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OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

Determination of Benchmark Compensation Amount for Certain Executives

AGENCY: Office of Federal Procurement Policy, OMB

ACTION: Notice

SUMMARY: The Office of Management and Budget is publishing the attached memorandum to the Heads of Executive Departments and Agencies announcing that \$763,029 is the “benchmark compensation amount” for certain executives in terms of costs allowable under Federal Government contracts during contractors’ fiscal year 2011. This determination is required under Section 39 of the Office of Federal Procurement Policy Act, as amended (41 U.S.C. 1127; formerly, 41 U.S.C. 435). The benchmark compensation amount applies to both defense and civilian agencies.

FOR FURTHER INFORMATION CONTACT: Raymond Wong, Office of Federal Procurement Policy, at 202-395-6805.

Lesley A. Field
Acting Administrator, Office of Federal Procurement Policy

MEMORANDUM FOR THE HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES

FROM: Lesley A. Field
Acting Administrator
Office of Federal Procurement Policy

SUBJECT: Determination of Benchmark Compensation Amount for Certain
Executives, Pursuant to Section 39 of the Office of Federal Procurement
Policy Act, as amended (41 U.S.C. 1127)

This memorandum sets forth the benchmark compensation amount for certain executives as required by Section 39 of the Office of Federal Procurement Policy (OFPP) Act, as amended (41 U.S.C. 1127; formerly, 41 U.S.C. 435). The statutory benchmark amount limits the allowability of compensation costs under Federal Government contracts as implemented at FAR 31.205-6(p). In less technical terms, the statute places a cap on the amount of contractor-paid executive compensation that the Federal Government will reimburse, in the case of those contractors that are performing contracts that are of a cost-reimbursable or other cost-based nature. It should be noted that, while the statute places a cap on the amount that the Federal Government will reimburse the contractor, the statute does not limit the amount of compensation that the contractor actually pays to its executives; contractors can, and do, provide compensation to their executives that exceed the statutory benchmark compensation amount.

Section 39 of the OFPP Act sets out a formula for determining the benchmark compensation amount. Specifically, the benchmark amount is set at the median (50th percentile) amount of compensation over a recent 12-month period for the five most highly compensated

employees in management positions at each home office and each segment of all publicly-owned companies with annual sales over \$50 million, and the determination is based on analysis of data made available by the Securities and Exchange Commission. Compensation for the fiscal year means the total amount of wages, salaries, bonuses, restricted stock, deferred and performance incentive compensation, and other compensation for the year, whether paid, earned, or otherwise accruing, as recorded in the employer's cost accounting records for the year.

After consultation with the Director of the Defense Contract Audit Agency, OFPP has determined, pursuant to the requirements of Section 39, that the benchmark compensation amount for certain executives for the contractors' fiscal year (FY) 2011 is \$763,029. This amount is for contractors' FY 2011 and subsequent contractor fiscal years, unless and until revised by OFPP. This benchmark compensation amount applies to contract costs incurred after January 1, 2011, under covered contracts of both the defense and civilian procurement agencies as specified in Section 39.

This past fall, the Administration proposed that Congress, starting with FY 2011, replace the existing statutory formula for calculating the cap on the amount that the Federal Government will reimburse Federal contractors (both defense and civilian). This proposal was contained in the President's Plan for Economic Growth and Deficit Reduction, which is on OMB's website at <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/jointcommitteereport.pdf>. In place of the formula that is in Section 39, the President's Plan proposed (on page 21) that Congress put in place a reimbursement cap that would be equal to the pay rate for the Federal Government's most senior executives, who are the heads of the 15 Cabinet departments and certain other high-level officials. These senior-most Federal officials are paid at the rate set for

positions at Level I of the Executive Schedule (5 U.S.C. 5312). During calendar year 2011, the pay for Level I positions was \$199,700, as set forth in Schedule 5 to Executive Order 13561 of December 22, 2010 (75 FR 81817, 81822; December 29, 2010).

