

**DEFENSE CONTRACT MANAGEMENT AGENCY**3901 A AVENUE, BUILDING 10500  
FORT LEE, VA 23801-1809

JAN 29 2016

MEMORANDUM FOR CMO COMMANDERS/DIRECTORS  
COST AND PRICING CENTER DIRECTORSUBJECT: Guidance on the Use of Blended Rates to Implement Multiple Compensation Caps  
**Target Audience Heads-Up:** DCMA ACOs, DACOs, CACOs, Price/Cost Analysts, and Cost Monitors**Background**

On October 24, 2014, the Director, Defense Pricing, Acquisition Technology and Logistics OUSD (AT&L) issued a memorandum "Use of Blended Rates to Implement Multiple Compensation Caps." The memorandum stated additional guidance on the implementation of blended rates would be issued by the DCMA in coordination with DCAA. This memorandum provides the information and guidance for implementing and reviewing contractor blending of multiple compensation caps while ensuring the total compensation priced or billed to the Government does not exceed the allowable limits established by law. Hereafter, the term ACO includes corporate administrative contracting officers (CACO), divisional administrative contracting officers (DACO), and ACOs who recommend and/or negotiate final overhead, billing and forward pricing rates.

The Executive Compensation cap is implemented at FAR 31.205-6(p). Contractors are now subject to multiple versions of FAR 31.205-6(p) in the same accounting period based on contract award date and agency. The contract clause at FAR 52.216-7 "Allowable Cost and Payment" applies the version of FAR 31.2 "Contracts with Commercial Organizations" in effect on the date of contract award. Accordingly, the amended FAR 31.205-6(p) "Limitation on allowability of compensation for certain contractor personnel" is applicable only to new contracts awarded on or after the effective date of the FAR revision.

Before 2012:

All US Government contracts entered into prior to December 31, 2011 are subject to the applicable fiscal year (FY) Compensation Cap established by OFPP (\$952,308 for 2012) on the 5 most highly compensated employees in management positions at each home office and segment of the contractor, whether or not the home office or segment reports directly to the contractor's headquarters.

2012, 2013, partial 2014:

The executive compensation caps for contracts awarded from January 1, 2012 through June 23, 2014 apply to all contractor employees performing DoD, NASA and Coast Guard contracts, but apply only to the top five executives for the remaining agencies. (Section 803, FY 2012 National Defense Authorization Act, Pub. Law 112-81, 125 Stat. 1485 (December 31, 2011)).

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Partial 2014 (June 24, 2014 and later):

All US Government contracts awarded by all agencies on or after June 24, 2014 are subject to the \$487,000 total executive compensation cap. (Section 702, Bipartisan Budget Act, Pub. Law 113-67, 127 Stat. 1165 (December 26, 2013)).

The executive compensation caps by year are:

\$693,951 in 2010  
\$763,029 in 2011  
\$952,308 in 2012  
\$487,000 beginning on June 24, 2014

Note: OFPP has not published the 2013 and 2014 (prior to June 24) limitations as of the date of this guidance.

**Blended Compensation CAP**

The cap amount for each year should be calculated as a weighted average by blending the separate cap amounts based on the contract actions entered into before June 24, 2014 and on or after June 24, 2014. The relative percentage that the new cap (effective on or after June 24, 2014) contributes to the blended rates will increase over time as the business mix shifts from modifications to older contracts (prior to June 24, 2014) to new contracts. This method does not require the contractor to develop multiple sets of rates and relies on the contractor's existing cost accounting practices and processes to apply the cap to all contracts subject to FAR 31.205-6(p). The contractor should be required to demonstrate the accuracy of their calculations based on their accounting records and to provide objective, auditable support for the basis selected for forward pricing rates, interim billing rates, and final incurred cost rates. The information used to calculate the blending should be consistent in quantum and detail with the information used to calculate the proposed rates.

Final Overhead Rates:

ACOs are to require contractors to identify the universe of contracts or other actions for which the final overhead rates are to be applied. A blended compensation cap is to be calculated based on the proportion of dollars incurred on contracts awarded before and on or after June 24, 2014. DCAA audits the data provided by the contractor for the fiscal year to ensure proper calculation of the actual blended compensation caps in its final overhead rate proposal. The audit ensures only the allowable compensation is billed each fiscal year based on the different authorized caps.

