Government contract compliance is a multi-faceted business objective, encompassing numerous diverse yet often interconnected processes and business controls. Sellers to the Federal government have to contend with a multitude of potential issues, from those involving financial management (e.g., cost allowability, contract financing, and contract billings) to acquisition (e.g., Buy America Act, socioeconomic reporting, price reasonableness, and government property management) to post-award execution issues (e.g., change control, limitations of cost and funds, Earned Value Management, and quality assurance)—to name just a few.

Three Christmas-time promulgations from the Federal government illustrate the diverse set of issues that must be addressed to be a "compliant" government contractor.

First, some good news relating to the thorny issue of "excessive pass-through costs." For some time now, the DOD has imposed a statutorily mandated prohibition on reimbursement of excessive pass-through costs. When the value of the orders a contractor (or lower-tier subcontractor) places with vendors/suppliers/subcontractors exceeds 70% of its total costs—and the Contracting Officer determines that the higher-tier contractor "adds no or negligible value"—then indirect costs and profit/fee applicable to the subcontracted work are unallowable for that contract. This assessment is made during the proposal phase, based on the estimated value of work to be subcontracted. Moreover, if (after contract award) the higher-tier contractor's amount of subcontracting unexpectedly exceeds 70% of its total cost, then it must notify its Contracting Officer and justify why it adds value—or risk having applicable indirect costs and profit/fee disallowed. (Fixed-price contracts are subject to a potential retroactive unilateral downward price adjustment.)

On December 23, 2009 DOD Director of Defense Procurement and Acquisition Policy Shay Assad issued a **Class Deviation** directing DOD Contracting Officers to utilize the recently published direction, solicitation provision, and contract clause found in the Federal Acquisition Regulation (FAR) in lieu of the now-obsolete direction, solicitation provision, and contract clause found in the Defense Federal Acquisition Regulation Supplement (DFARS). In addition, the Deviation exempts fixed-price incentive contracts awarded on the basis of adequate price competition from the FAR requirements relating to this issue.

Next, the Department of Commerce Bureau of Industrial Security (BIS) issued a **final rule** to 15 C.F.R. § 701 to implement requirements for the reporting of "offset agreements" in the sales of "weapon systems or defense-related items" to foreign entities. The existing reporting rule was revised to address criticisms in a GAO report (GAO-08-854). According to the rule, an "offset transaction" is –

Any activity for which the U.S. firm claims credit for full or partial fulfillment of the offset agreement. Activities to implement offset agreements are categorized as coproduction, technology transfer, subcontracting, credit assistance, training, licensed production, investment, purchases and other.

The rule defines both "direct" and "indirect" offsets. U.S. firms are required to file annual reports when offset agreements exceed $5 million in value, or when a firm has claimed an offset credit with its foreign customer of at least $250,000. The reports are required to include certain information, including (but not limited to) the NAICS code associated with the military export sale. If more than one NAICS code is applicable, then the contractor must apportion the sale into the appropriate NAICS code(s). The revised reporting requirements will be effective with firms' June 2010 reporting period.

Comments received in response to the draft rule included several criticisms. Among the criticisms was that the reporting requirements were burdensome and would result in additional costs to contractors. Commenters requested an 18-month implementation period. The BIS rule-makers were not impressed with the argument(s) submitted, noting "the 33 percent increase amounts to the addition of three hours to the existing nine hour burden." In a similar vein, the BIS drafters rejected the call for a long implementation period, making the rule effective in 30 days.

Finally, the DFARS supplemental cost principles (applicable to DOD contracts) were **revised** by issuance of a final rule on December 24, 2009 to address the allowability of the costs of leasing government equipment for display or demonstration purposes. One change was made to the DFARS language at 225-7303-2 ("Cost of doing business with a foreign government or international organization") to clarify that the limitations on cost allowability found at the 231.205-1 cost principle do not apply to FMS contracts, even though the general rule that "costs not allowable under FAR Part 31 are not allowable in pricing FMS contracts" is still valid. The final rule also revised that DFARS cost principle (231.205-1, Public Relations and Advertising Costs) to make unallowable "monies paid to Government associated with the leasing of Government equipment, including lease payments and reimbursement for support services …." In other words, a contractor cannot normally price into its proposals the cost of leasing equipment from the U.S. Government for display or demonstration purposes—unless it is pricing a Foreign Military Sale contract, in which case such costs may be included. (We have discussed the FMS program, generally, in **this article**

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Three compliance issues to think about, addressing diverse issues possibly of interest to only a few practitioners. Yet companies that sell to the U.S. government need to be aware of such issues and must comply with them. It is little wonder, therefore, that sellers in the Federal marketplace invest in people and systems and controls—and then constantly update them in response to the changing regulatory environment—and pass the cost of doing so to its government customers in the form of higher prices.