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Defense Acquisition Regulations System

48 CFR Parts 215, 234, 242 *et al.*

Defense Federal Acquisition Regulation Supplement; Business Systems—
Definition and Administration; Interim Rule

DEPARTMENT OF DEFENSE

Defense Acquisition Regulations System

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

[DFARS Case 2009–D038]

RIN 0750–AG58

Defense Federal Acquisition Regulation Supplement; Business Systems—Definition and Administration

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

ACTION: Interim rule with request for comments.

SUMMARY: DoD is amending the Defense Federal Acquisition Regulation Supplement (DFARS) to improve the effectiveness of DoD oversight of contractor business systems.

DATES: *Effective date:* May 18, 2011.

Comment date: Comments on the interim rule should be submitted in writing to the address shown below on or before July 18, 2011, to be considered in the formation of the final rule.

Applicability date: This rule applies to solicitations issued on or after May 18, 2011. Contracting officers are encouraged, to the extent feasible, to amend existing solicitations (including solicitations for delivery orders and task orders) in accordance with FAR 1.108(d), in order to include the clause at DFARS 252.242–7005, Contractor Business Systems, as applicable, in contracts (including delivery orders and task orders) to be awarded on or after May 18, 2011, and shall amend existing solicitations (including delivery orders and task orders) in accordance with FAR 1.108(d), in order to include the clause at DFARS 252.242–7005, Contractor Business Systems, as applicable, in contracts to be awarded on or after August 16, 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(s), 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 an initial proposed rule for Business Systems—Definition and Administration (DFARS Case 2009–D038) in the **Federal Register** on January 15, 2010 (75 FR 2457). Based on the comments received and subsequent revisions to the proposed rule, DoD published a second proposed rule on December 3, 2010 (75 FR 75550). The public comment period closed January 10, 2011. On January 7, 2011, the Ike Skelton National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2011 was signed into law (Pub. L. 111–383). NDAA section 893, Contractor Business Systems, set forth statutory requirements for the improvement of contractor business systems to ensure that such systems provide timely, reliable information for the management of DoD programs. Based on the comments received, the requirements of the NDAA, and subsequent revisions to the proposed rule, DoD is publishing this interim 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 clarifying the definition and administration of contractor business systems as follows:

A. DoD is defining 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.

B. DoD is implementing 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 significant deficiencies. Payments could be withheld on—

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

II. Discussion and Analysis

A. Analysis of Public Comments

The comments received in response to the second proposed rule have been analyzed and dispositioned as discussed below. The comments received were grouped under 34 general topics. A summary of the comments follows:

1. Business Systems

a. Earned Value Management Systems (EVMS)

The following comments were submitted concerning Earned Value Management Systems (EVMS):

Comment: Some respondents expressed concern over disapproval of EVM systems if the system is not validated within 16 months since DCMA is not currently able to meet this timeline.

Response: The rule requires contracting officers to determine the acceptability of the contractor's earned value management system in consultation with the functional specialist and auditor. Contracting officers are expected to consider all facts at their disposal when making such determinations. However, circumstances outside of a contractor's control may inhibit the initial validation of a contractor's EVMS. Therefore, 234.201(7)(iii)(A)(2)(ii) has been revised to state that the system will be disapproved “when initial validation is not successfully completed within the timeframe approved by the contracting officer * * *”

Comment: Conditions for disapproval of an EVM system are inconsistent where the definition of an acceptable EVMS means that the system generally complies with system criteria while the identification of a single deficiency can make a system unacceptable. Furthermore, while some respondents expressed concern that EVM system deficiencies are related to ill-defined

contractual requirements, other respondents indicated that criteria for disapproval of an EVM system are too strict and should be more subjective.

Response: The rule requires contracting officers to determine the acceptability of the contractor's earned value management system in consultation with the functional specialist and auditor. Contracting officers are expected to consider all facts at their disposal when making such determinations. Section 893 of the FY11 NDAA requires systems to be disapproved when there is a shortcoming in the system that affects materially the ability of DoD officials to rely on information produced by the system for management purposes. This interim rule is consistent with this requirement. In the case of EVM systems, this means the system has one or more significant deficiencies due to the contractor's failure to comply with the system criteria in the clause at 252.234-7002, Earned Value Management System. Since a system will only be disapproved when a significant deficiency exists, a system with deficiencies that do not materially affect the Government's ability to rely on information produced by the system is considered an acceptable system in accordance with the definition at 252.234-7002. Therefore, this rule is not inconsistent with the definition of an acceptable EVMS.

b. Estimating System

The following comments were submitted concerning estimating systems:

Comment: The respondent indicated that it is unreasonable for an acceptable estimating system to include controls for the contractor to compare projected results to actual results and analyze the differences. This is a major change in policy concerning fixed-price contracts and will open the door to wholesale Government access to contractor costs during fixed-price contract performance.

Response: This interim rule sets forth specific criteria for maintaining an acceptable estimating system. It is not 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. Such controls provide a valuable metric for demonstrating the accuracy of estimates produced by the system. Systems that consistently produce accurate estimates with a reasonable degree of confidence can significantly reduce the number of Government resources required to review cost and price proposals.

Accurate estimates also provide substantial advantages to the contractor by allowing a more accurate forecast of the projected rate of return. This existing requirement was relocated from 215.407-5-70 to the clause at 252.215-7002, Cost Estimating System Requirements.

c. Accounting Systems

The following comments were submitted regarding accounting systems:

Comment: The respondent recommended deleting the phrase "or functional specialist" from 242.7502(d)(2)(ii)(C). The respondent recommended that the 45 day period be extended to a 60 day period for a contractor to correct a deficiency or submit a corrective action plan as is currently in the DFARS. The policy at 242.7502(d)(2)(ii)(A) should include a requirement that the contracting officer's notification to the contractor include "sufficient detail to allow the contractor to understand the deficiencies and the potential impact to the Government" as is required in other system deficiency notifications. Finally, the respondent recommended that DCAA focus on the adequacy of a contractor's accounting system rather than the adequacy of the contractor's control environment and overall accounting system controls.

Response: The term functional specialist needs to be retained. When specialized expertise is required, the interim rule requires contracting officers to consult with auditors and other individuals with specialized experience, as necessary, to ensure a full understanding of issues. For example, certain issues relating to forecasted costs may require the expertise of engineers, price analysts, and others, to understand or evaluate the contractor's business system. It is not necessary to extend the 45 day period to 60 days. The contractor will be notified formally of deficiencies at the completion of the audit, and will be allowed 30 days to respond to the contracting officer's initial determination. The contractor will be well aware that a deficiency may need to be corrected and a corrective action plan may be needed well before that 45 day period begins. For clarity, the language pertaining to "sufficient detail" in a contracting officer's notification has been revised to state that a contracting officer's notification will provide "a description of each significant deficiency in sufficient detail to allow the contractor to understand the deficiency." DCAA will be reporting significant deficiencies in accordance with the new business systems rule.

Comment: The rule requires periodic monitoring of the accounting system but does not provide a definition of what the expectation or frequency of the accounting system reviews should be. Furthermore, the rule fails to recognize leading practices implemented in industry through continuous monitoring and exception reporting.

Response: The size and complexity of companies and their processes, operations, and accounting systems capabilities vary. Therefore, it is not feasible to establish specific requirements regarding the extent or frequency of periodic monitoring.

Comment: The respondent expressed concern that immaterial audit issues resulting from CAS 405 noncompliance audit reports will be considered significant, resulting in payment withholding and disputes. The respondent recommended eliminating accounting system criterion number 12 from the rule since remedies already exist through the application of the CAS administration clause as well as the Allowable Cost and Payment clause at FAR 52.216-7.

Response: The rule establishes criteria for an acceptable accounting system to provide reasonable assurance that applicable laws and regulations are complied with, accounting system and cost data are reliable, risk of misallocations and mischarges are minimized, and contract allocations and charges are consistent with billing procedures. An essential characteristic of an adequate accounting system for Government contract costing is the ability of the system to identify and exclude unallowable costs from costs charged to Government contracts. The remedies provided in the CAS administration clause and the Allowable Cost and Payment clause at FAR 52.216-7 do not replace the need for this essential control within a contractor's accounting system.

Comment: Accounting system criterion number 17 introduces the subjective and undefined terms "adequate" and "reliable" with regard to accounting systems providing data to be used to support follow-on acquisitions. It is not appropriate to tie the basis of estimates for proposals to the accounting system. Including this criterion in the accounting system and estimating system criteria is redundant.

