

DEPARTMENT OF DEFENSE**Defense Acquisition Regulations System****48 CFR Parts 215, 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.**ACTION:** Proposed rule with request for comments.**SUMMARY:** DoD is proposing to amend the Defense Federal Acquisition Regulation Supplement (DFARS) to improve the effectiveness of DoD oversight of contractor business systems.**DATES:** *Comment Date:* Interested parties should submit comments in writing to the address shown below on or before January 3, 2011.**ADDRESSES:** You may submit comments, identified by DFARS Case 2009-D038, using any of the following methods:

- *Regulations.gov:* <http://www.regulations.gov>. Submit comments via the Federal eRulemaking portal by inputting “DFARS Case 2009-D038” under the heading “Enter keyword or ID” and selecting “Search.” Select the link “Submit a Comment” that corresponds with “DFARS Case 2009-D038.” Follow the instructions provided at the “Submit a Comment” screen. Please include your name, company name (if any), and “DFARS Case 2009-D038” on your attached document.

- *E-mail:* dfars@osd.mil. Include DFARS Case 2009-D038 in the subject line of the message.

- *Fax:* 703-602-0350.

- *Mail:* Defense Acquisition Regulations System, Attn: Mr. Mark Gomersall, OUSD(AT&L)DPAP/DARS, Room 3B855, 3060 Defense Pentagon, Washington, DC 20301-3060.

Comments received generally will be posted without change to <http://www.regulations.gov>, including any personal information provided. To confirm receipt of your comment, please check <http://www.regulations.gov> approximately two to three days after submission to verify posting (except allow 30 days for posting of comments submitted by mail).

FOR FURTHER INFORMATION CONTACT:

Mr. Mark Gomersall, 703-602-0302.

SUPPLEMENTARY INFORMATION:**I. Background**

DoD published a proposed rule for Business Systems—Definition and Administration (DFARS Case 2009-D038) in the **Federal Register** on January 15, 2010 (75 FR 2457). The public comment period closed March 16, 2010. Based on the comments received and subsequent revisions to the proposed rule, DoD is publishing this rule again as a proposed rule with request for comments.

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 is considering a rule to clarify the definition and administration of contractor business systems as follows:

1. DoD is proposing to define contractor business systems as accounting systems, estimating systems, purchasing systems, earned value management systems (EVMS), material management and accounting systems (MMAS), and property management systems.

2. DoD is proposing to implement compliance enforcement mechanisms 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 deficiencies. Payments could be withheld on—

- Interim payments under—
 - Cost-reimbursement contracts;
 - Incentive-type contracts;
 - Time-and-materials contracts;
 - Labor-hour contracts;
 - Construction contracts that include FAR clause 52.232-27, Prompt Payment for Construction Contracts.
- Progress payments; and
- Performance-based payments.

II. Discussion and Analysis**A. Analysis of Public Comments**

The 370 comments received from 25 respondents have been dispositioned as discussed below. The comments received were grouped under 46 general topics. A summary of the comments follows:

1. 100 Percent Withholds

Comment: Respondents suggested that the proposed rule provides

administrative contracting officers (ACOs) insufficient standards to make 100 percent withhold determinations, and does not provide adequate provisions for contractor responses.

Response: DoD notes the concerns expressed by the respondents, and has revised the rule to remove the language from clause 52.242-7XXX, which set forth procedures for withholding up to 100 percent.

2. Accounting System

Comment: A number of respondents expressed concern about the criteria to be used to determine if a contractor has an acceptable accounting system.

Response: The language at clause 252.242-7YYY has been revised to clarify the criteria to be used to determine if a contractor has an acceptable accounting system and to delete vague criteria modifiers such as “including but not limited to” and “as applicable.”

3. Applicability of Rule

Comment: A number of respondents questioned the application of this rule against certain cost-type contracts. Additionally, some respondents expressed concern about the application of the rule to commercial contracts. Other respondents suggested the rule be applied to only a single contract instead of against all contracts that are dependent upon the deficient business system, and that the rule establish a minimum dollar threshold for the rule to be applicable.

Response: The Government may be at risk when a contractor's business systems contain deficiencies, regardless of contract type. Accordingly, it is appropriate for the ACO to withhold payments to protect the interest of the Government. Contracts awarded under FAR part 12 regulations will generally be exempt from the requirements of this rule. A system deficiency will result in application of a withhold against all contracts that contain the business system clause. However, DoD agrees with the recommendation for the establishment of a \$50 million threshold for application of the business system clause.

4. Arbitrary Withhold Percentages

Comment: A number of respondents expressed concern that the rule invokes mandatory withholds on payments to Government contractors that are arbitrary and punitive and have no relationship with actual harm to the Government.

Response: When contractors fail to maintain business systems, as is required by the terms and conditions of

their contracts, the withhold provisions help to protect the Government from the risks of overpayment, increased property losses, or nonconforming goods, among others, against which business systems are designed to ensure. The proposed rule would protect the Government by reducing contract payments temporarily during performance in an amount sufficient to mitigate the Government's risk. DoD is relying on the percentage withhold amount, not as a penalty for a deficiency, but as representing a good-faith estimate of the potential loss that is at risk where the actual amounts are difficult to estimate or quantify.

5. Assignment of Payments

Comment: If the contractor has assigned the right to receive payments to a financial institution under the Assignment of Claims Act, will payments be withheld from the assignee financial institution? If so, this would severely hamper the ability of small- to medium-sized businesses from obtaining financing to bid on contracts.

Response: This rule does not change any rights of the assignee of the assignment of claims provision at FAR subpart 32.8 or FAR clause 52.232-23. Assignees will continue to have the same rights and obligations that they had prior to the implementation of this rule. Therefore, if the contractor has assigned the right to receive payments, and deficiencies in the contractor's business systems necessitate the implementation of withholds, in accordance with the contract, payments will be withheld from the assignee. The mitigation of the impact on small businesses is discussed under comment topic number 42.

6. Audits

Comment: A number of respondents expressed concern that DCAA lacks the resources to perform required audits timely and adequately; that the proposed rule does not establish a business system approval duration, which essentially declares perpetual open-season on all contractor business system internal controls, and that the DCAA follow-up audit is not limited or otherwise focused upon the previously identified specific deficiency and the specific corrective actions, and therefore, will result in an endless cycle of deficiency reports and follow-up audits; that DCAA audit guidance on the reporting of internal control deficiencies, which requires all deficiencies to be considered significant, effectively ensures that all contractor business systems subject to audit will be found inadequate; that

audit reports are not informative enough to help the contracting officer make effective decisions, and that DCAA needs to expand its audit reports to go beyond rendering a pass/fail opinion, and include an analysis of the materiality of any deficiency.

Response: DCAA has committed to making follow-up business system audits a priority. However, DCAA recognizes that resources are limited, and has taken steps to address staffing challenges. A business system approval duration and/or narrowly focused DCAA follow-up audit would not be appropriate since, at any time after approval, contractor conditions could change, rendering the previously-reported opinion as not current. DCAA policy is to report only deficiencies determined to be significant deficiencies or material weaknesses in accordance with generally accepted Government auditing standards. The proposed rule language has been revised to state that "the report shall describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies and potential adverse impact to the Government."

7. Breach of Contract

Comment: One respondent believed that the failure of the United States Government to pay for goods and services provided could be a material breach of contract that would permit the contractor to stop work. The respondent stated that the requirement to compensate contractors for providing goods and services flows from the United States Constitution itself in the Fifth Amendment, and viewing failure to pay as a breach of contract has been recognized by the courts.

Response: DoD does not agree that failure to pay amounts withheld would be a breach of contract, and that the Fifth Amendment to the Constitution is implicated. The proposed rule would create an explicit contract term, and withholding will be authorized pursuant to that term. Execution of that contract term would not be a breach of contract. Similarly, there is no "taking" of property that could implicate the Fifth Amendment when a contractor is paid the amount it is entitled to under the clear terms of a valid contract.

8. Cash Flow

Comment: A number of respondents were concerned that the withholds would negatively impact cash flow for contractors, and are also likely to remain in effect for periods long beyond completion of any corrective action performed by contractors.

Response: The application of the payment withhold will impact and reduce a contractor's cash flow. However, the proposed rule would protect the Government by temporarily reducing contract payments during performance in an amount sufficient to mitigate the Government's risk when contractors fail to maintain business systems, as is required by the terms and conditions of their contracts. The revised language provides for the contracting officer, in consultation with the auditor or functional specialist, to discontinue withholding payments prior to audit verification if the contractor submits evidence that the deficiencies have been corrected. The sooner the contractor corrects the deficiencies, the sooner the cash flow will be restored.

9. Compliance Criteria

Comment: A number of respondents believe the compliance criteria in the proposed rule are subjective. These respondents believe that the proposed rule prematurely defines business systems without resolving the most critical component, which is the actual criteria against which contractor compliance will be measured, and that such criteria should be vetted with the public. The respondents assert that the proposed rule should define objective measurements by which to judge a system as deficient, and limit the criteria to a few well-defined metrics that cannot be embellished by subjective interpretation.

Response: DoD partially agrees with the respondents. The rule incorporates criteria that are already used by the Government under existing authority to evaluate the adequacy of contractor business systems. Furthermore, to reduce the subjectivity of the criteria, phrases such as "including but not limited to" and "as applicable" have been removed. The public is encouraged to comment on these criteria.

10. Consistency: Correction of All Deficiencies or Substantial Correction of Deficiencies

Comment: A number of respondents pointed out that some sections of the proposed rule indicate that a finding of system noncompliance will be withdrawn when the contractor has "substantially corrected" the system deficiencies. However, elsewhere, the proposed rule also states that the withhold will not be released until "all deficiencies have been corrected." The respondents suggested that the proposed rule should be revised so that it is consistent.

Response: DoD concurs with the respondents' recommendation, and has

revised the rule to state that the withholds will not be released until “all deficiencies have been corrected.”

11. Contracting Officer Discretion

Comment: One respondent believed that the proposed rule inappropriately and unnecessarily limits the discretion of the contracting officer to make critical determinations about these systems specifically, and about the relationship of these systems determinations to overall contract performance generally.

Response: The rule does not in any way limit the authority of contracting officers. Although the auditor is required to document the deficiencies in a report, the contracting officer has the authority to make all initial and final determinations of system deficiencies, implement and remove withholds, make determinations to approve, disapprove, and reapprove systems, and to take any other appropriate actions deemed in the best interests of the Government.

12. Contractor Appeal

Comment: A number of respondents expressed concern that there is no provision in the proposed rule to provide contractors with due process or alternative resolution, such as negotiation or alternate disputes resolution procedures, and that withholds are at the sole discretion of the ACO.

Response: DoD agrees that the final deficiency determination is at the sole discretion of the contracting officer. However, DoD disagrees that additional due process remedies are necessary. Contractors are afforded an opportunity to respond in writing within 30 days to an initial determination of deficiencies from the ACO that identifies deficiencies in any of the contractor’s business systems. Furthermore, DoD does not believe there is a need, or is it appropriate, to develop a dispute resolution process beyond that which is already available by statute and regulation. Additionally, other avenues of dispute resolution outside of the Contract Disputes Act are available for resolving disputes that may arise over determinations of system deficiencies. The policy set forth in FAR 33.204 still applies, so that informal negotiation and alternate disputes resolution remain available, and, in fact, are encouraged as alternative methods of resolving disputes.

13. DCAA/DCMA Policies

Comment: One respondent believed that the ultimate impact of this rule is dependent on current and future DCAA/DCMA policies that are not subject to the public comment process. According

to the respondent, because the DCMA and DCAA policies will have a significant cost or administrative impact on contractors, a strong argument can be made that such policies are not just internal agency policies, but policies that must be published for public comment, pursuant to the requirements of the Office of Federal Procurement Policy (OFPP) Act. Another respondent stated that DCAA’s current position on reporting system results is that if a system opinion is more than three years old, DCAA reports that there is “no audit on file,” and that DCAA has no opinion on the system. This respondent believed that procurement contracting officers and ACOs should be permitted to decide for themselves what they consider to be “too old” or “not relevant” for purposes of these system reviews, rather than permitting DCAA to simply avoid reporting on known information.

Response: DoD does not agree. The OFPP Act (41 U.S.C. 418b) is applicable to procurement policy, regulation, procedure, or form relating to the expenditure of appropriated funds that has (1) a significant effect beyond the internal operating procedures of the agency issuing the procurement policy, *et al.*, and (2) a significant increased cost or administrative impact on contractors or offerors. DCAA/DCMA internal policies and procedures that are referenced in this rule are internal policies and procedures and are not regulatory. Therefore, the OFPP Act public comment process is not applicable. DoD believes that contracting officers must rely on current and relevant information in order to make an appropriate determination as to whether to notify a contractor of a system deficiency and possible payment withhold. DoD does not believe that an audit report noting a deficiency that is in excess of three years old would constitute current information.

14. DCMA/DCAA Oversight

Comment: A number of respondents believe that the Commission on Wartime Contracting (CWC) hearings demonstrated that greater cooperation must be achieved between DCMA and DCAA to oversee Government contractors properly, and that this issue should be addressed before imposing more regulations on contractors, especially as severe and broad as those proposed.

Response: DoD is currently taking measures to improve coordination between DCMA and DCAA. Concurrent with these measures, DoD is issuing this rule to further improve the effectiveness of DCMA and DCAA oversight of business systems as recommended by

the Commission on Wartime Contracting.

15. DCMA/DCAA Resources

Comment: A couple of respondents suggested that DCMA and DCAA are under-resourced to execute the requirements of the rule, and that ACOs do not have the training to determine if a deficiency makes a system inadequate.

Response: The need to have effective oversight mechanisms is unrelated to resources. This rule does not add additional oversight responsibilities onto DCAA and DCMA; it merely provides provisions to help protect the Government from the risks of loss due to a contractor’s failure to maintain business systems, as is required by the terms and conditions of their contracts. DoD has confidence that contracting personnel will make appropriate determinations in accordance with this rule.

16. Deficiency Correction

Comment: A number of respondents expressed concern that the proposed rule provides incomplete guidance for ACOs to approve systems when deficiencies previously have been identified. These respondents question whether the ACO’s determination to reduce or discontinue the withholding of payments is discretionary, even if the contractor has corrected all deficiencies. One respondent is concerned that there is no measurable standard for the Government to decide to increase or decrease the payment withholds based on the monitoring of the contractor’s progress in correcting deficiencies.

Response: The revised rule language states that the contracting officer shall discontinue the withholding of payments and release any payments previously withheld when the contracting officer determines that the contractor has corrected all system deficiencies after receipt of auditor or functional specialist verification. Furthermore, the revised language provides for the contracting officer, in consultation with the auditor or functional specialist, to discontinue withholding payments prior to audit verification if the contractor submits evidence that the deficiencies have been corrected. DoD relies on the judgment of the ACO to make determinations to decrease or subsequently increase the withholding of payments, in accordance with the rule language, on a case-by-case basis.

