List of Subjects in 48 CFR Parts 209, 216, and 252

Government procurement.

Ynette R. Shelkin,

Editor, Defense Acquisition Regulations System.

Interim Rule Adopted as Final Without Change

■ Accordingly, the interim rule amending 48 CFR parts 209, 216, and 252, which was published at 76 FR 57674 on September 16, 2011, is adopted as a final rule without change.

[FR Doc. 2012–4040 Filed 2–23–12; 8:45 am]

BILLING CODE 5001–06–P

DEPARTMENT OF DEFENSE

Defense Acquisition Regulations System

48 CFR Parts 215, 232, 234, 242, 244, 245, and 252

RIN 0750–AG58

Defense Federal Acquisition Regulation Supplement; Business Systems—Definition and Administration (DFARS Case 2009–D038)

AGENCY: Defense Acquisition Regulations System, Department of Defense (DoD).

ACTION: Final rule.

SUMMARY: DoD is adopting as final, with changes, an interim rule amending the Defense Federal Acquisition Regulation Supplement (DFARS) to improve the effectiveness of DoD oversight of contractor business systems.

DATES: *Effective date:* February 24, 2012.

FOR FURTHER INFORMATION CONTACT: Mr. Mark Gomersall, 703–602–0302.

SUPPLEMENTARY INFORMATION:

I. Background

DoD published an initial proposed rule for Business Systems—Definition and Administration (DFARS Case 2009–D038) in the **Federal Register** on January 15, 2010 (75 FR 2457). Based on the comments received, DoD published a second proposed rule on December 3, 2010 (75 FR 75550). The public comment period closed January 10, 2011. On January 7, 2011, the National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2011 was signed into law (Pub. L. 111–383). Section 893 of the NDAA for FY 2011, Contractor Business Systems, set forth statutory requirements for the improvement of contractor business systems to ensure that such systems provide timely, reliable information for the management of DoD programs. Based on the comments received in response to the second proposed rule and the requirements of the NDAA for FY 2011, DoD published an interim rule with request for comments on May 18, 2011 (76 FR 28856). The public comment period ended on July 18, 2011. Comments were received from 14 respondents in response to the interim rule.

Contractor business systems and internal controls are the first line of defense against waste, fraud, and abuse. Weak control systems increase the risk of unallowable and unreasonable costs on Government contracts. To improve the effectiveness of Defense Contract Management Agency (DCMA) and Defense Contract Audit Agency (DCAA) oversight of contractor business systems, DoD has clarified the definition and administration of contractor business systems as follows:

A. Contractor business systems have been defined as accounting systems, estimating systems, purchasing systems, earned value management systems (EVMS), material management and accounting systems (MMAS), and property management systems.

B. Compliance enforcement mechanisms have been implemented in the form of a business systems clause which includes payment withholding that allows contracting officers to withhold a percentage of payments, under certain conditions, when a contractor's business system contains significant deficiencies. Payments could be withheld on—

- Interim payments under—
  - Cost-reimbursement contracts;
  - Incentive type contracts;
  - Time-and-materials contracts;
  - Labor-hour contracts;
- Progress payments; and
- Performance-based payments.

II. Discussion and Analysis

A. Analysis of Public Comments

1. Accounting System Monitoring

Comment: A respondent stated that DFARS 252.242–7006(c)(8) is vague. Periodic monitoring of the system can take many forms and be performed by numerous personnel. The respondent suggested that wording more in line with DFARS 252.244–7001(c)(18), DFARS 252.215–7002(d)(4)(xii), or DFARS 252.215–7002(d)(4)(xiii) would better state who is expected to perform the monitoring, why the monitoring is being performed, and would give a clearer expectation of level of monitoring to be performed.

Response: The size and complexity of companies and their processes, operations, and accounting systems capabilities vary. Therefore, it is not feasible to establish specific requirements regarding the extent or frequency of monitoring by the contractor. However, the term ''periodic'' has been removed and additional language has been added, similar to the language at 252.244–7001 and 252.215–7002, to clarify that the contractor's accounting system shall provide for management reviews or internal audits of the contractor's system to ensure compliance with the contractor's policies, procedures, and established accounting practices.

2. Business Systems Clause Prescription

Comment: A ''covered contract'' is defined at DFARS 242.7000(a) as one that is subject to Cost Accounting Standards (CAS). A respondent stated that the problem with this prescription is that a contracting officer will not typically know if the resulting contract will be subject to CAS when drafting the solicitation. A determination as to whether CAS applies to a particular contract is made after the offeror submits an offer containing the information required by the provision at FAR 52.230–1, Cost Accounting Notices and Certification. The contracting officer then inserts the appropriate CAS clauses in the contract, if necessary. The respondent suggested that one way to correct this is to add a paragraph to the clause making it self-deleting if CAS does not apply to the contract.

Response: The clause has been amended to make it self-deleting if CAS does not apply.

3. Definition of Covered Contract

Comment: A respondent suggested that the definition of ''covered contract'' be modified to match the definition in section 893 of the NDAA for FY 2011.

Response: Section 816 of the NDAA for 2012 redefined ''covered contract'' as ''a contract that is subject to the cost accounting standards promulgated pursuant to section 1502 of title 41, United States Code, that could be affected if the data produced by a contractor business system has a significant deficiency.'' The section 816 definition matches the definition used in this rule, therefore, no revisions are necessary.

4. Cost vs. Cost-Reimbursement

Comment: A respondent stated that the word ''cost'' is used throughout the rule when ''cost-reimbursement'' is what is meant. Unless this rule only applies to cost contracts, a specific type

of cost-reimbursement contract described at FAR 16.302, then ''cost'' needs to be changed to ''cost-reimbursement'' throughout the rule.

Response: The term ''cost'' has been replaced by ''cost-reimbursement,'' as appropriate, throughout the rule.

5. Certified Cost or Pricing Data

Comment: A respondent suggested that the word ''certified'' needs to be inserted before the term ''cost or pricing data'' at DFARS 242.7203(b). The clause at DFARS 252.215–7002 uses the term ''cost or pricing data'' twice in paragraph (c).

Response: The term ''cost or pricing data'' has been replaced by ''certified cost or pricing data,'' as appropriate, throughout the rule.

6. Fixed-Price Contract

Comment: A respondent suggested that the words ''fixed-price'' be inserted before the second instance of the word ''contract'' at DFARS 242.7502(a) so that the sentence is consistent with DFARS 242.7503(b).

Response: The language at DFARS 242.7502(a) applies to any contracts that provide for progress payments based on costs or on a percentage or stage of completion. Adding the words ''fixed-price'' before the second instance of the word ''contract'' is not compatible with the intent of DFARS 242.7502(a). However, DFARS 242.7503(b) has been revised to delete the fixed-price modifier so that the two sentences are consistent.

7. Property Management

Comment: A respondent stated that the proposed change to require administrative contracting officer (ACO) determination of property management system compliance is inconsistent with ACO determinations of other business systems. According to the respondent, except for property management, all business systems proposed for ACO determination of acceptability are reviewed by DCAA functional specialists outside of the DCMA or Program Office organizational structures, or by functional specialists who do not have a defined career field certification standard and warrant/letter of appointment. In those instances, functional specialist recommendations are advisory and the ACO determination of system status is necessary. The respondent stated that property management system compliance differs from the system status determinations cited in the proposed change in that property administrator certification/qualification requirements are identified under the unique Defense Acquisition Workforce Improvement Act (DAWIA) career field certification standard for industrial contract property management and they are issued letters of appointment, which requires them to routinely perform their duties as warranted contracting officers and communicate system status determinations. According to the respondent, ACO responsibility for determinations of property management system compliance does not support consistent treatment of contractors assigned for DCMA administration. The respondent noted that the DCMA Centers concept was established when it was found that certain specialty functions such as property, plant clearance, terminations, transportation, etc., suffered declines in communications and technical expertise due to lack of functional supervision. Within DCMA, infrastructure and tools to support consistency in property management reside in the DCMA Business Centers, not with the Chief Operating Officer/Chief Management Officer. Government Accountability Office Standards require performance of duties by appropriate, trained personnel. The respondent suggested that ACOs do not have the appropriate competencies (knowledge, skills, and abilities) to perform this function.