Interim Billing and Forward Pricing Rates

For each year included in an initial forward pricing rate proposal, revised proposal(s), and/or an update of an existing rate agreement as a result of cost monitoring activities, ACOs are to require the contractor to identify in writing the estimated universe of contracts or other actions



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to which the forward pricing rates are applied (excluding the costs of contracts already priced (backlog)). ACOs are to require the contractor to identify in writing the estimated universe of contracts or other actions to which the interim billing rates are applied. Each universe identifies the volume of costs estimated to be priced by year applicable to contracts awarded before and on or after June 24, 2014. Blended compensation caps for each year of the FPRP are to be calculated based on this information. The ACO, considering advice by DCAA, determines if the total proposed compensation to be priced on Government contracts throughout the period of the FPRP exceeds the total allowable compensation.

### Implementation

When a contractor chooses to use a blended compensation cap, the ACO must execute an advance agreement, as provided for in FAR 31.109 (Advance agreements). The advance agreement is used to set forth the agreed to process and frequency for providing auditable data necessary to support the calculation and application of the blended compensation cap for forward pricing, interim billing, and final rates, and the expiration date for the ending of the blended compensation cap estimating method. The ACO must invite DCAA to participate in prenegotiation review and subsequent negotiation discussions. More details on the use of advance agreements, including the template for advance agreement are found in Question #17 below.

The following Q&As are provided as the guidance referred to in Mr. Assad's memo dated October 24, 2014.

### **Guidance on the Implementation of Blended Compensation Caps**

#### **Question #1: Is blending a cost accounting practice change for a contractor?**

No. This is not considered a cost accounting practice change. Contractors should continue to follow their existing cost accounting practices for applying the compensation cap determined by blending.

#### **Question #2: Are any special calculations needed for 2014 since the implementing FAR rule wasn't effective until June 24, 2014?**

No. The blending methodology effectively takes into consideration the contract mix before and on or after June 24, 2014.

#### **Question #3: Must all contractors use the blended rate methods?**

No. This method is optional for contractors. Each contractor selects a method appropriate for their circumstances. Methods other than blending are also acceptable (e.g., using the new compensation cap effective on or after June 24, 2014 for all contracts regardless of award date, using multiple rates at each cap amount and applied to contracts based on award date).

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**Question #4: Is the blended rate always of the \$952,308 and \$487,000 cap amounts?**

No. The statutes for both of these cap amounts provide for periodic re-evaluation. Revised cap amounts for contracts prior to June 24, 2014 have been published in the Federal Register by OMB ([https://www.whitehouse.gov/omb/procurement\\_index\\_exec\\_comp](https://www.whitehouse.gov/omb/procurement_index_exec_comp)). Revised cap amounts for contracts on or after June 24, 2014 are available at <http://whitehouse.gov/omb/procurement/cccp>. The blended rate for each year is to be based on the cap amounts from these two sources applicable to the year for which it is being calculated.

**Question #5: Which contracts and subcontracts are considered “affected contracts” and are therefore included in dollar amounts used to calculate the blended rate?**

Contracts subject to FAR 31.2 are included (e.g., firm-fixed-price, fixed-price, fixed-price incentive, cost-reimbursement, etc.). Contracts not subject to FAR 31.2 are excluded, such as those for commercial items. Contracts for non-US Government customers are excluded. Foreign Military Sales (FMS) contracts are included, but direct sales contracts to other governments are excluded. For forward pricing rates, contract awards that have already been priced (referred to as backlog) are not be affected by the forward pricing rates and should therefore be excluded.

**Question #6: Are forward pricing/interim billing and final overhead rates using blended compensation cap be computed with consideration of the same “affected contracts”?**

No. Since the blended compensation cap for final overhead rates is used by the contractor to calculate allowable and billable costs for all contracts incurring costs during the year it is computed using contracts awarded and incurring cost in the current year as well as costs of contracts awarded previously. Since the blended compensation cap for forward pricing rates is only used to price new work, it is computed using new contract awards and other contract actions (e.g. modifications) to existing contracts to be awarded during the year. Interim billing rates generally follow the method used for forward pricing. The contracting officer can choose to calculate a separate compensation cap using the contracts to be affected by the billing rates when required to more closely approximate the final indirect cost rates. The circumstances for this variation should be spelled out in the advance agreement.