Response: The variation and complexity of business systems is such that it is not practical to eliminate subjective terms entirely. While the terms "adequate" and "reliable" imply a degree of subjectivity, they are sufficiently common to enable reasonable parties to agree on the set of

necessary characteristics to meet each threshold given the unique set of circumstances. It is not inappropriate to draw a connection between the basis of estimates for proposals and the accounting system. Achieving consistent and accurate estimates is dependent on obtaining accurate and reliable information, which often includes reported information about past results produced by the accounting system. The weight assigned to past results in developing estimates will vary depending on a variety of factors, including the similarity of past circumstances and the anticipated circumstances for which the estimate is being developed. In the case of a follow-on acquisition, as noted by the respondent, the circumstances are often similar, and thus actual results produced by the accounting system are likely to play a prominent role in developing the estimate. Estimators will likely improve accuracy when they consider the accounting system results during the development of their bases of estimates whether or not the acquisition is a follow-on acquisition.

Comment: Referencing 242.7502(g)(2)(v), which identifies reducing the negotiation objective for profit or fee as a means to mitigate risk of accounting system deficiencies, the respondent expressed concern that such reductions would be punitive to contractors beyond other measures in the rule. The respondent recommended removal of this paragraph.

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

d. Purchasing Systems

The following comments were submitted regarding purchasing systems:

Comment: DFARS 252.244–7001 requires purchasing policies that “comply with the Federal Acquisition Regulation (FAR) and the Defense FAR Supplement (DFARS).” The respondent requested that the rule clarify that requirements being imposed on contractors are done via contract clauses.

Response: All contractual requirements are identified and accomplished through contract clauses. There is no need to issue such a clarifying statement in this rule.

Comment: The definitions of subcontracts and purchase orders should be revised to exclude agreements

with vendors that would normally be applied to a contractor's G&A expenses or indirect costs.

Response: Because the Government reimburses contractors for its applicable share of indirect expenses, it would be inappropriate to revise the definitions of subcontracts and purchase orders to exclude agreements with vendors that would normally be applied to a contractor's G&A expenses or indirect costs.

Comment: Purchasing system criteria under items 252.244–7001(c)(2) and (c)(19) in the purchasing system clause appear to be redundant.

Response: Purchasing system criteria under 252.244–7001(c)(2) and (c)(19) are not redundant. The criterion under (c)(2) requires the contractor to include all flowdown clauses, including terms and conditions and any other clauses needed to carry out the requirements of the prime contract, in all applicable purchase orders and subcontracts, while the criterion under (c)(19) requires the contractor to establish and maintain policies and procedures to ensure the requirements of (c)(2) are accomplished.

Comment: The rule should establish a threshold under purchasing system criterion (c)(4) for the documentation of purchase orders (e.g., \$3,000).

Response: Since certain requirements should apply to all purchases, no threshold has been added in (c)(4).

Comment: The purchasing system criterion under item (c)(8) should be revised to be consistent with FAR part 15.

Response: This rule does not conflict with the extensive language under FAR part 15. The wording in (c)(8) and FAR part 15 is not inconsistent.

Comment: Purchasing system criteria under items (c)(10) and (c)(22) appear to be redundant.

Response: Purchasing system criteria under 252.244–7001(c)(10) and (c)(22) are not redundant. The criterion under (c)(10) requires the contractor to perform timely and adequate cost or price analysis and technical evaluation for each subcontractor and supplier proposal or quote to ensure fair and reasonable subcontract prices, while the criterion under (c)(22) requires the contractor to establish and maintain procedures to ensure the requirements of (c)(10) are accomplished.

Comment: Notification of subcontract awards that contain FAR and DFARS clauses allowing for Government audits should not be required in the purchasing system criterion under item (c)(16) since these clauses are required flowdowns on all direct-funded subcontracts.

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

Comment: The purchasing system criterion under item (c)(23) should be clarified so that the requirements are applicable to first-tier subcontractors.

Response: The suggested change to (c)(23) would make it inconsistent with the definition in FAR 44.101. Therefore, no change has been made.

e. Property Systems

The following comments were submitted regarding property systems:

Comment: Replace the phrase “previously unapproved” property management systems with the phrase “disapproved” for consistency.

Response: The phrase “previously unapproved property management system” in 245.105(e) has been replaced with the phrase “previously disapproved property management system” for consistency.

Comment: The proposed rule property system terminology is inconsistent with current FAR part 45. The proposed rule provides for “approval/disapproval” of a system while FAR part 45 and FAR clause 52.245–1 use the verbiage “adequate/inadequate.”

Response: The language in DFARS 245 supplements the FAR language, and is consistent with other business system sections as well as with section 893 of the NDA.

Comment: One respondent stated that it is unclear whether the proposed rule uses a two-step process for approval/disapproval of a property system where the Government property administrator initially determines if a deficiency exists that would make the system “inadequate” and then works with the contracting officer to determine if the system is “approved/disapproved” and whether payment withholding is required, or if the Government property administrator is acting as an agent of the cognizant contracting officer using a one-step process. Another respondent suggested that property administrators should have the authority to approve contractor property management systems, and report system deficiencies to the cognizant contracting officer recommending disapproval.

Disapproval authority should reside with the cognizant contracting officer.

Response: DFARS 245.105 is clear that Government property administrators are responsible for providing recommendations and reporting system deficiencies to the cognizant contracting officer, including recommendations regarding contractor property management system approval or disapproval. However, system approval or disapproval authority shall remain with the cognizant contracting officer.

2. Resources and Resolution Timing

Comment: DCMA and DCAA are under-resourced to execute the requirements of the rule. DCAA does not have resources to perform timely follow-up audits/system reviews or coordinate in a timely manner with contracting officers to remove payment withholdings, and contracting officers do not have the training to determine if a deficiency makes a system inadequate. There must be accountability within DCAA to conduct timely follow-up audits. Respondents recommended that contractors should be allowed to request follow-up audits when deficiencies are corrected; it should be mandated that DCAA and DCMA perform follow-up audits within 30 days of contractor notification that a deficiency has been corrected; and that the rule should permit qualified third party auditors to provide various accreditations and audits, as is the case with ISO standards or CMMI approvals.

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 contractor's failure to maintain business systems, as is required by the terms and conditions of their contracts. Contracting personnel will make appropriate determinations in accordance with this rule. DCMA and DCAA have been working closely to align their resources and ensure work is complementary. The increased cooperation and coordination between DCAA and DCMA will enable us to employ audit resources where they are needed. Further, the rule has been revised to require the contracting officer to reduce the payment withholding by at least 50 percent if the contracting officer has not made a determination whether the contractor has corrected all significant deficiencies as directed by the contracting officer's final determination, or has not made a determination whether there is a reasonable expectation that the

corrective actions have been implemented.

3. Contractor Appeals

Comment: DoD needs a contractor appeals process for implementing the payment withholding. The rule should be modified to require discussion with the PEO and/or SAE before any payment withholding action is taken. Due to the vague nature of the system criteria and subjective nature of the audit assessments, it will be difficult for contractors to challenge payment withholding determinations under the Contract Disputes Act.

Response: The final deficiency determination is at the sole discretion of the contracting officer. However, prior to making a final deficiency determination, contractors are afforded an opportunity to respond in writing within 30 days to an initial determination of deficiencies from the contracting officer that identifies significant deficiencies in any of the contractor's business systems. It is not necessary or 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 dispute resolution remain available, and, in fact, are encouraged as alternative methods of resolving disputes.

4. Risk of Harm and Materiality of Deficiencies

Comment: "Risk of harm" must be substantiated and verified. The final rule should define the phrase "potential risk of harm to the Government" which incorporates a nexus between the amount withheld and the specific harm that may accrue to the Government based on the system deficiency, and require that a deficiency be "material" or "significant." It is impossible to determine whether the proposed controls and remedial actions of this rule are reasonable and commensurate with the Government's risks. Payment withholdings are liquidated damages in disguise and, if excessive to the Government's risk, will be viewed as punitive.

