function may give DCAA access to audit information (e.g., workpapers, memos, etc.) that DCAA would not be able to access if it was doing the audit itself.

- The mandatory disclosure of deficiencies could lead to the government to withhold from a contractor amounts billed. Contractors may also be subject to cost disallowances, an inability to receive contracts and increased government scrutiny of their business systems.

- Audit firms also expressed concern about maintaining independence throughout the audit process.

The DoD has requested that comments on the proposed rule be submitted on or before Sept. 15, 2014. Stay tuned as we continue to follow this issue and its impacts on government contractors.

Kellye Jennings, partner with BDO's Government Contracting practice. She can be reached at kjennings@bdo.com.

BDO SPOTLIGHT: Q&A with Jean Labadini

How did you become interested in your career, especially your work with the Defense Contract Management Agency (DCMA)?

Sometimes we choose our path in life, but sometimes life's path chooses us. My career started almost 40 years ago when I took my first full-time job with an independent insurance, real estate and law office. I loved drafting, reading and revising the legal documents, but the staff consisted of only myself and the attorney. Needing growth opportunity I interviewed with Defense Contract Administration Services (DCAS) – now known as Defense Contract Management Agency (DCMA) – and accepted a position starting as a GS-3. I had a natural ability for reading, understanding and applying contract language, and my career launched very quickly. I worked in contracts, production, conducted purchasing system reviews and held warrants as an Administrative Contracting Officer (ACO), Systems ACO and Divisional ACO. I worked on staff for many years as a Senior Functional Advisor and Performance Management Integrator, retiring as the Director of the Contractor Purchasing System Reviews (CPSR) Group. I absolutely loved what I did and I approached every task with the interests of the government in the forefront of my mind. Anyone who knows me will say I was passionate, and I believe I served our country well.

What were your key accomplishments during your tenure?

I'm most proud of my reputation for being a person of integrity and for having profound knowledge of contract management processes and business systems. I had some great managers over the course of my career; and I'm especially thankful for those that recognized my potential early on, enrolling me in the Middle Management Program (MMP III) at the Simmons Graduate School of Management. I was considered a "go-to" person and a troubleshooter, resulting in a number of special assignments including the highly visible Druyun Study Team, the group responsible for reviewing the appropriateness of select Air Force contracting actions. I was also a lead instructor for many of DCMA's training initiatives, most notably contract financing, risk management and performance-based management. I was named the CPSR Director at a time when the Agency's management of that process was under unprecedented pressure by oversight organizations to improve the performance shortfall that resulted from years of resource reductions. I believe that appointment was recognition of my leadership skill, functional knowledge, and exemplified the confidence the Agency had in my ability to reestablish process integrity by supporting my initiatives to standardize review techniques and methodologies and provide more insightful review results.

How has your experience with the DCMA shaped your outlook on the government contracting industry and the counsel you provide for BDO clients specific to business systems?

The compliance business is challenging regardless of business size. But with acquisition regulations proliferating in this area, it's in the industry's best interests to get on board and stay up to speed. Having efficient and effective processes is a win-win for both sides of the table. One of the most important things contractors can do to improve their compliance processes is reconsider controls that may have withstood the test of time and seek guidance on new or more complex issues so that they can position themselves for continued success and take advantage of the latest opportunities.

What do you see as the biggest challenges facing the industry today?

If only we had a crystal ball! Emphasis on compliance and oversight comes and goes, but product quality and price – and the processes that impact them – are fundamental to government contracting. Counterfeit parts are putting lives and livelihood on the line. Finding them, getting them out of the supply chain and ensuring they're not bought again is now part of acquisition regulation. But the industry is still determining the best way to tackle this issue. Industry buyers and subcontract administrators have the same responsibility as government contracting officers when they sign procurement documents and

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BDO SPOTLIGHT

ensure the award is made to legitimate, i.e., responsive, responsible suppliers. The final rule didn't change that, but because the rule specifically targets electronic parts, and there is movement to apply the rule to all parts, I believe we will see a significant change in the level of coordination and interaction between procurement and quality management organizations. I would anticipate near-term challenges to directed source justifications for electronic parts and components containing electronic parts.

