

ALERT

Department of Defense Memorandum Attempts to Streamline Executive Compensation Calculations

October 29, 2014

On October 24, 2014, the Director of Defense Pricing within the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics issued a Memorandum authorizing defense contractors to use “blended rates” when implementing the multiple compensation caps that have been mandated by Congress in recent years. As we previously discussed, beginning with the passage of the National Defense Authorization Act for Fiscal Year 2012, Pub. L. No. 112-81, Congress has expanded the number of contractor employees who are subject to what was formerly known as the executive compensation cap and lowered the amount of compensation that contractors can allocate to federal government contracts and subcontracts as allowable costs. As a result, current rules provide that for contracts awarded on or after December 31, 2011, but before June 24, 2014, an allowable compensation cap of \$952,308 applies to all contractor employees performing Department of Defense (DOD), National Aeronautics and Space Administration (NASA), and Coast Guard contracts, as well as the five most highly paid executives performing contracts issued by all other agencies. For contracts awarded by any agency on or after June 24, 2014, the allowable compensation for all contractor and subcontractor employees is \$487,000, with annual Employment Cost Index adjustments.

Recognizing the challenges associated with the requirement to implement multiple allowable compensation rates simultaneously and the related administrative costs that contractors will incur to develop and monitor these complex calculations, the DOD Memorandum will allow DOD contractors to use a “blended rate” approach to

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calculating allowable compensation. The DOD Memorandum merely authorizes the use of blended rates. It does not require contractors to employ blended rates. Contractors that elect to use blended rates will calculate a weighted average composite compensation cap based on their contract volume before and after June 24, 2014. In order to implement the blended rates, contractors must execute an advance agreement with the relevant administrative contracting officer, which outlines the process for determining the blended rates, the auditable data to be submitted to substantiate the rates, and the length of time the rates are applicable.

It is important to note that the DOD Memorandum applies only to DOD contractors and subcontractors. Contractors that do not hold DOD contracts must continue to apply the specific compensation caps applicable to each of their contracts and subcontracts. Given the numerous changes to the allowable compensation rules in the last few years, all contractors should be vigilant in determining which rules apply to which contracts and ensuring that unallowable costs are accurately segregated.