Response: The intent of the rule is to authorize payment withholding when the contracting officer finds that there are one or more significant deficiencies due to the contractor's failure to meet one or more of the system criteria. The rule has been revised to consider

significant deficiencies in determining the adequacy of a contractor's business system and potential payment withholding in accordance with section 893 of the FY11 NDAA. 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 payment withholding remedy provides a measure of the overall contract performance of which the Government is deprived during the performance period, and for which the contractor should not receive the full financing payments. DoD is relying on the temporary payment withholding amounts, not as a penalty for a deficiency, but as representing a good-faith estimate sufficient to mitigate the Government's risk where the actual amounts are difficult to estimate or quantify. Deficiencies that do not directly relate to unallowable or unreasonable costs still pose risks to the Government, and may lead to harm that may not be calculated readily when the deficiencies are discovered. In most cases, the financial impact of a system deficiency cannot be quantified because the system produces unreliable information. When the financial impact of a deficiency is quantifiable, DoD expects contracting officers to take appropriate actions to reduce fees, recoup unallowable costs, or take legal action if fraudulent activity is involved.

5. Definition of Deficiency

Comment: The term "deficiency" is not clearly defined. The rule should define the terms "deficiency," "significant deficiency," and "material weakness." One respondent suggested these definitions be set forth in accordance with the definitions utilized by the Public Company Accounting Oversight Board (PCAOB).

Response: The interim rule has been revised to implement payment withholding procedures only for "significant deficiencies," therefore, it is not necessary to define "deficiency".

The rule is has been revised to define “significant deficiency” as a shortcoming in the business system that affects materially the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes, in accordance with section 893 of the NDAA. DoD will use the definition of “significant deficiency” in section 893 over the PCAOB definition. The term “material weakness” is not used in this rule.

6. System Approval Duration and Narrowly Focused Follow-up Audits

Comment: The rule should implement an approval duration for each business system, and require follow-up audits to narrowly focus on previously-identified deficiencies.

Response: While DCAA may perform a narrowly focused follow-up audit, imposing a required business system approval duration and/or specifically limiting the scope of the DCAA follow-up audit in this rule 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 in accordance with the definition of significant deficiency set forth in this rule and generally accepted Government auditing standards.

7. Contracting Officer/ACO References

Comment: The rule should reference “ACO” in lieu of “contracting officer” since ACOs will have the primary responsibility to approve contractor business systems.

Response: The contract administration functions in FAR 42.302 are sometimes performed by procurement contracting offices. Since procurement contracting offices are sometimes responsible for the approval and disapproval of contractor business systems, the term “ACO” has been replaced by “contracting officer” for accuracy.

8. Subjective Assessments and Vague Standards

Comment: The revised proposed rule includes incomplete and ambiguous definitions of acceptable business systems, and fails to address the concern with subjective assessments and vague standards, which will lead to inconsistent treatment within DCAA and DCMA.

Response: The rule incorporates criteria that are already used by the Government under existing authority to evaluate the adequacy of contractor

business systems. For example, the criteria for estimating systems are currently located in the DFARS at 215.407–5–70(d)(2). Given that these system criteria have been used for many years to assess contractor business systems, a reasonable person should be able to easily interpret and understand what is required to maintain an acceptable system. Each significant deficiency must be determined on its own set of facts and ultimately decided by the contracting officer. Inconsistent treatment of deficiencies is speculative.

9. Approval To Withhold Payments

Comment: The authority to order a payment withholding should be vested at a higher level than the contracting officer because many contracting officers do not have sufficient training or expertise in the full spectrum of business systems covered by the rule. Furthermore, contracting officers should be allowed to make independent business judgments without fear of DCAA elevating the matter to a formal disputes resolution board, unless the contracting officer has ignored or disregarded DCAA egregiously.

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

10. Other Remedies

Comment: The DCAA audit report should recommend whether a payment withholding is necessary, and if not, what other protections are available. DoD already has numerous other contracting tools available to protect itself from any actual loss associated with business system deficiencies. The proposed clause should state that a payment withholding under the clause is in lieu of, and not in addition to, other sanctions and remedies.

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 interim 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 want 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 payment withholding 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.

11. “Inadequate in Part”

Comment: The final rule should provide for “inadequate in part” determinations when minor system deficiencies will not affect the entire business system.

Response: “Inadequate in part” determinations when minor system deficiencies are found are not necessary. Contractor business systems will only be disapproved when the contracting officer determines that one or more significant deficiencies materially affect the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes.

12. Payment Withholdings Applied Per System or Per Deficiency

Comment: The rule is unclear whether a 5% payment withholding is applied against a single deficient business system or can be applied for each deficiency within a single system.

Response: Payment withholding procedures will be implemented on the basis of contractor business systems. While multiple payment withholdings may be implemented due to significant deficiencies in multiple contractor business systems, for clarity, the interim rule sets forth that the total percentage of payments withheld on amounts due under each progress payment, performance-based payment, or interim cost voucher, shall not exceed five percent for one or more significant deficiencies in any single contractor business system, and 10 percent for significant deficiencies in multiple contractor business systems.

13. DCAA/Functional Specialist Consultation

Comment: It is unclear what is meant by “consultation with the auditor or functional specialist” in terms of a

contracting officer's determination to discontinue withholding payments prior to audit verification. The language in DFARS 242.70X1 and 252.242-7XXX should explicitly state that the contracting officer may discontinue withholding payments without the need to wait for a final audit report from DCAA.

Response: The contracting officer is the only person with the authority to enter into, administer, and/or terminate contracts and make related determinations and findings. However, when specialized expertise is required, the interim rule requires contracting officers to consult with auditors and other individuals with specialized experience, as necessary, to ensure a full understanding of issues. The interim rule explicitly states that 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 and that the deficiencies no longer affect materially the ability of the Government to rely upon information produced by the system.

14. Risk Management vs. Risk Avoidance

Comment: The proposed rule's focus on risk avoidance rather than risk management has the potential of significantly increasing the cost of business systems without corresponding benefits. To make systems deficiency-proof in order to avoid significant payment withholdings, contractors may be forced to incur unnecessary costs that would be disproportionate to the incremental benefits of having near perfect systems. DoD has failed to consider the concept of causal or beneficial relationships between the costs to bring business systems into compliance with the rule, and the benefits of protecting the Government from perceived risk.

Response: DoD will only withhold payments in cases where there are significant deficiencies in the contractor's business systems. In such cases, the ability of the contractor to manage risk is questionable and the potential risk of harm to the Government is increased. Under the rule, a contractor business system may contain deficiencies that do not affect materially the ability of DoD officials to rely on information produced by the

system. Accordingly, the standard for withholding payments is commensurate with the risk of harm to the Government. In the long run, both the contractor's and Government's administrative costs should be reduced with the reliance on efficient contractor business systems.

15. Large Businesses

Comment: The revised rule improperly targets large businesses due to the \$50M dollar contract threshold.

Response: The \$50 million contract threshold has been removed from the interim rule. The threshold for application of the contractor business systems clause is set forth in section 893 of the NDAA, which defines a covered contractor as one that is subject to the Cost Accounting Standards under 41 U.S.C. chapter 15, as implemented in regulations found at 48 CFR 9903.201-1 (see the FAR Appendix).

16. DCAA Audit Standards

Comment: DCAA auditors apply a higher standard for identifying a deficiency in an accounting system ("less than a remote possibility that potential unallowable costs would be immaterial") than set forth in the rule. DCAA is not able to distinguish systemic errors or significant deficiencies from normal human errors or minor deficiencies. The rule may state that it is DCAA policy to report only deficiencies determined to be significant deficiencies or material weaknesses, however the DCAA December 19, 2008 MRD (titled Audit Guidance on Significant Deficiencies/ Material Weaknesses and Audit Opinions on Internal Control Systems) instructs auditors that anything which is subject to DCAA review should be considered significant.

Response: DCAA will report significant deficiencies in accordance with the definition of significant deficiency in this rule, as set forth in section 893 of the NDAA and the Generally Accepted Government Auditing Standards (GAGAS). Based on the definition in GAGAS, a significant deficiency is a deficiency, or combination of deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report data reliably. The GAGAS definition is consistent with the definition of significant deficiency in the contractor business systems clause. Additionally, contracting officers will administer this rule according to the requirements in section 893 of the NDAA.

17. Arbitrary and Punitive Payment Withholdings

Comment: The payment withholding percentages are punitive in nature and represent an arbitrary estimate based on pressure to incorporate business systems payment withholdings into the DFARS. The amount of the payment withholding should be commensurate with the level of risk to the Government and not set at arbitrary and punitive levels.

