The Federal Acquisition Regulation (FAR) (also known as Title 48 of the Code of Federal Regulations) establishes the general rules for cost allowability—*i.e.*, the rules regarding which costs the government will pay for and under what circumstances it will pay for those costs. Now that's not the *only* thing the FAR establishes, not by a long shot. But it's the part we are going to discuss today.

We say the FAR "establishes the general rules for cost allowability" because the FAR has supplementary regulations that may apply, depending on which Department or Agency of the Executive Branch you are dealing with. For example, the Department of Defense has its own "Defense Federal Acquisition Regulation Supplement" (aka, "DFARS"). Digging deeper, there may be additional rules and regulations established by local commands. For example, there's a FAR Supplement for the U.S. Army. And there's another one for the U.S. Air Force. *Et cetera*. You get the picture.

So the FAR is not the be-all-and-end-all in the discussion of cost allowability. But it *is* the start of the discussion.

The FAR establishes cost allowability rules in Part 31 ("Contract Cost Principles and Procedures"). Subpart 31.2 ("Contracts with Commercial Organizations") discusses cost principles and procedures that are to be followed by for-profit entities that do business (or want to do business) with the Federal government. Subpart 31.2 can, somewhat simplistically, be broken down into two pieces: nine "general principles" (called by the late Mel Rishe "the cornerstone principles"), and principles governing "selected costs". There are 52 selected cost principles (though several are "reserved" and Not Applicable to contractors). So for-profit contractors need to be aware of about 55 individual rules governing cost allowability.

(Note: We are of course eliding any discussion of the Cost Accounting Standards (CAS) found in Part 30 or contract financing/billing rules found in Part 32.)

Looking at the roughly 55 individual cost allowability rules, there is one rule that stands out among all the others, because of its complexity and sheer length and breadth of coverage. We're talking about the Cost Principle found at 31.205-6, Compensation for Personal Services. Actually, there are (at least) 17 separate rules found within that single Cost Principle, ranging from 31.205-6(a) ("general rules") to 31.205-6(q) ("allowability of employee stock ownership plans"). It covers such wide-ranging compensation topics as back pay, severance pay, pension costs, bonuses and other incentive compensation, postretirement benefits, fringe benefits, etc. It's a bear.

It's an intentially complex Cost Principle for a variety of reasons, likely the foremost of which is the notion that the biggest driver of contractors' costs is their labor costs. (Actually, with advances in factory automation, telecommunications/information technology, and process streamlining, we're not sure that's a valid assumption any longer. But we digress.) In addition, it's undeniable that contractors have, in the past, "gamed" compensation costs to their benefit. For example, waiting until just before the books close at year-end in order to see how room there is in the estimated indirect rates for incentive compensation, and then awarding incentive compensation based on that amount of "room" is one way contractors have gamed their compensation costs—to their benefit and presumably to the detriment of their government customers, who may have ended-up paying less had a different methodology been used. As the government (and Congress) became aware of the compensation "games," the rules evolved in order to close the regulatory loopholes that permitted them. Thus, here we are today, with a bear of a Cost Principle with which to comply.

Another important factor to consider is the impact of Federal government employees, the buyers and program managers, and quality assurance specialists, and cost monitors, and auditors, and pricing analysts, and logisticians, and all the folks who belong to the American Federation of Government Employees (**AFGE**). Not to engage in union-bashing (because we support the right of employees to organize and engage in collective bargaining), but it's a fact that AFGE has, for years, waged a war against a perceived inequality between private sector compensation and benefits, and the compensation and benefits offered to Federal employees. In fact, as recently as its official 2013 "Issue Papers," AFGE called for "capping taxpayer subsidies for contractors at $200,000 per annum" and devoted several pages of single-spaced arguments to supporting its position. The attacks by AFGE and others on contractor compensation have resulted in complex and somewhat arbitrary compensation "ceilings" that limit the amount of allowable employee compensation that can be priced and billed to the Federal government.

We have written several articles on the perceived inequality between civil servant pay and private sector pay. We finally concluded that there is insufficient information to reach a conclusion—and that there were too many contradictory studies for anybody to reach a conclusion. (Here's a **link to that article** .) We have also **attacked the notion** that the compensation paid to contractor executives (who may be helming companies in which Federal revenue is but a pittance of total corporate sales) is a valid target for rule-makers. We opined that it would have long-term repercussions on the quality of the defense industrial base. We argued setting compensation allowability ceilings too low (

e.g
, at $200K or $230K) would be a bad idea.

But our opinions and arguments didn't really stop Congress from passing **Section 803** of the 2012 National Defense Authorization Act (NDAA), or
Section 864
of the 2013 NDAA. Nor did it stop the FAR Councils from issuing an extremely complex and problematic interim rule in June, 2013, revising 31.205-6(p) employee compensation limits. We wrote about
that
piece of nefarious mischief
right here
.

Which brings us, by perhaps roundabout means, to the topic of this article: *what the heck has Congress done to contractor compensation ceilings this year?*
Depending on what bill you read (either the Bipartisan Budget Act of 2013 or the 2014 NDAA), you get a different compensation cost allowability answer. In the Budget Act, allowable contractor compensation was capped at $487,000. In the 2014 NDAA, allowable contractor compensation was capped at $625,000. How is a contractor supposed to know what the official limit is? The attorneys argue that the ceiling imposed by the bill signed last governs, but we're talking about a 24 hour timing difference. Does that really make a difference? Well, according to all the inside-The Beltway attorneys, yes. It does. Thus, according to pieces from
Jenner & Block
and
Crowell & Moring
, contractors should be working with the lower of the two compensation ceilings.

In fact, the world-class government contracts attorneys at Crowell & Moring prepared a really handy summary of the various compensation ceilings with which Federal contractors must comply. Here's a link to that **essential summary** . It illustrates just how complex and confusing the contractor compensation situation has become. The Crowell & Moring attorneys describe the situation as "confusing, inconsistent, and in some cases unenforceable."

But remember, dear readers, that contractors must comply with the Cost Principles in effect at the time their contract is awarded. If the FAR Councils revise the Compensation Cost Principles after contract award, perhaps in response to legislation such as the Bipartisan Budget Act or the NDAA, then the changes do not apply to that contract. (Yeah, some of the Compensation

Cost Principle changes attempt to apply the changes retroactively. Thus: the comment about unenforceability.) Any attempt to apply post-award cost allowability requirements to an awarded contract should at least result in an equitable adjustment to the contract price. Failure to provide that adjustment may be deemed to be a contract breach. If you have a Federal customer attempting to apply post-award allowability requirements to your awarded contract, you probably want to consult a knowledgeable and experienced attorney, just like the ones at Jenner & Block or Crowell & Moring.