17. Definition of Business System

Comment: Two respondents requested that the rule include a precise definition of an acceptable business system.

Response: The definition of the term “acceptable business systems” in clause 252.242–7XXX has been revised for clarity. The precise criteria for determining the acceptability of the six business systems are contained in the individual business systems clauses.

18. Definition of Deficiency

Comment: A number of respondents encouraged DoD to provide a clear and precise definition of a “deficiency.”

Response: The definition of “deficiency” used throughout the rule means a failure to maintain one or more system criteria of an acceptable business system. The criteria for each business system have been revised to provide more specificity.

19. Definition of Standards and System Requirements

Comment: One respondent noted that 242.7502 requires that the audit report contain sufficient information so that the ACO will be able to understand what the contractor must do to comply with the applicable “standard or system requirement.” The respondent was unsure what “standard” means in this context, since clause 252.242–7YYY (relating to accounting system administration) only refers to “system requirements,” and does not mention any standards.

Response: The language in 242.7502 has been revised to require the audit report to “describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies and the potential impact to the Government.” Additionally, the language in both 242.7502 and clause 252.242–7YYY has been revised to refer to “system criteria” to be consistent.

20. Estimating System

Comment: A number of respondents questioned whether contracting officers had the authority to make determinations on whether system deficiencies warrant withholds and to consider the impact of deficiencies on contractor proposals. Other respondents expressed concern with the criteria against which contractor estimating system compliance will be measured. One respondent expressed concern with the requirements that the estimating system include comparisons of projected results to actual results and an analysis of any differences.

Response: This rule is very clear that contracting officers have the authority to make determinations on whether system deficiencies warrant withholds and shall consider the impact of deficiencies on contractor proposals. This revised proposed rule sets forth specific criteria

for maintaining an acceptable estimating system. DoD does not believe it is unreasonable for a contractor to establish and maintain an acceptable estimating system that would include controls for the contractor to compare projected results to actual results and analyze any differences. This existing requirement was relocated from 215.407–5–70 into clause 252.215–7002.

21. Earned Value Management System (EVMS)

Comment: A number of respondents questioned how non-compliance with ANSI/EIA–748 fits into this rule because deficiencies in EVMS do not result in the billing of unallowable costs to the Government.

Response: A key DoD concern is the reliability of the contractor’s EVMS monthly reports. Even though the EVMS system may not directly result in the billing of unallowable costs to the Government, it does provide important information to senior-level Government officials to use when making management decisions regarding major weapon systems. Consequently, EVMS was included in the rule to ensure that DoD is receiving accurate and reliable EVMS information used to identify current and potential cost overruns, etc.; and if there are deficiencies with the contractors’ EVMS, that they are promptly corrected.

22. Failure To Follow Corrective Action Plan

Comment: One respondent recommended that the contracting officer be given the discretion to increase the amount of the withhold under the contract if the contractor inexcusably fails to follow the corrective action plan accepted by the Government or an acceptable alternative to that plan.

Response: The contracting officer has the discretion in determining whether the contractor is following its corrective action plan, and whether to increase the withholding percentage in accordance with clause 252.242–7XXX. The reason the contracting officer may decrease the withholding percentage from five percent to two percent (one percent for small businesses) is that an approved corrective action plan mitigates the Government’s risk by increasing the probability that system deficiencies will be corrected in a timely manner. Conversely, the reason for increasing the withhold back to five percent (two percent for small businesses) is to restate the appropriate protection for the Government, since the contractor has not adhered to its corrective action plan. The contracting officer has

complete discretion to make these determinations.

23. Financial Impact

Comment: Several respondents expressed concern that the proposed rule will increase administrative costs (to correct deficiencies) significantly and destabilize contractor cash management, which could have such financial impacts as to affect how the industrial base can support the warfighter and national security.

Response: DoD acknowledges that the application of the payment withhold will impact and reduce a contractor’s cash flow. Further, DoD acknowledges that the initial administrative costs to ensure business system compliance may increase. However, in the long run, both the contractor’s and Government’s administrative costs should be reduced with the reliance on efficient contractor business systems. Based on comments received, DoD has removed the 100 percent withhold from the rule and lowered the compounding of deficiency percentages to a maximum of 20 percent. However, DoD does not anticipate that the rule will cause long-term harm to the industrial base supporting our warfighter and national security. The intent of the proposed rule is to strengthen contractor business systems and provide a protection for the Government from the risks of deficient systems while contractors resolve their system deficiencies.

24. Formatting of Rule Language

Comment: A number of respondents believe the language of the proposed rule needs clarifying for more uniform application.

Response: DoD acknowledges the respondents’ comment and has clarified the language of the rule in accordance with public comments received.

25. General Agreement

Comment: A number of respondents expressed agreement with the rule, citing the necessity for contractors to maintain adequate business systems.

Response: DoD acknowledges the respondents’ support of the rule.

26. General Disagreement

Comment: A number of respondents expressed concern with the rule and requested it be withdrawn, citing claims that the rule (a) is biased against DoD contractors, (b) does not address problems with business system oversight with Government agencies, (c) will have unfavorable consequences to industry and Government agencies, and (d) is an unnecessary intrusion on the contractual relationship between

industry and Government. Specifically, respondents suggested that adequacy of business systems should be addressed as part of the preaward contracting phase rather than through payment withholds, and that many of the problems or deficiencies identified in supplier systems are traceable to ill-defined contracts, unstable funding, and individual interpretations of policy or guidance by inexperienced audit personnel. Finally, one respondent was concerned that this proposed rule uses a broad-brush approach to what appears to be a narrow problem growing out of battlefield contingency contracting and that, contrary to its intended purpose, this proposed rule will do little or nothing to assist the Government in achieving its goal of reducing fraud, waste, and abuse.

Response: DoD acknowledges the respondents' concern with the rule. However, the need to mitigate the Government's risk when contractors fail to comply with the terms and conditions of their contracts by failing to maintain adequate business systems necessitates this rule. DoD partially agrees that the adequacy of business systems should be addressed as part of the preaward contracting phase. However, this fact does not relieve the contractors' contractual obligations to maintain adequate business systems throughout the life of the contract. DoD disagrees with the respondent that system deficiencies are traceable to ill-defined contracts, unstable funding, and individual interpretations of policy or guidance. Business systems are company-wide or segment-wide systems with established policies and procedures that are applied across multiple contracts. This rule mitigates the Government's risk when contractors fail to maintain adequate business systems after contract award. While DoD acknowledges that issues with contractor business systems were discovered through reviews of contractors involved with battlefield contingency contracting, DoD does not believe that these issues are strictly confined therein. However, DoD notes that contractors outside of the contingency contracting arena will not be impacted by withholds implemented under this rule if failure to maintain adequate business systems, in accordance with the terms and conditions of their Government contracts, is limited to being a narrow problem growing out of battlefield contingency contracting, as the respondent suggests.

27. Impact on Government Systems

Comment: One respondent believed that the proposed rule will require additional resources at Defense Finance and Accounting Service and modifications of the Mechanization of Contract Administration Services system because all payments for contracts with withholds must be processed manually. Furthermore, one respondent suggested that contracting officers be granted the authority to release withholds under situations where funds are at risk of expiring or being canceled, or the contract is being closed.

Response: The Government is fully capable of modifying its automated systems to implement the rule. Contracting officers are the only ones granted the authority to release withholds. Withholds will be released once the system deficiency has been corrected, or a final audit has determined which costs are allowable under the contract.

28. Increased Litigation

Comment: A number of respondents believe the withholds will result in increased litigation that will drain the resources of both contractors and the Government, especially since the proposed rule states that Prompt Payment Act interest does not accrue on the withhold, and prudent contractors will immediately appeal the withhold pursuant to the Contract Disputes Act, where interest would accrue on the withhold if the Government's position is not sustained. Furthermore, most of the issues with deficient business systems could be resolved through the exercise of reasonable contracting officer discretion if the rule allowed it.

Response: DoD is uncertain whether the rule, in its final form, will lead to increased litigation. It would be unwieldy to establish a separate informal process for handling disagreements involving alleged system deficiencies, given that the Contract Disputes Act already is an established methodology for resolving disagreements, large and small. Furthermore, not every claim presented to the contracting officer under the Contract Disputes Act results in litigation. In fact, FAR 33.204 establishes the Government's policy to try to resolve all contractual issues in controversy by mutual agreement, even prior to the submission of a claim. The contracting officer has the authority to make all initial and final determinations of system deficiencies, implement and remove withholds, make determinations to approve, disapprove, and reapprove

systems, and to take any other appropriate actions deemed in the best interests of the Government.

29. Information Collection

Comment: One respondent believed that the information collection estimate that DoD included with the proposed rule is understated substantially.

Response: DoD does not agree with the respondent's comment. DoD notes that the supporting data referenced by the respondent exceeds the information collection requirements established under this rule. DoD believes the Paperwork Reduction Act estimates published with the proposed rule accurately reflect the contractors' costs to fulfill the information collection requirements of this rule. The hours and costs cited by the respondent with regard to EVMS do not reflect the Paperwork Reduction Act requirements of this rule.

30. Interest on Withholds

Comment: One respondent disagreed that the withholdings under clause 252.242-7XXX, Business Systems, are not subject to the interest penalty provisions of the Prompt Payment Act. While contract financing payments are generally not subject to the interest penalty, the Prompt Payment Act specifically makes the interest penalty applicable to interim vouchers under cost-reimbursement contracts for services. This statutory provision is implemented in FAR 52.232-25, Alternate I. Similarly, FAR 52.232-7 explicitly makes the interest penalty applicable to interim vouchers under time-and-materials and labor-hour contracts for services. Another respondent suggested that the rule allow for Prompt Payment Act interest on amounts withheld if later it is determined that the Government incorrectly applied the withhold.

Response: FAR 52.232-25(a)(5)(ii) states "The prompt payment regulations at 5 CFR 1315.10(c) do not require the Government to pay interest penalties if payment delays are due to disagreement between the Government and the Contractor over the payment amount or other issues involving contract compliance, or on amounts temporarily withheld or retained in accordance with the terms of the contract." Since amounts withheld pursuant to clause 252.242-7XXX are temporarily withheld in accordance with the terms of the contract, they are not subject to the interest penalty provisions of the Prompt Payment Act.

31. Internal Audits and Management Reviews

Comment: A number of respondents recommended that the Government be provided complete access to contractors' internal control systems, including internal audit reports and management reviews, to ensure a contractor has implemented appropriate corrections in response to audits and reviews. Further, one respondent suggested that this requirement should be based on the comprehensive internal control framework of the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Response: Auditors have access to contractors' records, as provided for under the FAR, to ensure contractors have implemented internal audits and management reviews. DoD does not agree with implementing the COSO internal control framework since COSO is a voluntary private-sector organization. It would be inappropriate to tie Government regulations to the COSO internal control framework since such policies are not subject to the Government's rulemaking process.

32. Legality of Withholds

Comment: Respondents believe the withholds set forth in the rule are arbitrary, punitive, contrary to public policy that requires the Government withholds to be reasonably related to Government risk, and could lead to a cessation of contract payments without any showing of actual harm to the Government. The respondents believe the rule would not survive legal challenge.

Response: 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, these 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. The 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 percentage withhold amount, 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.

33. Materiality of Deficiencies

Comment: Some respondents believe the quality and utility of contractor business system information could be greatly enhanced by requiring a clear segregation between system conditions that relate solely to policy enhancements, especially when the contractor has agreed to the policy enhancements or has already made the policy enhancements but DCAA has not yet reviewed them, and those system conditions that relate to unallowable or unreasonable costs being charged to Government contracts. Other respondents are concerned that the proposed rule does not make a distinction between minor deficiencies that likely pose no threat of significant harm to the Government, and material deficiencies that potentially pose such a threat. These respondents are concerned that current DCAA guidance requires reporting of any perceived deficiency that could directly or indirectly result in any amount, no matter how small, of unallowable costs being charged to a contract. To avoid such circumstances, it is absolutely necessary to impose a materiality requirement in regard to system deficiencies. One respondent stated that, although the rule requires the auditor or other cognizant functional specialist to assess the potential magnitude of the risk to the Government posed by the deficiency, the rule fails to establish objective criteria for such an assessment, including the need for evidence demonstrating a logical nexus between the deficiency and the risk. Finally, one respondent suggested the rule should focus on risk management rather than risk avoidance. As such, the pass-or-fail assessment of business systems in the rule does not adequately address relative degrees of impact or risk.

Response: DoD does not believe that it would be in the Government's best interest to attempt to segregate system deficiencies that relate solely to system policy and those system deficiencies that relate directly to unallowable or unreasonable costs. 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. Furthermore, DoD disagrees with the assertion that business systems will be deemed inadequate and payments withheld for minor deficiencies. The intent of the rule is to withhold payments when a deficiency exists that impairs the Government's ability to rely on the system's outputs. DoD has revised the rule to set forth objective business system criteria. DoD believes there is a logical nexus between system deficiencies and risk to the Government. The intent of the rule is to withhold payments when a deficiency exists that impairs the Government's ability to rely on the system's outputs. A system must provide reasonable assurance that the relevant system criteria are satisfied and that the risk of material misstatements caused by error or fraud is low. The rule has been revised to clarify that the contracting officer has the discretion to determine whether withholding is warranted to protect the Government. Accordingly, DoD disagrees that the rule is based on pass-fail criteria.

34. Material Management and Accounting System (MMAS)

Comment: Three respondents questioned the language at clause 252.242-7004 which requires a contractor's MMAS to have adequate internal controls to ensure system and data integrity. The respondents contend that internal controls (*i.e.*, policies and procedures) cannot provide absolute assurance as required here; the standard is reasonable assurance. The respondents cited the requirement that a contractor's MMAS shall have adequate internal controls to ensure system and data integrity, and shall "establish and maintain adequate levels of record accuracy, and include reconciliation of recorded inventory quantities to physical inventory by part number on a periodic basis." The respondents question what is an adequate level.

Response: The proposed rule does not require absolute assurance of compliance with any of the business system standards or criteria. The intent of the rule is to provide reasonable assurance that the system criteria are satisfied and that the risk of material misstatements caused by error or fraud is low. DoD further notes that this existing language in clause 252.242-7004 sets forth a desired 95 percent accuracy level.

35. Multiple Withholdings

Comment: The respondent stated that many of the contractor systems covered by this rule are, appropriately, implemented on a corporate-wide basis.

As a result, the respondent believed that that a deficiency finding would impact all proposals and contracts held by that company, including those that are not directly affected by the “deficient” system, and those that are outside DoD and not covered by this rule.

Response: This payment withholding requirement set forth in this rule applies only to contracts that contain clause 252.242–7XXX, Business Systems. The withholding is not necessarily limited to a single contract, but would apply to multiple contracts that are covered by clause 252.242–7XXX. A contractor’s respective business systems are relied upon by the Government for all contracts that contain the respective clauses pertaining to the individual business systems. Therefore, it is appropriate for withholds to be applied to multiple contracts that rely on the fidelity of the contractor’s respective business systems.