How do you see the proposed DFARS self-certification rule impacting the industry?
I have already had a few discussions with individuals that think the proposed rule applies to all business systems; however, it doesn't. The proposed rule essentially provides for third-party certification of accounting, estimating and material management accounting systems (MMAS) only. The most important consideration for contractors as they move to implement the rule is that they must ensure that whoever performs these reviews as part of their internal or third-party review understands the requirements and implementation of applicable acquisition regulations. Reviewers should be mindful of the fact that all of a contractor's business systems are related and integrated in some fashion. For example, many contractors thought that the business system rule drew a line in the sand and that DCAA was "out of the CPSR business," but many still face challenges with their purchasing system when DCAA conducts incurred cost and estimating system reviews that suggest weaknesses in their purchasing system. While a purchasing system review may only examine transactions generated during the past year, proposals that resulted in the contract under which procurements are generated could be much older. If costs are considered unsupported during incurred cost reviews or estimating system reviews, DCAA is at liberty to challenge the quality of the transactions generated by the purchasing system. The same would apply to the accounting system during billing system reviews or material buy orders generated by an MMAS system during a proposal review.

Jean Labadini is a senior advisor in Government Contractor Advisory Services and can be reached at jlabadini@bdo.com.

LIMITATIONS ON ALLOWABLE GOVERNMENT CONTRACTOR COMPENSATION COSTS

By Dexter Tucker, Natalie Wooten and Gary Tsai

OVERVIEW AND BACKGROUND

The Department of Defense (DoD), General Services Administration (GSA) and National Aeronautics and Space Administration (NASA) have issued an interim rule amending the Federal Acquisition Regulation (FAR) to implement section 702 of the Bipartisan Budget Act of 2013.[1] This interim rule is effective as of June 24, 2014, and limits compensation for contractor and subcontractor employees on DoD, GSA and NASA awards (with case-by-case exceptions). In addition, the interim rule implements the authority for heads of executive agencies to establish exceptions for engineers, scientists and other specialists if an agency determines that such exceptions are needed.

Enacted on Dec. 26, 2013, section 702 of the Bipartisan Budget Act of 2013 (Pub. L. 113-67) includes several provisions related to compensation limitations that impact both contractors and subcontractors alike. Specifically, section 702:

- Amends the allowable costs limits of contractor and subcontractor employee compensation to $487,000 per year;
- Revises the application of the compensation cap;
- Documents the associated formula used to compute the cap's annual adjustment. The formula will be adjusted annually to reflect the change in the Employment Cost Index for all workers as calculated by the Bureau of Labor Statistics.

As noted by Congress, the revised compensation cap "shall apply only with respect to costs of compensation incurred under contracts entered into on or after the date that is 180 days after the date of enactment of this Act," which was Dec. 26, 2013. Therefore, the $487,000 cap limitation applies to contractor and subcontractor employees for contracts awarded – and compensation costs incurred – on or after June 24, 2014.

CONTRACTOR IMPLICATIONS

The new cap limitation will likely affect contractors' indirect rates. Due to the significant decrease from the prior year's $952,308 compensation limit, some government contractors may face an increase of disallowed compensation costs. The impact

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COMPENSATION COSTS

will be most reflective, however, in the preparation of contractors' annual incurred cost submission and forward pricing rates, especially for fiscal year ending 2014. To comply, contractors may need to calculate multiple indirect rates in order to apply the limitations to different sets of contracts (awarded before or on/after June 24, 2014). Additionally, an alternative approach that has surfaced in industry discussions is the use of blended indirect rates taking into account the relevant cap periods. However, this blended rate method has not been historically accepted by the Defense Contract Audit Agency (DCAA) for excessive compensation. Either way, contractors may need to make significant changes to their accounting systems and internal processes.

