

AUTHORITY

This Acquisition Letter (AL) is issued by the Procurement Executive pursuant to a delegation from the Secretary and under the authority of the Federal Acquisition Regulation (FAR), Section 1.301(a)(2).

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<u>CITATION</u>	<u>TITLE</u>
DEAR 970.3102-2 DEAR 970.5204-13	Compensation for personal services Allowable costs and fixed-fee (Management and operating contracts)
DEAR 970.5204-14	Allowable costs and fixed-fee (support contracts)

Subject: Limitation on Allowability of Compensation for Certain Contractor Personnel

- I. Purpose.** The purpose of this AL is three-fold. First, it provides allowable cost guidance regarding the implementation of Section 808 of the Fiscal Year (FY) 1998 Defense Authorization Act (Pub.L. 105-85), which established a limitation on reimbursement of executive compensation incurred after January 1, 1998.

Second, it rescinds AL 97-05, July 21, 1997, which (1) provided guidance relative to Section 809 of FY 1997 Defense Authorization Act (Pub. L. 104-201) which established a \$250,000 cap on allowable compensation costs (taxable wages and elective deferrals) during FY 1997, and (2) formalized the compensation approval requirements established in the November 26, 1996, memorandum from the Procurement Executive.

Third, this AL revises guidance regarding management controls and salary approval requirements for top contractor management officials by the Head of the Contracting Activity and the Contractor Executive Compensation Board (Board).

- II. Background.** Section 808 of the Fiscal Year 1998 Defense Authorization Act (Pub. L. 105-85) established a limitation on the reimbursement of allowable compensation costs for certain contractor senior executives. The Act also directed the Administrator for the Office of Federal Procurement Policy (OFPP) to review commercially available surveys of executive compensation, and based on the results of the review determine a benchmark compensation amount to apply for each fiscal year. Section 808 states that if compensation for contractor senior executives exceeds

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the benchmark compensation amount determined for the FY by the Administrator for Federal Procurement Policy, it is unallowable.

On February 23, 1998, an interim rule was published in the Federal Register which amended the FAR compensation cost principle, 31.205-6, to include the new statutory requirements for executive compensation costs incurred after January 1, 1998, regardless of the date of the contract award. In addition to the interim rule, a Federal Register notice was also published on February 23, 1998, to provide all Federal agencies the benchmark compensation amount for FY 98 which is \$340,650. For contracts that contain either the Allowable Cost and Payment (FAR 52.216-7) or the Allowable Cost and Payment-Facilities (FAR 52.216-13) clause, no additional guidance is necessary regarding the application to DOE contracts.

Additional guidance is necessary, however, concerning the Department's reimbursement policy for contracts subject to the Department of Energy Acquisition Regulation (DEAR), Subpart 970.31 cost principles and containing either of the DEAR clauses at 970.5204-13, Allowable costs and fixed-fee (Management and Operating Contracts) or 970.5204-14, Allowable costs and fixed-fee (Support Contracts). In addition to the guidance provided in this AL, a final rule will be published shortly in the Federal Register to provide a cross-reference to the FAR cost principle regarding the determination of allowable executive compensation costs.

III. Guidance.

A. Scope: This guidance applies to (1) contracts subject to the cost principles at DEAR Subpart 970.31, and (2) salary approval requests for the top contractor management official for contracts subject to Chapter IV of DOE Order 350.1, Contractor Human Resource Management Programs.

B. Allowable/Unallowable Costs: Contracting Officers shall include the following statement in solicitations, new contract awards, modifications to, or extensions of existing contracts which are subject to the DEAR Subpart 970.31 cost principles:

For costs incurred after January 1, 1998, compensation of a senior executive in excess of \$340,650 are unallowable. This amount, known as the "benchmark compensation amount" is subject to annual adjustments as established by the Administrator, Office of Federal Procurement Policy. Allowable costs of executive compensation shall be determined pursuant to Federal Acquisition Regulation 31.205-6(p).