**Question #7: Can you provide illustrations of how the blended rate calculations could be made?**

Below are illustrations of how a contractor could calculate the blended rate.

Final overhead rates

This example uses a weighted average of the cap amount applicable to contracts awarded prior to June 24, 2014 and the cap amount applicable to contracts awarded on or after June 24, 2014 based on the compensation dollar amounts for those contracts and subcontracts incurred for the accounting period. Contractors can propose a methodology that makes sense and is verifiable for their situation and DCMA, in coordination with DCAA, is to determine if the proposed blending methodology is equitable prior to signing the advance agreement.



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Step 1: Identify the dollar amounts incurred for the year for contracts and subcontracts awarded prior to June 24, 2014 and from contracts and subcontracts awarded on or after June 24, 2014. This constitutes 100 percent of contract dollars for final overhead cost calculations. Determine the percentage of the total dollar amounts attributable to contracts awarded prior to June 24, 2014, and the percentage of the total dollar amounts for contracts awarded on and after June 24, 2014.

In the illustration shown in the table below, for 2014, the cost incurred for contracts awarded prior to June 24, 2014 are \$900,000, and dollars for contracts awarded on or after June 24, 2014 are \$100,000. The dollars for contracts awarded prior to June 24, 2014 are 90% of the total (\$900,000/\$1,000,000), and those awarded on or after June 24, 2014 are 10% (\$100,000/\$1,000,000).

Step 2: Identify the cap amounts pertinent to each contract award period as discussed in response to question #4. In the illustration shown in the table below, the cap amounts for “old” contracts awarded before June 24, 2014 is \$952,000 and for “new” contracts awarded on or after June 24, 2014 is \$487,000 (This illustration assumes the contractor is on a calendar year).

Step 3: Multiply each cap amount by the respective contract dollar amount percentage determined in Step 1. Add the two amounts. This is the blended compensation cap that the contractor applies for the year as part of the established cost accounting practice. In the illustration shown in the table below, the contractor calculates a blended rate for 2014 of \$906,000. This is the weighted average of the two cap amounts based on business volume. Shown mathematically, the detailed calculation is:  $(\$952,000 \times 90\%) + (\$487,000 \times 10\%) = \$906,000$ .

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Year	(Contract before 6/24/14)	(Contract on or after 6/24/14)	% old	% new	old cap (\$K)	new cap (\$K)	Blended Cap (\$K)
2014	\$900,000	\$100,000	90%	10%	\$952	\$487	\$906

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Forward Pricing Rates

Step 1: Identify the dollar amounts proposed to be priced for each year included in the proposal for contracts and subcontracts awarded prior to June 24, 2014 and from contracts and subcontracts awarded on or after June 24, 2014. This constitutes 100 percent of contract dollars to be priced using the blended rate. Determine the percentage of the total dollar amounts for proposed contract actions attributable to contracts awarded prior to June 24, 2014, and the percentage of the total dollar amounts for proposed contract actions awarded on and after June 24, 2014. In the illustration shown in the table below, for 2015, the dollars proposed to be awarded in 2015 for contracts awarded prior to June 24, 2014 are \$10,000, and dollars proposed to be awarded in 2015 contracts awarded on or after June 24, 2014 are \$190,000, for a total of \$200,000. The dollars for contracts awarded prior to June 24, 2014 are 5% of the total (\$10,000/\$200,000), and those awarded on or after June 24, 2014 are 95% (\$190,000/\$200,000).

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As previously stated, for forward pricing rates, contract dollars already priced (backlog) are not affected by the forward pricing rates and should be excluded.

Step 2: Identify the cap amounts pertinent to each contract award period as discussed in response to question #4. In the illustration shown in the table below, the cap amounts for “old” contracts awarded before June 24, 2014 is \$952,000 and for “new” contracts awarded on or after June 24, 2014 is \$487,000 (This illustration assumes the contractor is on a calendar year).