As with other similar historical rulings that affect cost recovery from the government, a contractor's ability to comply, enforce and monitor associated sound business practices is highly dependent upon maintaining compliant business systems. As a result of the interim rule, modifying three of the six relevant systems referenced in the Defense Federal Acquisition Regulation Supplement (DFARS) "Business Systems Rule" requirements – specifically, '*accounting and billing*,' '*procurement*' and '*estimating*' – may enhance a contractor's ability to comply with the established compensation limits, minimize risk of mischarging and misallocations and ensure contract allocations and charges result in accurate billings.

CONTRACTOR CONSIDERATIONS

It should be noted that a contractor's ability to manage and apply the multiple indirect rate model method within the business system environment may be quite onerous, depending on the functionality and features of automated accounting systems. Most job cost accounting systems do not include the capacity to manage multiple indirect rate models within the same fiscal year, but there are some steps that can be implemented within the various business subsystems that could help automate the calculation and application of multiple indirect rates.

Some of the configuration and control adjustments to the following subsystems for the multiple indirect rate method could include:

- **Compensation** – *to help identify employees within the organization that are subject to the compensation limit*
  - Establish codes or attributes within this subsystem to identify highly compensated executives and employees
  - Maintain the salary history for all employees sorted by the *'effective date'* for all salary adjustments
  - Maintain salary rates within the employee compensation system, even if utilizing a third-party payroll service provider
- **Labor** – *to identify labor categories and positions that may be exempt from compensation limits*
  - Establish both companywide and project-specific labor categories
  - Assign unique general labor categories to each employee from the companywide labor category list
  - Implement employee project workforce and project specific labor categories for all direct charging activities
- **Vendor/Subcontractor Management** – *to identify and monitor vendor/subcontractor employees that are subject to or exempt from compensation limits*
  - Establish project-specific vendor-employee labor categories
  - Implement vendor-employee project workforce for all charging activities
  - Execute unique requisition and purchase order types for identifying subcontractor metrics such as number of units, rate per hour and amount
- **General Ledger** – *to identify, capture and segregate potential unallowable compensation amounts and proper cost pool account assignments*
  - Establish appropriate unallowable labor accounts
  - Conduct periodic (at least monthly) reconciliation to subsidiary ledgers (accounts payable, labor distribution, timesheet history, payroll history, billing, etc.)
- **Indirect Cost Reporting** – *to appropriately capture, calculate, burden and allocate associated indirect cost rates to allowable and unallowable compensation-labor amounts*
  - Establish a secondary set of date-based project applied indirect cost pools
  - Utilize and maintain a test instance of your production data for each processing cycle to calculate a secondary indirect cost rate structure
- **Project Cost and Revenue Reporting** – *to calculate and recognize revenue utilizing recoverable indirect cost rates*
  - Establish indirect rate cost and budget ceilings to calculate and recognize revenue if your accounting system is unable to maintain a secondary set of indirect cost pools
- **Billing** – *to calculate and recover allowable indirect and reimbursable direct charges*
  - Establish target and/or provisional indirect rate cost and budget ceilings if your accounting system is unable to maintain a secondary set of indirect cost pools

The required adjustments to business systems will vary by contractor. The previously referenced adjustments by subsystem are not a comprehensive list of changes, nor do they all apply to every contractor. Ultimately, contractors will need to establish or modify the accounting systems, accounting methods and corresponding accounting procedures to comply with this new rule.

1 As published in the Federal Register Vol. 79, No. 121 dated June 24, 2014.

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R&D CREDITS FOR GOVERNMENT CONTRACTORS: ARE YOU MISSING OUT?

By Patrick Wallace, Senior Director, R&D Tax Services and Chris Bard, National Managing Principal, R&D Tax Services

According to recent IRS statistics, U.S. corporations reported research and development (R&D) tax credits exceeding $8.5 billion in 2010. Approximately 86 percent of the credits were claimed by businesses in the manufacturing, information, and scientific and technical services industries. Many of these businesses provide their products or services – in whole or in part – to government agencies. Is your business one of them?

