

Government contractor quarterly review

Providing quarterly regulatory updates to government contractor executives and compliance professionals.

PwC Government Contracts Practice | Report for Q2 Government Fiscal Year | April 2023

During Q2, the Department of Defense (DoD) issued three new DFARS final rules (pgs 1, 4), and issued an extensive study of the financial health of the defense industrial base (pg 3). Meanwhile, companies seeking new and expanded federal grant opportunities were finally provided detailed program and application information for the CHIPS Act (pgs 1-2) and implementation guidance for the Build America, Buy America Act (pg 2).

Overview of the CHIPS Act Notice of Funding Opportunity

In late February, the first [Notice of Funding Opportunity](#) (NOFO) for the [CHIPS and Science Act of 2022](#) was released to the public. Companies seeking CHIPS Act funding in the form of direct assistance, loans, or loan guarantees can now gain a better understanding of key program and application requirements.

Key Application Stages:

1. Statement of Interest – Brief description of the project and must come 21 days before submission of the pre-application or full application.
2. Pre-Application - More detailed description of the proposed application. The Department of Commerce (DOC) will provide written feedback on submitted Pre-Application material.
3. Full Application – An extensive report on the proposed project that covers the twelve major sections described in the NOFO.
4. Due Diligence – After application is approved the DOC will require additional information on national security, financial, environmental, and other issues.

CHIP Act NOFO information continued on pg 2

New DFARS Final Rules: Direct Cost Settlement, IR&D Cost Allowability, and Contractor Bid Evaluations

The Department of Defense (DoD) recently issued three final rules updating the Defense Federal Acquisition Regulation Supplement (DFARS).

1. Direct Cost Settlement

The first rule update, [Case 2022-D021](#), adds to DFARS 242.302(b) by allowing a procuring contracting officer (PCO) to authorize the contract administration office (CAO) to negotiate and settle direct costs that are questioned in indirect cost rate proposal audits.

This ruling allows the ACO to settle all questioned direct costs, assuming the delegation of authority is granted. Permitting ACOs negotiate and settle questioned direct costs may increase efficiency in the negotiation process. However, depending on a variety of factors, including the contractor's relationships with their respective contracting officers, this new rule could result in more questioned and disallowed direct costs. Accordingly, contractors should remain proactive in self-assessing allowability of direct costs and setting up accounting system configuration and processes to capture and segregate unallowable direct costs.

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> **CHIPS Act NOFO continued...**

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The NOFO also discusses the key criteria applicants must discuss in their applications.

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| Economic and National Security Objectives | Demonstrates U.S reliance on foreign production and assesses national security concerns through supply chain advancement |
| Commercial Viability | To confirm long lasting demand for the project(s) output and impact of future supply. |
| Financial Strength | The overall project(s) financial ability to withstand stress and market volatility. |
| Technical Feasibility and Readiness | The ability to execute on the project from construction, implementation and operational execution. |
| Workforce Development | A criterion to confirm the plans set forth are coherent, achievable, and equitable to generate talent needs and robust learning. |
| Broader Impacts | Focuses on how the project(s) will improved the local community and broaden the US infrastructure. |

Proposed Guardrails

To confirm that CHIPS Act funding is properly used to promote United States security objectives, a [proposed rule](#) was released that attempts to establish guardrails that limit “the material expansion of semiconductor manufacturing capacity in a foreign country of concern.” If an awardee does not comply with this proposed rule, the Government may recover the full amount of Federal financial assistance provided as stated in the NOFO as the “Expansion Clawback.”

Key Takeaways

The CHIPS Act NOFO details robust documentation efforts to secure federal funding to supplement the production of semiconductor manufacturing plants. Companies with projects and investments that can benefit from these funding opportunities should internally assess if this funding would benefit their short, and long term business goals and if they are able to comply with funding requirements and guardrails.

> **Build America, Buy America: What Contractors Should Know**

The Office of Management and Budget (OMB) has proposed revisions to previous guidance for grants and other funding agreements that implement the Build America, Buy America Act (BABA) Act provisions of the Infrastructure Investment and Jobs Act (IIJA).

The BABA Act will govern the use of funds awarded to contractors under the IIJA, which will manifest as grants and other financial assistance given by state and local governments for infrastructure projects. The Act requires that all iron, steel, manufactured products, and construction materials for these projects be produced in the U.S. In addition to the domestic production requirement of manufactured products, as of October 2022, 60% of the cost of the components of these products must be of components produced in the U.S., a recent increase that is subject to future changes through 2029.

Any company seeking to use a manufactured product only produced overseas must apply for a non-availability waiver. This process will receive more scrutiny than in the past, as all waivers will be subject to public review and comment.

Key Takeaways

Companies receiving public infrastructure funds should be aware that sourcing products from a U.S. firm is not sufficient to facilitate compliance with these new requirements. Rather, organizations will need to assess multiple levels of their supply chain to verify the original source of covered products and materials. Commercial companies new to federally-assisted infrastructure projects will need to familiarize themselves with these regulations in order to maintain compliance.

