What Government Contractors Should Know:

10 Regulatory Compliance and DCAA Guidance Updates to be Aware of Now and Heading into 2017

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Introduction

The government has been busy in 2016 issuing final and proposed rules related to an array of regulatory compliance requirements associated with U.S. federal government contracts. Specifically, the Federal Acquisition Regulation Council (FAR Council) – defined to include the Department of Defense (DoD), the National Aeronautics and Space Administration (NASA), and the General Services Administration (GSA), plus, the Department of Labor (DOL), the DoD, the GSA, and the Small Business Administration (SBA) all have issued specific Agency rules pertaining to performance and compliance under government contracts.

Additionally, the Defense Contract Audit Agency (DCAA) has issued recent internal guidance in 2016 that contractors should be knowledgeable of as well.

Further discussion of 10 recent and noteworthy government contract compliance requirements and guidance items are summarized below.

1. Fair Pay and Safe Workplaces Executive Order

Synopsis - The FAR Council and the DOL issued a final rule August 25, 2016, effective October 25, 2016, implementing Executive Order 13673. The final rule requires, among other things, for contractors to report to the government labor law violations under 14 specific labor laws. Key provisions of this final rule include:

- Applicability limited to the legal entity responsible for performing the contract
- Effective dates to be on a phased-in schedule starting October 25, 2016 and initially limited to a one-year look back
- For the one-year period beginning October 25, 2016, disclosures of labor law violations will be required only for prime contractors – subcontractor disclosures will not be required until October 25, 2017 and subcontractors are obligated to report directly to the DOL, not the prime contractor
- For the first six months after October 25, 2016, the requirement for prime contractors to disclose labor law violations will apply only under solicitations valued at $50 million or more; starting April 25, 2017, solicitations valued at or above $500,000 will be covered
- Starting September 12, 2016, the DOL will offer a “pre-assessment” process, which will allow contractors to come forward to the DOL “to discuss their history of compliance with labor laws” and secure guidance on whether “additional compliance measures are necessary.”

As a result of a lawsuit filed October 7, 2016 by the Associated Builders and Contractors of Southeast Texas, a federal judge sitting in the U.S. District Court for the Eastern District of Texas issued a preliminary (not permanent) injunction October 24, 2016, one day before the effective date of the related final rule, staying implementation of most of the requirements contained in the Executive Order. The only portion of the Executive Order that was not enjoined by the government and was allowed to proceed relates to the paycheck transparency provisions.

Takeaway - It is too early to tell what the downstream consequences of the preliminary injunction may be. Likely, the government will challenge the judge's recent decision and further litigation will ensue. Further, contractors should not accept related clauses or representation requirements that may be contained in new solicitations, excluding paycheck transparency requirements.

Nonetheless, contractors should assess now, internal business system processes and capabilities to monitor, track, and report applicable violations. Ideally, other processes or internal controls exist and are operating effectively to avoid a violation to begin with. Some form of supply chain oversight, perhaps a representation from the subcontractor, should also be considered. Labor law compliance and related systems of internal controls currently are, for the moment, outside the DCAA's purview and are not addressed in related audit programs or internal control matrices. However, that may change. Consequences for violations vary, and may include, adverse FAR Part 9 responsibility determinations, termination of contracts, and suspension or debarment considerations. For now, though, these risks are significantly mitigated based on the October 24, 2016 decision. However, the risk posture may change pending the ultimate resolution of this matter.

2. Paid Sick Leave

Synopsis - The DOL issued a final rule September 29, 2016 implementing Executive Order 13706. The final rule is applicable to covered solicitations issued on or after January 1, 2017 and entitle applicable employees to accrue one hour of sick leave for every thirty hours worked with a minimum annual accrued amount of 56 hours per calendar year. Specifically, the final rule applies to solicitations and resulting covered contracts defined as follows:

- Procurement contracts for construction covered by the Davis-Bacon Act
- Contracts for services covered by the Service Contract Act
- Contracts for concessions
- Contracts in connection with federal property or lands and related to offering services for federal employees, their dependents, or the general public

Takeaway - From a cost accounting perspective, implementation of the final rule may result in adverse cost impacts to contractors applicable to certain contracts subject to coverage under the Cost Accounting Standards (CAS).The potential adverse cost impacts, assumed to be the direct result from the implementation of the final rule, will likely require contractors to change their existing cost accounting practices (from cash basis to accrual basis) to conform with the new requirement. The change in cost accounting practices should be deemed by the government as a mandatory change for which increased costs under applicable CAS-covered contracts is permitted.

