FAR Council Finalizes Rule Capping Allowable Compensation for All Employees

October 3, 2016

WHAT: The FAR Council finalized its previous Interim Rule that capped the allowability of compensation for all contractor employees at the benchmark set by Congress in Section 702 of the Bipartisan Budget Act of 2013. That cap, which covers all compensation (the total amount of wages, salary, bonuses, deferred compensation, and employer contributions to defined contribution pension plans), remains at $487,000.

WHEN: The FAR Council issued the Final Rule on September 30, 2016, but the Interim Rule has been applicable since June 24, 2014.

WHAT DOES IT MEAN FOR INDUSTRY: For contracts awarded on or after June 24, 2014, contractors (and subcontractors) will not be able to seek reimbursement for compensation costs incurred that exceed the benchmark compensation amount.

- **Exceptions:** The Final Rule includes an exception that allows agency heads to establish "narrowly targeted exceptions for scientists, engineers, or other specialists" if they determine that an exception is "needed to ensure that the executive agency has continued access to needed skills and capabilities." But no agency invoked the exception in either FY 2014 or FY 2015.
- **No Adjustment Yet:** Section 702 required that the benchmark be adjusted annually based on the Employment Cost Index for all workers (calculated by the Bureau of Labor Statistics). The Final Rule, like the Interim Rule, assigns the responsibility for adjustments to the administrator for OFPP. FAR 31.205-6(p)(4)(ii) ((p)(3)(ii) in the Interim Rule). Nonetheless, OFPP has not yet increased the cap from its original amount. Meanwhile, between June 2014 and June 2016 the Employment Cost Index for all civilian workers increased by approximately 4.4% (from 121.4 to 126.7).
- **No Changes Recommended (by DoD or OMB):** Section 702 also required that OMB and DoD evaluate alternative benchmarks and report back to Congress. OMB and DoD concluded in August that all of the alternatives identified to date "would not be more effective" in serving as an "affordable and fiscally responsible cap" and thus did not recommend any changes.

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Practice Areas

Government Contracts

- **Blended Caps:** Many contractors will have contracts subject to multiple caps pursuant to the current and earlier compensation limitation provisions—at least (1) for contracts awarded prior to June 24, 2014, *see* FAR 31.205-6(p)(2-3), and (2) for contracts awarded on or after June 24, 2014, *see* FAR 31.205-6(p)(4). Therefore, as we previously discussed, the Director, Defense Pricing has encouraged the use of blended caps—*i.e.*, a weighted average composite cap that reflects the volume of contracts subject to each cap. Many of the details will vary by contractor, including the scope of each cap (*e.g.*, company-wide, division, or segment) and the type of supporting information needed to support the cap. Additionally, DCMA policy requires that contractors execute an advance agreement in order to use a blended cap. DCAA has issued two audit alerts this year regarding the use of blended caps, underscoring the requirement for an advance agreement (16-PSP-005, issued February 19, 2016; 16-PSP-007, issued June 30, 2016).