36. Property Management System

Comment: One respondent believed that withholding against all of a contractor’s financing payments would be grossly out of proportion with the damage because FAR also already protects the Government’s interest for deficiencies in a property management system by specifically addressing remediation for individual pieces of lost, damaged, destroyed, or stolen Government property.

Response: FAR 45.105 provides that if the contractor does not correct property management system deficiencies, the contracting officer may revoke the Government’s assumption of risk for loss, damage, destruction, or theft; and/or the exercise of other rights or remedies available to the contracting officer. However, these remedies do not mitigate the Government’s risk that the contractor could fail to perform on the contract. The proposed rule further mitigates the Government’s risk by withholding payments temporarily when the contractor’s property management system has deficiencies.

37. Purchasing System

Comment: A number of respondents expressed concern with the purchasing system criteria against which contractor compliance will be measured. A number of respondents questioned the criteria in the proposed rule that required a purchasing system that procures materials “at the most economical cost.” One respondent asserted that the DoD purchasing system requirement should be limited to verification that FAR/DFARS required flow downs from the prime or higher-tier contract have been included in the purchase order or

subcontract. One respondent questioned whether it is possible to grant system approval while corrective actions are being pursued, and whether withholds would apply in this circumstance.

Response: This revised proposed rule sets forth specific criteria for maintaining an acceptable purchasing system. DoD has revised the language under clause 252.244–7XXX to require “An organizational and administrative structure that ensures effective and efficient procurement of required quality materials and parts at the best value from responsible and reliable sources,” consistent with current Federal acquisition policy. Compliance with the policy and procedures requirements in clause 252.244–7XXX is necessary to provide reasonable assurance to the contracting officer that the purchasing system does not contain any deficiencies. The contracting officer is responsible for determining whether all required flow-down clauses, including terms and conditions, and any other clauses needed to meet the requirements of the prime contract, are included in the contractor’s purchasing system policies and procedures for letting subcontracts. Additionally, the Government reviews the contractor’s purchasing system to ensure that subcontract clauses required under the contractor’s purchasing system policies are not contrary to Government law or regulation. Deficiencies that may result in a withhold may not be significant enough to result in a system disapproval. In a scenario in which a system has been disapproved and withholds have been implemented, all deficiencies must be corrected before the temporary withholds are discontinued. For system reapproval, the deficiencies must be corrected substantially in the judgment of the contracting officer. The contracting officer has the discretion to make both system approval and withhold determinations separately on a case-by-case basis.

38. Resolution Timing

Comment: Respondents believe that the Government should have a time limitation requirement to follow up on corrective actions, make system approval decisions, and remove withholds.

Response: DoD acknowledges the respondents’ concern regarding the timing of follow-up audits. Therefore, the rule has been revised so that “If, prior to the receipt of verification, the contractor submits evidence that the deficiencies have been corrected, and the contracting officer, in consultation with the auditor or functional specialist,

determines that there is a reasonable expectation that the corrective actions have been implemented, the contracting officer may discontinue withholding payments pending receipt of verification and release any payments previously withheld.”

39. Risk-based Withholding

Comment: A number of respondents suggested that any reductions in payment should be in proportion to the potential damage/risk to the Government and should be imposed only after demonstrating a reasonable basis for the actual damage suffered by the Government.

Response: The intent of the rule is to authorize payment withholding when the contracting officer determines there are one or more system deficiencies that adversely affect a contractor’s business system, leading to a potential risk of harm to the Government. The potential risk of harm may be a risk that cannot be quantified in terms of dollars, such as a deficiency that would compromise contract performance. 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, these 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. The 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 percentage withhold amount, 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.

40. Roles of DCAA/DCMA

Comment: A number of respondents were concerned that most contracting officers will not have the requisite training and expertise to reach independent conclusions relative to

auditor/contractor disagreements over internal controls. The respondents expect contracting officers will, more often than not, simply concur with auditor conclusions out of expediency and safety to avoid being reported to the DoD IG for investigation, which will greatly endanger equity and fairness. These respondents suggested that DoD first addresses the adjudication process and the independence of DCAA. The respondent stated that DFARS must be absolutely clear with regard to the roles and authority of the ACO and the auditor.

Response: The DoD memo dated December 4, 2009, "Resolving Contract Audit Recommendations," clearly defines the roles and responsibilities of DCAA and DCMA and provides procedures for adjudicating differences. DoD has confidence that contracting officers possess the technical knowledge, skills, and experience necessary to reach independent determinations on business systems based on sound judgment as required by FAR 1.602-2, Responsibilities.

41. Rule Application

Comment: Two respondents suggested that since the information cited in the CWC testimony concerned companies that were involved with contingency contracting in Afghanistan and Iraq, that the proposed rule is overly broad and should be limited only to contingency contracting.

Response: DoD notes that while the issues surrounding contractor business systems came to light under the findings of the CWC hearings, it is a longstanding DoD policy to rely upon effective and efficient contractor business systems beyond the realm of the contingency contracting arena. DoD does not believe that these issues are limited strictly to contingency contracting.

42. Small Business Impact

Comment: Several respondents commented that the proposed rule imposes potentially burdensome requirements on small businesses, since with the exception of EVMS and estimating system requirements, business system requirements apply to all contractors and contracts, regardless of size. Thus, small businesses would be required to implement and maintain the same business systems as those systems implemented by the largest contractors. The respondents recommended the rule impose reasonable limitations on the applicability of the requirements for contractor business systems based on the size of the contractor or contract.

Response: DoD agrees that the rule could potentially have an adverse

impact on small business and has established thresholds designed to limit the impact on small business.

Additionally, the rule has been revised to reduce the percentage of payments withheld if a small business has a deficiency that poses a potential risk of harm to the Government.

43. Withhold Alternatives

Comment: A number of respondents believe the proposed rule is unnecessary because the Government already has a number of enforcement mechanisms to ensure that material deficiencies in contractor systems do not result in unchecked fraud, waste, or abuse in Government contracting and to provide contractors with appropriate incentives to quickly address any deficiencies. Some of the respondents recommended that the rule be revised to state that contracting officers should not impose duplicative remedies or sanctions.

Response: The existing regulatory remedies are not an effective substitute for a contract clause that will mitigate the Government's risk while contractors correct business system deficiencies.

The proposed rule is required to supplement existing enforcement mechanisms and protect the Government's interests while the contractor completes correction of system deficiencies. DoD does not wish to limit the contracting officer's discretion to apply any and all regulatory measures, as warranted by the circumstances. For example, if a contractor has a deficiency in its property management system, the contracting officer may implement a withhold to protect the Government's risk of the contractor failing to perform on the contract, and may also revoke the Government's assumption of liability to protect the Government from risk of loss of the Government's furnished property.

44. Withhold Impacts

Comment: Several respondents believe the proposed rule would have unintended consequences such as establishing a barrier to entry for new contractors, harming the cash flow of existing contractors and hurting their ability to obtain financing, prompting unnecessary administrative cost and improvements to business systems, adversely impacting financial performance metrics of return on investment and return on sales, and impacting the ability of contractors to attract debt and equity investment at beneficial rates. One respondent believed that the unintended consequences could directly result in loss of jobs and would be contrary to supporting our warfighters and our

national security, both of which depend on a healthy industrial base.

Response: DoD does not believe that the rule will cause long-term harm to the defense industrial base or national security. DoD recognizes that there may be a short-term financial impact on a contractor who fails to maintain adequate business systems in accordance with the terms of its contract. However, the Government has the responsibility to protect the taxpayers. DoD believes that contractors who maintain adequate systems will not be impacted by this rule and, in fact, will benefit from effective business systems.

45. Withhold Impacts on Government Oversight Costs

Comment: One respondent recommended that DoD abandon the proposed clause 252.242-7XXX because it will increase the Government's oversight and enforcement costs.

Response: DoD appreciates the respondent's concern. However, acceptable contractor business systems are the first line of defense against fraud, waste, and abuse. As such, it is in the Government's, and ultimately the taxpayers', best interest to ensure contractors maintain adequate business systems.

46. Withhold Percentages

Comment: A number of respondents expressed concern over the percentages to be withheld, that the rule does not establish a maximum dollar amount that may be withheld, and that cumulative withholds of up to 50 percent per contract are inappropriate.

Response: DoD appreciates the respondents' concerns regarding the withhold percentages. Accordingly, the proposed rule has been revised to reduce the amount that can be withheld for business system deficiencies from ten percent to five percent (two percent for small business). If the Contractor submits an acceptable corrective action plan, the contracting officer will, as appropriate, reduce the withholding to two percent (one percent for small businesses). The contracting officer will authorize the contractor to bill for amounts previously withheld when the contracting officer determines all deficiencies have been corrected. Additionally, DoD has revised the rule to reduce the cumulative percentage of payments that can be withheld on one or more business systems to 20 percent (10 percent for small businesses). This limitation refers to the amount that can be withheld on any payment if deficiencies exist in one or more business systems. The establishment of

a maximum dollar amount that may be withheld across multiple contracts would be inappropriate.

B. Summary of Proposed Rule Changes

As a result of the public comments received, the following changes were made to the proposed rule:

1. To the extent practicable, the rule has been reorganized to provide consistency across each of the business systems. Additionally, throughout the rule, the term “ACO” has been replaced by “contracting officer” for accuracy.

2. The definition of “deficiency” used throughout the rule means a failure to maintain one or more system criteria of an acceptable business system. This definition has been set forth within each of the specific business system clauses 252.215–7002, 252.234–7002, 252.242–7004, 252.242–7XXX, 252.242–7YYY, 252.244–7XXX, and 252.245–7XXX.

3. The system criteria for each of the business systems have been set forth in clause 252.242–7XXX, Business Systems, as well as in each of the individual business system clauses, 252.215–7002, 252.234–7002, 252.242–7004, 252.242–7YYY, 252.244–7XXX, and 252.245–7XXX.

4. In the “policy” paragraphs for each of the business systems, 215.407–5–70(c)(2), 234.201(5), 242.7203(c), 242.7502(b), 244.305–70(a), and 245.105(b), cognizant contracting officers, in consultation with the auditor and, where applicable, the functional specialist, shall determine the acceptability of the contractor’s business systems and approve or disapprove the system.

5. The “disposition of findings” paragraphs for each of the business systems, 215.407–5–70(e)(2), 234.201(7), 242.7203(c), 242.7502(d), 244.305–70(c), and 245.105(d), have been reorganized and revised to set forth procedures for reporting of findings, and making initial and final determinations as follows:

(a) If there are system deficiencies, the auditor’s or functional specialist’s report to the contracting officer shall describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies and the potential adverse impact to the Government; and

(b) Revised initial and final determination procedures have been set forth.

6. The business system approval paragraphs, 215.407–5–70(f), 234.201(8), 242.7203(d), 242.7502(e), 244.305–70(d), and 245.105(e), are established to provide procedures for contracting officers to promptly approve a previously unapproved business system and notify the contractor when the

contracting officer determines, in consultation with the auditor and/or functional specialist, that the contractor has substantially corrected the system deficiencies, removing any potential risk of harm to the Government.

7. The contracting officer notifications paragraphs, 215.407–5–70(g), 234.201(9), 242.7203(e), 242.7502(f), 244.305–70(e), and 245.105(f), are established to provide procedures for contracting officers to promptly distribute copies of a determination to withhold, remove withholds, and approve or disapprove a system to the auditor, payment office, contracting officers at the buying activities, and cognizant contracting officers in contract administration activities.

8. Paragraphs 242.7502(g) and 244.305–70(f), on mitigating risk of accounting system and purchasing system deficiencies on specific proposals, are established to provide contracting officers with procedures for evaluating whether a deficiency impacts the negotiations, and if so, what alternatives the contracting officer should consider.

9. Section 245.105 is rewritten in its entirety as previously noted, and for consistency with the other business systems covered under this rule.

10. Section 242.70X1 Business system deficiencies, has been revised in its entirety to set forth policy and procedures for contracting officers to make a determination to withhold payments; provide appropriate notifications; monitor and verify the correction of contractor deficiencies; and implement, reduce, increase, and discontinue payment withholding.

11. Section 242.70X2 Contract clause, has been revised to set forth a \$50 million threshold and revise the companion clauses that set forth the requirements for the use of clause 252.242–7XXX, Business Systems.

12. In each of the clauses revised under this rule, 252.215–7002, 252.234–7002, 252.242–7004, 252.242–7YYY, and 252.244–7XXX, the language has been revised to replace the phrase and paragraph headings entitled “system requirements” with “system criteria,” and to delete from the clauses the phrases “but is not limited to” and “but not limited to.”

13. The “System deficiencies” paragraphs in each of the individual business systems clauses, 252.215–7002(e), 252.234–7002(i), 252.242–7004(e), 252.242–7YYY(d), and 252.244–7XXX(d), have been revised for consistency and clarity.

14. In each of the individual business system clauses revised under this rule, the following language has been added

under paragraphs 252.215–7002(f), 252.234–7002(i)(4), 252.242–7004(f), 252.242–7YYY(e), and 252.244–7XXX(e): “If the Contractor receives the Contracting Officer’s final determination of system deficiencies, the Contractor shall, within 45 days of receipt of the final determination, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies.”

15. In each of the individual business system clauses revised under this rule, the “Withholding payments” paragraphs, 252.215–7002(g), 252.234–7002(k), 252.242–7004(g), 252.242–7YYY(f), and 252.244–7XXX(f), are revised as follows: “If the Contracting Officer determines that there are one or more system deficiencies that adversely affect the Contractor’s purchasing system, leading to a potential risk of harm to the Government, and the contract includes the clause at 252.242–7XXX, Business Systems, the Contracting Officer will withhold payments in accordance with that clause.”

16. Clause 252.215–7002 is revised as follows:

(a) The definition of an “estimating system” has been revised to include the phrase “budgeting and planning controls,” and under subparagraph (5), to add the phrase “budgeting and planning” and the phrase “and budgets.”

(b) Minor revisions to paragraph (d) system criteria, include the addition of the phrase “and budgets” in subparagraphs (i), (ii), and (v); the addition of the phrase “and budgeting” in subparagraphs (iii), (iv), and (xii); replacement of the word “appropriate” with “adequate” in subparagraph (v); deletion of the phrase “where appropriate” in subparagraph (xi); replacement of the phrase “comply with this regulation” with “ensure timely follow-up actions are taken on the management review recommendations” in subparagraph (xii); replacement of the phrase “the comparison” with “budgetary data supporting indirect cost estimates and comparisons” in subparagraph (xiii); addition of the phrase “and notify the Contracting Officer” in subparagraph (xiv); deletion of subparagraph (xv) and its replacement with new subparagraphs (xv), (xvi), and (xvii).

17. Clause 252.234–7002 is revised as follows:

(a) Definitions of “acceptable earned value management system” and “earned value management system” are added.