Response: DAWIA requirements for the industrial property management specialist workforce do not alter, and are not inconsistent with DFARS requirements for contracting officers to make determinations regarding a contractor's business system approval or disapproval. This responsibility exists apart from DAWIA requirements for acquisition personnel and regardless of agency processes for formally appointing individuals as property administrators or plant clearance officers. The DFARS rule does not contemplate or require contracting officers to have technical expertise in each of the six identified business systems. Contracting officers will continue to rely on functional specialists to perform the necessary contractor systems reviews as they always have. DCMA's ''Center'' concept is not universal to all of DCMA property operations. For example, a number of property administrators and plant clearance officers do not report operationally to the property center (now referred to as the property ''group''), and instead report directly to DCMA International. DFARS 245.105 is clear that Government property administrators are responsible for providing recommendations and reporting system deficiencies to the cognizant contracting officer, including recommendations regarding contractor property management system approval or disapproval. However, the authority for a determination of system approval or disapproval shall remain with the cognizant contracting officer who is also responsible for applying a payment withhold for disapproved business systems in accordance with DFARS 252.242–7005, Contractor Business Systems.

8. Cognizant Contracting Officer

Comment: A respondent requested that a definition of ''cognizant contracting officer'' be added to ensure that it is clear who is responsible for (1) assessing and approving/disapproving the six business systems, (2) making the decision to withhold payments, and (3) implementing and tracking withholds.

Response: The term ''cognizant contracting officer'' is used throughout the DFARS to identify the appropriate contracting officer assigned specific responsibilities such as approving or disapproving a contractor's business systems and making payment withhold decisions under this rule.

9. DoD Officials' Remediation Responsibility

Comment: A number of respondents stated that the interim rule does not address DoD officials working with the contractor to remediate deficiencies or to develop a corrective action plan. The NDAA for FY 2011 contains the requirement for DoD officials to work with the contractor to correct cited deficiencies. The respondents suggested that this language be explicitly stated in the final rule along with additional language that would promote a ''team effort'' resolution of any significant deficiency. Further, the respondents suggested that the Government should be required to consider mitigating controls as part of any evaluation as to the reliability of information produced by a business system(s).

Response: The language in the rule complies with the NDAA for FY 2011. The rule identifies cognizant contracting officers as the DoD officials who are available to work with contractors in the process of identifying significant deficiencies, accepting corrective action plans, and monitoring the contractor's progress in correcting the deficiencies. Contracting officers will notify the contractor, in writing, providing a description of each significant deficiency in sufficient detail to allow the contractor to understand the deficiency, and then identify any issues with a contractor's corrective action plan.

10. Audit Report Quality

Comment: A respondent stated that DCAA does not have a clean audit opinion on the integrity of the audits they perform; reliance is being placed on an audit agency that must qualify its own audit reports. According to the respondent, the GAO audit reports cited the DCAA for many deficiencies that bring into question the validity of audit reports issued against contractors' business systems. The respondent stated that DCAA should not be viewed as the experts and withholds should not be based on audit reports or audit report quality control systems of questionable validity. The respondent asserted that the Government is attempting to hold contractors to a level of perfection that their own audit agency is unable to maintain. Consequently, the respondent suggested that the audit report should not be used as the sole foundation for a contracting officer's determination of system adequacy, particularly if regulatory withholding of payment will be the result.

Response: Currently, DCAA reports for audits performed in accordance with Generally Accepted Government Auditing Standards (GAGAS) must be qualified because the current external opinion has expired. This qualification solely states that the time frame required by GAGAS for an external peer review has expired. Outside of this exception, all of DCAA's audits are being performed in accordance with GAGAS. Furthermore, the objective of the rule is to ensure that contractor business systems provide timely, reliable information for the management of DoD programs. Contracting personnel will make appropriate determinations in accordance with this rule.

11. Resources and Resolution Timing

Comment: A number of respondents stated that DCAA and DCMA are not properly staffed to address the new DFARS rule. Further, with regard to EVMS, the rule provides extensive authority to contracting officers and DCAA and DCMA auditors in evaluating implementation of the ANSI/EIA 748 standard, which was intentionally designed to be flexible. According to the respondents, the magnitude of programs and contractors requiring EVMS surveillance and assessment inherently results in less experienced personnel in positions with this authority. The respondents suggested that Government resources are not adequate in numbers or depth of skills to provide the required oversight.

Response: This rule does not add additional oversight responsibilities to DCAA and DCMA, but instead mitigates the Government's risk when contractors fail to maintain business systems, as is required by the terms and conditions of their contracts. Contracting personnel will continue to make appropriate determinations in accordance with this rule. DoD has been taking measures to align resources and ensure work is complementary. The increased cooperation and coordination between DCAA and DCMA will enable DoD to employ audit resources where they are needed.

12. Impact on the Government and Contracting Community

Comment: A respondent stated that long-term withholds will hurt the Government and contracting community. Some system deficiencies can be corrected almost immediately, leaving the withhold in place until DCAA completes its follow-up audit. According to the respondent, reducing the percentage of the withhold to half of the initial percentage will still place contractors in a financial crisis. The respondent stated that contractors will have to increase their bids to cover potential withholds, which would increase the overall price to the Government.

Response: Both the contractors' and the Government's administrative costs should be reduced in the long run with the reliance on efficient contractor business systems.

13. National Security

Comment: A respondent stated that the withholding of payments could lessen competition and endanger national security. According to the respondent, national security in many respects is dependent on contractors. From weapon systems to wartime services, contractors perform a vital role in national security. The respondent stated that the economic times are bleak, which is already requiring contractors to operate on thin margins. The respondent expressed concern that if a contractor has a withhold placed upon its billings and is unable to meet financial obligations and, therefore, is unable to meets its contractual terms due to reduced cash flow, then national security will be compromised.

Response: This rule will not cause long term harm to the defense industrial base or national security. Rather, DoD contractor competition and national security will be enhanced with the improvement of DoD contractors' business systems, and imminent cost savings that will result. Contractor business systems and internal controls are the first line of defense against waste, fraud, and abuse. Weak control systems increase the risk of unallowable and unreasonable costs on Government contracts, unnecessarily draining limited DoD resources at the taxpayers' expense.

14. Significant Deficiency

Comment: A respondent expressed concern that DCAA has not updated its guidance to reflect the definition of significant deficiency. According to the respondent, DCAA has not issued audit guidance to align its definition of significant deficiency to that in the NDAA and interim rule. DCAA's latest guidance in its MRD 08–PAS–011(R) dated March 2, 2008, starts out defining a significant deficiency as a ''potential unallowable cost that is not clearly immaterial.'' However, in MRD 08–PAS–043(R) dated December 19, 2008, DCAA clarified its guidance that ''DCAA only performs audits of contractor systems that are material to Government contract costs'' and that a contractor's ''failure to accomplish any applicable control objective should be reported as a significant deficiency/material weakness.'' The respondent stated that DCAA's clarification changes the criteria from a ''potential unallowable cost that is not clearly immaterial'' to if any deficiency is found during an audit, it is reported and the system is rated as inadequate. The respondent expressed concern that DCAA's guidance is constantly changing with no oversight body to regulate its audit policies.

Response: DCAA is in the process of updating its guidance and will report significant deficiencies in accordance with the definition of significant deficiency in this rule, as set forth in section 893 of the NDAA for FY 2011. Additionally, contracting officers will administer this rule according to the requirements in section 893 of the NDAA for FY 2011, as implemented in this rule.

Comment: A respondent recommended that the following language be added to the contractor business systems clauses: ''Significant deficiencies are characterized by all of the following: (1) The system is not compliant to contract requirements; (2) There is significant net harm to the Government resulting in mismanagement, and schedule and cost impacts to the contracts covered by the business system; (3) The corrections to the system are worthwhile, and the related future benefits are clearly and substantially greater than the cost to correct; (4) The net harm to the contractor or the Government caused by the flaws in the business systems must

exceed five million dollars; and (5) Deficiencies must be directly related to contract management.''

