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OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

Determination of Benchmark Compensation Amount for Certain Executives and Employees

AGENCY: Office of Federal Procurement Policy, Office of Management and Budget

ACTION: Notice

SUMMARY: The Office of Management and Budget is publishing the attached memorandum to the Heads of Executive Departments and Agencies announcing that \$952,308 is the “benchmark compensation amount” for certain executives and employees in terms of costs allowable under Federal Government contracts during contractors’ fiscal year 2012. This determination is required under Section 39 of the Office of Federal Procurement Policy Act, as amended (41 U.S.C. § 1127). 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.

Joseph G. Jordan
Administrator, Office of Federal Procurement Policy

MEMORANDUM FOR THE HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES

FROM: Joseph G. Jordan
Administrator
Office of Federal Procurement Policy

SUBJECT: Determination of Benchmark Compensation Amount for Certain Executives and Employees, 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 employees of Federal Government contractors as required by Section 39 of the Office of Federal Procurement Policy (OFPP) Act, as amended (41 U.S.C. § 1127) for the purposes of section 4304(a)(16) of title 41 and section 2324(e)(1)(P) of title 10. The statutory benchmark amount (the “cap”) limits the allowability of compensation costs under Federal Government contracts as implemented at Federal Acquisition Regulation (FAR) 31.205-6(p). In less technical terms, the statute places a cap on the total annual compensation amount the Federal Government will reimburse a contractor for the compensation the contractor provides to each of its employees for work done pursuant to certain Federal Government contracts. This cap applies to the compensation of certain contractor senior executives on contracts with civilian agencies (i.e., agencies other than the Department of Defense (DOD), the National Aeronautics and Space Administration (NASA), and the United States Coast Guard), and the compensation of all contractor employees on contracts with defense agencies (i.e., DOD, NASA and Coast Guard), when the contractor is performing contracts that are of either a cost-reimbursable nature 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

employees. Contractors can, and do, provide compensation to their employees that exceed the amount that is reimbursed by the Federal Government.

Section 39 of the OFPP Act sets out a formula for determining the cap amount. Specifically, the cap amount is set at the median (50th percentile) amount of compensation provided, over the most recent year for which data is available, to the five most highly compensated employees in management positions at each home office and each segment of all publicly-owned U.S. companies with annual sales over \$50 million. The determination is based on analysis of data made available by the Securities and Exchange Commission. Compensation 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.

When the cap was raised to \$693,951 for Fiscal Year (FY) 2010, the President called on Congress to repeal the current statutory formula and replace it with a lower, more sensible limit that is on par with what the Government pays its own executives and employees. Over the last several years, the Administration has strongly reiterated the need for reforms to the current statutory framework and Congress has considered several proposals to reform the compensation cap. To date, however, Congress has not revised the cap amount or the formula for adjusting the cap. Instead, Congress made only a modest change that expanded application of the statutory cap on defense contracts from the contractor's senior executives to all of its employees (section 803 of the National Defense Authorization Act for FY 2013, Pub. L. 112-81, December 31, 2011). This expansion of the applicability of the cap to all contractor employees did not cover contracts with the civilian agencies, so the cap for those contracts remains applicable only to certain contractor

senior executives, which is defined as the five most highly compensated employees in management positions at each home office and each segment of the contractor.

After consultation with the Director of the Defense Contract Audit Agency, OFPP has determined, pursuant to the requirements of Section 39, that the FY 2012 cap amount for the compensation of a contractor employee covered by this provision is \$952,308. (By comparison, the cap for FY 2011 was \$763,029, which means that the statutorily-mandated formula for calculating the cap has generated a one-year increase of nearly \$190,000 in the amount that taxpayers are required to reimburse contractors for their compensation practices.) This amount applies to limit the costs of compensation for contractor employees that are reimbursed by the Government to the contractor for costs incurred on all contracts, after January 1, 2012 and in subsequent contractor FYs, unless and until revised by OFPP. This applies to covered contracts for both defense and civilian procurement agencies, as specified in Section 39. Additionally, as explained above, with regard to civilian agencies, the cap continues to cover compensation to the same limited number of contractor executives as did the Section 39 caps for FY 2011 and prior years. With regard to covered contracts awarded by DOD, NASA, and the Coast Guard, the cap covers compensation for all contractor employees. Consequently, the cap may apply to different groups of contractor employees, employed by the same contractor, if that contractor has contracts with both defense and civilian agencies.