(b) Paragraph (c) is revised as follows: “If this contract has a value of \$50 million or more, the Contractor shall use

an EVMS that has been determined to be acceptable by the cognizant Federal agency." The phrase "to be in compliance with the EVMS guidelines as stated in paragraph (a)(1) of this clause" is hereby deleted.

(c) Paragraphs (c) and (g) are revised to replace the references to paragraph (a)(1) with references to paragraph (b)(1).

(d) Paragraph (j), System disapproval, is hereby added to set forth when a contracting officer will disapprove a contractor's EVMS.

(e) Paragraph (h) is renumbered as paragraph (l) and is revised to provide the following qualifying phrase: "With the exception of paragraphs (i) through (k) of this clause * * *" Additionally, the reference to paragraph (b) is replaced by a reference to paragraph (c).

18. Clause 252.242-7002 is revised to add the definition of "acceptable material management and accounting system."

19. Clause 252.242-7XXX is revised as follows:

(a) The definition of "acceptable business systems" has been revised to delete the words "this contract" such that acceptable business systems "means business systems that comply with the terms and conditions of the applicable business system clauses listed in the definition of "business systems" in this clause."

(b) The definition of "business systems" has been revised to update the references to the applicable clauses for the property management system, 252.245-7XXX, Contractor Property Management System Administration, and purchasing system, 252.244-7XXX, Contractor Purchasing System Administration.

(c) Paragraph (c), System deficiencies, has been revised for clarity to state under subparagraph (1) that "The Contractor shall respond in writing within 30 days to an initial determination that there are one or more system deficiencies that adversely affect the Contractor's business system leading to a potential risk of harm to the Government." Furthermore, the phrase "that adversely affect the Contractor's business system leading to a potential risk of harm to the Government" is also added for clarity.

(d) Paragraph (d) is revised for clarity, as well, to—

(i) Reduce the withhold percentage from 10 percent to five percent (two percent for small businesses) and from five percent to two percent (one percent for small businesses) if the Contractor submits an acceptable corrective action plan within 45 days of a notice of the

Contracting Officer's intent to withhold payments;

(ii) Set forth procedures for Contracting Officers to withhold payments from progress payments and performance-based payments, or issue a contract modification requiring the Contractor to implement the withholding on interim cost vouchers on cost, labor-hour, and time-and-materials contracts;

(iii) Reduce the cumulative percentage of payments withheld on one or more business systems from 50 percent to 20 percent (10 percent for small businesses);

(iv) Delete the potential 100 percent withhold for deficiencies that are highly likely to lead to improper contract payments or represent an unacceptable risk of loss to the Government;

(v) Add construction contracts that include FAR clause 52.232-27 to the list of interim payments applicable to this clause; and

(vi) Add subparagraph (5) to set forth that "Payment withholding shall not apply to payments on fixed-price line items where performance is complete and the items were accepted by the Government."

(e) Paragraph (e) is revised for clarity, as well, to—

(i) Revise procedures for Contracting Officers to discontinue withhold payments from progress payments and performance-based payments, and unilaterally issue a contract modification to discontinue the payment withholding from billings on interim cost vouchers, and authorize the Contractor to appropriately bill for any monies previously withheld if the Contracting Officer determines the Contractor has corrected all deficiencies in a business system; and

(ii) Revise procedures for Contracting Officers to continue to withhold payments from progress payments and performance-based payments, or require the Contractor to continue the withholding from its billings on interim cost vouchers if the Contracting Officer determines the Contractor has not corrected all deficiencies in a business system.

20. Clause 252.242-7YYY is revised as follows:

(a) The definition of "acceptable accounting system" is revised to replace the phrase "requirements under" with the phrase "system criteria in," and replace the word "invoice" with the word "billing."

(b) The definition of "accounting system" is revised to replace "reporting data" with "reporting" and to add the phrase "and may include subsystems for specific areas such as indirect and other

direct costs, compensation, billing, labor, and general information technology."

(c) Paragraph (b), General, is revised to clarify that "Failure to maintain an acceptable accounting system, as defined in this clause, shall result in the withholding of payments if the contract includes the clause at 252.242-7XXX, Business Systems, and also may result in disapproval of the system."

21. Clause 252.244-7XXX is revised as follows:

(a) The definition of an "acceptable purchasing system" is added.

(b) The definition of "purchasing system" is revised to delete the purchasing system criteria language in subparagraphs (1) through (6), which has been relocated to the system criteria paragraph (c).

22. New clause 252.245-7XXX, Contractor Property System Administration, has been added for consistency with the other business system clauses, 252.215-7002, 252.234-7002, 252.242-7004, 252.242-7YYY, and 252.244-7XXX.

III. Executive Order 12866

This is a significant regulatory action and, therefore, was subject to review under section 6(b) of Executive Order 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

DoD has prepared an initial regulatory flexibility analysis consistent with 5 U.S.C. 603. A copy of the analysis may be obtained from the point of contact specified herein. The analysis 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 entities contractually required to maintain one or more of the defined contractor business systems. While DoD did not receive comments with specific impacts on small businesses, based on comments received, DoD has revised the proposed rule to establish a \$50 million threshold designed to limit the impact on small business. Additionally, the rule has been revised to reduce the percentage of payment withholding if a small business has a deficiency that poses a potential risk of harm to the Government.

At this time, DoD is unable to estimate the number of small entities to which this rule will apply. Therefore, DoD invites comments from small

business concerns and other interested parties on the expected impact of this rule on small entities.

DoD will also consider comments from small entities concerning the existing regulations in subparts affected by this rule in accordance with 5 U.S.C. 610. Interested parties must submit such comments separately and should cite 5 U.S.C. 610 (DFARS Case 2009–D038) in correspondence.

V. Paperwork Reduction Act

The Paperwork Reduction Act (44 U.S.C. chapter 35) applies because the proposed rule contains information collection requirements. In accordance with 5 CFR 1320.8, DoD invited comments regarding the information collection estimate that DoD included with the initial proposed rule published on January 15, 2010, at 75 FR 2457. In response, DoD received one comment. The respondent asserted that DoD's estimates are substantially understated. However, the supporting data referenced by the respondent exceeds the information collection requirements established under this rule. The hours and costs cited by the respondent with regard to EVMS do not reflect the Paperwork Reduction Act requirements of this rule. With no further specific Paperwork Reduction Act comments received, and no further revisions in this proposed rule to the information collection requirements, DoD believes the estimates published with the proposed rule accurately reflect the contractors' costs to fulfill the information collection requirements of this rule.

Written comments and recommendations on the proposed information collection should be sent to Ms. Jasmeet Seehra at the Office of Management and Budget, Desk Officer for DoD, Room 10236, New Executive Office Building, Washington, DC 20503, or e-mail Jasmeet.K.Seehra@omb.eop.gov, with a copy to the Defense Acquisition Regulations System, Attn: Mr. Mark Gomersall, OUSD(AT&L)DPAP/DARS, Room 3B855, 3060 Defense Pentagon, Washington, DC 20301–3060.

Comments can be received from 30 to 60 days after the date of this notice, but comments to OMB will be most useful if received by OMB within 30 days after the date of this notice.

To request more information on this proposed information collection or to obtain a copy of the proposal and associated collection instruments, please write to the Defense Acquisition Regulations System, Attn: Mr. Mark Gomersall, OUSD(AT&L)DPAP/DARS, Room 3B855, 3060 Defense Pentagon,

Washington, DC 20301–3060, or e-mail dfars@osd.mil. Include DFARS Case 2009–D038 in the subject line of the message.

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

Government procurement.

Ynette R. Shelkin,

Editor, Defense Acquisition Regulations System.

Therefore, DoD proposes to amend 48 CFR parts 215, 234, 242, 244, 245, and 252 as follows:

1. The authority citation for 48 CFR parts 215, 234, 242, 244, 245, and 252 continues to read as follows:

Authority: 41 U.S.C. 421 and 48 CFR chapter 1.

PART 215—CONTRACTING BY NEGOTIATION

2. Amend section 215.407–5–70 by:

- a. Adding introductory text to paragraph (a);
- b. Revising paragraph (a)(4);
- c. Revising the heading of paragraph (c);
- d. Revising paragraphs (c)(2) and (c)(3);
- e. Removing paragraph (c)(4);
- f. Redesignating paragraphs (d)(1), (d)(2), and (d)(3) as paragraphs (c)(4), (c)(5), and (c)(6);
- g. Revising newly designated paragraphs (c)(4) and (c)(5);
- h. Removing the heading of paragraph (d);
- i. Removing paragraphs (e), and (f);
- j. Redesignating paragraph (g) as paragraph (d); and
- k. Adding new paragraphs (e) through (g) to read as follows:

215.407–5–70 Disclosure, maintenance, and review requirements.

(a) *Definitions.* As used in this subsection—

* * * * *

(4) Deficiency is defined in 252.215–7002, Cost Estimating System Requirements.

(b) * * *

(c) *Policy.*

* * * * *

(2) The cognizant contracting officer, in consultation with the auditor, for contractors subject to paragraph (b)(2) of this subsection shall—

(i) Determine the acceptability of the disclosure and approve or disapprove the system; and

(ii) Pursue correction of any deficiencies.

(3) The auditor conducts estimating system reviews.

(4) An acceptable system shall provide for the use of appropriate

source data, utilize sound estimating techniques and good judgment, maintain a consistent approach, and adhere to established policies and procedures.

(5) In evaluating the acceptability of a contractor's estimating system, the contracting officer, in consultation with the auditor, shall determine whether the contractor's estimating system complies with the system criteria for an acceptable estimating system as prescribed in 252.215–7002, Cost Estimating System Requirements.

* * * * *

(e) *Disposition of findings—(1) Reporting of findings.* The auditor shall document findings and recommendations in a report to the contracting officer. If the auditor identifies any estimating system deficiencies, the report shall describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies and the potential adverse impact to the Government.

(2) *Initial determination.* (i) The contracting officer shall review all findings and recommendations and, if there are no deficiencies that adversely affect the system, shall promptly notify the contractor in writing that the contractor's estimating system is acceptable and approved; or

(ii) If the contracting officer determines that there are one or more system deficiencies that adversely affect the contractor's estimating system, leading to a potential risk of harm to the Government, the contracting officer shall—

(A) Promptly make an initial determination on any system deficiencies and notify the contractor, in writing, providing a description of the deficiency in sufficient detail to allow the contractor to understand the deficiency and its potential harm to the Government;

(B) Request the contractor to respond in writing to the initial determination within 30 days; and

(C) Promptly evaluate the contractor's responses to the initial determination, in consultation with the auditor or functional specialist, and make a final determination.

(3) *Final determination.* (i) The contracting officer shall make a final determination and notify the contractor in writing that—

(A) The contractor's estimating system is acceptable and approved, or

(B) System deficiencies still remain. The notice shall indicate the adequacy of any proposed or completed corrective action. The contracting officer shall—

(1) Request that the contractor, within 45 days of receipt of the final determination, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies;

(2) Disapprove the system in accordance with 252.215-7002, Cost Estimating System Requirements, if the contracting officer determines that one or more deficiencies warrant system disapproval based on the risk to the Government; and

(3) Withhold payments in accordance with 252.242-7XXX, Business Systems, if the clause is included in the contract and the contracting officer determines that there are one or more system deficiencies that adversely affect the contractor's estimating system, leading to a potential risk of harm to the Government.

(ii) Follow the procedures relating to a correction of system deficiencies in PGI 215.407-5-70(e)(3).

(f) *System approval.* The contracting officer shall promptly approve a previously disapproved estimating system and notify the contractor when the contracting officer determines that the contractor has substantially corrected the system deficiencies removing the potential risk of harm to the Government.

(g) *Contracting officer notifications.* The cognizant contracting officer shall promptly distribute copies of a determination to withhold, remove withholds, and approve or disapprove a system to the auditor; payment office; affected contracting officers at the buying activities; and cognizant contracting officers in contract administration activities.

PART 234—MAJOR SYSTEM ACQUISITION

2A. Add section 234.001 to read as follows:

234.001 Definition.

As used in this subpart—

Acceptable earned value management system and *earned value management system* are defined in 252.234-7002, Earned Value Management System.

Deficiency is defined in 252.234-7002, Earned Value Management System, and is synonymous with *noncompliance*.

3. Amend section 234.201 by adding paragraphs (5) through (9) to read as follows:

234.201 Policy.

* * * * *

(5) The cognizant contracting officer, in consultation with the functional specialist and auditor, shall—

(i) Determine the acceptability of the contractor's earned value management system and approve or disapprove the system; and

(ii) Pursue correction of any deficiencies.

(6) In evaluating the acceptability of a contractor's earned value management system, the contracting officer, in consultation with the functional specialist and auditor, shall determine whether the contractor's earned value management system complies with the system criteria for an acceptable earned value management system as prescribed in 252.234-7002, Earned Value Management System.

(7) *Disposition of findings—(i) Reporting of findings.* The functional specialist or auditor shall document findings and recommendations in a report to the contracting officer. If the functional specialist or auditor identifies any deficiencies in the contractor's earned value management system, the report shall describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies and the potential adverse impact to the Government.

(ii) *Initial determination.* (A) The contracting officer shall review all findings and recommendations and, if there are no deficiencies that adversely affect the system, shall promptly notify the contractor, in writing, that the contractor's earned value management system is acceptable and approved; or (B) If the contracting officer determines that there are one or more system deficiencies that adversely affect the contractor's earned value management system, leading to a potential risk of harm to the Government, the contracting officer shall—

(1) Promptly make an initial determination on any system deficiencies and notify the contractor, in writing, providing a description of the deficiency in sufficient detail to allow the contractor to understand the deficiencies and the potential adverse impact to the Government;

(2) Request the contractor to respond in writing to the initial determination within 30 days; and

(3) Evaluate the contractor's response to the initial determination, in consultation with the auditor or functional specialist, and make a final determination.

(iii) *Final determination.* (A) The contracting officer shall make a final determination and notify the contractor, in writing, that—

(1) The contractor's earned value management system is acceptable and approved, or

(2) Systems deficiencies still remain. The notice shall indicate the adequacy of any proposed or completed corrective action. The contracting officer shall—

(i) Request that the contractor, within 45 days of receipt of the final determination, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies;

(ii) Disapprove the system in accordance with 252.234-7002, Earned Value Management System, when initial validation is not successfully completed within a 16 month period from contract award, or the existing earned value management system contains one or more deficiencies in high-risk guidelines in ANSI/EIA-748 standards (guidelines 1, 3, 6, 7, 8, 9, 10, 12, 16, 21, 23, 26, 27, 28, 30, or 32). For the remaining 16 guidelines in ANSI/EIA-748 standards, the contracting officer shall use discretion to disapprove the system based on input received from functional specialists and the auditor; and

(iii) Withhold payments in accordance with 252.242-7XXX, Business Systems, if the clause is included in the contract and the contracting officer determines that there are one or more system deficiencies that adversely affect the contractor's earned value management system, leading to a potential risk of harm to the Government.