The President's proposal was in response to the fact that the existing statutory formula (enacted in 1997) has resulted in the reimbursement cap tripling since the mid-1990s: whereas the reimbursement ceiling for 1995 was \$250,000, the statutory formula has resulted in substantial annual increases in the subsequent years, so that by FY 2010 the reimbursement ceiling had reached \$693,951. And, as this notice announces, the statutory formula has resulted in a reimbursement ceiling for FY 2011 of \$763,029. This is an increase in just one year of nearly \$70,000 – and of 10% -- in the amount that the taxpayers can be required to reimburse Federal contractors for the compensation that the contractors have decided to pay their executives. This rate of growth in the cap (both from 1995 onward, and in this most recent year) has far outpaced the rate of inflation, the rate of growth of private-sector salaries generally, and the rate of growth of Federal salaries – forcing our taxpayers to reimburse contractors for levels of executive compensation that cannot be justified for Federal contract work.

This is the direct result of the fact that the statutory formula sets the reimbursement ceiling, and increases it from one year to the next, by reference to considerations that have no relationship to the type of work that contractors are actually performing under Federal contracts that are cost-reimbursable or are otherwise cost-based. As noted above, the formula under Section 39 requires that the reimbursement ceiling be set, and adjusted annually, by reference to the amount that equals the following: the median (50th percentile) amount of compensation, over a recent 12-month period, that all publicly-owned companies with annual sales over \$50 million have paid to their five most highly compensated employees in management positions at each

home office and each segment. It is this formula, and not any comparable improvement in contractor performance (and the benefits that the taxpayers receive from these contracts), that has resulted in the one-year increase of \$70,000 (10%) from FY 2010 to FY 2011, and the tripling from 1995 to FY 2011, in the amount that the taxpayers can be required to reimburse Federal contractors for the compensation that the contractors have chosen to pay to their senior executives.

By proposing to replace the existing statutory formula with a reimbursement cap that is tied to the salary of a Cabinet official (such as the Secretary of Defense), the President's Plan would bring parity between the amount that the American public pays for the senior executives of the Federal Government and for the senior executives of those contractors who perform work for the Federal Government on a cost-reimbursable or other cost-based arrangement. (As is the case with the current formula under Section 39 of the OFPP Act, the proposal in the President's Plan would not impose any limits on the amount of compensation that a contractor pays to its executives; the proposed cap at the level of the salaries of Cabinet officials would limit only how much the taxpayers will reimburse the contractors for the compensation decisions that the contractors have chosen.)

To date, Congress has not adopted the Administration's proposal to replace the existing statutory formula for determining the reimbursement cap. However, in Section 803 of the recently-enacted National Defense Authorization Act for FY 2012 (H.R. 1540; P.L. 112-81, December 31, 2011) (NDAA), Congress did extend the applicability of the existing cap to any contractor employee performing under a "covered contract" under 10 U.S.C. 2324 (which are contracts awarded by the Department of Defense, the Coast Guard, and NASA), with the exception that "the Secretary of Defense may establish one or more narrowly targeted exceptions

for scientists and engineers upon a determination that such exceptions are needed to ensure that the Department of Defense has continued access to needed skills and capabilities.”

The effect of this new statutory provision is that, while the cap on reimbursement based on the Section 39 formula is retained, it will now apply to more employees – essentially all employees performing covered contracts for the Department of Defense, Coast Guard, and NASA (with narrowly targeted exceptions). This means that, for the first time, there will be a statutory cap (at the Section 39 level) on reimbursement for employee compensation for all employees performing under covered contracts, rather than only for a limited number of executives as has been the rule under Section 39 until now.

However, this broader application of the Section 39 cap does not apply to FY 2011. That is because Section 803 of the NDAA provides that its amendments “shall apply with respect to costs of compensation incurred after January 1, 2012.” Accordingly, the benchmark compensation amount in this notice, for FY 2011, applies only to the same limited number of contractor executives as did the Section 39 caps for FY 2010 and prior years. The broader application called for in Section 803 of the NDAA will be implemented through regulation and addressed in future notices.

Questions concerning this memorandum may be addressed to Raymond Wong, OFPP, at 202-395-6805.

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