Although many government contractors have a basic understanding of the R&D credit, some misperceptions still exist. As such, many do not claim the full credit to which they are entitled. Here are eight facts you need to know to take full advantage of an R&D credit:

1. What is an R&D credit?

Intended to stimulate more R&D and R&D-related activity in the U.S., the federal R&D credit equals up to 20 percent of the amount by which a business' qualified spending exceeds its historical R&D spending. Most states also have an R&D credit, so that typically the combined net after-tax benefit equals 10 to 15 percent of qualified spending. Each credit dollar can be used to offset a dollar of certain kinds of tax liability.

2. What are R&D activities?

Qualified R&D activities must attempt to develop or improve the functionality or performance of products, manufacturing processes, software, inventions, techniques or other components. They must rely on the principles of engineering or the physical, biological or computer sciences, and involve evaluating alternatives to eliminate uncertainty regarding a component's appropriate design or whether/how it can be produced. Neither the success of the activity, nor (generally) the level of technological advancement, is a consideration. Examples of qualified activities from recent court cases include: evaluating a third party's technology to see how it performs within an existing production process; scale-up activities to resolve engineering uncertainties not eliminable through testing on smaller processes or equipment; and integrating existing components into an overall design for a new system.

3. Our R&D activities are paid for by the government. Are we entitled to a credit?

It depends. You are only entitled to a credit if your agreement with the government provides that your business is both at economic risk for the activities and is allowed to use its results or retains other meaningful rights to the results. For example, if the agreement says the government has to pay you regardless of the activities' success, you're not at risk and not entitled to a credit – at least for those "funded" activities.

The seminal court cases that provide guidance regarding funded research are Lockheed Martin (addressing rights to the research) and *Fairchild* (economic risk). More recently, relying on *Fairchild*, a district court in *Geosyntec Consultants* ruled that certain contracts of the taxpayer did not provide for funded research. In all of these cases, the courts have ruled that the contractor's agreement with the government or third party determines whether the research is funded. In the case of government contractors, as the *Lockheed* and *Fairchild* cases make clear, many government contractors do indeed qualify for the credit.

4. What expenses are eligible?

Taxable wages for employees who perform, directly support or supervise qualified activities; at least 65 percent of payments to contractors who perform qualified services; and the cost of supplies and certain computer and cloud-computing services used in qualified activities.

5. Does the location of the activity matter?

The work has to be performed in the U.S. to qualify for the federal credit, and the majority of states that provide similar credits have the same requirement. Because state benefits

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R&D CREDITS

range from very low to up to 40 percent of qualified spending, choosing the location for your R&D activities can increase your return on investment. If your company is in a loss position, expenses for activities performed in the 10-plus states that provide a refundable or transferable credit can yield an immediate benefit – even if you're not paying taxes now. If you do work outside the U.S., more than 30 countries provide similar or more generous benefits.

6. How does a company benefit?

A business' legal structure and tax-filing status will influence how it and its owners benefit from the R&D credit. Credits generated by a C corporation, for example, may be used to offset only corporate level income or franchise tax. Credits generated by pass-through entities, S corporations, partnerships and limited liability companies taxed as partnerships, are passed through to partners and shareholders and can typically offset only tax associated with the activity or business that generated the credits. Passive shareholders or partners can be subject to unfavorable alternative minimum tax (AMT) treatment caused by a requirement to add back their proportionate share of the pass-through entity's R&D expenses when determining their AMT income.

7. When would we benefit?

The federal R&D credit is available for expenses paid or incurred through Dec. 31, 2013. As it routinely has in the past, however, the credit expired on Dec. 31, 2013, so that until it is extended – as it has been 15 or so times – businesses cannot benefit, for estimated tax or financial-statement purposes, from expenses paid or incurred during 2014. Fiscal year taxpayers can currently include the benefit generated by creditable expenses paid or incurred during 2013, but no one can properly take a benefit for expenses paid or incurred after 2013.

For expenses incurred prior to Dec. 31, 2013, businesses can generally claim credits in any open tax year, generally the last three, but exams and losses can extend this to up to the last 15 years. Credits generated since 1997 that cannot be utilized in the year in which they were generated can now be carried back one year and carried forward 20.

Although businesses can claim credits for prior years on amended returns, they should consider making certain elections that taxpayers can only make on a timely filed original, rather than amended, return.