Step 3: Multiply each cap amount by the respective contract dollar amount percentage determined in Step 1. Add the two amounts. This is the blended compensation cap that the contractor is to apply for the year as part of the established cost accounting practice. In the illustration shown in the table below, the contractor calculated a blended rate for 2014 of \$510,250. This is the weighted average of the two cap amounts based on business volume. Shown mathematically, the detailed calculation is:  $(\$952,000 \times 5\%) + (\$487,000 \times 95\%) = \$510,250$ .

Year	Backlog - Already Priced Not Affected by Forward Pricing Rates	New Pricing (e.g. Modification)	New Pricing	% old	% new	old cap (\$K)	new cap (\$K)	Blended Cap (\$K)
		(Contract before 6/24/14)	(Contract on or after 6/24/14)					
2015	\$750,000	\$10,000	\$190,000	5%	95%	\$952	\$487	\$510.25
2016	\$500,000	\$10,000	\$490,000	2%	98%	\$952	\$487	\$496.30
2017	\$300,000	\$10,000	\$740,000	1%	99%	\$952	\$487	\$493.20
2018	\$150,000	\$10,000	\$840,000	1%	99%	\$952	\$487	\$492.47
2019	\$ -	\$10,000	\$990,000	1%	99%	\$952	\$487	\$491.65

**Question #8: Are the Blended rates determined by the contractor as a whole, by division, or by each segment of the contractor?**

The contractor should propose an approach to the Government, and demonstrate and support its approach prior to the advance agreement being signed. The ACO reviews the viability of the approach in consultation with DCAA to ensure an allowability of total compensation can be determined. The approved approach and requirements to support the rates must be detailed in the advance agreements. The blending of the cap amounts should be consistent with how the contractor provides its incurred cost submissions.

**Question #9: How long can the contractor use the blended rate?**

The length of time a contractor uses the blended rate depends on whether the contractor continues to incur or price costs on affected contracts that were awarded prior to the June 24,



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2014 date. As long as costs are incurred or priced on affected contracts awarded before that date, the blending of the cap amounts may be permitted.

**Question #10: How often will a blended compensation caps be calculated by the contractor?**

Typically a contractor will calculate the blended cap at least twice for each year. The first calculation for the year is to establish forward pricing and proposed interim billing rates based upon a **forecast** of the proportion of dollars for contracts awarded prior to June 24, 2014 and the dollars for contracts awarded on or after June 24, 2014. In cases where a contractor is awarded a significant contract not anticipated after establishing blended interim billing rates, the contractor may need to re-calculate the cap considering the impact of the award. The second calculation for the year is to establish final overhead rates based upon the **actual** proportion of dollar amounts from contracts awarded prior to June 24, 2014 and those awarded on or after June 24, 2014. Contractors' calculations of the blended compensation caps should be included as a separate schedule in the submittals. This requirement is included in an advance agreement. The blended compensation cap established for forward pricing may occur more frequently. The contractor should ensure the blended compensation cap is updated and consistent with the FPRP for every update provided throughout the year.

**Question #11: In computing the dollar amounts used to calculate the blended rate, are delivery orders issued on or after June 24, 2014 related to a Basic Ordering Agreement (BOA) awarded prior to June 24, 2014 considered to be prior to June 24, 2014 like the BOA or on or after June 24, 2014 when the order was issued?**

The BOA is not a contract. Each delivery order related to the BOA is considered a new and separate contract award with the clause at FAR 52.216-7 that relies on FAR 31.2 in effect at the time of the order. Therefore, for purpose of calculating the blended rate, delivery orders are considered based on their award date(s), in this case on or after June 24, 2014, not that of the BOA.

**Question #12: In computing the dollar amounts used to calculate the blended rate, are task orders issued on or after June 24, 2014 related to an Indefinite Delivery/indefinite Quantity (IDIQ) contract awarded prior to June 24, 2014 considered to be prior to June 24, 2014 like the IDIQ, or on or after June 24, 2014 when the order was issued?**

The IDIQ is a contract with the clause at FAR 52.216-7 subject to the FAR 31.2 in effect at the time of the award, which in this case is prior to June 24, 2014. Each task order awarded related to the IDIQ continues to rely on the original IDIQ contract with the FAR 52.216-7 and FAR 31.2 in effect at the time of the IDIQ award, which in this case is prior to June 24, 2014. For purposes of calculating the blended rate, the orders are considered based on the award date of the IDIQ contract.