Contractors should assess now existing cost accounting practices and determine if a change in practice is required. If a change is required, communicate with contracting officers early and notify them of potential requests for equitable adjustment to allow recovery of increased costs due to the mandatory change in cost accounting practice.

3. Federal Tax Delinquency and Felony Convictions

Synopsis - The FAR Council issued a final rule September 30, 2016, effective immediately. The final rule adds to current FAR Part 9 responsibility criteria and requires any corporation responding to applicable federal solicitations, to make a representation pertaining to unpaid federal tax liabilities and felony convictions for violations of any federal law. Key provisions of this final rule include:

- Contractor representations whether it has any unpaid federal tax liability that has been assessed and is not being appealed or paid in a timely manner, or a felony conviction for a violation under any federal law within the preceding 24 months

- These representations are required under all federal solicitations pursuant to FAR 9.104-7(d), including – commercial items, commercially available off-the-shelf items, and procurements under the simplified acquisition threshold (currently $150,000)

- The final rule and implementing FAR clause are silent on exceptions due to materiality or significance of the unpaid tax liability, so assume there is no exemption for insignificant or immaterial amounts

- Affirmative contractor responses to either unpaid tax liability or recent felony convictions will require the government to not award a contract to that corporation and notify the agency suspension and debarment official to review the matter and make a determination if further action (suspension or debarment) is necessary to protect the government's interests.

Takeaway - Contractors should assess now internal business system processes and capabilities, ethics and compliance programs, and disclosure practices to enhance and demonstrate FAR Part 9 responsibility requirements, and engage early with the government to make such demonstrations, when applicable.

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4. Counterfeit Electronic Parts

Synopsis - The DoD issued a final rule August 30, 2016, effective same date, revising the previously issued proposed rule of March 25, 2016. The final rule, to include commercial item acquisitions and procurements less than the simplified acquisition threshold (currently $150,000), clarifies the allowability criteria of costs incurred and associated with counterfeit electronic parts, including suspect counterfeit electronic parts and rework or corrective action required to remedy the use or inclusion of such parts. Initially, these costs were unallowable unless the subject parts were sourced as government furnished property. These costs may now be allowable pursuant to the final rule if the following criteria are met:

- Contractors maintain an operational system to detect and avoid counterfeit electronic parts and suspect counterfeit electronic parts that had been reviewed and approved by the DoD

- Contractors be made aware of counterfeit electronic parts or suspect counterfeit electronic parts and provide timely (i.e., within 60 days after the contractor becomes aware) notice to the Government.

Takeaway - Contractors that receive and use electronic parts for ultimate sale to the DoD need to maintain robust systems to detect and avoid use of counterfeit parts. Maintenance of adequate and effective business systems will not only limit the risk of not detecting counterfeit parts, but will also be helpful when demonstrating the operational system requirement noted above to support cost recovery opportunities.

Additionally, it is likely only a matter of time before these rules are extended to all, or other, parts and not simply limited to only electronic parts. So, take the time now to assess business systems and supply chain capabilities to reduce procurement risks.