8. What lies ahead for the R&D credit?

Most commentators and recent legislative activity in Washington suggest that Congress and the President will retroactively extend the credit, although it most likely will not happen until after the November midterm elections. Recently, the House Ways and Means Committee and Senate Finance Committee held hearings and drafted legislation proposing extensions of the credit.

Many of these bills also call for additional enhancements, including increasing the credit's rate, allowing its use against AMT, and increasing its benefit for startup companies. President Obama has consistently supported similar enhancements, as well as making the credit permanent. Because the R&D credit can provide a return of up to about 15 percent of a business' qualified spending, government contractors hope the credit will be retroactively extended.

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PErspective in Government Contracting

As the U.S. political and economic environments continue to stabilize, private equity investment in government contractors is increasingly attractive. Small and mid-sized businesses – specifically those in the healthcare and cybersecurity industries – that concentrate on government spending have been able to demonstrate high-quality backlogs and pipelines, enticing interest from private equity investors. According to a recent article in *The New York Times*, despite a minimal decline in the forecast for federal spending on healthcare, it is still expected to grow faster than any other federal budget item and could become the federal government's biggest expense by 2030. Furthermore, a recent *Defense News* article notes that the Department of Defense's proposed fiscal year 2015 budget includes more than $5 billion related to cybersecurity spending, which is just a piece of the government's overall proposed budget of $13 billion for cybersecurity. These trends, coupled with the private equity industry's recent move toward creating funds specifically aimed at deals with smaller businesses, establishes a positive outlook for small and mid-sized government contractors.

While targets are ripe, uncertainty in the defense sector and ongoing sequestration fears could impact the amount of investment. As a result of last year's sequestration and budget uncertainties, defense spending has declined a total of 10.7 percent over the past three years, and prime defense companies have averaged a 5.3 percent revenue drop over that same time frame, according to the *Washington Business Journal*. The question remains whether these declines will continue in the face of lingering budget concerns.

Recent analysis by *Bloomberg Government* shows that the last lengthy defense spending decline took place from 1986 through 1998 and resulted in consolidation on a massive scale throughout the industry. We haven't yet reached similar points of spending decline and resulting consolidation in the current market; however, more deals are likely further down the road. An upside for potential PE investors is that there has always been a rebound, and the government has historically proved to be a very loyal customer.

PErspective in Government Contracting is a feature examining the role of private equity in the government contracting industry.

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REGULATORY UPDATES

Proposed DFARS Rules

Case 2012-D042: Business Systems Compliance; the Department of Defense (DoD) has proposed to amend the Defense Federal Acquisition Regulation Supplement (DFARS) business system criteria. The proposed rule introduces new requirements for large government contractors including annual reporting, triennial CPA audits and documentation requirements. The new rule seeks to improve the efficiency and effectiveness of contractors' systems (i.e., accounting, estimating, material management and account) based on contractor self-evaluations. This plan would also allow contractors to choose their own independent Certified Public Accountant (CPA) to perform audits. The results of the self-evaluation and CPA audit would then be reviewed by the government.

The proposed rule would apply to solicitations and contracts that include a contractor business systems clause. Comments to be considered in the compilation of the final rule are due in writing by Sept. 15, 2014.

Case 2012-D051: Service Contract Reporting; DoD has proposed to revise the DFARS to implement section 807 of the National Defense Authorization Act (NDAA). This rule would require contractors to report service contract direct labor and corresponding dollar value data for prime and subcontractors in the Enterprise-wide Contractor Manpower Reporting Application (ECMRA) database. The populated data will allow DoD to report the inventory of contractor full-time equivalent direct labor. The information obtained will support DoD's management in making strategic planning decisions. This proposed rule would apply to all small business concerns with DoD contracts or subcontracts that contain service requirements exceeding the simplified acquisition threshold.