Response: When contractors fail to maintain business systems, as is required by the terms and conditions of their contracts, the payment withholding provisions help to protect the Government from the risks of overpayment, increased property losses, or nonconforming goods, among others, against which contractor business systems are designed to ensure. The interim 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 payment withholding amounts, 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. The percentage of progress payments, performance-based payments, and interim payments set forth in this rule is in accordance with section 893 of the NDAA.

18. Release of Payment Withholdings

Comment: DCAA does not issue audits addressing "reasonable expectation that the corrective actions have been implemented." The only existing audit solution is to complete the entire follow-up audit, which will not be performed in a timely manner due to DCAA's backlog. Furthermore, the rule should provide guidance to avoid perpetual payment withholdings when deficiencies in multiple business systems overlap and the timing of corrective action plans differ.

Response: There is no requirement that DCAA issue audits addressing "reasonable expectation that the corrective actions have been implemented." The interim rule explicitly states that 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 significant 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. Since payment withholding procedures will be implemented on the basis of contractor business systems, if prior to the correction of one or more significant deficiencies, other significant deficiencies are identified in another business system, the contracting officer may revise the original final determination or issue a subsequent determination to disapprove the latter business system and implement additional payment withholdings. Contracting officers will provide direction in their determination(s), identify the significant deficiencies that need to be corrected in order to approve each disapproved business system, and discontinue the withholding of payments and release any payments previously withheld. If one previously disapproved contractor business system is approved, but significant deficiencies remain in another system, the contracting officer will continue to withhold payments relating to the remaining disapproved business system until the significant deficiencies relating to that business system have been determined to have been corrected.

19. Multiple Compliance Regimes

Comment: The rule provides a different set of contractor business systems requirements for DoD and NASA contractors than are required for civilian contractors.

Response: The business systems criteria contained in the business systems clauses have been used in practice for several decades by Government personnel to assess the reliability and accuracy of management information produced by the applicable system. Because they are designed to be consistent with GAGAS, which are based on standards developed by the American Institute of Certified Public Accountants (AICPA), the system criteria are applicable equally to DoD, NASA, and civilian contractors.

20. NDAA Compliance

A number of respondents, citing section 893 of the NDAA, provided the following recommendations:

Comment: Contractor business system disapproval should be based on "significant deficiencies" as defined in section 893 of the NDAA, and the maximum cap should be reduced to 10 percent in accordance with the NDAA.

Response: The interim rule has been revised to reflect the language in section 893 of the NDAA by incorporating the statutory language regarding "significant deficiencies" and reducing the

cumulative payment withholding percentage from 20 percent to 10 percent.

Comment: The proposed rule mandates payment withholdings on all contracts, including firm-fixed price contract types, while the NDAA language makes payment withholdings discretionary, and permits them to be applied only to CAS-covered contracts and not fixed-price contract types. The rule should be adjusted to exclude those contract types, including firm-fixed-price contracts that have been discretely excluded by the Authorization Act.

Response: Section 893 requires the Secretary of Defense to develop and initiate a program for the improvement of contractor business systems to ensure that such systems provide timely, reliable information for the management of Department of Defense programs. Furthermore, the statute sets forth that an appropriate official of the Department of Defense may withhold up to 10 percent of progress payments, performance-based payments, and interim payments under covered contracts from a covered contractor, as needed, to protect the interests of the Department and ensure compliance, if one or more of the contractor business systems of the contractor has been disapproved. To comply with this requirement, under the mandated DoD program for the improvement of contractor business systems, which includes the implementation of this interim rule, DoD has interpreted the definition of "covered contract" to mean a contract that is subject to the Cost Accounting Standards under 41 U.S.C. chapter 15, as implemented in regulations found at 48 CFR 9903.201-1 (see the FAR Appendix), which includes CAS-covered fixed-price type contracts and performance-based contracts, as well as cost type contracts.

Comment: In accordance with the NDAA, the rule should identify DoD officials who are responsible for the approval or disapproval of contractor business systems. Furthermore, DoD officials must be made available to work with the contractor to develop corrective action plans and schedules for implementation.

Response: The interim rule continues to identify cognizant contracting officers as the DoD officials who are responsible for the approval or disapproval of contractor business systems.

21. Contract Applicability

Comment: A number of respondents questioned the application of this rule against cost type contracts while other respondents questioned the application of this rule against fixed-price contracts.

Additionally, some respondents expressed concern about the application of the rule to commercial contracts and construction contracts. Other respondents suggested that payment withholdings should only be applied to contracts which fall under the business system found to be deficient, and only to contracts administered by the contracting officer making the determination decision.

Response: The Government is at risk when a contractor's business systems contain significant deficiencies, regardless of contract type. Accordingly, it is appropriate for the contracting officer 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 may result in application of a payment withholding against all contracts that contain the business systems clause. The rule has been tailored to comply with section 893 of the FY11 NDAA. DoD has interpreted the definition of "covered contract" to include CAS-covered cost type contracts as well as CAS-covered fixed-price type contracts and performance-based contracts since section 893 also allows up to 10 percent of progress payments and performance-based payments to be withheld. The interim rule provides the contracting officer with the sole discretion to withhold payments from one or more contracts containing the clause at 252.242-7005, Contractor Business Systems. To ensure consistency, it is DoD policy that only one contracting officer, normally an ACO, has the responsibility and authority for approval, disapproval, and general oversight of contractor business systems. When the cognizant contracting officer renders a determination to approve or disapprove a system and withhold payments, all contracting officers with contracts affected by the determination are required to abide by the cognizant contracting officer's decision. The rule complies with this long-established practice.

22. DCAA/DCMA Internal Policies

Comment: By allowing DCMA/DCAA to determine the criteria by which contractor business systems will be measured through their internal policies and procedures, it should make those internal policies and procedures subject to the OFPP Act public comment process.

Response: This rule does not contain references to DCAA/DCMA internal policies to determine the criteria by

which contractor business systems will be measured. Rather, as defined in each of the individual business system clauses in the rule, the definition of an acceptable system means a system that complies with the system criteria set forth in each clause, which have been published for public comment.

23. Cumulative Payment Withholdings

Comment: The respondent questioned whether the 20 percent withhold in the proposed rule is in addition to other withholding remedies a contracting officer may assess.

Response: In accordance with section 893 of the NDAA, the cumulative payment withholding percentage set forth under this interim rule is reduced from 20 percent to 10 percent. This interim rule does not limit the contracting officer's discretion to apply any and all regulatory measures, as warranted by the circumstances, including other applicable payment withholdings. 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.

24. CAS

Comment: The respondent expressed concern that there is no adjudication process prior to implementation of payment withholdings for disagreements or disputes regarding interpretation and implementation of CAS. Contractors should not be subject to payment withholdings on matters which await the decision of the judiciary.

Response: The finding of a significant deficiency in a business system results in only a temporary withholding from certain payments to protect the Government from potential harm. This does not constitute a permanent contractual decrement stemming from a CAS noncompliance. A contractor is not precluded from challenging any underlying CAS or other determinations through the contract disputes or other resolution processes. An additional adjudication process is not warranted for this rule. Furthermore, a deficiency that causes a CAS noncompliance may impact other business systems.

25. Dollar Limitations

Comment: The lack of dollar limitations at the contract level will lead to payment withholdings that exceed the amount required to protect the government. The value withheld at the contract level should be limited to \$100,000 (and at subsequent thresholds of \$250,000, \$500,000, and \$1,000,000) until authorization is received from

DCMA headquarters. The approval of payment withholdings above the thresholds should be based on evidence that actual risk or harm in excess of the limit exists.

Response: To ensure sufficient mitigation of the Government's risk, the interim rule provides the contracting officer with the sole discretion to withhold payments from one or more contracts containing the clause at 252.242-7005, Contractor Business Systems. Contracting officers will select one or more contracts from which payments will be withheld. In selecting the contract or contracts from which to withhold payments, the contracting officer shall ensure that the total amount of payment withholding does not exceed 10 percent of the total amount billed.

26. Standard of Risk

Comment: The respondent recommended that any final rule establish a clear, simple, and uniform standard of risk to the Government in the procedures that are applicable across all of the business systems.

Response: The definition of a significant deficiency establishes a uniform standard of risk. A significant deficiency is defined as a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes.