(B) Follow the procedures relating to correction of system deficiencies at PGI 234.201(7)(iii).

(8) *System approval.* The contracting officer shall promptly approve a previously disapproved earned value management system and notify the contractor when the contracting officer determines that the contractor has substantially corrected the system deficiencies, removing the potential risk of harm to the Government.

(9) *Contracting officer notifications.* The cognizant contracting officer shall promptly distribute copies of a determination to withhold, remove withholds, and approve or disapprove a system to the auditor; payment office; affected contracting officers at the buying activities; and cognizant contracting officers in contract administration activities.

PART 242—CONTRACT ADMINISTRATION AND AUDIT SERVICES

4. Add subpart 242.70 to read as follows:

Subpart 242.70—Business Systems

Sec.

242.70X1 Business system deficiencies.
 242.70X2 Contract clause.

Subpart 242.70—Business Systems**242.70X1 Business system deficiencies.**

(a) *Definition.* As used in this subpart—

Acceptable business systems and business systems are defined in 252.242–7XXX, Business Systems.

Deficiency is defined in 252.242–7XXX, Business Systems.

(b) *Determination to withhold payments.* If the contracting officer determines that one or more system deficiencies adversely affect the contractor's business systems included in 252.242–7XXX, Business Systems, that lead to a potential risk of harm to the Government, the contracting officer will—

(1) Promptly notify the contractor, in writing, of the contracting officer's determination to implement payment withholding in accordance with 252.242–7XXX, Business Systems. The notice of payment withhold shall be included in the contracting officer's written final determination for the business system and shall inform the contractor that—

(i) Payments shall be withheld in accordance with 252.242–7XXX, Business Systems, until the contracting officer determines that all system deficiencies have been corrected; and

(ii) The contracting officer reserves the right to take other actions within the terms and conditions of the contract.

(2) Provide all contracting officers administering contracts containing 252.242–7XXX, Business Systems, a copy of the determination and instructions for issuing unilateral contract modifications to withhold payments on those contracts, and reducing progress payments and performance-based payments, as applicable. The contracting officer shall also provide a copy of the determination to the auditor; payment office; affected contracting officers at the buying activities; and cognizant contracting officers in contract administration activities.

(3) Contracting officers shall use a format substantially the same as the following for unilateral modifications for making an initial payment withholding, reducing the payment withholding, and discontinuing the payment withholding in accordance with 252.242–7XXX, Business Systems:

(i) Use this format for unilateral modifications for implementing payment withholding:

Payment Withholding

(A) The purpose of this unilateral modification is to implement a payment withholding per the terms of 252.242–7XXX, Business Systems, and as a result of the Contracting Officer's determination, dated YYYY/MM/DD, with respect to the deficiencies found in the Contractor's system(s).

(B) Effective immediately, five percent (two percent for small businesses) of each request for payment under this contract will be withheld as described below. Upon receipt of an acceptable corrective action plan from the Contractor, a determination will be made with respect to reducing the percentage being withheld to two percent (one percent for small businesses) until the Contracting Officer determines that the Contractor has corrected all system deficiencies, as identified in the Contracting Officer's determination. Failure to follow the accepted corrective action plan will result in an increase in the percentage withheld against each payment under this contract to five percent (two percent for small businesses). Such reduction or increase will be made by contract modification.

(C) For payments under cost, labor-hour, or time-and-materials contracts: The Contractor shall apply a five percent (two percent for small businesses) withhold to the amount being billed and prepare a cost voucher in Wide Area WorkFlow (WAWF) for the net amount due. The Contractor shall show the amount withheld on the current billing, as well as the cumulative amount withheld to date on this contract in accordance with 252.242–7XXX, in the Comments block of the Miscellaneous Info Tab in WAWF.

(D) For progress payments: The Contractor shall prepare the request in WAWF without applying any withhold percentage. The Contracting Officer will reduce the approved amount by five percent (two percent for small businesses) and record the amount being withheld on the progress payment request, as well as the cumulative amount withheld on this contract in accordance with 252.242–7XXX, in the Comments block of the Miscellaneous Info Tab in WAWF.

(E) For performance-based payments: The Contractor shall prepare the request in WAWF without applying any withhold percentage to the performance-based payment event schedule amounts. The Contracting Officer will reduce the amount approved by five percent (two percent for small businesses) and record the

amount being withheld on the performance-based payment, as well as the cumulative amount withheld on this contract, in accordance with 252.242–7XXX, in the Comments block of the Miscellaneous Info Tab in WAWF.

(F) These payment withhold amounts will not be recorded in Mechanization of Contract Administration Services as withholds and there is no ACTION required on the part of the payment office to effect the withhold.

(ii) Use this format for unilateral modifications for reducing payment withholding:

Reduction of Temporary Payment Withholding

(A) The purpose of this unilateral modification is to reduce the payment withholding percentage per the terms of 252.242–7XXX, Business Systems, as a result of receiving an acceptable corrective action plan from the contractor, dated YYYY/MM/DD, for resolving deficiencies in its system(s) as identified in the Contracting Officer's determination, dated YYYY/MM/DD. This reduction is prospective and previous amounts withheld will not be reduced or released at this time.

(B) Effective immediately, two percent (one percent for small businesses) of each request for payment under this contract will be withheld as described below. The two percent (one percent for small businesses) being withheld will remain in effect until the Contracting Officer determines that the Contractor has corrected all system deficiencies as identified in the Contracting Officer's determination. Failure to follow the accepted corrective action plan will result in an increase in the percentage withheld against each payment under this contract to five percent (two percent for small businesses). Such increase will be made by contract modification.

(C) For payments under cost, labor-hour, or time-and-materials contracts: The Contractor shall apply a two percent (one percent for small businesses) withhold to the amount being billed and prepare a cost voucher in Wide Area WorkFlow (WAWF) for the net amount due. The Contractor shall show the amount withheld on the current billing, as well as the cumulative amount withheld to date on this contract in accordance with 252.242–7XXX, in the Comments block of the Miscellaneous Info Tab in WAWF.

(D) For progress payments: The Contractor shall prepare the request in WAWF without applying any withhold percentage. The Contracting Officer will reduce the approved amount by two percent (one percent for small

businesses) and record the amount being withheld on the progress payment request, as well as the cumulative amount withheld on this contract, in accordance with 252.242-7XXX, in the Comments block of the Miscellaneous Info Tab in WAWF.

(E) For performance-based payments: The Contractor shall prepare the request in WAWF without applying any withhold percentage to the performance-based payment event schedule amounts. The Contracting Officer will reduce the amount approved by two percent (one percent for small businesses) and record the amount being withheld on the performance-based payment, as well as the cumulative amount withheld on this contract, in accordance with 252.242-7XXX, in the Comments block of the Miscellaneous Info Tab in WAWF.

(F) These payment withhold amounts will not be recorded in Mechanization of Contract Administration Services as withholds and there is no ACTION required on the part of the payment office to effect the withhold.

(iii) Use the format below if payment withholding is discontinued pending receipt of auditor or functional specialist verification and based on evidence that the contractor has corrected all system deficiencies, in accordance with 252.242-7XXX, Business Systems:

Discontinuation of Payment Withholding

(A) The purpose of this unilateral modification is to discontinue the payment withhold as identified in Modification XXXXX and release previous amounts withheld on this contract, in accordance with 252.242-7XXX, Business Systems.

(B) The discontinuation of the payment withhold is made pending receipt of verification and based on evidence submitted by the Contractor that all the Contractor's system(s) deficiencies identified in the Contracting Officer's determination, dated YYYY/MM/DD, have been corrected.

(C) The Contractor is authorized to submit a bill in the amount of \$XXXXXXXX. The billed amount should be submitted on the same type of invoice as the withhold was originally taken, as appropriate.

(iv) Use the format below if payment withholding is discontinued after auditor or functional specialist verification that the contractor has corrected all system deficiencies, in accordance with 252.242-7XXX, Business Systems:

Discontinuation of Payment Withholding

(A) The purpose of this unilateral modification is to discontinue the payment withhold as identified in Modification XXXXX and release previous amounts withheld on this contract, in accordance with 252.242-7XXX, Business Systems.

(B) The discontinuation of the payment withhold is made based on verification that all the contractor's system(s) deficiencies identified in the Contracting Officer's final determination, dated YYYY/MM/DD, have been corrected.

(C) The Contractor is authorized to submit a bill in the amount of \$XXXXXXXX. The billed amount should be submitted on the same type of invoice as the withhold was originally taken, as appropriate.

(c) If the contracting officer determines that none of the system deficiencies adversely affect any of the contractor's business systems included in 252.242-7XXX, Business Systems, that lead to potential risk of harm to the Government, the contracting officer shall promptly notify the contractor in writing of the contracting officer's determination not to implement payment withholds in accordance with 252.242-7XXX, Business Systems.

(d) *Monitoring contractor's corrective action.* The contracting officer, in consultation with the auditor or functional specialist, shall monitor the contractor's progress in correcting the deficiencies. The contracting officer shall notify the contractor of any decision to decrease or increase the amount of payment withholding in accordance with 252.242-7XXX, Business Systems.

(e) *Correction of system deficiencies.*

(1) If the contractor notifies the contracting officer that the contractor has corrected the system deficiencies, the contracting officer shall request the auditor or functional specialist to review the correction to verify that the deficiencies have been corrected. If, after receipt of verification, the contracting officer determines that the contractor has corrected all system deficiencies, the contracting officer shall discontinue the withholding of payments and release any payments previously withheld.

(2) Prior to the receipt of verification, the contracting officer may discontinue withholding payments pending receipt of verification, and release any payments previously withheld, if the contractor submits evidence that the deficiencies have been corrected, and the contracting officer, in consultation

with the auditor or functional specialist, determines that there is a reasonable expectation that the corrective actions have been implemented.

242.70X2 Contract clause.

Use the clause at 252.242-7XXX, Business Systems, in solicitations and contracts when the expected contract value is equal to or greater than \$50 million, and when the solicitation or contract includes any of the following clauses:

(a) 252.215-7002, Cost Estimating System Requirements.

(b) 252.234-7002, Earned Value Management System.

(c) 252.242-7004, Material Management and Accounting System.

(d) 252.242-7YYY, Accounting System Administration.

(e) 252.244-7XXX, Contractor Purchasing System Administration.

(f) 252.245-7XXX, Contractor Property Management System Administration.

5. Revise section 242.7201 to read as follows:

242.7201 Definitions.

As used in this subpart—
Acceptable material management and accounting system, material management and accounting system, and valid time-phased requirements are defined in 252.242.7004, Material Management and Accounting System.
Deficiency is defined in 252.242.7004, Material Management and Accounting System.

6. Amend section 242.7202 by:
a. Redesignating the introductory text as paragraph (a);
b. Redesignating existing paragraphs (a) through (c) as paragraphs (a)(1) through (a)(3), respectively; and
c. Adding new paragraphs (b) and (c) to read as follows:

242.7202 Policy.

* * * * *

(b) The cognizant contracting officer, in consultation with the auditor and functional specialist, shall—

(1) Determine the acceptability of the contractor's MMAS and approve or disapprove the system; and

(2) Pursue correction of any deficiencies.

(c) In evaluating the acceptability of the contractor's MMAS, the contracting officer, in consultation with the auditor and functional specialist, shall determine whether the contractor's MMAS complies with the system criteria for an acceptable MMAS as prescribed in 252.242-7004, Material Management and Accounting System.

7. Amend section 242.7203 by:

- a. Removing paragraph (c);
- b. Redesignating paragraph (d) as paragraph (c);
- c. Revising newly designated paragraph (c); and
- d. Adding new paragraphs (d) and (e) to read as follows:

242.7203 Review procedures.

* * * * *

(c) *Disposition of findings*—(1) *Reporting of findings.* The auditor or functional specialist shall document findings and recommendations in a report to the contracting officer. If the auditor or functional specialist identifies any MMAS deficiencies, the report shall describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies and the potential adverse impact to the Government.

(2) *Initial determination.* (i) The contracting officer shall review findings and recommendations and if there are no deficiencies that adversely affect the system, shall promptly notify the contractor, in writing, that the contractor's MMAS is acceptable and approved; or

(ii) If the contracting officer determines that there are one or more system deficiencies that adversely affect the contractor's MMAS, leading to a potential risk of harm to the Government, the contracting officer shall—

(A) Promptly make an initial determination on any system deficiencies and notify the contractor, in writing, providing a description of deficiencies in sufficient detail to allow the contractor to understand the deficiencies and the potential adverse impact to the Government;

(B) Request the contractor to respond in writing to the initial determination within 30 days; and

(C) Promptly evaluate the contractor's response to the initial determination in consultation with the auditor or functional specialists, and make a final determination.

(3) *Final determination.* (i) The ACO shall make a final determination and notify the contractor that—

(A) The contractor's MMAS is acceptable and approved, or

(B) System deficiencies still remain. The notice shall indicate the adequacy of any proposed or completed corrective action. The contracting officer shall—

(1) Request that the contractor, within 45 days of receipt of the final determination, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies;

(2) Make a determination to disapprove the system in accordance with 252.242-7004, Material Management and Accounting System, if the contracting officer determines that one or more deficiencies warrant system disapproval based on the risk to the Government; and

(3) Withhold payments in accordance with 252.242-7XXX, Business Systems, if the clause is included in the contract and the contracting officer determines that there are one or more system deficiencies that adversely affect the contractor's MMAS, leading to a potential risk of harm to the Government.

(ii) Follow the procedures relating to correction of system deficiencies in PGI 242.7203.

(d) *System approval.* The contracting officer shall promptly approve a previously disapproved MMAS and notify the contractor when the contracting officer determines that the contractor has substantially corrected the system deficiencies, removing the potential risk of harm to the Government.

(e) *Contracting officer notifications.* The cognizant contracting officer shall promptly distribute copies of a determination to withhold, remove withholds, and approve or disapprove a system to the auditor; payment office; affected contracting officers at the buying activities; and cognizant contracting officers in contract administration activities.

8. Revise subpart 242.75 to read as follows:

Subpart 242.75—Contractor Accounting Systems

Sec.

242.7501 Definitions.

242.7502 Policy.

242.7503 Contract clause.

Subpart 242.75—Contractor Accounting Systems

242.7501 Definitions.

As used in this subpart—
Acceptable accounting system, and *accounting system* are defined in 252.242-7YYY, Accounting System Administration.

Deficiency is defined in 252.242-7YYY, Accounting System Administration.

242.7502 Policy.

(a) Contractors receiving cost-reimbursement, incentive-type, time-and-materials, or labor-hour contracts, contracts which provide for progress payments based on costs or on a percentage or stage of completion, or construction contracts that include the

clause at FAR 52.232-27, Prompt Payment for Construction Contracts, shall maintain an acceptable accounting system.