5. Transactional Data Reporting under GSA Contracts

Synopsis - The GSA issued a final rule June 23, 2016, effective same date, requiring contractors report transactional data from orders placed against certain Federal Supply Schedule (FSS) contracts, Governmentwide Acquisition Contracts (GWACs), and Governmentwide Indefinite-Delivery, Indefinite-Quantity (IDIQ) contracts. A primary objective of the final rule is to "provide business intelligence to strengthen "best value" decision-making by ordering activities, which will allow customers to take full advantage of the wide variety and complexity of products and services offered by Schedule Partners and pass on savings to the taxpayer". Key provisions of this final rule include:

- Mandatory reporting for new offers received after implementation of the final rule and optional for existing schedule holders; i.e., mass contract modifications are anticipated to incorporate these new requirements into existing contracts; however, contractors have the option to accept these modifications

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- Monthly electronic reporting of up to 11 specific transactional sales data items related to applicable contracts

- Reporting requirements to be implemented on a phased-in approach with a planned start date of August 2016

- Contract modifications under the new rule will no longer require commercial sales practices (Form CSP-1) reporting nor most favored customer and sales/discounting tracking (formally the Price Reduction clause);

- Industrial Funding Fee payments will now be received only electronically

- Schedules and Special Item Numbers affected during the Roll-Out (in order) are – 581, 72, 03FAC, 51V, 75, 73, 70 and 00CORP.

Takeaway - Contractors should assess now existing information system capabilities regarding capture and reporting of up to 11 specific data elements. Contractors should also perform a risk assessment of overall GSA sales and volume as a consideration when deciding to accept the contract modification(s).

Further, as this reporting requirement is new and being implemented on a pilot and phased-in basis, it is unknown how the government will use the data for purposes of subsequent price reasonableness determinations and related negotiations.

6. SBA Mentor-Protégé Program

Synopsis - The SBA issued a final rule July 25, 2016, effective August 24, 2016, expanding the classes of small businesses eligible to participate in the program. The current program limits mentor protégé arrangements only to certified 8(a) small disadvantaged businesses. The revised plan under the final rule will expand to now include service-disabled veteran owned small businesses (SDVOSB), HUBZone small businesses, women-owned small businesses (WOSB) and small businesses generally. The SBA will begin October 1, 2016 receiving applications from eligible small businesses to participate in the program.

Separately, the SBA issued a proposed rule in September 2016 revising several elements of the current mentor-protégé program. Key provisions of this proposed rule include:

- Expansion of mentor participation to large businesses not currently operating under an approved subcontracting plan

- Expansion of protégé participation to include:
  - entities owned and controlled by Native Hawaiian Organizations or Indian tribes
  - non-traditional defense contractors
  - entities providing goods or services in the private sector that are critical to enhancing the capabilities of the defense supplier base

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- Limitation of protégé participation to only one mentor agreement at a time and for five years from initiation of the first agreement

- Requirement that protégés' size must be less than half the SBA size limit for the primary NAICS code

Takeaway - Both the proposed and final rules provide increased opportunities for large and small businesses to participate in the mentor-protégé program and further expand opportunities to seek federal government contracts. As always, for contractors new to government contracting, some form of due diligence regarding government contract compliance requirements and corresponding internal capabilities is recommended to limit down-stream risk during performance.

7. Small Business Subcontracting Plans

Synopsis - The FAR Council issued a final rule July 14, 2016, effective November 1, 2016, adding various criteria and requirements associated with administration of small business subcontracting plans. These statutory amendments will affect prime contractor responsibilities on how they deal with subcontractors and report to the government. Key provisions of this final rule include:

- Requires prime contractors to make good faith efforts to utilize their proposed small business subcontractors during performance of a contract to the same degree the prime contractor relied on the small business in preparing and submitting its bid or proposal

- To the extent a prime contractor is unable to make a good faith effort to utilize its small business subcontractors as described above, requires the prime contractor to explain, in writing, within 30 days of contract completion, to the contracting officer the reasons why it was unable to do so

- Authorizes contracting officers to calculate subcontracting goals in terms of total contract dollars in addition to the required goals in terms of total subcontracted dollars

- Requires subcontracting plans, including modifications under the subcontracting plan threshold, if said modifications would cause the contract to exceed the plan threshold

- Requires prime contractors with subcontracting plans on task and delivery order contracts to report order level subcontracting information after November 2017.

