



Use of Blended Rates for Multiple Compensation Caps

Government Contracts Update

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History

In December 2013, the Bipartisan Budget Act of 2013 (BBA) was passed with an allowability compensation limit/cap for government contractors. To address this BBA requirement, the FAR Council issued an interim rule effective June 24, 2014 revising the Compensation Cost Principle found in FAR Part 31.205-6(p). The new cap/limit only applies to:

- 1) Flexibly priced contracts/subcontracts awarded on or after June 24, 2014; and
- 2) Costs incurred on or after June 24, 2014.

In other words, it is not retroactive to the beginning of the year nor does it impact contracts/subcontracts awarded before June 24, 2014. Since the effective date of the interim FAR rule is June 24, it will not coincide with most federal contractors' fiscal years.

Depending on a federal contractors cost recovery strategy, this will create a situation where the contractor will have contracts/subcontracts with different compensation ceilings and employee applicability that will result in Multiple Rates in a fiscal year e.g., different G&A Rates for contracts awarded before and on or after June 24, 2014. Based on past history, Multiple Rates for a given year create more complexity and result in increased costs for both the Government (longer audits) and contractors e.g., ensuring that multiple rate calculations are done properly and accurately.

Department of Defense (DOD) Solution

The DOD recognized the potential issue of contractors having multiple rates applicable to different contracts. In October 2014, the DOD issued a memorandum entitled *Use of Blended Rates to Implement Multiple Compensation Caps*. The DOD concluded that "contractors' use of a 'blended rate' approach is deemed as a practical and cost efficient solution to implement these requirements." The memorandum further states "contract administration office contracting officers and contractors will execute an advance agreement in accordance with FAR 31.109 for each contractor that *chooses to employ the blended rate method* [emphasis added]".

Civilian Agencies

The DOD memorandum only applies to the Defense Department and does not apply to Civilian Agencies. Contractors working with Civilian Agencies should check for Policy/Guidance from their Civilian Agencies and if none has been released as yet, contractors should work with their Administrative Contracting Officers (ACOs) to enter into advance agreements to protect the financial interests of both parties.

Please be aware that some Civilian Agencies may choose to follow DOD memorandums and guidance.

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The Multiple Rates (Blended Rates) Options

As previously stated, DOD contractors and some Civilian contractors will have to decide on an option for calculating their Fiscal Year 2014 indirect cost rates. The October 24, 2014 memorandum states “blended rates will be calculated by each individual contractor as a weighted average composite cap amount specific to their contract volume prior to June 24, 2014, and on or after June 24, 2014”. The memorandum also states that contractors may elect another compliant method.

So what are the other compliant methods? According to the Defense Contract Audit Agency’s (DCAA) Contract Audit Manual (CAM), Section 6-414.9, Audit Considerations for FY 1995 and FY 1996 Ceilings, they are as follows:

- 1) A blended rate calculated as a weighted average composite cap amount specific to their contract volume as cited above (only with an advance agreement).
- 2) The lower of the two compensation caps, which is the simplest method to use (the \$487,000 ceiling).
- 3) Contractors can use their established cost accounting practices to calculate multiple rates. This is a complicated method of calculating provisional/final indirect cost rates. It will cause hardship in the billings and contract administration departments and increase your business systems compliance risk until your prior to June 24, 2014 contracts and subcontracts end.
- 4) Contractors can use contract credits in which credits are issued on the contracts covered by the new cap. This is the most complicated method. For details about this method see CAM section 6-414.9.

How to Choose an Option

It is up to the contractor to select the best option for them based on such factors as:

- 1) The volume in number/dollar amounts of impacted contracts/subcontracts.
- 2) The internal resources and level of expertise available within the organization.
- 3) The volume in number/dollar amounts of personnel impacted by the \$487,000 compensation cap including subcontractor employees.
- 4) The number/dollar amounts of the personnel qualifying for the compensation cap exemptions (e.g., Science, Technology, Engineering, and Math).
- 5) The overall amount that would be forfeited after considering individual contract/subcontract indirect cost rate ceilings versus the time and cost to properly (defensibly) calculate the blended rates.

It is important to remember that when choosing an option, it most likely will impact your future years’ provisional/final indirect cost rate calculations and submissions.