ASBCA Case Focuses on Defining “Cost” under CAS

Intracompany lease payments at center of dispute

Summary:

When is a cost actually a cost? In recent months, the Armed Services Board of Contract Appeals (ASBCA) has heard and commented on several cases focused on this fundamental question as it relates to FAR 31 and CAS compliance.

In early March, the ASBCA denied the government’s request for summary judgment regarding a dispute over whether intracompany lease payments that exceeded the “normal costs of ownership” of the property should be included within the contractor’s G&A base. The government claimed that this exclusion artificially increased the G&A rate and violated CAS 405, 410, and 420. The contractor argued that the excess portions of their lease payments were not considered “costs” and therefore should be excluded from the G&A base. They justified this by claiming that their right to occupy the rental properties was not contingent on paying the excess portions of the leases, as their parent company controlled the landlords.

Ultimately, the ASBCA denied the government’s motion for summary judgment, finding enough material facts remained in dispute.

Key Takeaways:

The case highlights how a fact-intensive inquiry may be necessary to determine if certain types of payments qualify as “costs” for government contract cost accounting.

As such and to avoid disputes with the government, there should be a careful assessment of accounting practices to evaluate compliance with CAS. Additionally, it is necessary for leasing arrangements to be carefully vetted with related parties to determine if they result in unallowable costs under FAR 31.



DoD Study Finds No Revisions to Profit Guidelines are Required

According to the DoD’s recently released [Defense Contract Finance Study](#), the defense industrial base on the whole is financially healthy and, therefore, revisions to the department’s approach and methodologies for assessing contract profits are unnecessary.

The study evaluated the effects of the department’s contract financing and profit policies on the defense industry. Areas assessed included contractors’ financial health, financing regulations, comparisons to the commercial marketplace, and impacts to subcontractors.

Despite the major headline findings, the study also noted that subcontractors and suppliers do not receive the same level of cashflow benefits as experienced by prime contractors, despite up to 70% of aggregate defense work being performed by subcontractors. The study also found that small businesses face issues in obtaining working capital to cover their operating expenses.

Key Takeaways

Despite the impacts of inflation and other economic uncertainties, defense contractors should not expect the DoD to modify its methodology on profit negotiation anytime soon. However, subcontractors may benefit from any future rulemaking that promotes downstream cashflow benefits (i.e., beyond existing FAR rules). Likewise, prime contractors should actively monitor the timeliness of their payments to subcontractor and suppliers supporting government programs to maintain compliance with their own contracts.

DFARS Final Rules: Key Takeaways for Contractors

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2. Cost Allowability Considerations for Independent Research and Development Cost

In January, DoD issued a final rule, Case 2017-D018, incorporating Section 824 of the FY2017 National Defense Authorization Act, which:

- Requires the Defense Contract Audit Agency (DCAA) to provide an annual report to Congress on contractors' independent research and development (IR&D) and bid and proposal (B&P) expenditures financed by DoD contracts
- Updates DFARS 231.205-18 regarding the treatment of and allowability considerations for IR&D expenses.

In a reversal from prior proposed language, the final rule updates DFARS 231.205-18 to only require that the contractor's chief executive officer determine IR&D "will advance the needs of DoD for future technology and advanced capability." The draft rule had required an actual submission by the CEO to the government to substantiate this determination.

To confirm IR&D allowability, contractors must report projects generating IR&D costs to the Defense Technical Information Center (DTIC) online as well as update their DTIC submissions at least annually, no later than 3 months after the end of their fiscal year, and at project completion. While the proposed rule initially had a requirement for the CEO to include a statement along with IR&D costs in the submission to the DTIC, the final rule removed this requirement. In addition to segregating IR&D costs from B&P costs, this update makes IR&D costs allowable following CEO approval of these costs.

3. Contractor Bid Evaluations

The other final rule, Case 2019-D009, updates DFARS 204.7602 to require contracting officers to use the Supplier Performance Risk System (SPRS) when evaluating offers and quotes in response to solicitation requests (including those under FAR part 12 procedures for commercial products and services). SPRS is a DoD enterprise application that gathers and stores information on price, item, quality, delivery, and performance data to develop 3 different risk assessments officers can use in their evaluation.

With the expanded role SPRS scores may play in future bid evaluations, contractors should be proactively monitoring their SPRS scores and if all of their relevant information is up-to-date, such as the NIST SP 800-171 self-assessment results. Furthermore, companies should have robust compliance programs in place that increase both the actual and perceived levels of contractor responsibility (FAR 9.104-1).

PwC is thoroughly versed in government contracting. We can help you navigate the challenging and conflicting demands from strategy through execution to help meet your government contracting needs.

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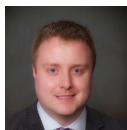
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