Takeaway - Prime contractors should review now existing business system processes and capabilities to address these requirements to avoid potential compliance risks – including, for example, CPSR inadequacy and negative past performance evaluation.

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8. Thresholds and Submission of Certified Cost or Pricing Data

Synopsis - The DoD issued a Defense Procurement and Acquisition Policy (DPAP) memo June 21, 2016 to the Army, Navy, and Air Force encouraging participation in the pilot program allowed under the 2016 National Defense Authorization Act (NDAA) to assess the impacts and risks associated with raising the threshold requiring submission of certified cost or pricing data (commonly known as the Truth in Negotiations Act ([TINA]) on selected procurements from $750,000 to $5,000,000. The DPAP memo requests each of the buying commands to select a candidate acquisition for participation in the pilot program and submit to the Director, DPAP for approval.

Separately, the DoD issued a proposed rule August 30, 2016 to implement provisions of the 2016 National Defense Authorization Act allowing exemptions to submission of certified cost or pricing data related to acquisitions valued at less than $7,500,000 and applicable to small businesses or nontraditional defense contractors responding to solicitations utilizing a technical, merit-based selection procedure (e.g., broad agency announcement) or the Small Business Innovation Research (SBIR) Program.

Takeaway - With the issuance of the DPAP memo and separate proposed DoD rule, three possible thresholds may ultimately exist related to certified cost or pricing data submission requirements. The combined objectives of the pertinent provisions of the 2016 NDAA and the DoD proposed rule appear to focus on streamlining the acquisition process using a risk-based framework and increasing the government's access to industry's research and innovation technology capabilities. It is currently unknown how, or if, the pilot program may ultimately affect the current submission requirement threshold of $750,000.

Contractors will now need to understand and document these additional exemptions for purposes of monitoring submission of certified cost or pricing data as well as flow-down requirements to subcontractors. Additionally, it will be confusing as the thresholds for coverage under the CAS no longer align in all situations; i.e., the CAS and TINA requirements may no longer be the same at $750,000.

9. The DCAA's Selected Areas of Cost Guidebook

Synopsis - The DCAA released on the DCAA web site (http://www.dcaa.mil) in September 2016 new internal audit guidance entitled 'Selected Areas of Cost Guidebook'. The new guidance in not complete and is in process; however, 13 areas of cost have been revised from the prior guidance in Chapter 7 of the DCAA's Contract Audit Manual (CAM).

The subject guidance replaces Chapter 7 of the CAM and currently is structured to include 75 chapters, many of which will be revised as progress continues on its completion. Many of the chapters are somewhat narrow in focus and address specific elements of cost for which a corresponding cost principle (FAR Subpart 31.2) does not exist; e.g., banked vacations costs, mentor-protégé costs, no cost storage contracts, weather related closure and Workforce Investment Act.

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Takeaway - It is too early to assess the effects or implications of this guidance as it is very recent and incomplete. However, as the Guidebook appears to be the new DCAA audit guidance, take the time now during its formation to understand the DCAA audit objectives and areas of focus.

10. Selected DCAA Memorandums for Regional Directors (MRDs)

Synopsis - The DCAA issued six MRDs on their website thus far in 2016. MRDs of note include:

- Audit Guidance on the Impact of the National Defense Authorization Act on DCAA's Audit Support to Non-Defense Agencies (9/30/16)
- Audit Guidance on Revised Policy and Procedures for Low-Risk Incurred Cost Proposal Less Than $250 Million in ADV (5/27/16)
- Audit Alert on DCMA Implementation Guidance on Blended Compensation Caps (2/19/16)
- Updated Audit Guidance on the Treatment of Overdue Indirect Rate Proposals (2/11/16)

Takeaway - Knowing the DCAA's internal audit guidance, i.e., MRDs, audit programs, internal control matrices, checklists, and the CAM, is critical to enhance the likelihood of an effective audit and successful outcome. MRDs are issued periodically and several are posted on the DCAA website. Public access to this internal guidance may become scarce though, as the DCAA's development and use of VIPER (intranet portal not publicly available) progresses.

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