Response: The respondent's suggested language exceeds the definition of ''significant deficiency'' in the NDAA for FY 2011 and has not been added to this rule.

Comment: With respect to the language relating to the finding of a significant deficiency by the contracting officer, the interim rule states: ''The initial determination by the Government will describe the deficiency in sufficient detail to allow the contractor to understand the deficiency.'' A respondent suggested that this language be expanded to include a specific explanation as to how the deficiency identified was determined to be a significant deficiency and further, why information produced by the business system under review is considered not to be reliable in accordance with the requirements of the enabling legislation, the NDAA for FY 2011, which defines a significant deficiency as ''A shortcoming in the system that materially affects the ability of DoD to rely upon information produced.''

Response: ''Significant deficiency'' means a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes. The contracting officer's significant deficiency determination will describe the significant deficiency in sufficient detail to allow the contractor to understand the deficiency. This rule incorporates criteria for each business system, which define the aspects of the system that materially affect the ability of DoD to rely on information produced. Determinations of significant deficiencies will be based on the contractor's failure to comply with the business system criteria.

15. University Affiliated Research Center (UARC)

Comment: The interim rule exempts from coverage those contracts with educational institutions or Federally Funded Research and Development Centers operated by educational institutions. A respondent stated that the rule appears to subsume UARCs within the category of educational institutions, and requested that the final rule specifically list UARCs as exempt from application of the rule.

Response: The final rule exempts UARCs from the clause at DFARS 252.242–7005, Contractor Business Systems.

16. Financial Impact of a System Deficiency

Comment: A respondent took exception to DoD's response to a public comment from the second proposed rule, that in most cases, the financial impact of a system deficiency cannot be quantified because the system produces unreliable information. A respondent stated that contractors have fiduciary responsibilities to produce reliable information and make bona fide efforts to quantify everything that Government officials request.

Response: DoD relies on the information produced by contractor business systems unless those systems are found to contain significant deficiencies. Contractors have fiduciary responsibilities to produce reliable information. However, if a system is determined to have a significant deficiency, in most cases, DoD is unable to rely on that system to provide a reliable, quantifiable financial impact of that deficiency.

17. Subjective Implementation of the Rule

Comment: A respondent expressed serious reservations as to the need for the rule, and identified potential harms to contractors if the rule is administered in an inconsistent or arbitrary fashion. According to the respondent, because the determination of a system deficiency is dependent upon the subjective interpretation of critical system criteria, application of the rule could well lead to inconsistent treatment by individual contracting officers and their DCAA advisers.

Response: This rule incorporates criteria for each business system, which define the aspects of the system that materially affect the ability of DoD to rely on information produced. Determinations of significant deficiencies will be based on the contractor's failure to comply with the business system criteria. Each significant deficiency must be determined on its own set of facts and ultimately decided by the contracting officer.

18. Excessive Costs

Comment: A number of respondents expressed concern that because of the significant potential cash flow impact, contractors may be forced to incur unnecessary costs (which will, in turn, ultimately be passed on to the Government) to make their systems deficiency-proof in an attempt to avoid significant withholdings. According to the respondents, while this may seem like an appropriate goal, the costs of approaching a level nearing perfection are disproportionate to the incremental benefits of having a perfect system. The respondents stated that this rule will ultimately result in non-value added direct or indirect costs. The respondents suggested that better solutions exist that have benefits that will accrue to all of the interested parties.

Response: The mandate of section 893 of the NDAA for FY 2011 is to improve contractor business systems to achieve timely and reliable information. Contract terms explicitly require contractors to maintain business systems as a condition of contracting responsibility and, in some cases, eligibility for award. Contract prices are negotiated on the basis that contractors will maintain such systems, so that the Government does not need to maintain far more extensive inspection and audit functions than it already does. DoD contractor competition will be enhanced with the improvement of DoD contractors' business systems and imminent cost savings that will result.

19. Application of Withholdings

Comment: A respondent suggested that the final rule should explicitly limit the contracting officer's discretion to apply withholdings against only those contracts and invoices that could be affected by the identified system deficiency.

Response: The contracting officer has the sole discretion to identify covered contracts containing the clause at DFARS 252.242–7005, against which to apply payment withholds. DFARS 252.242–7005(d) limits implementation of a payment withhold for significant deficiencies in a contractor business system required under a contract. However, this does not limit the contracting officer's discretion to apply withholds against only those contracts and invoices that could be affected by the identified system deficiency.

20. Nexus Between Potential Harm and Withholding

Comment: A respondent stated that one of the most significant problems with the interim rule is that it fails to require any nexus whatsoever between (a) the identified system deficiency and the potential financial harm to the Government; (b) the identified system deficiency and the nature of the specific invoices against which the withholdings will be applied; and (c) the identified system deficiency and the total amount of the withholding. The respondent stated that DCAA's audit report should provide recommendations to the contracting officer as to whether withholding payment is necessary to

protect the Government's interests, and if not, what other protections might be available to the Government. The respondent suggested that such other protections might include: (1) Closer monitoring of payment requests submitted by the contractor in light of the noted deficiency; or (2) a decrement to certain, but not all, contract payments (or a withholding less than 5 percent) that might be more commensurate with the potential financial risk to the Government. The respondent further suggested that the final rule should clarify that the contracting officer must justify, in writing, the need to withhold against certain invoices based upon: (1) The nature of the particular system deficiency; (2) the perceived impact to the Government's reliability of information generated by such system due to the particular deficiency; (3) the nature of the invoices against which the withholdings will be applied and their correlation to the perceived risks associated with the specific system deficiency; and (4) the amount of withholding necessary to adequately protect the Government's interests due to the deficiency. The respondent suggested that requiring a written withholding determination will properly protect contractors from unreasonable or punitive withholdings that are unrelated to the system deficiency as well as ensure the withholdings are tailored to the Government's interests.

Response: The intent of the rule is to authorize payment withholding when the contracting officer finds that there are one or more significant deficiencies due to the contractor's failure to meet one or more of the system criteria. The rule requires contracting officers to consider significant deficiencies in determining the adequacy of a contractor's business system and potential payment withholding in accordance with section 893 of the NDAA for FY 2011. Contract terms explicitly require contractors to maintain the business systems in question as a condition of contracting responsibility and, in some cases, eligibility for award. Contract prices are negotiated on the basis that contractors will maintain such systems, so that the Government does not need to maintain far more extensive inspection and audit functions than it already does. Failure of the contractor to maintain acceptable systems during contract performance deprives the Government of assurances for which it pays fair value. While not ''deliverable'' services under specific contract line items, the contractual requirements for the contractor business systems are material terms, performance of which is required to ensure contracts will be performed on time, within cost estimates, and with appropriate standards of quality and accountability. The payment withholding remedy provides a measure of the overall contract performance of which the Government is deprived during the performance period, and for which the contractor should not receive the full financing payments. DoD is relying on the temporary payment withholding amounts, not as a penalty for a deficiency, but as representing a good-faith estimate sufficient to mitigate the Government's risk where the actual amounts are difficult to estimate or quantify. Deficiencies that do not directly relate to unallowable or unreasonable costs still pose risks to the Government, and may lead to harm that may not be calculated readily when the deficiencies are discovered. In most cases, the financial impact of a system deficiency cannot be quantified because a deficient system produces unreliable information. When the financial impact of a deficiency is quantifiable, DoD expects contracting officers to take appropriate actions to reduce fees, recoup unallowable costs, or take legal action if fraudulent activity is involved.

21. Subcontractor Costs

Comment: A respondent suggested that the final rule should exempt subcontractor costs from withholding under a prime contractor's invoice. Unless the identified system deficiency of the prime contractor casts some doubt on the reliability of the subcontractor's costs in the prime's invoice, the subcontractor costs should be removed from the calculation of any withholding.