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**Question #13: In computing the dollar amounts used to calculate the blended rate, are the dollar amounts of contract modifications made on or after June 24, 2014 to a contract awarded prior to June 24, 2014 considered prior to or on or after June 24, 2014?**

A contract with the clause at FAR 52.216-7 is subject to the FAR 31.2 in effect at the time of award, in this case prior to June 24, 2014. Modification is not a new contract, so it would be subject to FAR 31.2 in effect at the time of the initial contract award. Since the contractually applicable cap is the one prior to June 24, 2014, for purposes of calculating the blended rate, the dollar amounts for this modification are subject to the cap at time of contract award, prior to June 24, 2014.

**Question #14: In computing the dollar amounts used to calculate the blended rate, are contract options exercised on or after June 24, 2014 from a contract awarded prior to June 24, 2014 considered prior to or on or after June 24, 2014?**

Properly exercised options are priced under the cap in effect at the time the original contract is awarded. The original contract has the FAR 52.216-7 clause and is subject to FAR 31.2 in effect at the time of the award, in this case prior to June 24, 2014. However, if the exercise of the options results in a new contract on or after June 24, 2014, the new contract is subject to FAR 31.2 in effect on or after June 24, 2014. Therefore, for purposes of the blended rate, the cap dollar amount for the resulting new contract from the exercise of the options is the cap set on or after June 24, 2014.

**Question #15: What coordination is necessary with DCAA?**

Prior to signing an advance agreement or accepting a methodology, the ACO, in accordance with FAR 31.109(f)(3), as appropriate, must invite DCAA, to review the computation of the compensation cap, and participate in prenegotiation discussions and /or subsequent negotiations. DCAA identifies contractor proposed processes and calculations that could result in the executive compensation that exceeds the allowable cap. For forward Pricing Rates and final Overhead Rates, the ACO must follow the guidance in DCMA-INST 130 "Forward Pricing Rates" and DCMA-INST 125 "Final Overhead Rates."

**Question #16: What must the ACO do to resolve and/or disposition the audit report which takes exception to the proposed forward pricing rates using blended cap?**

The ACO has the responsibility to prevent the total proposed compensation to be priced on Government contracts throughout the period of the FPRP from exceeding the total allowable compensation. DCAA identifies questioned costs when their review indicates the total proposed compensation exceeds the total allowable compensation in FPRPs. Accordingly, the ACO must clearly address the DCAA findings related to blended compensation caps included in rates in a separate line item in the PNOM or MFR. The ACO must follow the process in DCMA-INST 126 "Contract Audit Follow Up" to resolve and/or disposition the audit report.



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**Question #17: Do I need an advance agreement with the contractor prior to using a blended compensation cap method for establishing rates?**

Yes, a template below is provided for your use.

[Advance Agreement Template]

**ADVANCE AGREEMENT FOR BLENDED RATES  
BETWEEN THE UNITED STATES GOVERNMENT  
AND [CONTRACTOR FULL NAME]**

This Advance Agreement (“Agreement”) is entered into between the Department of Defense, represented by the Defense Contract Management Agency, on behalf of the United States Government (“Government”) and [Contractor Full Name], on its own behalf and on behalf of its affected Business Units (hereinafter referred to collectively as “Contractor”). The Government and the Contractor are collectively referred to herein as “the Parties.”

This Agreement is entered into by the Parties under the authority of Federal Acquisition Regulation (“FAR”) 31.109, “Advance Agreements,” FAR 31.205-6(p), “Limitation on Allowability of Compensation,” and Cost Accounting Standard (“CAS”) 48 C.F.R. 9904.405, “Accounting for Unallowable Costs.” Additionally, this Agreement is entered into in accordance with the Director, Defense Pricing Acquisition Technology and Logistics OUSD (AT&L) memorandum dated October 24, 2014 to implement the use of composite compensation cap amounts (“blended rates”) for executive compensation.

This Agreement is effective upon signature by both parties, and unless cancelled under the provisions herein, remains effective until [MMM DD, YYYY], as to all identified costs properly recorded in Contractor’s FY [XXXX-YYYY] accounting periods.