(b) The cognizant contracting officer, in consultation with the auditor, shall—

- (1) Determine the acceptability of a contractor's accounting system and approve or disapprove the system; and
- (2) Pursue correction of any deficiencies.

(c) In evaluating the acceptability of a contractor's accounting system, the contracting officer, in consultation with the auditor, shall determine whether the contractor's accounting system complies with the system criteria for an acceptable accounting system as prescribed in 252.242-7YYY, Accounting System Administration.

(d) *Disposition of findings*—(1) *Reporting of findings.* The auditor shall document findings and recommendations in a report to the contracting officer. If the auditor identifies any accounting system deficiencies, the report shall describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies and the potential adverse impact to the Government. Follow the procedures at PGI 242.70X1(b) for reporting of deficiencies.

(2) *Initial determination.* (i) The contracting officer shall review findings and recommendations and, if there are no deficiencies that adversely affect the system, shall promptly notify the contractor, in writing, that the contractor's accounting system is acceptable and approved; or

(ii) If the contracting officer determines that there are one or more system deficiencies that adversely affect the contractor's accounting system, leading to a potential risk of harm to the Government, the contracting officer shall—

(A) Promptly make an initial determination on any system deficiencies and notify the contractor, in writing;

(B) Request the contractor to respond in writing to the initial determination within 30 days; and

(C) Evaluate the contractor's response to the initial determination, in consultation with the auditor or functional specialist and make a final determination.

(3) *Final determination.* (i) The contracting officer shall make a final determination and notify the contractor, in writing, that—

(A) The contractor's accounting system is acceptable and approved, or

(B) System deficiencies still remain. The notice shall indicate the adequacy

of any proposed or completed corrective action. The contracting officer shall—

(1) Request that the contractor, within 45 days of receipt of the final determination, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies;

(2) Make a determination to disapprove the system in accordance with 252.242–7YYY, Accounting System Administration, if the contracting officer determines that one or more deficiencies warrant system disapproval based on the risk to the Government; and

(3) Withhold payments in accordance with 252.242–7XXX, Business Systems, if the clause is included in the contract and the contracting officer determines that there are one or more system deficiencies that adversely affect the contractor's accounting system, leading to a potential risk of harm to the Government.

(ii) Follow the procedures relating to correction of system deficiencies in PGI 242.7502.

(e) *System approval.* The contracting officer shall promptly approve a previously disapproved accounting system and notify the contractor when the contracting officer determines that the contractor has substantially corrected the system deficiencies, removing the potential risk of harm to the Government.

(f) *Contracting officer notifications.* The cognizant contracting officer shall promptly distribute copies of a determination to withhold, remove withholds, and approve or disapprove a system to the auditor; payment office; affected contracting officers at the buying activities; and cognizant contracting officers in contract administration activities.

(g) *Mitigating the risk of accounting system deficiencies on specific proposals.* (1) Field pricing teams shall discuss identified accounting system deficiencies and their impact in all reports on contractor proposals until the deficiencies are resolved.

(2) The contracting officer responsible for negotiation of a proposal generated by an accounting system with an identified deficiency shall evaluate whether the deficiency impacts the negotiations. If it does not, the contracting officer should proceed with negotiations. If it does, the contracting officer should consider other alternatives, e.g.—

(i) Allowing the contractor additional time to correct the accounting system deficiency and submit a corrected proposal;

(ii) Considering another type of contract, e.g., a fixed-price incentive (firm target) contract instead of a firm-fixed price;

(iii) Using additional cost analysis techniques to determine the reasonableness of the cost elements affected by the accounting system's deficiency;

(iv) Segregating the questionable areas as a cost-reimbursable line item;

(v) Reducing the negotiation objective for profit or fee; or

(vi) Including a contract (reopener) clause that provides for adjustment of the contract amount after award.

(3) The contracting officer who incorporates a reopener clause into the contract is responsible for negotiating price adjustments required by the clause. Any reopener clause necessitated by an accounting system deficiency should—

(i) Clearly identify the amounts and items that are in question at the time of negotiation;

(ii) Indicate a specific time or subsequent event by which the contractor will submit a supplemental proposal, including cost or pricing data, identifying the cost impact adjustment necessitated by the deficient accounting system;

(iii) Provide for the contracting officer to unilaterally adjust the contract price if the contractor fails to submit the supplemental proposal; and

(iv) Provide that failure of the Government and the contractor to agree to the price adjustment shall be a dispute under the Disputes clause.

242.7503 Contract clause.

Use the clause at 252.242–7YYY, Accounting System Administration, in solicitations and contracts when contemplating—

(a) A cost-reimbursement, incentive-type, time-and-materials, or labor-hour contract;

(b) A fixed-price contract with progress payments made on the basis of costs incurred by the contractor or on a percentage or stage of completion; or

(c) A construction contract that includes the clause at FAR 52.232–27, Prompt Payment for Construction Contracts.

PART 244—SUBCONTRACTING POLICIES AND PROCEDURES

9. Add subpart 244.1 to read as follows:

Subpart 244.1—General

Sec.

244.101 Definitions.

Subpart 244.1—General

244.101 Definitions.

As used in this subpart—

Acceptable purchasing system, and *purchasing system* are defined in 252.244–7XXX, Purchasing System Administration.

Deficiency is defined in 252.244–7XXX, Purchasing System Administration.

10. Revise section 244.305–70 to read as follows:

244.305–70 Policy.

Use the procedures of this subsection instead of FAR 44.305–2(c) and 44.305–3(b).

(a) The cognizant contracting officer, in consultation with the purchasing system analyst or auditor, shall—

(1) Determine the acceptability of the contractor's purchasing system and approve or disapprove the system; and

(2) Pursue correction of any deficiencies.

(b) In evaluating the acceptability of the contractor's purchasing system, the contracting officer, in consultation with the purchasing system analyst and auditor, shall determine whether the contractor's purchasing system complies with the system criteria for an acceptable purchasing system as prescribed in 252.244–7XXX, Contractor Purchasing System Administration.

(c) *Disposition of findings*—(1) *Reporting of findings.* The purchasing system analyst or auditor shall document findings and recommendations in a report to the contracting officer. If the purchasing system analyst or auditor identifies any purchasing system deficiencies, the report shall describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies and the potential adverse impact to the Government.

(2) *Initial determination.* (i) The contracting officer shall review all findings and recommendations and, if there are no deficiencies that adversely affect the system, shall promptly notify the contractor that the contractor's purchasing system is acceptable and approved; or

(ii) If the contracting officer determines that there are one or more system deficiencies that adversely affect the contractor's purchasing system, leading to a potential risk of harm to the Government, the contracting officer shall—

(A) Promptly make an initial determination on any system deficiencies and notify the contractor, in writing, providing a description of the deficiencies in sufficient detail to allow

the contractor to understand the deficiencies and the potential adverse impact to the Government;

(B) Request the contractor to respond in writing to the initial determination within 30 days; and

(C) Evaluate the contractor's response to the initial determination in consultation with the auditor or functional specialist, and make a final determination.

(3) *Final determination.* (i) The contracting officer shall make a final determination and notify the contractor, in writing, that—

(A) The contractor's purchasing system is acceptable and approved, or

(B) System deficiencies still remain. The notice shall indicate the adequacy of any proposed or completed corrective action. The contracting officer shall—

(1) Request that the contractor, within 45 days of receipt of the final determination, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies;

(2) Make a determination to disapprove the system in accordance with 252.244–7XXX, Contractor Purchasing System Administration, if the contracting officer determines that one or more deficiencies warrant system disapproval based on the risk to the Government; and

(3) Withhold payments in accordance with 252.242–7XXX, Business Systems, if the clause is included in the contract and the contracting officer determines that there are one or more system deficiencies that adversely affect the contractor's purchasing system, leading to a potential risk of harm to the Government.

(ii) Follow the procedures in accordance with 252.244–7XXX, Contractor Purchasing System Administration, and PGI 244.305–70 for disposition of report findings.

(d) *System approval.* The contracting officer shall promptly approve a previously disapproved purchasing system and notify the contractor when the contracting officer determines that the contractor has substantially corrected the system deficiencies, removing the potential risk of harm to the Government.

(e) *Contracting officer notifications.* The cognizant contracting officer shall promptly distribute copies of a determination to withhold, remove withholds, and approve or disapprove a system to the auditor; payment office; affected contracting officers at the buying activities; and cognizant contracting officers in contract administration activities.

(f) *Mitigating the risk of purchasing system deficiencies on specific proposals.* (1) Source selection evaluation teams shall discuss identified purchasing system deficiencies and their impact in all reports on contractor proposals until the deficiencies are resolved.

(2) The contracting officer responsible for negotiation of a proposal generated by a purchasing system with an identified deficiency shall evaluate whether the deficiency impacts the negotiations. If it does not, the contracting officer should proceed with negotiations. If it does, the contracting officer should consider other alternatives, e.g.—

(i) Allowing the contractor additional time to correct the purchasing system deficiency and submit a corrected proposal;

(ii) Considering another type of contract, e.g., a fixed-price incentive (firm target) contract instead of firm-fixed price;

(iii) Using additional cost analysis techniques to determine the reasonableness of the cost elements affected by the purchasing system's deficiency;

(iv) Segregating the questionable areas as a cost-reimbursable line item;

(v) Reducing the negotiation objective for profit or fee; or

(vi) Including a contract (reopener) clause that provides for adjustment of the contract amount after award.

(3) The contracting officer who incorporates a reopener clause into the contract is responsible for negotiating price adjustments required by the clause. Any reopener clause necessitated by a purchasing system deficiency should—

(i) Clearly identify the amounts and items that are in question at the time of negotiation;

(ii) Indicate a specific time or subsequent event by which the contractor will submit a supplemental proposal, including cost or pricing data, identifying the cost impact adjustment necessitated by the deficient purchasing system;

(iii) Provide for the contracting officer to unilaterally adjust the contract price if the contractor fails to submit the supplemental proposal; and

(iv) Provide that failure of the Government and the contractor to agree to the price adjustment shall be a dispute under the Disputes clause.

11. Add new section 244.305–7X to read as follows:

244.305–7X Contract clause.

Use the clause at 252.244–7XXX, Contractor Purchasing System

Administration, in solicitations and contracts containing the clause at FAR 52.244–2, Subcontracts.

PART 245—GOVERNMENT PROPERTY

12. Revise section 245.105 to read as follows:

245.105 Contractor's property management system compliance.

(a) *Definitions*—(1) *Acceptable property management system* and *property management system* are defined in 252.242–7XXX, Contractor Property Management System Administration.

(2) *Deficiency* is defined in 252.242–7XXX, Contractor Property Management System Administration.

(b) *Policy.* The cognizant contracting officer, in consultation with the property administrator, shall—

(1) Determine the acceptability of the system and approve or disapprove the system; and

(2) Pursue correction of any deficiencies.

(c) In evaluating the acceptability of a contractor's property management system, the contracting officer, in consultation with the property administrator, shall determine whether the contractor's property management system complies with the system criteria for an acceptable property management system as prescribed in 252.242–7XXX, Contractor Property Management System Administration.

(d) *Disposition of findings*—(1) *Reporting of findings.* The property administrator shall document findings and recommendations in a report to the contracting officer. If the property administrator identifies any property system deficiencies, the report shall describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies and the potential adverse impact to the Government.

(2) *Initial determination.* (i) The contracting officer shall review findings and recommendations and, if there are no deficiencies that adversely affect the system, shall promptly notify the contractor, in writing, that the contractor's property management system is acceptable and approved; or

(ii) If the contracting officer determines that there are one or more system deficiencies that adversely affect the contractor's property management system, leading to a potential risk of harm to the Government, the contracting officer shall—

(A) Promptly make an initial determination on any system deficiencies and notify the contractor, in writing, providing a description of

deficiencies in sufficient detail to allow the contractor to understand the deficiencies and the potential adverse impact to the Government;

(B) Request the contractor to respond in writing to the initial determination within 30 days and;

(C) Evaluate the contractor's response to the initial determination, in consultation with the property administrator and make a final determination;

(3) *Final determination.* (i) The contracting officer shall make a final determination and notify the contractor, in writing, that—

(A) The contractor's property management system is acceptable and approved, or

(B) System deficiencies still remain. The notice shall indicate the adequacy of any proposed or completed corrective action. The contracting officer shall—

(1) Request that the contractor, within 45 days of receipt of the final determination, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies;

(2) Promptly make a determination to disapprove the system if the contracting officer determines that one or more deficiencies warrant the system disapproval based on the risk to the Government; and

(3) Withhold payments in accordance with 252.242-7XXX, Business Systems, if the clause is included in the contract and the contracting officer determines that there are one or more system deficiencies that adversely affect the contractor's property system, leading to a potential risk of harm to the Government.

(ii) Follow the procedures in PGI 245.105 for disposition of report findings.

(e) *System Approval.* The contracting officer shall promptly approve a previously unapproved property management system and notify the contractor when the contracting officer determines, in consultation with the property administrator, that the contractor has substantially corrected the system deficiencies, removing the potential risk of harm to the Government.

(f) *Contracting officer notifications.* The cognizant contracting officer shall promptly distribute copies of a determination to withhold, remove withholds, and approve or disapprove a system to the auditor; payment office; affected contracting officers at the buying activities; and cognizant contracting officers in contract administration activities.

12A. Add new section 245.105-7X to read as follows:

245.105-7X Contract clause.

Use the clause at 252.245-7XXX, Contractor Property System Administration, in solicitations and contracts containing the clause at FAR 52.245-1, Government Property.

PART 252—SOLICITATION PROVISIONS AND CONTRACT CLAUSES

13. Revise section 252.215-7002 to read as follows:

252.215-7002 Cost estimating system requirements.

As prescribed in 215.408(2), use the following clause:

COST ESTIMATING SYSTEM REQUIREMENTS (DATE)

(a) *Definitions.* As used in this clause—
Acceptable estimating system means an estimating system that complies with the system criteria in paragraph (d) of this clause, and provides for a system that—

(1) Is maintained, reliable, and consistently applied;

(2) Produces verifiable, supportable, and documented cost estimates that are an acceptable basis for negotiation of fair and reasonable prices;

(3) Is consistent with and integrated with the Contractor's related management systems; and

(4) Is subject to applicable financial control systems.

Deficiency means a failure to meet one or more system criteria of an acceptable estimating system.

Estimating system means the Contractor's policies, procedures, and practices for budgeting and planning controls, and generating estimates of costs and other data included in proposals submitted to customers in the expectation of receiving contract awards. Estimating system includes the Contractor's—

(1) Organizational structure;

(2) Established lines of authority, duties, and responsibilities;

(3) Internal controls and managerial reviews;

(4) Flow of work, coordination, and communication; and

(5) Budgeting, planning, and estimating methods, techniques, accumulation of historical costs, and other analyses used to generate cost estimates and budgets.

(b) *General.* The Contractor shall establish, maintain, and comply with an acceptable estimating system.