Response: Business system deficiencies affect all cost elements. Such deficiencies may impact accumulating and recording of subcontractor costs and increase the risk of unallowable and unreasonable costs on DoD contracts.

22. Time Limit for Withholdings

Comment: The interim rule provides that if the contracting officer does not make a timely determination within 90 days as to whether a significant deficiency has been remediated, the withholding percentage of monies due will be reduced by 50 percent. A number of respondents expressed concern that if the contracting officer continues to not render a decision, withholding at this reduced level could continue indefinitely. The respondents suggested that the final rule should be revised to remove the withholdings in their entirety after 90 days of inaction by the Government.

Response: Contracting officers will make timely decisions and promptly discontinue payment withholding when they determine that there are no remaining significant deficiencies. The rule requires contracting officers to reduce withholding directly related to the significant deficiencies by at least 50 percent if, within 90 days of receipt of the contractor notification that the contractor has corrected the significant deficiencies, the contracting officer has not made a determination. This language is sufficient to mitigate a contractor's risk due to inaction by the Government.

23. Application to Existing Contracts

Comment: A respondent stated that the interim rule establishes guidelines for contracting officers to determine when the provisions of the interim rule will become effective, and properly focuses on the treatment of existing solicitations and future contracts. However, the respondent expressed concern that the rule is silent on the treatment of pre-existing contracts that obviously do not include the contractor business systems clause. The respondent suggested that unless the contractor and the Government agree upon a bilateral modification, it would be improper for the contracting officer to modify unilaterally an existing contract that imposes such significant new obligations and potential liabilities on the contractor.

Response: Revisions to the DFARS set forth in this rule do not affect existing contracts that do not include the business systems clause unless the contractor and the Government agree to modify the contract bilaterally.

24. Commercial Contracts

Comment: A respondent suggested that the rule should exempt commercial contracts explicitly. More specifically, the clauses at DFARS 252.242–7006, Accounting System Administration, and DFARS 252.244–7001, Contractor Purchasing Systems Administration, appear to be applicable to time-and-materials (T&M) and labor-hour contracts as written, per their prescriptions. The respondent questioned whether these provisions are applicable to T&M and firm-fixed-price (FFP) labor-hour contracts for commercial items. The respondent noted that there are times when DoD enters into T&M and labor-hour contracts using commercial labor rates such as GSA negotiated rates or other commercial rates. However, DFARS 252.242–7006 includes phrases such as

''segregation of direct costs from indirect costs, allocation of indirect costs, exclusion of unallowables'' that are not relevant principles for commercial-item contracts. According to the respondent, DFARS 252.244–7001 appears to be applicable if a contractor has any T&M or FFP labor-hour contracts, regardless of whether subcontractors are performing this labor. The respondent questioned whether the prescriptions of the clauses should indicate their applicability only to noncommercial-item T&M and labor-hour contracts, or whether the clauses should indicate what would be applicable to commercial-item contractors.

Response: In accordance with FAR 12.301(d)(1), the clauses at DFARS 252.242–7006, Accounting System Administration, and DFARS 252.244–7001, Contractor Purchasing Systems Administration, are not applicable to T&M and FFP labor-hour contracts for commercial items. Furthermore, paragraph (6) of 48 CFR 9903.201–1, CAS Applicability, exempts FFP, T&M, and labor-hour contracts and subcontracts, for the acquisition of commercial items. Consequently, commercial-item contracts are not covered contracts and will not contain the clause at DFARS 252.242–7005, Contractor Business Systems.

25. Significant Deficiency Determination Review

Comment: A respondent suggested that language should be inserted in the final rule that would require any withhold decision resulting from a business system significant deficiency to be approved at least two levels above the contracting officer prior to the imposition of the withhold.

Response: The contracting officer is the only person with the authority to enter into, administer, and/or terminate contracts and make related determinations and findings. DoD contracting personnel are skilled professionals. All contracting personnel are required by law to obtain a certification to ensure they have the requisite skills in contracting. When specialized expertise is required, contracting officers consult with auditors and other individuals with specialized experience, as necessary, to ensure a full understanding of issues. In fact, the rule requires such consultations. Accordingly, the contracting officer is the appropriate authority for making decisions regarding contractor business systems.

26. Prompt Contracting Officer Notification

Comment: A respondent stated that in numerous places in the rule, the term ''promptly'' is used to describe the response time required of the contracting officer, while the contractor is given a very specific response time (i.e., 30 days). The respondent recommended that the Government response time be equally specific in terms of number of days, and that the contracting officer provide an initial written determination on any significant deficiency within 30 days of discovery.

Response: In fairness to the Government and contractors, the contracting officer must take whatever time is appropriate and necessary to review findings and recommendations prior to making an initial determination if one or more significant deficiencies materially affects the ability of DoD officials to rely upon information produced by the system.

27. Required Withholds

Comment: A respondent stated that the NDAA for FY 2011 provides the contracting officer the latitude to make reasonable decisions regarding withholding stating that ''an appropriate official of the Department of Defense may withhold up to 10 percent. * * *,'' however, the rule makes withholds an imperative. The respondent suggested that the rule should reflect the language in the law.

Response: Section 893 of the NDAA for FY 2011 requires the Secretary of Defense to develop and initiate a program for the improvement of contractor business systems to ensure that such systems provide timely, reliable information for the management of DoD programs. Further, the statute sets forth that an appropriate official of the Department of Defense may withhold up to 10 percent of progress payments, performance-based payments, and interim payments under covered contracts from a covered contractor, as needed, to protect the interests of the Department and ensure compliance, if one or more of the contractor business systems has been disapproved. As a matter of policy, the DoD program that implements section 893 mandates withholds for significant deficiencies found in contractor business systems to protect DoD and the U.S. taxpayers from potential waste, fraud, and abuse, as allowed for in the statute.

28. Internal Controls

Comment: A respondent suggested that internal controls should be explicitly defined using the Generally Accepted Government Auditing Standards definition, which states that internal controls are ''an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: Effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.''

Response: The rule focuses on ''business systems,'' which includes internal controls and the specific criteria that those systems must meet to be acceptable. The term ''internal controls'' is commonly defined throughout professional accounting documents and literature and, therefore, does not require an explicit definition in this rule.

29. Estimating System Integration

Comment: A respondent expressed concern that integrating business systems without clear benefit is costly, disruptive, and an allowable cost. The respondent recommended that the estimating system language be changed to eliminate the requirement to integrate the contractor's estimating system with the contractor's related management systems.

Response: An effective estimating system must gather and process information from other business systems outside the traditional estimating departmental functions. For example, a soundly functioning estimating department will find it necessary to obtain information about historical purchases from the accounting system to help form reliable estimates of prospective direct material purchases. System integration promotes consistency and prevents individual departments within a company from generating output without consideration of information available in other related business systems. Fair and reasonable estimates for future work must be reflective of the contractor organization as a whole, which requires a level of integration. An estimating system that is disconnected to the other contractor business systems is a reflection of poor internal controls.

30. Executive Order 12866

Comment: A respondent suggested that requirements for systems integration and oversight by applicable financial control systems are very expensive, specify contractor behavior instead of desired outcome, and should be eliminated, if feasible. In general, the interim rule should be harmonized with Executive Order 12866, which directs agencies, to the extent feasible, to

specify performance objectives rather than behavior, and to assess all costs and benefits of available regulatory alternatives, and to select regulatory approaches that maximize net benefits.

Response: The desired outcomes for the requirements for business systems integration and oversight by applicable financial control systems are to achieve accurate, complete, and current data, and consistency across the contractor's business systems. In accordance with Executive Order 12866, DoD has assessed all costs and benefits of available regulatory alternatives and has selected the regulatory approach that maximizes net benefits, including potential economic, environmental, public health and safety effects, distributive impacts, and equity.

31. Materiality

Comment: A respondent stated that the term ''material'' requires better amplification in the final rule to reduce variability in interpretation. The respondent suggested that the final rule should specify that when determining materiality, a contracting officer or auditor should rely on established Government standards such as CAS and Federal Accounting Standards Advisory Board statements.