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The Risks of Using Blended Rates without Advanced Agreements

Since the DOD memorandum discusses the usage of advance agreements, a contractor operating without an advance agreement that has significant compensation costs exceeding the June 24, 2014 compensation cap is creating management and financial risk for the firm. Without an advanced agreement, we believe that the DCAA, Civilian Auditors, or CPA firms contracted to perform government audits, could:

- 1) Reject/deem inadequate Incurred Cost Submissions (ICS) that use blended rates.
- 2) Determine that the use of blended rates *was unauthorized by the Government* and the ICS results in expressly unallowable costs (i.e., the part of the blended rate compensation that was over the June 24, 2014 cap and that blended rate was allocated to contracts covered by the new cap) which are subject to Penalties under Title 31 of the United States Code, Sections 1301 (Purpose Statute) and 1341(a) (1) (Anti-Deficiency Act); also see CAM section 6-414.9.
- 3) Expand audit scope or conduct additional system audits (e.g. compensation, billings, contracting, and purchasing).
- 4) Wrongfully apply the FAR 31.205-6(p) new compensation cap to all employees versus the top five (5) Senior Executives (as described in Appendix A) for “open” indirect cost submission years.

Conclusion

This change in the compensation cost principle could create difficulties for contractors in forecasting and calculating their provisional/final indirect cost rates. With limited options/guidance from the Government and limited resources at the contractors, some firms may not have the necessary time to adequately assess the cost impact on their business. CostTrend can assist with or prepare the cost impact so that the contractor can make an informed business decision.

For more information on the compensation cap or to review your options, please contact CostTrend Consulting at 703.657.0270 or info@costtrend.com.

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Appendix A

Guideline for the Compensation Cap - FAR 31.205-6(p)

Summary of the applicable Compensation Caps

Date	DoD, NASA and the Coast Guard	To all executive agencies, <i>other than</i> DoD, NASA and the Coast Guard	Subcontracts thereunder
After January 1, 1998	Senior executive (1) (OFPP)	Senior executive (1) (OFPP)	No
After January 1, 1999	Senior executive (2) (OFPP)	Senior executive (2) (OFPP)	No
After January 1, 2012	All employees (OFPP)	Senior executive (2) (OFPP)	No
On or After June 24, 2014	All employees (3) (CECP)	All employees (3) (CECP)	Yes

Office of Federal Procurement Policy (OFPP)

Benchmark Executive Compensation Amount	Fiscal Year	For Costs Incurred After	Federal Register Notice
\$952,308	2012	1/1/2012	78 FR 72930
\$763,029	2011	1/1/2011	77 FR 24226
\$693,951	2010	1/1/2010	75 FR 19661
\$684,181	2009	1/1/2009	74 FR 23893
\$612,196	2008	1/1/2008	73 FR 15779
\$597,912	2007	1/1/2007	72 FR 14300
\$546,689	2006	1/1/2006	71 FR 26114
\$473,318	2005	1/1/2005	70 FR 23888
\$432,851	2004	1/1/2004	69 FR 26897

Once an OFPP compensation cap is established for a fiscal year, it is applicable for that fiscal year for a contractor and subsequent fiscal years, unless and until revised by OFPP. The OFPP cap applies to contract costs incurred after a stated date.

If the contractor's fiscal year does not coincide with the fiscal year for the compensation cap as determined by OFPP, the compensation cap as determined by OFPP is adjusted for the contractor's fiscal year, and the compensation cap, as adjusted, is applicable to the contractor's fiscal year. The sum of the pro-rata portions of the compensation cap for the fiscal years straddled by the contractor's fiscal year is the compensation amount, as adjusted, applicable to the contractor.

More info at http://www.whitehouse.gov/omb/procurement_index_exec_comp

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Contractor Employees Compensation Cap (CECP)

The new Contractor Employees Compensation Cap (CECP) is \$487,000 for costs claimed on contracts and subcontracts awarded on or after June 24, 2014. The cap will be adjusted annually based on the Bureau of Labor Statistics Employment Cost Index and not the OFPP Administrator.

More info at www.whitehouse.gov/omb/procurement/cecp

Notes for Appendix A

1) Senior executive means--

- The Chief Executive Officer (CEO) or any individual acting in a similar capacity at the contractor's headquarters;
- The four most highly compensated employees in management positions at the contractor's headquarters, other than the CEO; and
- If the contractor has intermediate home offices or segments that report directly to the contractor's headquarters, the five most highly compensated employees in management positions at each such intermediate home office or segment.

2) Senior executive means--the five most highly compensated employees in management positions at each home office and each segment of the contractor, whether or not the home office or segment reports directly to the contractor's headquarters.

3) Exceptions. An agency head may establish one or more narrowly targeted exceptions for scientists, engineers, or other specialists upon a determination that such exceptions are needed to ensure that the executive agency has continued access to needed skills and capabilities. In making such a determination, the agency shall consider, at a minimum, for each contractor employee in a narrowly targeted excepted position--

- The amount of taxpayer funded compensation to be received by each employee; and
- The duties and services performed by each employee.

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