(c) *Applicability.* Paragraphs (d) and (e) of this clause apply if the Contractor is a large business and either—

(1) In its fiscal year preceding award of this contract, received Department of Defense (DoD) prime contracts or subcontracts, totaling \$50 million or more for which cost or pricing data were required; or

(2) In its fiscal year preceding award of this contract—

(i) Received DoD prime contracts or subcontracts totaling \$10 million or more (but less than \$50 million) for which cost or pricing data were required; and

(ii) Was notified in writing by the Contracting Officer that paragraphs (d) and (e) of this clause apply.

(d) *System criteria.* (1) The Contractor shall disclose its estimating system to the Administrative Contracting Officer (ACO) in writing. If the Contractor wishes the Government to protect the information as privileged or confidential, the Contractor must mark the documents with the appropriate legends before submission.

(2) An estimating system disclosure is acceptable when the Contractor has provided the ACO with documentation that—

(i) Accurately describes those policies, procedures, and practices that the Contractor currently uses in preparing cost proposals; and

(ii) Provides sufficient detail for the Government to reasonably make an informed judgment regarding the acceptability of the Contractor's estimating practices.

(3) The Contractor shall—

(i) Comply with its disclosed estimating system; and

(ii) Disclose significant changes to the cost estimating system to the ACO on a timely basis.

(4) The Contractor's estimating system shall provide for the use of appropriate source data, utilize sound estimating techniques and good judgment, maintain a consistent approach, and adhere to established policies and procedures. An acceptable estimating system shall accomplish the following functions—

(i) Establish clear responsibility for preparation, review, and approval of cost estimates and budgets;

(ii) Provide a written description of the organization and duties of the personnel responsible for preparing, reviewing, and approving cost estimates and budgets;

(iii) Ensure that relevant personnel have sufficient training, experience, and guidance to perform estimating and budgeting tasks in accordance with the contractor's established procedures;

(iv) Identify and document the sources of data and the estimating methods and rationale used in developing cost estimates and budgets;

(v) Provide for adequate supervision throughout the estimating and budgeting process;

(vi) Provide for consistent application of estimating and budgeting techniques;

(vii) Provide for detection and timely correction of errors;

(viii) Protect against cost duplication and omissions;

(ix) Provide for the use of historical experience, including historical vendor pricing information, where appropriate;

(x) Require use of appropriate analytical methods;

(xi) Integrate information available from other management systems;

(xii) Require management review, including verification of the company's estimating and budgeting policies, procedures, and practices;

(xiii) Provide for internal review of, and accountability for, the acceptability of the estimating system, including the budgetary data supporting indirect cost estimates and comparisons of projected results to actual results, and an analysis of any differences;

(xiv) Provide procedures to update cost estimates and notify the Contracting Officer in a timely manner throughout the negotiation process;

(xv) Provide procedures that ensure subcontract prices are reasonable based on a documented review and analysis;

(xvi) Provide estimating and budgeting practices that consistently generate sound proposals that are compliant with the provisions of the solicitation and are adequate to serve as a basis to reach a fair and reasonable price; and

(xvii) Have an adequate system description, including policies, procedures, and estimating and budgeting practices that comply with the Federal Acquisition Regulation and Defense Federal Acquisition Regulation Supplement.

(e) *System deficiencies.* (1) The Contracting Officer will provide an initial determination to the Contractor, in writing, on any system deficiencies. The initial determination will describe the deficiency in sufficient detail to allow the Contractor to understand the deficiency and its potential harm to the Government.

(2) The Contractor shall respond within 30 days to a written initial determination from the Contracting Officer that identifies deficiencies in the Contractor's estimating system. If the Contractor disagrees with the initial determination, the Contractor shall state, in writing, its rationale for disagreeing.

(3) The Contracting Officer will evaluate the Contractor's response and notify the Contractor, in writing, of the Contracting Officer's final determination concerning—

- (i) Remaining deficiencies;
- (ii) The adequacy of any proposed or completed corrective action; and
- (iii) System disapproval, if the Contracting Officer determines that one or more deficiencies warrant system disapproval based on the risk to the Government.

(f) If the Contractor receives the Contracting Officer's final determination of system deficiencies, the Contractor shall, within 45 days of receipt of the final determination, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies.

(g) *Withholding payments.* If the Contracting Officer determines that there are one or more system deficiencies that adversely affect the Contractor's estimating system, leading to a potential risk of harm to the Government, and the contract includes 252.242-7XXX, Business Systems, the Contracting Officer will withhold payments in accordance with that clause.

(End of clause)

14. Revise section 252.234-7002 to read as follows:

252.234-7002 Earned Value Management System.

As prescribed in 234.203(2), use the following clause:

EARNED VALUE MANAGEMENT SYSTEM (DATE)

(a) *Definitions.* As used in this clause—
Acceptable earned value management system means an earned value management system that generally complies with system criteria in paragraph (b) of this clause.

Deficiency means a failure to meet one or more system criteria of an acceptable earned value management system.

Earned value management system means an earned value management system that complies with the earned value management system guidelines in the ANSI/EIA-748.

(b) *System Criteria.* In the performance of this contract, the Contractor shall use—

(1) An Earned Value Management System (EVMS) that complies with the EVMS guidelines in the American National Standards Institute/Electronic Industries Alliance Standard 748, Earned Value Management Systems (ANSI/EIA-748); and

(2) Management procedures that provide for generation of timely, reliable, and verifiable information for the Contract Performance Report (CPR) and the Integrated Master Schedule (IMS) required by the CPR and IMS data items of this contract.

(c) If this contract has a value of \$50 million or more, the Contractor shall use an EVMS that has been determined to be acceptable by the cognizant Federal agency. If, at the time of award, the Contractor's EVMS has not been determined by the cognizant Federal agency to be in compliance with the EVMS guidelines as stated in paragraph (b)(1) of this clause, the Contractor shall apply its current system to the contract and shall take necessary actions to meet the milestones in the Contractor's EVMS plan.

(d) If this contract has a value of less than \$50 million, the Government will not make a formal determination that the Contractor's EVMS complies with the EVMS guidelines in ANSI/EIA-748 with respect to the contract. The use of the Contractor's EVMS for this contract does not imply a Government determination of the Contractor's compliance with the EVMS guidelines in ANSI/EIA-748 for application to future contracts. The Government will allow the use of a Contractor's EVMS that has been formally reviewed and determined by the cognizant Federal agency to be in compliance with the EVMS guidelines in ANSI/EIA-748.

(e) The Contractor shall submit notification of any proposed substantive changes to the EVMS procedures and the impact of those changes to the cognizant Federal agency. If this contract has a value of \$50 million or more, unless a waiver is granted by the cognizant Federal agency, any EVMS changes proposed by the Contractor require approval of the cognizant Federal agency prior to implementation. The cognizant Federal agency will advise the Contractor of the acceptability of such changes as soon as practicable (generally within 30 calendar days) after receipt of the Contractor's notice of proposed changes. If the cognizant Federal agency waives the advance approval requirements, the Contractor shall disclose EVMS changes to the cognizant Federal agency at least 14 calendar days prior to the effective date of implementation.

(f) The Government will schedule integrated baseline reviews as early as

practicable, and the review process will be conducted not later than 180 calendar days after contract award, the exercise of significant contract options, and the incorporation of major modifications. During such reviews, the Government and the Contractor will jointly assess the Contractor's baseline to be used for performance measurement to ensure complete coverage of the statement of work, logical scheduling of the work activities, adequate resourcing, and identification of inherent risks.

(g) The Contractor shall provide access to all pertinent records and data requested by the Contracting Officer or duly authorized representative as necessary to permit Government surveillance to ensure that the EVMS complies, and continues to comply, with the performance criteria referenced in paragraph (b) of this clause.

(h) When indicated by contract performance, the Contractor shall submit a request for approval to initiate an over-target baseline or over-target schedule to the Contracting Officer. The request shall include a top-level projection of cost and/or schedule growth, a determination of whether or not performance variances will be retained, and a schedule of implementation for the rebaselining. The Government will acknowledge receipt of the request in a timely manner (generally within 30 calendar days).

(i) *System deficiencies.* (1) The Contracting Officer will provide an initial determination to the Contractor, in writing, on any system deficiencies. The initial determination will describe the deficiency in sufficient detail to allow the Contractor to understand the deficiency and its potential harm to the Government.

(2) The Contractor shall respond within 30 days to a written initial determination from the Contracting Officer that identifies deficiencies in the Contractor's EVMS. If the Contractor disagrees with the initial determination, the Contractor shall state in writing its rationale for disagreeing.

(3) The Contracting Officer will evaluate the Contractor's response and notify the Contractor, in writing, of the Contracting Officer's final determination concerning—

- (i) Remaining deficiencies;
- (ii) The adequacy of any proposed or completed corrective action; and
- (iii) System non-compliance, when the Contractor's existing EVMS contains one or more deficiencies in any of the 32 foundational guidelines in ANSI/EIA-748.

(4) If the Contractor receives the Contracting Officer's final determination of system deficiencies, the Contractor shall, within 45 days of receipt of the final determination, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies.

(j) *System disapproval.* The Contracting Officer will disapprove the Contractor's EVMS when—

- (1) Initial validation is not successfully completed within a 16 month period from contract award; or
- (2) The existing EVMS contains one or more deficiencies in high-risk guidelines in ANSI/EIA-748 standards (guidelines 1, 3, 6,

7, 8, 9, 10, 12, 16, 21, 23, 26, 27, 28, 30 or 32). For the remaining 16 guidelines in ANSI/EIA-748 standards, the Contracting Officer will use discretion to disapprove the system based on input received from functional specialists and the auditor.

(k) *Withholding payments.* If the Contracting Officer determines that there are one or more system deficiencies that adversely affect the Contractor's EVMS, leading to a potential risk of harm to the Government, and the contract includes 252.242-7XXX, Business Systems, the Contracting Officer will withhold payments in accordance with that clause.]

(l) With the exception of paragraphs (i) through (k) of this clause, the Contractor shall require its subcontractors to comply with EVMS requirements as follows:

(1) For subcontracts valued at \$50 million or more, the following subcontractors shall comply with the requirements of this clause:

[Contracting Officer to insert names of subcontractors (or subcontracted effort if subcontractors have not been selected) designated for application of the EVMS requirements of this clause.]

(2) For subcontracts valued at less than \$50 million, the following subcontractors shall comply with the requirements of this clause, excluding the requirements of paragraph (c) of this clause:

[Contracting Officer to insert names of subcontractors (or subcontracted effort if subcontractors have not been selected) designated for application of the EVMS requirements of this clause.]

(End of clause)

15. Amend section 252.242-7004 by:
- a. Revising the section heading, clause title, and the clause date;
 - b. Adding paragraphs (a)(4) and (a)(5);
 - c. Removing paragraph (d);
 - d. Redesignating existing paragraph (e) as paragraph (d); and
 - e. Adding new paragraphs (e) through (g) to read as follows:

252.242-7004 Material management and accounting system (MMAS).

* * * * *

MATERIAL MANAGEMENT AND ACCOUNTING SYSTEM (MMAS) (DATE)

(a) * * *

(4) *Acceptable material management and accounting system* means a MMAS that generally complies with the system criteria in paragraph (d) of this clause.

(5) *Deficiency* means a failure to meet one or more system criteria of an acceptable material management and accounting system.

* * * * *

(e) *System deficiencies.* (1) The Contracting Officer will provide an initial determination to the Contractor, in writing, on any system

deficiencies. The initial determination will describe the deficiency in sufficient detail to allow the Contractor to understand the deficiency and its potential harm to the Government.

(2) The Contractor shall respond within 30 days to a written initial determination from the Contracting Officer that identifies deficiencies in the Contractor's MMAS. If the Contractor disagrees with the initial determination, the Contractor shall state, in writing, its rationale for disagreeing.

(3) The Contracting Officer will evaluate the Contractor's response and notify the Contractor, in writing, of the Contracting Officer's final determination concerning—

- (i) Remaining deficiencies;
- (ii) The adequacy of any proposed or completed corrective action; and
- (iii) System disapproval if the Contracting Officer determines that one or more deficiencies warrants system disapproval based on the risk to the Government.

(f) If the Contractor receives the Contracting Officer's final determination of system deficiencies, the Contractor shall, within 45 days of receipt of the final determination, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies.

(g) *Withholding payments.* If the Contracting Officer determines that there are one or more system deficiencies that adversely affect the Contractor's MMAS, leading to a potential risk of harm to the Government, and the contract includes 252.242-7XXX, Business Systems, the Contracting Officer will withhold payments in accordance with that clause.

(End of clause)

16. Add section 252.242-7XXX to read as follows:

252.242-7XXX Business systems.

As prescribed in 242.70X2, use the following clause:

BUSINESS SYSTEMS (DATE)

(a) *Definitions.* As used in this clause—
Acceptable business systems means business systems that comply with the terms and conditions of the applicable business system clauses listed in the definition of "Business Systems" in this clause.

Business systems means—

(1) Accounting system, if this contract includes 252.242-7YYY, Accounting System Administration;

(2) Earned value management system, if this contract includes 252.234-7002, Earned Value Management System;

(3) Estimating system, if this contract includes 252.215-7002, Cost Estimating System Requirements;

(4) Material management and accounting system, if this contract includes 252.242-7004, Material Management and Accounting System;

(5) Property management system, if this contract includes 252.245-7XXX, Contractor Property System Administration; and

(6) Purchasing system, if this contract includes 252.244-7XXX, Contractor Purchasing System Administration.

Deficiency means a failure to meet one or more system criteria of an acceptable business system.

(b) *General.* The Contractor shall establish and maintain acceptable business systems in accordance with the terms and conditions of this contract.

(c) *System deficiencies.* (1) The Contractor shall respond, in writing, within 30 days to an initial determination that there are one or more system deficiencies that adversely affect the Contractor's business system leading to a potential risk of harm to the Government.

(2) The Contracting Officer will evaluate the Contractor's response and notify the Contractor, in writing, of the final determination as to whether the business system contains deficiencies that adversely affect the Contractor's business system leading to a potential risk of harm to the Government. If the Contracting Officer determines that the Contractor's business system contains such deficiencies, the final determination will include a notice to withhold payments.

(d) *Withholding of payments.* (1) If the Contracting Officer issues the final determination with a notice to withhold payments for deficiencies in a business system required under this contract, the Contracting Officer will, as applicable, withhold five percent (two percent for small businesses) of amounts due from progress payments and performance-based payments, and unilaterally issue a contract modification requiring the Contractor to withhold five percent (two percent for small businesses) from its billings on interim cost vouchers on cost, labor-hour, and time-and-materials contracts until all deficiencies have been corrected. The Contractor shall, within 45 days of receipt of the notice, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies.