27. Payment Withholding Process

Comment: Respondents suggested that the final rule should require direct communication between the contracting officer, DCAA, and the contractor to allow discussion relating to an identified deficiency before payment is withheld. The proposed clause should provide sufficient time for the contracting officer and contractor to address potential system deficiencies. The respondents recommended that the rule require the contracting officer to work collaboratively with the contractor in determining whether deficiencies exist, whether there is a material risk of harm, and how to resolve the deficiencies without resorting to a payment withholding; and allow the contractor 90 days to address the potential deficiencies and submit a response documenting its position before the contracting officer can issue a final determination and impose a payment withholding. Otherwise, the rule denies a contractor due process by allowing the contracting officer to issue initial determinations prior to receiving all the facts from the contractor.

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

28. Simplify Administrative Burden

Comment: The rule should simplify the administrative burden for the accounting for payment withholdings against numerous invoices.

Response: The interim rule provides the contracting officer with the sole discretion to withhold payments from one or more contracts containing the clause at 252.242-7005, Contractor Business Systems. The administrative burden for the accounting for payment withholdings against numerous invoices is thus simplified by not mandating that payment withholdings be applied against all of a contractor's available contracts.

29. DCAA/DCMA Roles

Comment: One respondent suggested that the wording in 215.407-5-70(c)(3) should be revised to state "the auditor, on behalf of the cognizant contracting officer, conducts estimating system reviews" to establish that the contracting officer is the lead Federal official, not the auditor. Respondents questioned the ability of DCAA and DCMA to resolve audit recommendations, and further questioned the ability of DCAA and DCMA to execute their duties effectively in the absence of a procedure for resolving different judgments regarding a deficiency.

Response: FAR 1.6 sets forth contracting officer authority and responsibilities. The addition of language to DFARS 215.407-5-70 stating that the contracting officer is the lead Federal official is unnecessary. The DoD memorandum dated December 4, 2009, "Resolving Contract Audit Recommendations," clearly defines the roles and responsibilities of DCAA and DCMA and provides procedures for adjudicating differences.

30. Functional Specialist

Comment: Reference to a functional specialist under estimating systems should be deleted.

Response: The contracting officer is the only person with the authority to enter into, administer, and/or terminate contracts and make related determinations and findings. However, when specialized expertise is required, the interim rule requires contracting officers to consult with auditors and other individuals with specialized experience, as necessary, to ensure a full understanding of issues. Certain issues relating to forecasted costs may require the expertise of engineers, price analysts, and others to understand or evaluate the contractor's estimating system.

31. Policies and Procedures

Comment: The proposed rule contains inconsistent, ill-defined system criteria for policies and procedures. The requirement for policies and/or procedures is the same for all business systems and, therefore, the proposed rule should be consistent by using the terms "policies and procedures" in all sections defining system criteria. The proposed rule should be revised to specify that a business system's criteria for policies and procedures should be in writing.

Response: System criteria are consistent with well-established Government practices and procedures for assessing the contractor business systems. For some business systems, the DFARS language supplements established FAR criteria, while other business systems criteria are established or revised by this interim rule. Therefore, it would be inappropriate to attempt to force incorrect terminology into business systems criteria for the sake of consistency. The systems criteria contained in the business systems clauses have been used for many years by Government personnel to assess the reliability and accuracy of management information produced by the applicable system.

32. Impact to Industry

Comment: One respondent commented that the proposed payment withholding regime will threaten the solvency of contractors and preclude many companies from contracting with the Government. The respondent indicated that the payment withholding regime will be particularly harsh on small businesses.

Response: In the long run, both the contractor's and the Government's administrative cost should be reduced

with the reliance on efficient contractor business systems. The rule has been revised to exclude small businesses in accordance with section 893 of the FY2011 NDAA.

33. Effectiveness of This Rule

Comment: The respondent indicated that the proposed payment withholding is not tailored reasonably to address the Department's intended goal of preventing unallowable and unreasonable costs and waste, fraud, and abuse and improving the effectiveness of DCAA and DCMA.

Response: As noted by the respondent, contractor business systems play an important role in preventing waste, fraud, and abuse. Significant systems deficiencies place a substantial resource burden on DCMA and DCAA due to the increased oversight needed to protect the interests of the Government. The rule provides contracting officers with an additional tool to mitigate the Government's risk while contractors correct business systems deficiencies. Reliable contractor business systems employ internal controls to prevent unallowable and unreasonable costs, as well as waste, fraud, and abuse. Additionally, it reduces burden on Government resources, thereby allowing DCMA and DCAA resources to be employed more effectively.

34. Minor Corrections

Comment: For 252.215-7002, the lead-in reference to the prescription should be 215.407-5-70.

Response: Referencing 215.407-5-70 as the prescription for the clause at 252.215-7002 would be incorrect. DFARS 215.408(2) prescribes the use of the clause at 252.215-7002.

Comment: For 252.215-7002(e) and 252.242-7004(e), change from "on any system deficiency" to "of any system deficiency."

Response: Correction has been made in the interim rule.

Comment: The respondent recommended making the phrase "consultation with the auditor or functional specialist" consistent throughout the rule.

Response: Where appropriate, the phrase "consultation with the auditor or functional specialist" has been made consistent throughout the rule.

Comment: The respondent recommended making the phrase "all findings and recommendations" consistent throughout the rule.

Response: Where appropriate, the phrase "all findings and recommendations" has been made consistent throughout the rule.

Comment: The proposed rule intends to add new paragraphs (d) and (e) to revised 242.7203, but the text of the additional paragraphs denominates them at paragraphs (c) and (d).

Response: Correction has been made in the interim rule.

B. Summary of Proposed Rule Changes

As a result of public comments received in response to the revised proposed rule and the requirements set forth under section 893 of the NDAA, the following changes have been made to the interim rule:

1. The term "significant deficiency" is defined, in accordance with section 893, as a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes. The definition of the term "significant deficiency" provides for associated changes to the rule as follows:

(a) The term "significant deficiency" is used in lieu of phrases such as "deficiency that adversely affects the system" and "deficiency that adversely affects the system, leading to a potential risk of harm to the Government" as the basis for business systems disapprovals and payment withholdings.

(b) The phrases "the potential adverse impact to the Government" and "its potential harm to the Government" are no longer required to describe the detail to which significant deficiencies are described by auditors and functional specialists to contracting officers, and by contracting officers to contractors.

2. While the proposed rule allowed for the implementation of payment withholdings with or without disapproval of system deficiencies that adversely affect the contractor's business systems, this interim rule sets forth requirements that a contracting officer's final determination shall include a disapproval of the contractor's business system and the implementation of payment withholdings if a significant deficiency still exists after the contracting officer's evaluation of the contractor's response to the initial significant deficiency determination.

3. Where the proposed rule allowed for system approval after the contracting officer determines that the contractor has substantially corrected the system deficiencies removing the potential risk of harm to the Government, this interim rule requires that there are no remaining significant deficiencies before a system is approved.

4. The contracting officer will be required to reduce a payment

withholding by at least 50 percent if the contracting officer has not made a determination whether the contractor has corrected all significant deficiencies as directed by the contracting officer's final determination, or has not made a determination whether there is a reasonable expectation that the corrective actions have been implemented.

5. The 16-month timeframe for completion of a contractor's initial Earned Value Management System validation has been revised to allow for a timeframe that is approved by the contracting officer to allow for flexibility in the initial validation process.

6. The term "covered contract" has been defined, in accordance with section 893, as a contract that is subject to the Cost Accounting Standards under 41 U.S.C. chapter 15, as implemented in regulations found at 48 CFR 9903.201–1 (see the FAR Appendix). The definition of the term "covered contract" provides for associated changes to the rule as follows:

(a) The clause prescription for the clause at 252.242–7005, Contractor Business Systems, requires that the resulting contract will be a "covered contract," which exempts small business contracts. Consequently, all language pertaining to payment withholdings for small business has been struck from the rule.

(b) While the proposed rule set forth a \$50 million contract threshold for the incorporation of the clause at 252.242–7005, Contractor Business Systems, this interim rule prescribes the incorporation of the clause for covered contracts in accordance with the established definition.

7. The proposed rule applied payment withholdings against all contracts that contained the clause at 252.242–7005, Contractor Business Systems. This interim rule allows the contracting officer the discretion to withhold payments from one or more contracts containing the clause.