Response: The rule requires that an acceptable business system comply with the system criteria set forth under each of the six business system clauses. The criteria for each business system defines the aspects of the system that materially affect the ability of DoD to rely on information produced. Determinations of significant deficiencies will be based on the contractor's failure to comply with the business system criteria. For example, the system criteria under the clause at DFARS 252.242–7006, Accounting System Administration, requires that the contractor's accounting system ''shall provide for * * * Accounting practices in accordance with standards promulgated by the Cost Accounting Standards Board, if applicable, otherwise, Generally Accepted Accounting Principles.'' Each significant deficiency must be determined on its own set of facts regarding compliance with the system criteria.

32. Due Process

(A) *Comment:* A respondent stated that the rule denies a contractor due process and notification of alleged noncompliance by allowing the contracting officer to issue initial determinations prior to receiving all the facts, and giving the contractor only 30 days to respond. The respondent suggested that the contractor should be given 60 days from the initial determination that a significant deficiency exists to respond to the contracting officer, and also provide the contracting officer the flexibility to allow more than 60 days if deemed necessary.

Response: The rule provides adequate opportunities for communication between the contracting officer and the contractor prior to the implementation of payment withholds. The contractor will be notified of a preliminary finding of a deficiency during the course of formal system reviews and audits. This occurs before the auditor or functional specialist releases a report to the contractor and contracting officer. After receiving a report, the contracting officer will promptly evaluate and issue an initial determination. The contractor is then allowed 30 days to respond to any significant deficiencies. Contractors are given ample opportunity to present their position during system reviews. Accordingly, the requirement for a contractor to respond within 30 days of an initial determination is adequate. The rule does not preclude the contracting officer from granting a contractor additional time to respond should that be requested and warranted.

(B) *Comment:* A respondent stated that provisions in these clauses do not nullify rights under other contract clauses or due process actions. The respondent recommended adding the phrase ''except for actions resolved under contract disputes'' to the end of the sentence in DFARS 252.242–7005(d)(8).

Response: Nothing in the rule negates the contracting parties' rights and obligations under the Contract Disputes Act and disputes clause, the availability of other avenues of dispute resolution, or the entitlement to Contract Disputes Act interest on contractor claims. However, Prompt Payment Act interest entitlement is not intended in any event. Under these circumstances, a reference to disputes resolution in DFARS 252.242–7005(d)(8) is not needed.

33. Cost Considerations

Comment: A respondent recommended that plans and actions to correct significant deficiencies should always include cost considerations, as there will be a direct and indirect impact on contracts.

Response: While cost is a consideration, the criteria placed in the systems clauses for the six business systems covered by this rule have been identified as critical to assure the Government that the information created by the systems is reliable and that the systems operate to protect the Government's interest. There may be more than one way to correct a system deficiency. In selecting a particular corrective action, cost may be a factor for contractors to discuss with the Government when presenting a plan for corrective action.

34. PGI Language

Comment: A respondent referenced DFARS 215.407–5–70(e)(3)(ii) which instructs contracting officers to follow the procedures relating to monitoring a contractor's corrective action and the correction of significant deficiencies in DFARS Procedures, Guidance, and Information (PGI) 215.407–5–70(e). The respondent suggested that since PGI is not regulation, references to specific PGI should stay out of regulation.

Response: The PGI procedures referenced in DFARS 215.407–5–70(e)(3)(ii) are mandatory internal DoD procedures applicable to monitoring a contractor's corrective action and the correction of significant deficiencies. Although the internal procedures are not part of the regulation, inclusion in the DFARS of the requirement to follow the procedures is necessary in order to make the procedures mandatory. In other instances, a reference to PGI may be necessary in order to notify contracting officers that additional guidance is available.

35. Earned Value Management Systems (EVMS)

Comment: A respondent recommended that DoD validate the requirements of EVMS (ANSI/EIA–748 standard) with regard to reliability, effectiveness, and efficiency prior to proceeding to a final rule.

Response: DoD recognizes the 32 guidelines in the ANSI/EIA–748 for use on defense acquisition programs. These guidelines have become, and continue to be, the universally accepted criteria against which industry and the Government determine and document the reliability and effectiveness of their EVMS. The National Defense Industrial Association Program Management Systems Committee is required to periodically reaffirm ANSI/EIA–748 and make any required revisions, with full and active participation by the Government. Therefore, DoD continues to recognize the EVMS guidelines in the revised version of ANSI/EIA–748 and will continue to direct their use in DoD's earned value management policy.

36. Substantially Corrected Deficiencies

Comment: A respondent recommended that the contracting officer request the auditor or functional

specialist to review the contractor's corrective action when the deficiencies have been ''substantially'' corrected, and discontinue withholding of payments, release any payments previously withheld, and approve the system upon a contracting officer determination that the contractor has ''appropriately'' corrected significant deficiencies in lieu of the requirement that the contractor has corrected ''all'' significant deficiencies.

Response: Significant deficiency, in the case of a contractor business system, means a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes. For this reason, the contracting officer shall discontinue the withholding of payments, release any payments previously withheld, and approve the system only after the contracting officer determines that the contractor has corrected all significant deficiencies as directed by the contracting officer's final determination.

37. Delivery of Contract Line Items

Comment: A respondent suggested that the contracting officer discontinue withholding of payments and release any payments previously held upon delivery of contract line items.

Response: In accordance with the clause at DFARS 252.242–7005, Contractor Business Systems, a payment withhold is only applied to progress payments, performance-based payments, and interim payments under cost-reimbursement contracts, incentive type contracts, T&M contracts, and labor-hour contracts. Payment withholding shall not apply to payments on fixed-price line items where performance is complete and the items were accepted by the Government. However, since contract line items under cost-reimbursement contracts are based on a contractor's actual costs and not on negotiated fixed prices, payment withholding will not be discontinued and previously withheld payments will not be released until the contract is completed, or all significant deficiencies have been corrected, whichever comes first.

38. Other Remedies

Comment: Reducing the negotiation objective for profit or fee is listed as one option for contracting officers to consider during negotiations when a proposal is generated by a purchasing system with an identified deficiency. A respondent suggested that this is a punitive and inappropriate response to a system deficiency and should be removed.

Response: This rule does not limit the contracting officer's discretion to apply any and all regulatory measures, as warranted by the circumstances, including mitigating the risk of system deficiencies by reducing the negotiation objective for profit or fee.

39. Property System Approval/Disapproval

Comment: A respondent suggested that property systems be determined to be adequate or inadequate instead of being approved or disapproved.

Response: The language in DFARS part 245 is consistent with other business systems language, as well as with section 893 of the NDAA for FY 2011.

40. Estimating System Infrastructure

Comment: A respondent stated that contractors must have the latitude to establish their own effective and efficient infrastructure to achieve specific ''performance objectives.'' Contractors must be judged by the quality of outcome rather than on externally imposed processes and policies. The respondent suggested replacing the phrase ''Estimating system means the Contractor's policies, procedures, and practices for budgeting and planning controls * * *'' with ''Estimating system means the Contractor's infrastructure for budgeting and planning controls * * *.''

Response: Effective internal control systems are process oriented rather than focused on outcomes alone. Effective policies, procedures, and practices are the foundation for all organizations to achieve their operational, financial, and compliance objectives on a consistent basis.

41. Privileged or Confidential

Comment: A respondent suggested revising DFARS 252.215–7002(d)(1) as follows: ''The Contractor shall disclose its estimating system to the Administrative Contracting Officer (ACO), in writing. The Government 'shall' protect the information as privileged or confidential. The Contractor must mark the documents with the appropriate legends before submission as well.''

Response: This rule is not intended to change the Government's existing obligations under law and regulation to protect a contractor's privileged or confidential information. The advisory at DFARS 252.215–7002(d)(1) that contractors mark documents with appropriate legends is intended to encourage good business practices in order to help the Government identify information that the contractor wishes to be protected.