Compensation for costs incurred after January 1, 1998, means: the total amount of wages, salary, bonuses and deferred compensation (see FAR 31.205-6(k)) and employer contributions to defined contribution pension plans (see FAR 31.205-6(j)(5) and (j)(8))

for the fiscal year, whether paid, earned, or otherwise accruing, as recorded in the contractor's cost accounting records for the fiscal year. It does not include fringe benefits, such as health benefits, and employer contributions to defined benefit pension plans. If reasonable in amount, these elements of compensation are allowable irrespective of the cap.

The benchmark compensation amount of \$340,650 is to be used for FY 98 and subsequent contractor fiscal years, unless and until revised by OFPP. This limitation is the sole statutory limitation on allowable senior executive compensation costs incurred after January 1, 1998, under new or previously existing contracts, and applies whether or not the affected contracts were previously subject to a statutory limitation on such costs. The limitation on allowable costs for senior executive compensation is subject to a cap of \$250,000 for FY 97 (taxable wages and elective deferrals) and \$340,650 for FY 98.

NOTE: There is an important distinction between the definition of "compensation" applicable to the \$250,000 cap imposed for FY 97 in AL 97-05, and that which is applicable to the \$340,650 for costs incurred during FY 98. The term "compensation" in the former was limited to taxable wages and elective deferrals. The term "compensation" for FY 98 costs includes wages, salary, bonuses and deferred compensation. Additional guidance regarding FY 98 compensation costs is provided in this AL.

Senior executive means: (1) the contractor's Chief Executive Officer or any individual acting in a similar capacity; (2) the contractor's four most highly compensated employees in management positions other than the chief executive officer; and (3) if the contractor has intermediate home offices or segments that report directly to the contractor's corporate headquarters, the five most highly compensated employees in management positions at each such intermediate home office or segment.

C. Salary Approval:

1. Heads of Contracting Activities are delegated authority to approve the salaries for the top contractor management official subject to the limitations contained in C.5 below. Salary requests which are not consistent with the parameters established in this AL, but are otherwise determined appropriate by the Heads of Contracting Activities (HCA), must be approved by the Contractor Executive Compensation Board. Board approval for exception to the parameters is not required for top contractor management official salaries that are proposed at less than \$100,000.

2. An assessment of an individual's performance and that of their organization shall be obtained from Headquarters program offices prior to approving the salary.

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3. Notification shall be provided to the Cognizant Secretarial Officer (CSO) 48 hours prior to approving salary.
4. Notification of the final salary determination for both the top contractor management official and their deputy, and the effective date of the determination, shall be provided to the CSO and the Procurement Executive.
5. HCA's shall adhere to the following parameters in authorizing reimbursement of the salary for the top contractor management official:
 - The salary to be reimbursed by DOE shall not exceed \$225,000 per annum. This limitation applies to annual salary and any allowable variable compensation.
 - Salary actions due to recruitment or promotion are limited to the lesser of a maximum of 10 percent above the candidate's current salary, or a maximum of 6 percent above the prior incumbent's reimbursed salary.
 - Salary increases which are neither recruitment nor promotion actions, shall not exceed 6 percent per annum.
 - Except for promotions and "acting" situations, only one salary increase per individual is permitted during any twelve month period.
 - A salary increase shall be within the contractor's original salary range for the position and in accordance with the contractor's salary increase distribution program.
 - A salary increase shall not exceed industry benchmarks.

NOTE: The forgoing parameters apply to contractor executive salary approval only. The salary approval requirements are not to be confused with the maximum total compensation limitation which limits the allowability of compensation for contractor senior executives. Also, the maximum salary limitation and the maximum percentage increase limitation will be issued by the Procurement Executive before the beginning of each fiscal year based on analysis conducted by a team of DOE Headquarters and field representatives.

- IV. **Effective Date.** This AL is effective on the date of issuance. This guidance supersedes any previous statutory cap on executive compensation. Previous contracts which contained another statutory cap may be modified to incorporate this new cap.
- V. **Expiration Date.** This AL remains in effect until superseded or canceled.