8. This rule revises procedures for the implementation of payment withholdings by replacing the requirement for contracting officers to issue unilateral modifications with the requirement to issue written notifications. Therefore, references to unilateral modifications for payment withholding as well as the sample language for the unilateral modifications have been deleted from this rule.

9. The clause prescription at 242.7002 for the clause at 252.242–7005, Contractor Business Systems, is revised to exempt contracts with educational institutions or Federally Funded

Research and Development Centers (FFRDCs) operated by educational institutions.

10. The references to construction contracts that include the clause at FAR 52.232–27, Prompt Payment for Construction Contracts, under 242.7502(a), 242.7503, and 252.242–7005 have been removed as unnecessary.

11. The initial written determination language under 242.7502(d)(2)(ii)(A) has been revised to provide a description of each significant deficiency in sufficient detail to allow the contractor to understand the deficiency.

12. In accordance with section 893, the term "business system" is replaced with the term "contractor business system."

13. In accordance with section 893, the total percentage of payments that may be withheld on a contract shall not exceed 10 percent. Additionally, while multiple payment withholdings may be implemented due to significant deficiencies in multiple contractor business systems, for clarity, the interim rule limits the total percentage of payments withheld to five percent for one or more significant deficiencies in any single contractor business system.

14. The accounting system criteria under 252.242–7006(a)(1) has been revised to delete the unnecessary phrase "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."

15. The purchasing system criteria under paragraph (c) of the clause at 252.244–7001, Contractor Purchasing System Administration, has been revised to add paragraph (24) requiring contractors to establish and maintain procedures to notify the Contracting Officer in writing if—

(a) The Contractor changes the amount of subcontract effort after award such that it exceeds 70 percent of the total cost of work to be performed under the contract, task order, or delivery order. The notification shall identify the revised cost of the subcontract effort and shall include verification that the Contractor will provide added value; or

(b) Any subcontractor changes the amount of lower-tier subcontractor effort after award such that it exceeds 70 percent of the total cost of the work to be performed under its subcontract. The notification shall identify the revised cost of the subcontract effort and shall include verification that the subcontractor will provide added value as related to the work to be performed by the lower-tier subcontractor(s).

III. Executive Order 12866 and Executive Order 13563

Executive Orders 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. This is a "significant regulatory action" and, therefore, was subject to review under section 6(b) of 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 solicitations and contracts that are subject to the Cost Accounting Standards under 41 U.S.C. chapter 15, as implemented in regulations found at 48 CFR 9903.201–1 (see the FAR Appendix), other than in contracts with educational institutions or Federally Funded Research and Development Centers (FFRDCs) operated by educational institutions, and include one or more of the defined contractor business systems.

Since contracts and subcontracts with small businesses are exempt from CAS requirements, DoD estimates that this rule will have no impact on small businesses. However, 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 this

interim rule contains information collection requirements requiring the approval of the Office of Management and Budget. DoD invites comments on the following aspects of the interim rule: (a) Whether the collection of information is necessary for the proper performance of the functions of DoD, including whether the information will have practical utility; (b) the accuracy of the estimate of the burden of the information collection; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of the information collection on respondents, including the use of automated collection techniques or other forms of information technology.

DoD received one comment regarding the information collection estimate that was included with the initial proposed rule published on January 15, 2010, at 75 FR 2457. The respondent asserted that DoD's estimates were substantially understated. However, the supporting data referenced by the respondent exceeded the information collection requirements established under this rule. The hours and costs cited by the respondent with regard to EVMS did not reflect the Paperwork Reduction Act requirements of this rule. DoD received no comments regarding the information collection estimate in response to the second proposed rule published on December 3, 2010 at 75 FR 75550. With no further specific Paperwork Reduction Act comments received, and no further revisions in this interim rule to the information collection requirements, DoD concludes that the estimates published with the proposed rule accurately reflect the contractors' costs to fulfill the information collection requirements of this rule. The following is a summary of the information collection requirements.

The business systems clauses in this interim rule contain requirements for contractors to respond to initial and final determinations of deficiencies. The information contractors will be required to submit to respond to deficiencies in four of the six business systems defined in this rule have been approved by the Office of Management and Budget as follows:

- (1) Accounting Systems—OMB Clearance 9000-0011;
- (2) Estimating Systems—OMB Clearance 0704-0232;
- (3) Material Management and Accounting Systems—OMB Clearance 0704-0250;
- (4) Purchasing Systems—OMB Clearance 0704-0253;

(5) Earned Value Management Systems—OMB Control Number 0704-0479; and

(6) Contractors Property Management System—OMB Control Number 0704-0480.

The information contractors will be required to submit to respond to deficiencies in contractors' EVMS is estimated as follows:

Number of respondents—186.
Responses per respondent—48.
Annual responses—8,928.
Burden per response—40 hours.
Annual burden hours—357,120 hours.

The information contractors will be required to submit to respond to deficiencies in contractors' property management systems is estimated as follows:

Number of respondents: 2,646.
Responses per respondent: 1.
Annual responses: 2,646.
Average burden per response: 1.2 hours.

Annual burden hours: 3,200 hours.
Needs and Uses: DoD needs the information required by the business systems clause in this interim rule to mitigate the risk of unallowable and unreasonable costs on Government contracts when a contractor has one or more deficiencies in a business system.

Affected public: The business systems clause will be used in solicitations and contracts that include any of the following clauses:

- (1) 252.215-7002, Cost Estimating System Requirements;
- (2) 252.234-7002, Earned Value Management System;
- (3) 252.242-7004, Material Management and Accounting System;
- (4) 252.242-7006, Accounting System Administration;
- (5) 252.244-7001, Contractor Purchasing System Administration;
- (6) 252.245-7003, Contractor Property System Administration.

Frequency: On occasion.

VI. Determination To Issue an Interim Rule

A determination has been made under the authority of the Secretary of Defense, that urgent and compelling reasons exist to publish an interim rule prior to affording the public an opportunity to comment. This interim rule implements section 893 of the Ike Skelton National Defense Authorization Act for Fiscal Year 2011. Section 893 requires the improvement of contractor business systems to ensure that such systems provide timely, reliable information for the management of DoD programs. 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.

In implementing section 893, this rule will improve the effectiveness of DoD oversight for contractor business systems. More effective and efficient management of DoD programs is key to achieving greater efficiency and productivity in defense spending. It is essential that DoD immediately commence to require these improvements to contractor business systems, and to undertake the enhanced oversight necessary for expenditures of taxpayer dollars. Comments received in response to this interim rule will be considered in the formation of the final rule.

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, 48 CFR parts 215, 234, 242, 244, 245, and 252 are amended 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. 1303 and 48 CFR chapter 1.

PART 215—CONTRACTING BY NEGOTIATION

■ 2. Amend section 215.407-5-70 by revising paragraphs (a)(4), (c), and (e) through (g) to read as follows:

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

(a) * * *

(4) *Significant deficiency* is defined in the clause at 252.215-7002, Cost Estimating System Requirements.

(c) *Policy*. (1) The contracting officer shall—

(i) Through use of the clause at 252.215-7002, Cost Estimating System Requirements, apply the disclosure, maintenance, and review requirements to large business contractors meeting the criteria in paragraph (b)(2)(i) of this section;

(ii) Consider whether to apply the disclosure, maintenance, and review requirements to large business contractors under paragraph (b)(2)(ii) of this section; and

(iii) Not apply the disclosure, maintenance, and review requirements to other than large business contractors.

(2) The cognizant contracting officer, in consultation with the auditor, for

contractors subject to paragraph (b)(2) of this section, 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 the clause at 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 significant estimating system deficiencies, the report shall describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies.

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

(ii) If the contracting officer finds that there are one or more significant deficiencies (as defined in the clause at 252.215–7002, Cost Estimating System Requirements) due to the contractor's failure to meet one or more of the estimating system criteria in the clause at 252.215–7002, the contracting officer shall—

(A) Promptly make an initial written determination on any significant deficiencies and notify the contractor, in writing, providing a description of each significant deficiency in sufficient detail to allow the contractor to understand the deficiency;

(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, and no significant deficiencies remain, or

(B) Significant deficiencies remain. The notice shall identify any remaining significant deficiencies, and 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 the clause at 252.215–7002, Cost Estimating System Requirements; and

(3) Withhold payments in accordance with the clause at 252.242–7005, Contractor Business Systems, if the clause is included in the contract.

(ii) Follow the procedures relating to monitoring a contractor's corrective action and the correction of significant deficiencies in PGI 215.407–5–70(e).