42. Flow Down

Comment: DFARS clause 252.244–7001, paragraph (c)(16), requires notification to the Government of the award of all subcontracts that contain the FAR/DFARS flowdown clauses that allow for Government audit and to ensure the performance of audits. A respondent recommended that the rule articulate this specific FAR/DFARS clause and define whose responsibility it is to both conduct the audit and ensure the performance of the audit. Paragraph (c)(17) of this clause requires the contractor to ''enforce'' certain Government policies for subcontracts. The respondent stated that prime contractors can flow down requirements or certify to certain attestations, or ensure to the best of their ability, but cannot enforce them with a subcontract. That can be accomplished only by the subcontractors themselves. The respondent recommended that DoD replace the word ''enforce'' with ''implement.''

Response: The notification requirement under the purchasing system criterion in the clause at DFARS 252.244–7001, paragraph (c)(16), is appropriate. The criterion does not require flow down of FAR and DFARS clauses to subcontracts, but instead establishes the requirement that the contractor notify the Government of the award of all subcontracts that contain the FAR and DFARS flowdown clauses that allow for Government audit of those subcontracts, and ensure the performance of audits of those subcontracts.

43. Potential Risk of Harm

Comment: With reference to DFARS 252.245–7003(f), a respondent suggested that ''Potential risk of harm'' has been removed from other interim rules and should be removed here, as well.

Response: The phrase ''potential risk of harm'' has been removed from DFARS 252.245–7003(f).

44. Quicker Deficiency Corrections

Comment: A respondent stated that an auditor or functional analyst may identify a significant deficiency in one or more systems that may be corrected by relatively simple means, such as a change in policies, practices, or minor changes to the software of the system itself. Often the deficiency is identified and agreed to by the contractor and appropriate changes are made even before the deficiency report is received by the contracting officer, thus allowing

the auditor or functional analyst to review the changes being made to the business system. According to the respondent, in such cases, the contracting officer should have the option not to withhold any amounts from billings; as it reads now, it is unclear that the contracting officer has this option. Furthermore, such language would encourage quicker resolution for correcting deficiencies that are not in dispute since it would encourage contractors to accelerate making changes even before the contracting officer issues an initial determination. The other remedies for significant deficiencies would continue as is. The respondent recommended adding optional language to the contracting officer's final determination that states ''the contractor's business system is acceptable and approved based upon the corrective actions already taken by the contractor.''

Response: The withholding of payments shall not be implemented until the contracting officer issues a final determination that significant deficiencies remain. If a significant deficiency is corrected by relatively simple means, and appropriate changes are made before the deficiency report is received by the contracting officer, DoD expects that the contracting officer would utilize sound business judgment in issuing initial and final determinations, and implementing payment withholds, if applicable.

45. Contractor Appeals

Comment: One respondent recommended that when a contracting officer issues a final determination of a significant deficiency, the letter sent to the company should include language referring to the Contracts Disputes Act and what rights the contractor may have to appeal the contracting officer decision. According to the respondent, it is not clear that there is any appeal from the contracting officer's final decision, even though the decision may be completely in error. The respondent stated that the interim rule also does not address how such an appeal should be addressed by the contracting officer. It appears based on the Government comments to the interim rule that the Contracts Disputes Act of 1978 would apply to disputes over significant deficiencies in business systems. According to the respondent, it is not clear whether the final determination made by the contracting officer is subject to the appeals process outlined in FAR 33.211 or whether the contractor may have to certify and send a claim to the contracting officer to initiate the FAR part 33 process. The respondent suggested that this should be clarified in the final rule for the benefit of the Government and the contractors. Another respondent expressed concern that the appeals process in FAR 33.204 does not address the issue of the contracting officer having sole authority to implement the rule.

Response: Final determinations on the adequacy of the contractor's business systems under the rule are not contracting officer's final decisions for the purposes of the Contract Disputes Act of 1978 (CDA). Because the final determinations are not made in response to a claim submitted for a decision by a contractor against the Government related to a contract, they are not final decisions in accordance with the CDA. Further clarification in the rule of the disputes process or the rights the contractor may have under the CDA does not appear necessary.

46. Definition of Deficiency

Comment: A respondent stated that clarification of materiality in regard to system deficiencies continues to be inadequate. The interim rule indicates that a single significant deficiency in an EVMS guideline may result in withdrawal of EVMS approval for a company and subsequent implementation of the 5 percent payment withholding clause. The respondent stated that industry continues to maintain that this does not allow for tempering of findings based on risk, the degree of potential harm to the Government that could result from the identified deficiency, or any other factor that would indicate whether the deficiency is material in nature. The respondent suggested an incremental process for withholding of payments and withdrawal of EVMS system approval that takes materiality of deficiencies into consideration and incorporates DCMA's Corrective Action Request process and definitions for severity of findings of EVMS deficiencies.

Response: All significant deficiencies pose risks to the Government and may lead to harm that may not be readily calculated when the deficiencies are discovered. The intent of the rule is to withhold payments when there is a shortcoming in the system that materially affects the ability of DoD officials to rely on information produced by the system for management purposes, i.e., significant deficiency. In the case of EVM, a disapproval would mean the system has one or more significant deficiencies due to the contractor's failure to comply with the system criteria in the clause at DFARS 252.234–7002, Earned Value Management System, and the contracting officer would be required to apply a withhold in accordance with the clause at DFARS 252.242–7005, Contractor Business Systems.

47. EVMS Functional Specialist Consultation

Comment: A respondent stated that it continues to be unclear where the functional specialist resides in regards to EVMS, the CMO, or the DCMA Earned Value Management Center.

Response: EVMS functional specialists operate out of the DCMA Earned Value Management Center.

48. Contractor Monitoring and Reporting

Comment: A respondent suggested standardization of two contractor requirements across all business systems to (1) monitor and periodically review the business system to ensure compliance with established policies and procedures and (2) upon request, present results of those internal reviews to the administrative contracting officer (along the lines of DFARS 252.242–7004(c)(2) and (d)(10)). Currently, both requirements are included in the interim rule, but not for all business systems.

Response: While the system criteria language is not standardized across all business systems clauses, each business system clause contains system-specific requirements for contractor monitoring and disclosure. For example, under the property system criteria, the contractor is required to ''establish and maintain procedures necessary to assess its property management system effectiveness, and shall perform periodic internal reviews and audits. Significant findings and/or results of such reviews and audits pertaining to Government property shall be made available to the Property Administrator.'' Furthermore, the contractor ''shall periodically perform, record, and disclose physical inventory results.''

49. System Approval

Comment: A respondent suggested that the rule make it clear that based on section 893(b)(4) of the NDAA for FY 2011, a business system is considered to be approved absent a finding by the contracting officer of a significant deficiency.

Response: Section 893(b)(4) of the NDAA for FY 2011 simply requires development of a program to ''provide for the approval of any contractor business system that does not have a significant deficiency.'' Approval of a business system is an affirmative action.

The absence of a finding of a significant deficiency is not considered a system approval; however, a system review or audit that does not result in a finding of one or more significant deficiencies will lead to a system approval under the rule.

50. Contractor Notification

Comment: A respondent suggested that the rule provide that the contractor should have simultaneous access with the contracting officer to any report of a significant deficiency in order to expedite a thoughtful and timely response, given the interim rule has specific time frames in terms of responding to the Government.

Response: The rule provides adequate opportunities for communication between the contracting officer and the contractor prior to the implementation of payment withholds. The contractor will be notified of a preliminary finding of a deficiency during the course of formal systems reviews and audits. This occurs before the auditor or functional specialist releases a report to the contractor and contracting officer. After receiving a report, the contracting officer will promptly evaluate and issue an initial determination. The contractor is then allowed 30 days to respond to any significant deficiencies. Contractors are given ample opportunity to present their position during systems reviews.

51. Deficiencies Across Multiple Systems

Comment: A respondent suggested that language be added to the final rule that makes it clear that if one specific deficiency relates to more than one business system, that withholding not be calculated twice for the same deficiency, as this would in essence represent double counting and would produce an inequitable result.