Case 2014-D008: Defense Contractors Performing Private Security Functions; DoD proposed new guidance intended to ensure coverage on the broader requirements for defense contractors performing private security functions outside the U.S. The areas of concern include contingency operations,

combat operations and humanitarian operations, as well as specially designed operations. The new section would require contractors to register all weapons, vehicles and helicopters used in conjunction with operations performed by private security functions in the Synchronized Predeployment and Operation Tracker (SPOT) system. In addition, these operations would need to comply with the American National Standard Management System for Quality of Private Security Operations – Requirements with Guidance.

Case 2014-D003: Taxes – Foreign Contracts in Afghanistan; two new clauses are being proposed by DoD that will notify contractors of Afghan tax requirements. The clauses are to be included in contracts stating the exemption for paying liability for Afghan taxes. Clause 252.229-70XX, Taxes – Foreign Contracts in Afghanistan, would also provide exemption from paying any tax or similar charge from the contract price in Afghanistan. The second clause, 252.229-70YY, Taxes – Foreign Contracts in Afghanistan (Military Technical Agreement), is specific to contacts awarded on behalf of NATO.

Proposed FAR Rules

RIN 1235-AA10: Establishing a Minimum Wage for Contractors; the Department of Labor has proposed regulations to implement Executive Order 13658, establishing a Minimum Wage for Contractors. With this proposition, the minimum wage paid by those contractors to workers performing on covered federal contracts will be raised to $10.10 per hour, beginning Jan. 1, 2015. Starting Jan. 1, 2016, and annually thereafter, the minimum wage will be determined by the Secretary of Labor. Changes to the minimum wage will be published at least 90 days prior to the effective date, will not be less than the wage rate at the time of determination and will increase in accordance with a change in the Consumer Price Index for Urban Wage Earners and Clerical Workers. The comment period for this proposed rule expired on July 28, 2014.

Case 2013-012: Review and Justification of Pass-Through Contracts; DoD, GSA and NASA are proposing to amend the FAR to implement section 802 of the National Defense Authorization Act of fiscal year (FY) 2013. Section 802 will provide additional requirements relative to the review and justification of Pass-Through contracts. This new proposal specifically addresses agencies pursuant to FAR 52.215-22. It will require contracting officers to review the contract, task order, or delivery order offered by contractors intending to award subcontracts for more than 70 percent of the total cost of work to be performed against certain justification criteria.

Interim FAR Rules

Case 2014-12: Limitation on Allowable Government Contractor Compensation Costs;

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REGULATORY UPDATES

effective June 24, 2014 DoD, GSA and NASA issued an interim rule to limit compensation for all employees (with case by case exceptions) to implement section 702 of the Bipartisan Budget Act of 2013.

The Bipartisan Budget Act of 2013 (Pub. L. 113–67) was enacted on Dec. 26, 2013. Section 702 of the law amended the allowable cost limits of contractor and subcontractor employee compensation. Specifically, section 702 revised the application of the compensation cap, the amount of the cap and the associated formula for annually adjusting it.

Section 702 of the law set the initial limitation on allowable contractor and subcontractor employee compensation costs at $487,000 per year, which will be adjusted annually to reflect the change in the Employment Cost Index for all workers as calculated by the Bureau of Labor Statistics.

This limitation applies to cost incurred on or after June 24, 2014 under contracts issued on or after June 24, 2014 for contractors/subcontractors.

This is going to impact mid to large government contractors. It is important to consider how this is going to impact FY 2014 ICPs and FPRs. Multiple indirect rates may need to be calculated to apply to different sets of contracts specifically to account for compensation costs incurred prior to and after the legislated new rule.

Final FAR Rules

Case 2013–017: Allowability of Legal Costs for Whistleblower Proceedings; on July 25, 2014, DoD, GSA and NASA issued a final rule addressing the allowability of legal costs of a contractor or subcontractor related to whistleblower proceedings. The rule implements a section of the National Defense Authorization Act (NDAA) for FY 2013 that addresses the allowability of legal costs incurred by a contractor or subcontractor related to a whistleblower proceeding commenced by the submission of a complaint of reprisal by the contractor or subcontractor employee. The new rule amends FAR 31.205-47 to make such costs unallowable if the contractor is found liable for fraud or similar misconduct in the whistleblower proceeding.