(2) If the Contractor submits an acceptable corrective action plan within 45 days of receipt of a notice of the Contracting Officer's intent to withhold payments, the Contracting Officer will, as appropriate, reduce withholding to two percent (one percent for small businesses) from progress payments and performance-based payments, and issue a unilateral modification to reduce the percentage withheld on interim cost vouchers to two percent (one percent for small businesses) until the Contracting Officer determines that the Contractor has corrected all deficiencies identified in the final determination. However, if at any time, the Contracting Officer determines that the Contractor has failed to follow the accepted corrective action plan, the Contracting Officer will issue a unilateral modification to increase the percentage withheld to the percentage initially withheld, until the Contracting Officer determines that the Contractor has corrected all deficiencies identified in the final determination.

(3) The total percentage of payments withheld on amounts due under each progress payment, performance-based payment, or interim cost voucher, for deficiencies on one or more business systems, shall not exceed 20 percent (10 percent for small businesses) on this contract.

(4) For the purpose of this clause, payment means any of the following payments authorized under this contract:

- (i) Interim payments under—
 - (A) Cost-reimbursement contracts;
 - (B) Incentive-type contracts;
 - (C) Time-and-materials contracts;
 - (D) Labor-hour contracts;

(E) Construction contracts that include the clause at Federal Acquisition Regulation 52.232–27, Prompt Payment for Construction Contracts.

- (ii) Progress payments.
- (iii) Performance-based payments.

(5) Payment withholding shall not apply to payments on fixed-price line items where performance is complete and the items were accepted by the Government.

(6) The withholding of any amount or subsequent payment to the Contractor shall not be construed as a waiver of any rights or remedies the Government has under this contract.

(7) Notwithstanding the provisions of any clause in this contract providing for interim, partial, or other payment withholding on any basis, the Contracting Officer may withhold payment in accordance with the provisions of this clause.

(8) The payment withholding authorized in this clause is not subject to the interest-penalty provisions of the Prompt Payment Act.

(e) *Correction of deficiencies.* (1) The Contractor shall notify the Contracting Officer, in writing, when the Contractor has corrected the business system's deficiencies.

(2) Once the Contractor has notified the Contracting Officer that all deficiencies have been corrected, the Contracting Officer shall take one of the following actions:

(i) If the Contracting Officer determines the Contractor has corrected all deficiencies in a business system, the Contracting Officer will, as appropriate, discontinue the withholding of progress payments and performance-based payments, and unilaterally issue a contract modification to discontinue the payment withholding from billings on interim cost vouchers under this contract associated with that business system, and authorize the contractor to bill for any monies previously withheld that are not also being withheld due to deficiencies on other business systems under this contract. Any payment withholding in effect on other business systems under this contract will remain in effect until the deficiencies for those business systems are corrected.

(ii) If the Contracting Officer determines the Contractor has not corrected all system deficiencies, the Contracting Officer will continue the withholding of progress payments and performance-based payments, and the Contractor shall continue withholding amounts from its billings on interim cost vouchers in accordance with paragraph (d) of this clause, and not bill for any monies previously withheld.

(End of clause)

17. Add section 252.242–7YYY to read as follows:

252.242–7YYY Accounting system administration.

As prescribed in 242.7503, use the following clause:

ACCOUNTING SYSTEM ADMINISTRATION (DATE)

(a) *Definitions.* As used in this clause—

(1) *Acceptable accounting system* means a system that complies with the system criteria in paragraph (c) of this clause to provide reasonable assurance that—

- (i) Applicable laws and regulations are complied with;
- (ii) The accounting system and cost data are reliable;
- (iii) Risk of misallocations and mischarges are minimized; and
- (iv) Contract allocations and charges are consistent with billing procedures.

(2) *Accounting system* means the Contractor's system or systems for accounting methods, procedures, and controls established to gather, record, classify, analyze, summarize, interpret, and present accurate and timely financial data for reporting in compliance with applicable laws, regulations, and management decisions, and may include subsystems for specific areas such as indirect and other direct costs, compensation, billing, labor, and general information technology.

(3) *Deficiency* means a failure to meet one or more system criteria of an acceptable accounting system.

(b) *General.* The Contractor shall establish and maintain an acceptable accounting system. Failure to maintain an acceptable accounting system, as defined in this clause, shall result in the withholding of payments if the contract includes 252.242–7XXX, Business Systems, and also may result in disapproval of the system.

(c) *System criteria.* The Contractor's accounting system shall provide for—

- (1) A sound internal control environment and accounting framework and organizational structure that is adequate for producing accounting data that is reliable and costs that are recorded, accumulated, and billed on Government contracts in accordance with contract terms;
- (2) Proper segregation of direct costs from indirect costs;
- (3) Identification and accumulation of direct costs by contract;
- (4) A logical and consistent method for the accumulation and allocation of indirect costs to intermediate and final cost objectives;
- (5) Accumulation of costs under general ledger control;
- (6) Reconciliation of subsidiary cost ledgers and cost objectives to general ledger;
- (7) Approval and documentation of adjusting entries;
- (8) Periodic monitoring of the system;
- (9) A timekeeping system that identifies employees' labor by intermediate or final cost objectives;
- (10) A labor distribution system that charges direct and indirect labor to the appropriate cost objectives;
- (11) Interim (at least monthly) determination of costs charged to a contract through routine posting of books of account;
- (12) Exclusion from costs charged to Government contracts of amounts which are

not allowable in terms of Federal Acquisition Regulation (FAR) part 31, Contract Cost Principles and Procedures, and other contract provisions;

(13) Identification of costs by contract line item and by units (as if each unit or line item were a separate contract), if required by the contract;

(14) Segregation of preproduction costs from production costs, as applicable;

(15) Cost accounting information, as required—

- (i) By contract clauses concerning limitation of cost (FAR 52.232–20), limitation on payments (FAR 52.216–16), or allowable cost and payment (FAR 52.216–7); and
- (ii) To readily calculate indirect cost rates from the books of accounts;

(16) Billings that can be reconciled to the cost accounts for both current and cumulative amounts claimed and comply with contract terms;

(17) Adequate, reliable data for use in pricing follow-on acquisitions; and

(18) Accounting practices in accordance with standards promulgated by the Cost Accounting Standards Board, if applicable, otherwise, Generally Accepted Accounting Principles.

(d) *System deficiencies.* (1) The Contracting Officer will provide an initial determination to the Contractor, in writing, on any system deficiencies. The initial determination will describe the deficiency in sufficient detail to allow the Contractor to understand the deficiency and its potential harm to the Government.

(2) The Contractor shall respond within 30 days to a written initial determination from the Contracting Officer that identifies deficiencies in the Contractor's accounting system. If the Contractor disagrees with the initial determination, the Contractor shall state, in writing, its rationale for disagreeing.

(3) The Contracting Officer will evaluate the Contractor's response and notify the Contractor, in writing, of the Contracting Officer's final determination concerning—

- (i) Remaining deficiencies;
- (ii) The adequacy of any proposed or completed corrective action; and
- (iii) System disapproval, if the Contracting Officer determines that one or more deficiencies warrant system disapproval based on the risk to the Government.

(e) If the Contractor receives the Contracting Officer's final determination of system deficiencies, the Contractor shall, within 45 days of receipt of the final determination, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies.

(f) *Withholding payments.* If the Contracting Officer determines that there are one or more system deficiencies that adversely affect the Contractor's accounting system, leading to a potential risk of harm to the Government, and the contract includes 252.242–7XXX, Business Systems, the Contracting Officer shall withhold payments in accordance with that clause.

(End of clause)

18. Add section 252.244–7XXX to read as follows:

252.244-7XXX Contractor purchasing system administration.

As prescribed in 244.305-7X, insert the following clause:

CONTRACTOR PURCHASING SYSTEM ADMINISTRATION (DATE)

(a) *Definitions.* As used in this clause—
Acceptable purchasing system means a purchasing system that complies with the system criteria in paragraph (c) of this clause.

Deficiency means a failure to meet one or more system criteria of an acceptable purchasing system.

Purchasing system means the Contractor's system or systems for purchasing and subcontracting, including make or buy decisions, the selection of vendors, analysis of quoted prices, negotiation of prices with vendors, pricing and administering of orders, and expediting delivery of materials.

(b) *General.* The Contractor shall establish and maintain an acceptable purchasing system. Failure to maintain an acceptable purchasing system, as defined in this clause, may result in disapproval of the system by the Contracting Officer and/or withholding of payments.

(c) *System criteria.* The Contractor's purchasing system shall—

(1) Have an adequate system description including policies, procedures, and purchasing practices that comply with the Federal Acquisition Regulation (FAR) and the Defense FAR Supplement (DFARS);

(2) Ensure that all applicable purchase orders and subcontracts contain all flow-down clauses, including terms and conditions and any other clauses needed to carry out the requirements of the prime contract;

(3) Maintain an organization plan that establishes clear lines of authority and responsibility;

(4) Ensure all purchase orders are based on authorized requisitions and include a complete and accurate history of purchase transactions to support vendor selected, price paid, and document the subcontract/purchase order files which are subject to Government review;

(5) Establish and maintain adequate documentation to provide a complete and accurate history of purchase transactions to support vendors selected and prices paid;

(6) Apply a consistent make-or-buy policy that is in the best interest of the Government;

(7) Use competitive sourcing to the maximum extent practicable, and ensure debarred or suspended contractors are properly excluded from contract award;

(8) Evaluate price, quality, delivery, technical capabilities, and financial capabilities of competing vendors to ensure fair and reasonable prices;

(9) Require management level justification and adequate cost or price analysis, as applicable, for any sole or single source award;

(10) Perform adequate cost or price analysis and technical evaluation for each subcontractor and supplier proposal or quote to ensure fair and reasonable subcontract prices;

(11) Document negotiations in accordance with FAR 15.406-3;

(12) Seek, take, and document economically feasible purchase discounts, including cash discounts, trade discounts, quantity discounts, rebates, freight allowances, and company-wide volume discounts;

(13) Ensure proper type of contract selection and prohibit issuance of cost-plus-a-percentage-of-cost subcontracts;

(14) Maintain subcontract surveillance to ensure timely delivery of an acceptable product and procedures to notify the Government of potential subcontract problems that may impact delivery, quantity, or price;

(15) Document and justify reasons for subcontract changes that affect cost or price;

(16) Notify the Government of the award of all subcontracts that contain the FAR and DFARS flow-down clauses that allow for Government audit of those subcontracts, and ensure the performance of audits of those subcontracts;

(17) Enforce adequate policies on conflict of interest, gifts, and gratuities, including the requirements of the Anti-Kickback Act;

(18) Perform internal audits or management reviews, training, and maintain policies and procedures for the purchasing department to ensure the integrity of the purchasing system;

(19) Establish and maintain policies and procedures to ensure purchase orders and subcontracts contain mandatory and applicable flow-down clauses, as required by the FAR and DFARS, including terms and conditions required by the prime contract and any clauses required to carry out the requirements of the prime contract;

(20) Provide for an organizational and administrative structure that ensures effective and efficient procurement of required quality materials and parts at the best value from responsible and reliable sources;

(21) Establish and maintain selection processes to ensure the most responsive and responsible sources for furnishing required quality parts and materials and to promote competitive sourcing among dependable suppliers so that purchases are reasonably priced and from sources that meet contractor quality requirements;

(22) Ensure performance of adequate price or cost analysis on purchasing actions; and

(23) Establish and maintain procedures to ensure that proper types of subcontracts are selected, and that there are controls over subcontracting, including oversight and surveillance of subcontracted effort.

(d) *System deficiencies.* (1) The Contracting Officer will provide notification of initial determination to the Contractor, in writing, of any system deficiencies. The initial determination will describe the deficiency in sufficient detail to allow the Contractor to understand the deficiency and its potential harm to the Government.

(2) The Contractor shall respond within 30 days to a written initial determination from the Contracting Officer that identifies deficiencies in the Contractor's purchasing system. If the Contractor disagrees with the initial determination, the Contractor shall state, in writing, its rationale for disagreeing.

(3) The Contracting Officer will evaluate the Contractor's response and notify the

Contractor, in writing, of the Contracting Officer's final determination concerning—

(i) Remaining deficiencies;

(ii) The adequacy of any proposed or completed corrective action; and

(iii) System disapproval, if the Contracting Officer determines that one or more deficiencies warrant system disapproval based on the risk to the Government.

(e) If the Contractor receives the Contracting Officer's final determination of system deficiencies, the Contractor shall, within 45 days of receipt of the final determination, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies.

(f) *Withholding payments.* If the Contracting Officer determines that there are one or more system deficiencies that adversely affect the Contractor's purchasing system, leading to a potential risk of harm to the Government, and the contract includes 252.242-7XXX, Business Systems, the Contracting Officer will withhold payments in accordance with that clause.

(End of clause)

19. Add section 252.245-7XXX to read as follows:

252.245-7XXX Contractor property management system administration.

As prescribed in 245.105-7X, insert the following clause:

CONTRACTOR PROPERTY MANAGEMENT SYSTEM ADMINISTRATION (DATE)

(a) *Definitions.* As used in this clause—
Acceptable property management system means a property system that complies with the system criteria in paragraph (c) of this clause.

Deficiency means a failure to meet one or more system criteria of an acceptable property management system.

Property management system means the Contractor's system or systems for managing and controlling Government property.

(b) *General.* The Contractor shall establish and maintain an acceptable property management system. Failure to maintain an acceptable property management system, as defined in this clause, may result in disapproval of the system by the Contracting Officer and/or withholding of payments.

(c) *System criteria.* The Contractor's property management system shall be in accordance with paragraph (f) of the contract clause at Federal Acquisition Regulation 52.245-1.

(d) *System deficiencies.* (1) The Contracting Officer will provide an initial determination to the Contractor, in writing, of any system deficiencies. The initial determination will describe the deficiency in sufficient detail to allow the Contractor to understand the deficiency and its potential harm to the Government.

(2) The Contractor shall respond within 30 days to a written initial determination from the Contracting Officer that identifies deficiencies in the Contractor's property management system. If the Contractor disagrees with the initial determination, the Contractor shall state, in writing, its rationale for disagreeing.

(3) The contracting officer will evaluate the Contractor's response and notify the Contractor, in writing, of the Contracting Officer's final determination concerning—

- (i) Remaining deficiencies;
- (ii) The adequacy of any proposed or completed corrective action; and
- (iii) System disapproval, if the Contracting Officer determines that one or more deficiencies warrant system disapproval based on the risk to the Government.

(e) If the Contractor receives the Contracting Officer's final determination of system deficiencies, the Contractor shall, within 45 days of receipt of the final determination, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies.

(f) *Withholding payments.* If the Contracting Officer determines that there are one or more system deficiencies that

adversely affect the Contractor's property management system, leading to a potential risk of harm to the Government, and the contract includes 252.242-7XXX, Business Systems, the Contracting Officer will withhold payments in accordance with that clause.

(End of clause)

[FR Doc. 2010-30072 Filed 12-2-10; 8:45 am]

BILLING CODE 5001-08-P