Response: Withholds are based on deficient business systems. A significant deficiency may result in the disapproval of multiple business systems resulting in a withhold applied against each system up to a maximum withhold of 10 percent per contract. Specific system criteria or requirements exist for each of the business systems. If a significant deficiency exists, then the ability to rely on information produced by the system is materially affected and the contracting officer is required to issue a final determination with a notice to withhold payments. There is a connection between the payment withhold and the business system. If similar significant deficiencies are determined to exist for multiple contractor business systems according to the published criteria for those systems, then a withhold could apply for each business system required under the contract.

52. Corrective Action Plan (CAP)

Comment: A respondent suggested that the current business systems language be modified in the final regulation indicating that withholding not be required if an acceptable corrective action plan is in place.

Response: Payment withholds are applied when the contracting officer makes a final determination to disapprove a contractor's business system in accordance with the clause at DFARS 252.242–7005, Contractor Business Systems. Submission of a corrective action plan doesn't mean that the contractor has corrected all significant deficiencies identified in the final determination. Rather, the corrective action plan provides milestones and identifies actions that will eliminate the significant deficiencies. Until the contracting officer has evidence that the contractor has corrected the significant deficiencies, a payment withhold must remain in place in order to protect the interests of the Government.

53. Miscellaneous Editorial Comments

Comment: One respondent submitted a number of miscellaneous editorial comments.

Response: Miscellaneous editorial comments have been considered and incorporated into the final rule, as appropriate.

B. Summary of Rule Changes

As a result of public comments received in response to the interim rule, the following changes have been made:

1. DFARS 215.407–5–70(d) is removed. The criteria for maintaining an acceptable estimating system have been relocated to the clause at 252.215–7002, Cost Estimating System Requirements.

2. DFARS 232.503–15 has been revised to correct the reference to the system criteria at DFARS 252.242–7004(d)(7).

3. DFARS 242.302(a)(4) has been deleted and an additional contract administration function to approve or disapprove contractor business systems has been added at DFARS 242.302(a)(S–74).

4. The term ''cost'' has been replaced by ''cost-reimbursement,'' as appropriate, in DFARS 242.7000(b)(1) and DFARS 252.242–7005(e).

5. The phrase ''and are expected to correct the significant deficiencies'' has been added to the end of DFARS 242.7000(d)(2) for clarity.

6. Under DFARS 242.7001, Contract clause, University Associated Research Centers (UARCs) has been added to the list of entities to which the clause at DFARS 252.242–7005 does not apply.

7. DFARS 242.7502(g)(2)(ii) and (iv) are revised to remove specific examples of alternatives that contracting officers should consider to mitigate the risk of accounting system deficiencies on proposals where the deficiency impacts negotiations. These examples are removed so that contracting officers do not misinterpret these as being appropriate for mitigating all accounting system deficiencies.

8. The term ''cost or pricing data'' has been replaced by ''certified cost or pricing data,'' as appropriate, in DFARS 242.7502(g)(3)(ii), DFARS 244.305–70(f)(3)(ii), and DFARS 252.215–7002(c)(1) and (2).

9. The words ''fixed-price'' have been deleted from 242.7503(b) for clarity.

10. The words ''compliance with'' have been added at DFARS 252.215–7002(d)(4)(xii) for clarity, as well as numerous changes in punctuation have been made throughout 252.215–7002(d)(4).

11. The clause at 252.242–7005, Contractor Business Systems, has been amended to clarify that the clause is applicable only to contracts awarded that are subject to Cost Accounting Standards (CAS), since a contracting officer is not likely to know if the resulting contract will be subject to CAS when drafting the solicitation. As a result, paragraphs (a) through (e) have been redesignated as (b) through (f).

12. The clause at DFARS 252.242–7005, Contractor Business Systems, has been amended to clarify the language regarding Contracting Officer determinations made based on the evidence submitted by the Contractor, that there is a reasonable expectation that the Contractor's corrective actions have been implemented and are expected to correct the significant deficiencies. Additionally, the clause language has been amended to require that Contracting Officers reduce withholding directly related to the significant deficiencies by at least 50 percent if, within 90 days of receipt of the Contractor notification that the Contractor has corrected the significant deficiencies, the Contracting Officer has not made a determination. In amending this clause, paragraph (f)(iii) has been added and former paragraphs (f)(iii) and (iv) have been redesignated as (f)(iv) and (v).

13. The clause at DFARS 252.242–7006, Accounting System Administration, has been amended to delete the term ''periodic monitoring''

under paragraph (c)(8), and add additional language to clarify the intent of the system criterion.

14. The clause at DFARS 252.245–7003, Contractor Property Management System Administration, has been amended to delete from paragraph (f) the phrase ''leading to a potential risk of harm to the Government.''

III. Executive Orders 12866 and 13563

Executive Orders (E.O.s) 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). E.O. 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. This is a significant regulatory action and, therefore, was subject to review under section 6(b) of E.O. 12866, Regulatory Planning and Review, dated September 30, 1993. This rule is not a major rule under 5 U.S.C. 804.

IV. Regulatory Flexibility Act

A final regulatory flexibility analysis has been prepared consistent with the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.,* and is summarized as follows:

The objective of the rule is to establish a definition for contractor business systems and implement compliance mechanisms to improve DoD oversight of those contractor business systems. The requirements of the rule will apply to solicitations and contracts that are subject to the Cost Accounting Standards under 41 U.S.C. chapter 15, as implemented in regulations found at 48 CFR 9903.201–1 (see the FAR Appendix), other than in contracts with educational institutions, Federally Funded Research and Development Centers operated by educational institutions, or University Associated Research Centers, and include one or more of the defined contractor business systems.

No comments were submitted by the public or from the Chief Counsel for Advocacy of the Small Business Administration in response to the initial regulatory flexibility analysis published with the interim rule.

DoD does not expect this rule to have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.,* because contracts and subcontracts with small businesses are exempt from Cost Accounting Standards (CAS) requirements.

The business systems clause in the proposed rule contains a requirement for contractors to respond to initial and final determinations of deficiencies. The information contractors will be required to submit to respond to deficiencies in the six business systems defined in this rule have been approved by the Office of Management and Budget as follows:

(1) Accounting Systems—OMB Clearance 9000–0011.

(2) Estimating Systems—OMB Clearance 0704–0232.

(3) Material Management and Accounting Systems (MMAS)—OMB Clearance 0704–0250.

(4) Purchasing Systems—OMB Clearance 0704–0253.

(5) Earned Value Management Systems—OMB Clearance 0704–0479.

(6) Property Management Systems—OMB Clearance 0704–0480.

Since contracts and subcontracts with small businesses are exempt from CAS requirements, DoD estimates that small entities will not be impacted by projected reporting, recordkeeping, and other compliance requirements of the rule.

There were no significant alternatives identified that would meet the requirements of the applicable statutes.

V. Paperwork Reduction Act

The rule contains information collection requirements that require the approval of the Office of Management and Budget under the Paperwork Reduction Act (44 U.S.C. chapter 35). The business systems clause in the proposed rule contains a requirement for contractors to respond to initial and final determinations of deficiencies. OMB has cleared this information collection requirement under OMB Control Numbers 0704–0479, Business Systems—Definition and Administration, DFARS 234, Earned Value Management Systems; and 0704–0480, Business Systems—Definition and Administration, DFARS 245, Contractors Property Management System.

The information contractors will be required to submit to respond to deficiencies in four of the six business systems defined in this rule were approved previously by the Office of Management and Budget as follows:

(1) Accounting Systems—OMB Clearance 9000–0011.

(2) Estimating Systems—OMB Clearance 0704–0232.

(3) MMAS—OMB Clearance 0704–0250.

(4) Purchasing Systems—OMB Clearance 0704–0253.

List of Subjects in 48 CFR Parts 215, 232, 234, 242, 244, 245, and 252

Government procurement.

Ynette R. Shelkin,

Editor, Defense Acquisition Regulations System.