Final DFARS Rules

Case 2012-D055: Detection and Avoidance of Counterfeit Electronic Parts; DoD published the final rule to address contractors' responsibility to detect and avoid the use or inclusion of counterfeit electronic parts or suspect counterfeit electronic parts. The rule will only be applicable to Cost Accounting Standards (CAS)-covered contractors. Both small businesses and contracts for the acquisition of commercial items will be exempt. CAS-covered contracts will be required to establish and maintain a detection and avoidance system. The system will include risk-based policies and procedures to address:

(1) The training of personnel.
(2) The inspection and testing of electronic parts, including criteria for acceptance and rejection.
(3) Processes to abolish counterfeit parts proliferation.
(4) Processes for maintaining electronic part traceability.
(5) Use of suppliers that are the original manufacturer, sources with the express written authority of the original manufacturer or current design activity, including an authorized aftermarket manufacturer or suppliers that obtain parts exclusively from one or more of these sources.
(6) The reporting and quarantining of counterfeit electronic parts and suspect counterfeit electronic parts.
(7) Methodologies to identify suspect counterfeit electronic parts and to rapidly determine if a suspect counterfeit electronic part is, in fact, counterfeit.
(8) Design, operation and maintenance of systems to detect and avoid counterfeit electronic parts and suspect counterfeit electronic parts.
(9) Flow down of counterfeit detection and avoidance requirements.
(10) Process for keeping continually informed of current counterfeiting information and trends.
(11) Process for screening the Government-Industry Data Exchange Program (GIDEP) reports and other credible sources of counterfeiting information.
(12) Control.

Executive Order

Fair Pay and Safe Workplace: Under this Executive Order and beginning in 2016, contractors wishing to participate in federal contracts exceeding $500,000 must:

(1) Disclose recent violations of workplace laws (within the preceding three years);
(2) Provide wage notifications to employees regarding hours worked, overtime hours, pay and any deductions; and
(3) Not require employees to sign pre-dispute arbitration agreements (for companies with at least $1 million in federal contracts).

In addition, the prime contractor must flow down these requirements to any subcontract exceeding $500,000, excluding those for commercially available off-the-shelf-items. The prime is also responsible for "determining whether a subcontractor is a responsible source that has a satisfactory record of integrity and business ethics."

While the disclosure of recent workplace violations may not preclude a potential contractor from an award, the agency will use the information to determine if the potential contractor is "responsible." In the post-award period, contract officers may consider these reported incidents as grounds for action against a contractor.

Requirement to Report Summary Data on Employee Compensation: On Aug. 8, 2014, the Office of Federal Contract Compliance Programs (OFCCP) proposed to amend one of its regulations for Executive Order 11246, Equal Employment Opportunity, which sets forth the reporting obligations of federal contractors and subcontractors. This proposed rule would amend the regulation to require that certain federal contractors and subcontractors supplement their Employer Information Report (EEO–1 Report) with summary information on compensation paid to employees, as contained in the Form W–2 Wage and Tax Statement (W–2) forms, by sex, race, ethnicity and specified job categories, as well as other relevant areas. Comments are due by Nov. 6, 2014 to be considered in the final rule.

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MARK YOUR CALENDAR...

OCTOBER 2014

October 20-24
Federal Publications Seminars' Contract Compliance Week
Waterview Conference Center at CEB
Arlington, Va.

October 23-24
The 2014 Joint Ventures Conference
Marriott Downtown
New York, N.Y.

October 30
BDO Executive Seminar: Government Contract Compliance Issues and DCAA Challenges*
Hilton DFW Lakes Executive Conference Center
Grapevine, Texas

NOVEMBER 2014

November 4-5
FAR Workshop
Executive Conference and Training Center
Sterling, Va.

November 6
BDO's Supercircular Webinar*
Registration link coming soon

November 6
2014 National Small Business Federal Contracting Summit
Embassy Suites
Washington, D.C.

DECEMBER 2014

December 9-11
National Veterans Small Business Engagement
Georgia World Congress Center
Atlanta, Ga.

* Indicates that BDO is sponsoring and/or speaking at this event.

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