Now THEREFORE, the Parties hereby agree as follows:

1. The Parties will discharge their respective responsibilities to develop a transitional compensation cap amount for Contractor by using the blended rate methodology detailed in Paragraph 2.
2. [Insert details regarding the approved methodology. Specifics will vary by Company.]
3. Contractor will submit interim billing rates and forward pricing rates based on a forecast of the proportion of dollars for affected contracts and pricing actions for contracts awarded prior to June 24, 2014, and contracts awarded on or after June 24, 2014 using the methodology agreed to above. Contractor also agrees that if they are awarded a significant contract, or anticipate significant variance in costs to be incurred that was not considered when establishing blended interim billing rates, or if they identify changes to future years forecasted base amounts used in establishing the blended forward pricing rates they will do an assessment to determine if a re-calculation is necessary.

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4. Contractor agrees to include a detailed schedule demonstrating the calculation of the blended rates using the methodology agreed to in Paragraph 2 in their final overhead rate submission. Contractor must demonstrate the accuracy of their calculations based on their accounting records, and maintain sufficient records for audit and negotiation of final overhead rates.

5. Contractor agrees to include a detailed schedule in the forward pricing rate submission demonstrating the blended rates calculated using the method described above does not result in pricing total compensation to the Government in excess of that allowed by the terms of anticipated contracts. Contractor understands and acknowledges that a corresponding adjustment to proposed rates to remove unallowable excess compensation costs above the compensation limits will be made once the DCAA audit is complete.

6. The Government has the right to, at any time, review the Contractor's blended rates and supporting documentation for accuracy and compliance with the terms of this Agreement and the authorities cited herein.

7. The Government agrees to authorize Contractor's use of the blended rates when it is determined that the blended rates are accurate and comply with the terms of this Agreement, the authorities cited herein, and any and all applicable authorities.

8. This Agreement applies to all Government flexibly-priced contracts and subcontracts performed by Contractor during FY XXXX-YYYY. Such contracts and the affected business units are identified in Attachment 1.

9. This Agreement establishes no precedent concerning the allowability, allocability or reasonableness of costs incurred by Contractor.

10. This Agreement does not change any costs or rate ceiling, or any specific allowance or disallowance, established by the terms and conditions of any contract to which this Agreement applies.

11. If the terms of this Agreement conflict with the terms of a Government contract to which this Agreement applies, the terms of the contract shall take precedence.

12. The parties retain the right to unilaterally and immediately cancel this agreement upon written notification to the other party. However, it is understood that each party will give the other party at least 30 calendar days' written notice, unless urgent and compelling reasons exist, prior to cancelling the Agreement.

13. The invalidation of any segregable phrase(s), provision(s), or clause(s) of this Agreement shall not affect the validity of any of the remaining portions of this Agreement. No delay or failure of the Government in exercising any right, power, privilege, or remedy under this Agreement shall affect or waive any such right, power, privilege, or remedy, or impair any further exercise thereof.



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14. Any changes to this Agreement must be executed in writing by the Parties with signatures of authorized officials of the Parties.

15. The data contained in this Agreement shall not be disclosed outside the Government, nor shall it be duplicated, used or disclosed in whole or in part for any purpose other than as authorized by law or regulation.

16. The undersigned official of Contractor warrants, by signature, that he or she has the proper authority to execute this Agreement on behalf of Contractor.

THE UNITED STATES GOVERNMENT

CONTRACTOR

Signed: \_\_\_\_\_

Signed: \_\_\_\_\_

Name: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_


Date: \_\_\_\_\_

[End of the Template]

**Conclusion**

This guidance was developed in coordination with DCAA. It provides a practical methodology for implementing the requirements of section 702 of the Bipartisan Budget Acts of 2013 and its application will only remain in effect for a limited number of years. Thus, this guidance will not be incorporated into a current instruction and/or future manual. It will be posted to the FPRA resource page.

Questions related to this memorandum should be directed to Mr. Luke S. Baey, DCMA-AQD, (804)416-9190 or by e-mail at [luke.baey@dcma.mil](mailto:luke.baey@dcma.mil).



Timothy P. Callahan  
Executive Director, Contracts

Attachment(s):

TAB A. Memorandum for Guidance on the Use of Blended Rates to Implement Multiple Compensation Caps issued by the Director, Defense Pricing, on October 24, 2014