(f) *System approval.* The contracting officer shall promptly approve a previously disapproved estimating system and notify the contractor when the contracting officer determines that there are no remaining significant deficiencies.

(g) *Contracting officer notifications.* The cognizant contracting officer shall promptly distribute copies of a determination to approve a system, disapprove a system and withhold payments, or approve a previously disapproved system and release withheld payments, 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

■ 3. 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 the clause at 252.234–7002, Earned Value Management System.

Significant deficiency is defined in the clause at 252.234–7002, Earned Value Management System, and is synonymous with *noncompliance*.

■ 4. 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 the clause at 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 significant 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.

(ii) *Initial determination.* (A) The contracting officer shall review all findings and recommendations and, if there are no significant deficiencies, 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 finds that there are one or more significant deficiencies (as defined in the clause at 252.234–7002, Earned Value Management System) due to the contractor's failure to meet one or more of the earned value management system criteria in the clause at 252.234–7002, the contracting officer shall—

(1) Promptly make an initial written determination on any significant deficiencies and notify the contractor, in writing, providing a description of each significant deficiency in sufficient detail to allow the contractor to understand the deficiencies;

(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, and no significant deficiencies remain, or

(2) Significant deficiencies remain. The notice shall identify any remaining significant deficiencies, and 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 the clause at 252.234–7002, Earned Value Management System, when initial validation is not successfully completed within the timeframe approved by the contracting officer, or the contracting officer determines that the existing earned value management system contains one or more significant 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). When the contracting officer determines that the existing earned value management system contains one or more significant deficiencies in one or more of 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 the clause at 252.242–7005, Contractor Business Systems, if the clause is included in the contract.

(B) Follow the procedures relating to monitoring a contractor's corrective action and the correction of significant deficiencies at PGI 234.201(7).

(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 there are no remaining significant deficiencies.

(9) *Contracting officer notifications.* The cognizant contracting officer shall promptly distribute copies of a determination to approve a system, disapprove a system and withhold payments, or approve a previously disapproved system and release withheld payments 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

■ 5. Add subpart 242.70 to read as follows:

SUBPART 242.70—CONTRACTOR BUSINESS SYSTEMS

Sec.

242.7000 Contractor business system deficiencies.

242.7001 Contract clause.

SUBPART 242.70—CONTRACTOR BUSINESS SYSTEMS

242.7000 Contractor business system deficiencies.

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

Acceptable contractor business systems and *contractor business systems* are defined in the clause at 252.242–7005, Contractor Business Systems.

Covered contract means a contract that is subject to the Cost Accounting Standards under 41 U.S.C. chapter 15, as implemented in regulations found at 48 CFR 9903.201–1 (see the FAR Appendix).

Significant deficiency is defined in the clause at 252.242–7005, Contractor Business Systems.

(b) *Determination to withhold payments.* If the contracting officer makes a final determination to disapprove a contractor's business system in accordance with the clause at 252.242–7005, Contractor Business Systems, the contracting officer shall—

(1) In accordance with agency procedures, identify one or more covered contracts containing the clause at 252.242–7005, Contractor Business Systems, from which payments will be withheld. When identifying the covered contracts from which to withhold payments, the contracting officer shall ensure that the total amount of payment withholding under 252.242–7005, does not exceed 10 percent of progress payments, performance-based payments, and interim payments under cost, labor-hour, and time-and-materials contracts billed under each of the identified covered contracts. Similarly, the contracting officer shall ensure that the total amount of payment withholding under the clause at 252.242–7005, Contractor Business Systems, for each business system does not exceed five percent of progress payments, performance-based payments, and interim payments under

cost, labor-hour, and time-and-materials contracts billed under each of the identified covered contracts. The contracting officer has the sole discretion to identify the covered contracts from which to withhold payments.

(2) Promptly notify the contractor, in writing, of the contracting officer's determination to implement payment withholding in accordance with the clause at 252.242–7005, Contractor Business Systems. The notice of payment withholding shall be included in the contracting officer's written final determination for the contractor business system and shall inform the contractor that—

(i) Payments shall be withheld from the contract or contracts identified in the written determination in accordance with the clause at 252.242–7005, Contractor Business Systems, until the contracting officer determines that there are no remaining significant deficiencies; and

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

(3) Provide all contracting officers administering the selected contracts from which payments will be withheld, a copy of the determination. 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.

(c) *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 the clause at 252.242–7005, Contractor Business Systems.

(d) *Correction of significant deficiencies.* (1) If the contractor notifies the contracting officer that the contractor has corrected the significant 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 significant deficiencies as directed by the contracting officer's final determination, the contracting officer shall discontinue the withholding of payments, release any payments previously withheld, and approve the system, unless other significant deficiencies remain.

(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 significant 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.

(3) Within 90 days of receipt of the contractor notification that the contractor has corrected the significant deficiencies, the contracting officer shall—

(i) Make a determination that—

(A) The contractor has corrected all significant deficiencies as directed by the contracting officer's final determination in accordance with paragraph (d)(1) of this section;

(B) There is a reasonable expectation that the corrective actions have been implemented in accordance with paragraph (d)(2) of this section; or

(C) The contractor has not corrected all significant deficiencies as directed by the contracting officer's final determination in accordance with paragraph (d)(1) of this section, or there is not a reasonable expectation that the corrective actions have been implemented in accordance with paragraph (d)(2) of this section; or

(ii) Reduce withholding directly related to the significant deficiencies covered under the corrective action plan by at least 50 percent of the amount being withheld from progress payments and performance-based payments, and direct the contractor, in writing, to reduce the percentage withheld on interim cost vouchers by at least 50 percent, until the contracting officer makes a determination in accordance with paragraph (d)(3)(i) of this section.

(4) If, at any time, the contracting officer determines that the contractor has failed to correct the significant deficiencies identified in the contractor's notification, the contracting officer will continue, reinstate, or increase withholding from progress payments and performance-based payments, and direct the contractor, in writing, to continue, reinstate, or increase the percentage withheld on interim cost vouchers to the percentage initially withheld, until the contracting officer determines that the contractor has corrected all significant deficiencies as directed by the contracting officer's final determination.

(e) For sample formats for written notifications of contracting officer determinations to initiate payment

withholding, reduce payment withholding, and discontinue payment withholding in accordance with the clause at DFARS 252.242-7005, Contractor Business Systems, see PGI 242.7000.

242.7001 Contract clause.

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

(a) The resulting contract will be a covered contract as defined in 242.7000(a); and

(b) The solicitation or contract includes any of the following clauses:

(1) 252.215-7002, Cost Estimating System Requirements.

(2) 252.234-7002, Earned Value Management System.

(3) 252.242-7004, Material Management and Accounting System.

(4) 252.242-7006, Accounting System Administration.

(5) 252.244-7001, Contractor Purchasing System Administration.

(6) 252.245-7003, Contractor Property Management System Administration.

■ 6. Revise sections 242.7201 and 242.7202 to read as follows:

242.7201 Definitions.

Acceptable material management and accounting system, material management and accounting system, and valid time-phased requirements are defined in the clause at 252.242-7004, Material Management and Accounting System.

Significant deficiency is defined in the clause at 252.242.7004, Material Management and Accounting System.

242.7202 Policy.

(a) DoD policy is for its contractors to have an MMAS that conforms to the standards in paragraph (e) of the clause at 252.242-7004, Material Management and Accounting System, so that the system—

(1) Reasonably forecasts material requirements;

(2) Ensures the costs of purchased and fabricated material charged or allocated to a contract are based on valid time-phased requirements; and

(3) Maintains a consistent, equitable, and unbiased logic for costing of material transactions.

(b) The cognizant contracting officer, in consultation with the auditor and functional specialist, if appropriate, 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, if appropriate, shall determine whether the contractor's MMAS complies with the system criteria for an acceptable MMAS as prescribed in the clause at 252.242-7004, Material Management and Accounting System.

■ 7. Amend section 242.7203 by revising paragraphs (c) and (d) and adding paragraph (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 significant MMAS deficiencies, the report shall describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies.