■ Accordingly, the interim rule amending 48 CFR parts 215, 234, 242, 244, 245, and 252, which was published in the **Federal Register** at 76 FR 28856 on May 18, 2011, is adopted as a final rule with the following changes:

■ 1. The authority citation for 48 CFR parts 215, 232, 242, and 244 is revised to read as follows:

Authority: 41 U.S.C. 1303 and 48 CFR chapter 1.

PART 215—CONTACTING BY NEGOTIATION

215.407–5–70 [Amended]

■ 2. Amend section 215.407–5–70 by removing paragraph (d) and redesignating paragraphs (e) through (g) as paragraphs (d) through (f).

PART 232—CONTRACT FINANCING

232.503–15 [Amended]

■ 3. In section 232.503–15, in the introductory text of paragraph (d), remove ''conforms to the standard at 252.242–7004(e)(7)'' and add ''conforms to the system criteria at 252.242–7004(d)(7)'' in its place.

PART 242—CONTRACT ADMINISTRATION AND AUDIT SERVICES

■ 4. In section 242.302, remove paragraph (a)(4) and add paragraph (a)(S–74) to read as follows:

242.302 Contract administration functions.

(a) * * *

(S–74) Approve or disapprove contractor business systems, as identified in the clause at 252.242–7005, Contractor Business Systems.

* * * * *

242.7000 [Amended]

■ 5. Amend section 242.7000 as follows:

■ a. In paragraph (a), in the definition for ''Covered contract'', add ''(10 U.S.C. 2302 note, as amended by section 816 of Pub. L. 112–81)'' at the end of the sentence;

■ b. In paragraph (b)(1), remove ''under cost, labor-hour, and time-and-materials contracts billed'' and add ''under cost-reimbursement, labor-hour, and time-and-materials contracts billed'' in its place each time it occurs.

■ c. In paragraph (d)(2), add ''and are expected to correct the significant deficiencies'' at the end of the sentence.

■ 6. In section 242.7001, revise the introductory text to read as follows:

242.7001 Contract clause.

Use the clause at 252.242–7005, Contractor Business Systems, in solicitations and contracts (other than in contracts with educational institutions, Federally Funded Research and Development Centers (FFRDCs), or University Associated Research Centers (UARCs) operated by educational institutions) when—

* * * * *

242.7502 [Amended]

■ 7. In section 242.7502, in paragraph (g)(2)(ii), remove ‘‘, e.g., a fixed-price incentive (firm target) contract instead of a firm-fixed-price’’, remove paragraph (g)(2)(iv) and redesignate paragraphs (g)(2)(v) and (g)(2)(vi) as paragraphs (g)(2)(iv) and (g)(2)(v), and in paragraph (g)(3)(ii), remove ‘‘including cost or pricing data’’ and add ‘‘including certified cost or pricing data’’ in its place.

242.7503 [Amended]

■ 8. In section 242.7503, in paragraph (b), remove ‘‘A fixed-price contract with progress payments’’ and add ‘‘A contract with progress payments’’ in its place.

PART 244—SUBCONTRACTING POLICIES AND PROCEDURES

244.305–70 [Amended]

■ 9. In section 244.305–70, in paragraph (f)(3)(ii), remove ‘‘including cost or pricing data’’ and add ‘‘including certified cost or pricing data’’ in its place.

■ 10. The authority citation for 48 CFR part 252 continues to read as follows:

Authority: 41 U.S.C. 1303 and 48 CFR chapter 1.

PART 252—SOLICITATION PROVISIONS AND CONTRACT CLAUSES

252.215–7002 [Amended]

■ 11. Amend section 252.215–7002 as follows:

■ a. Remove the clause date ‘‘(MAY 2011)’’ and add ‘‘(FEB 2012)’’ in its place.

■ b. In paragraph (a), in the definition for ‘‘Acceptable estimating system’’, remove ‘‘an estimating system complies with’’ and add ‘‘an estimating system that complies with’’ in its place.

■ c. In paragraphs (c)(1) and (c)(2)(i), remove ‘‘for which cost or pricing data were required’’ and add ‘‘for which certified cost or pricing data were required’’ in its place.

■ d. In paragraphs (d)(4)(i) through (d)(4)(xv), remove ‘‘;’’ at the end of the sentence and add ‘‘.’’ in its place and in paragraph (d)(4)(xvi), remove ‘‘; and’’ at the end of the sentence and add ‘‘.’’ in its place.

■ 12. Amend section 252.242–7005 as follows:

■ a. Remove the clause date ‘‘(MAY 2011)’’ and add ‘‘(FEB 2012)’’ in its place.

■ b. Redesignate paragraphs (a) through (e) as (b) through (f) and add new paragraph (a).

■ c. In newly redesignated paragraph (e)(1), remove ‘‘cost vouchers on cost, labor-hour, and time-and-materials contracts’’ and add ‘‘cost vouchers on cost-reimbursement, labor-hour, and time-and-materials contracts’’ in its place and remove ‘‘as directed by the contracting officer’s final determination’’ and add ‘‘as directed by the Contracting Officer’s final determination’’ in its place.

■ d. In newly redesignated paragraph (e)(3)(ii), remove ‘‘percentage limits in paragraph (d)(3)(i) of this clause’’ and add ‘‘percentage limits in paragraph (e)(3)(i) of this clause’’ in its place.

■ e. In newly redesignated paragraph (f)(2)(ii), remove ‘‘in accordance with paragraph (d) of this clause’’ and add ‘‘in accordance with paragraph (e) of this clause’’ in its place.

■ f. Further redesignate newly redesignated paragraphs (f)(2)(iii) and (f)(2)(iv) as paragraphs (f)(2)(iv) and (f)(2)(v), add new paragraph (f)(2)(iii), and revise newly redesignated paragraph (f)(2)(iv).

The additions and revisions read as follows:

252.242–7005 Contractor business systems.

* * * * *

(a) This clause only applies to covered contracts that are subject to the Cost Accounting Standards under 41 U.S.C. chapter 15, as implemented in regulations found at 48 CFR 9903.201–1 (see the FAR Appendix).

* * * * *

(f) * * *

(2) * * *

(iii) If the Contracting Officer determines, based on the evidence submitted by the Contractor, that there is a reasonable expectation that the corrective actions have been implemented and are expected to correct the significant deficiencies, the Contracting Officer will discontinue withholding payments, and release any payments previously withheld directly related to the significant deficiencies identified in the Contractor notification, and direct the Contractor, in writing, to discontinue the payment withholding from billings on interim cost vouchers associated with the Contracting Officer’s final determination, and authorize the Contractor to bill for any monies previously withheld.

(iv) If, within 90 days of receipt of the Contractor notification that the Contractor has corrected the significant deficiencies, the Contracting Officer has not made a determination in accordance with paragraphs (f)(2)(i), (ii), or (iii) of this clause, the Contracting Officer will reduce withholding directly related to the significant deficiencies identified in the Contractor notification by at least 50 percent of the amount being withheld from progress payments and performance-based payments, and direct the Contractor, in writing, to reduce the payment withholding from billings on interim cost vouchers directly related to the significant deficiencies identified in the Contractor notification by a specified percentage that is at least 50 percent, but not authorize the Contractor to bill for any monies previously withheld until the Contracting Officer makes a determination in accordance with paragraphs (f)(2)(i), (ii), or (iii) of this clause.

* * * * *

252.242–7006 [Amended]

■ 13. In section 252.242–7006, remove the clause date ‘‘(MAY 2011)’’ and add ‘‘(FEB 2012)’’ in its place and in paragraph (c)(8), remove ‘‘Periodic monitoring of the system’’ and add ‘‘Management reviews or internal audits of the system to ensure compliance with the Contractor’s established policies, procedures, and accounting practices’’ in its place.

252.245–7003 [Amended]

■ 14. In section 252.245–7003, remove the clause date ‘‘(MAY 2011)’’ and add ‘‘(FEB 2012)’’ in its place and in paragraph (f), remove ‘‘leading to a potential risk of harm to the Government,’’.

[FR Doc. 2012–4045 Filed 2–23–12; 8:45 am]

BILLING CODE 5001–06–P