Because Congress has not changed or replaced the statutory formula for setting the cap, the Administration is compelled by statute to raise the cap for another year in accordance with that statutory formula. In other words, under current law, the Administration has no flexibility to depart from the statutory requirement that the cap be adjusted annually based on the application of the statutorily-mandated formula. Under the statutory formula, the cap for the reimbursement

ceiling must be adjusted from one year to the next, and these annual adjustments must be based on annual survey data of compensation amounts for certain senior executives of publicly-owned U.S. companies with annual sales over \$50 million. As has been amply demonstrated throughout the 15 years in which this statutory formula has governed, the statutory reliance on the survey data bears no relationship to (1) the type of work that contractor employees are actually performing under applicable Federal contracts and (2) the general trends in the U.S. economy with respect to increases in prices and wages. The statutorily-driven outcome is that, each year, taxpayers must continue to go even further down the path of paying for increases in the reimbursement cap that far outpace the growth of inflation and the wages of most of America's working families. Prior to the enactment of the statutory formula in 1998, the reimbursement cap was an amount that was specified by statute; for Fiscal Year 1997, Congress set the cap at \$250,000. When the current statutory formula went into effect, it increased the cap to \$340,650 (for costs incurred after January 1, 1998). Since then, the statutory formula has generated annual increases that have now resulted in the cap reaching \$952,308 (for costs incurred after January 1, 2012). In addition to this statutorily-dictated amount being a one-year increase of nearly \$190,000 (from the prior cap of \$763,029 for FY 2011) and a two-year increase of nearly \$260,000 (from the cap of \$693,951 for FY 2010), this amount also represents an increase in the cap of 55% over the last four years (from the cap of \$612,196 for FY 2008).*

Earlier this year, the Administration again urged Congress to reform the compensation cap. The Administration's proposal would replace the current formula with a benchmark compensation

* Congress set the reimbursement cap at \$250,000 for FY 1997 in P.L. 104-201, § 809, and P.L. 104-208, § 8071. The current statutory formula, with its annually-required adjustments, was put into place by P.L. 105-85, § 808, as amended by P.L. 105-261, § 804. The statutory formula increased the cap to \$340,650 for costs incurred after January 1, 1998, and the subsequent annual increases have raised the cap to \$342,986 (1999); \$353,010 (2000); \$374,228 (2001); \$387,783 (2002); \$405,273 (2003); \$432,851 (2004); \$473,318 (2005); \$546,689 (2006); \$597,912 (2007); \$612,196 (2008); \$684,181 (2009); \$693,951 (2010); \$763,029 (2011); and now \$952,308 (2012).

cap that is tied to the President's salary – which is currently \$400,000 – and apply it across-the-board to all contractor employees on all defense and civilian cost-based contracts. Employers would continue to have the discretion to compensate their employees at any level they deem appropriate -- the cap would continue to only limit how much the Government will reimburse the contractors for the services of those employees. Tying the cap to the President's salary provides a reasonable level of compensation for high value Federal contractor employees while ensuring taxpayers are not saddled with paying excessive compensation costs. Importantly, the proposal provides for an exemption to the cap if, and only if, an agency determines such additional payment is necessary to ensure it has access to the specialized skills required to support mission requirements, such as for certain key scientists or engineers. These important reforms can save taxpayers hundreds of millions of dollars over what they will have to pay if the cap remains unchanged.

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

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