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

(ii) If the contracting officer finds that there are one or more significant deficiencies (as defined in the clause at 252.242-7004, Material Management and Accounting System) due to the contractor's failure to meet one or more of the MMAS system criteria in the clause at 252.242-7004, Material Management and Accounting System, the contracting officer shall—

(A) Promptly make an initial written determination on any significant deficiencies and notify the contractor, in writing, providing a description of each significant deficiency in sufficient detail to allow the contractor to understand the deficiency;

(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 specialist, 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, and no deficiencies remain, or

(B) Significant deficiencies remain. The notice shall identify any remaining significant deficiencies, and 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 the clause at 252.242–7004, Material Management and Accounting System; and

(3) Withhold payments in accordance with the clause at 252.242–7005, Contractor Business Systems, if the clause is included in the contract.

(ii) Follow the procedures relating to monitoring a contractor's corrective action and the correction of significant 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 there are no remaining significant deficiencies.

(e) *Contracting officer notifications.* The cognizant contracting officer shall promptly distribute copies of a determination to approve a system, disapprove a system and withhold payments, or approve a previously disapproved system and release withheld payments 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 and Related Controls

Sec.

242.7501 Definitions.

242.7502 Policy.

242.7503 Contract clause.

Subpart 242.75—Contractor Accounting Systems and Related Controls

242.7501 Definitions.

As used in this subpart—

Acceptable accounting system, and *accounting system* are defined in the clause at 252.242–7006, Accounting System Administration.

Significant deficiency is defined in the clause at 252.242–7006, Accounting System Administration.

242.7502 Policy.

(a) Contractors receiving cost-reimbursement, incentive type, time-and-materials, or labor-hour contracts, or contracts which provide for progress payments based on costs or on a percentage or stage of completion, shall maintain an accounting system.

(b) The cognizant contracting officer, in consultation with the auditor or functional specialist, 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 or functional specialist, shall determine whether the contractor's accounting system complies with the system criteria for an acceptable accounting system as prescribed in the clause at 252.242–7006, 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 significant accounting system deficiencies, the report shall describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies. Follow the procedures at PGI 242.7502 for reporting of deficiencies.

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

(ii) If the contracting officer finds that there are one or more significant deficiencies (as defined in the clause at 252.242–7006, Accounting System Administration) due to the contractor's failure to meet one or more of the accounting system criteria in the clause at 252.242–7006, the contracting officer shall—

(A) Promptly make an initial written determination on any significant deficiencies and notify the contractor, in writing, providing a description of each significant deficiency in sufficient detail to allow the contractor to understand the deficiency;

(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 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, and no significant deficiencies remain, or

(B) Significant deficiencies remain. The notice shall identify any remaining significant deficiencies, and 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 the clause at 252.242–7006, Accounting System Administration; and

(3) Withhold payments in accordance with the clause at 252.242–7005, Contractor Business Systems, if the clause is included in the contract.

(ii) Follow the procedures relating to monitoring a contractor's corrective action and the correction of significant 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 there are no remaining significant deficiencies.

(f) *Contracting officer notifications.* The cognizant contracting officer shall promptly distribute copies of a determination to approve a system, disapprove a system and withhold payments, or approve a previously disapproved system and release withheld payments 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 adjust the contract price unilaterally 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 252.242–7006, 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.

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 the clause at 252.244–7001, Contractor Purchasing System Administration.

Significant deficiency is defined in the clause at 252.244–7001, Contractor Purchasing System Administration.

244.304 [Removed]

■ 10. Remove section 244.304.

■ 11. Revise section 244.305 to read as follows:

244.305 Granting, withholding, or withdrawing approval.

244.305–70 Policy.

Use 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 or auditor, shall determine whether the contractor's purchasing system complies with the system criteria for an acceptable purchasing system as prescribed in the clause at 252.244–7001, 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 auditor or purchasing system analyst identifies any significant purchasing system deficiencies, the report shall describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies.

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

(ii) If the contracting officer finds that there are one or more significant deficiencies (as defined in the clause at 252.244–7001, Contractor Purchasing System Administration) due to the contractor's failure to meet one or more of the purchasing system criteria in the clause at 252.244–7001, the contracting officer shall—

(A) Promptly make an initial written determination on any significant deficiencies and notify the contractor, in writing, providing a description of each significant deficiency in sufficient detail to allow the contractor to understand the deficiency;

(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 purchasing system analyst, 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, and no significant deficiencies remain, or

(B) Significant deficiencies remain. The notice shall identify any remaining significant deficiencies, and 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 the clause at 252.244–7001, Contractor Purchasing System Administration; and

(3) Withhold payments in accordance with the clause at 252.242–7005, Contractor Business Systems, if the clause is included in the contract.

(ii) Follow the procedures relating to monitoring a contractor's corrective action and the correction of significant deficiencies in PGI 244.305–70.

(d) *System approval.* The contracting officer shall promptly approve a previously disapproved purchasing system and notify the contractor when the contracting officer determines that there are no remaining significant deficiencies.

(e) *Contracting officer notifications.* The cognizant contracting officer shall promptly distribute copies of a determination to approve a system, disapprove a system and withhold payments, or approve a previously disapproved system and release withheld payments 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 adjust the contract price unilaterally 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.

244.305–71 Contract clause.

Use the clause at 252.244–7001, 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 Contractors' property management system compliance.

(a) *Definitions*—

(1) *Acceptable property management system* and *property management system* are defined in the clause at 252.245–7003, Contractor Property Management System Administration.

(2) *Significant deficiency* is defined in the clause at 252.245–7003, 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 the clause at 252.245–7003, 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 significant property system deficiencies, the report shall describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies.

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

(ii) If the contracting officer finds that there are one or more significant deficiencies (as defined in the clause at 252.245–7003, Contractor Property Management System Administration) due to the contractor's failure to meet one or more of the property management system criteria in the clause at 252.245–7003, the contracting officer shall—

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

significant deficiency in sufficient detail to allow the contractor to understand the deficiency;

(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, and no significant deficiencies remain, or

(B) Significant deficiencies remain. The notice shall identify any remaining significant deficiencies, and 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 the clause at 252.245–7003, Contractor Property Management System Administration; and

(3) Withhold payments in accordance with the clause at 252.242–7005, Contractor Business Systems, if the clause is included in the contract.

(ii) Follow the procedures relating to monitoring a contractor's corrective action and the correction of significant deficiencies in PGI 245.105.

(e) *System approval*. The contracting officer shall promptly approve a previously disapproved property management system and notify the contractor when the contracting officer determines, in consultation with the property administrator, that there are no remaining significant deficiencies.

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

■ 13. Amend section 245.107 by adding paragraph (d) to read as follows:

245.107 Contract clauses.

* * * * *

(d) Use the clause at 252.245–7003, Contractor Property Management System Administration, in solicitations and contracts containing the clause at FAR 52.245–1, Government Property.

PART 252—SOLICITATION PROVISIONS AND CONTRACT CLAUSES

■ 14. 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 (May 2011)

(a) Definitions.

Acceptable estimating system means an estimating system 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, documented, and timely 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.

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, estimating methods, techniques, accumulation of historical costs, and other analyses used to generate cost estimates.

Significant deficiency means a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes.

(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 requirements.* (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 provided with the prime proposal, when practicable;

(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) *Significant deficiencies.* (1) The Contracting Officer will provide an initial determination to the Contractor, in writing, of any significant deficiencies. The initial determination will describe the deficiency in sufficient detail to allow the Contractor to understand the deficiency.

(2) The Contractor shall respond within 30 days to a written initial determination from the Contracting Officer that identifies significant 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 significant deficiencies;
- (ii) The adequacy of any proposed or completed corrective action; and
- (iii) System disapproval, if the Contracting Officer determines that one or more significant deficiencies remain.

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

(g) *Withholding payments.* If the Contracting Officer makes a final determination to disapprove the Contractor's estimating system, and the contract includes the clause at 252.242–7005, Contractor Business Systems, the Contracting Officer will withhold payments in accordance with that clause.

(End of clause)

■ 16. 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 (MAY 2011)

(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.

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

Significant deficiency means a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes.

(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 (CFA). If, at the time of award, the Contractor's EVMS has not been determined by the CFA 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 CFA 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 CFA. If this contract has a value of \$50 million or more, unless a waiver is granted by the CFA, any EVMS changes proposed by the Contractor require approval of the CFA prior to implementation. The CFA 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 CFA waives the advance approval requirements, the Contractor shall disclose EVMS changes to the CFA 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—

- (1) Contract award;
- (2) The exercise of significant contract options; and
- (3) 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) *Significant deficiencies.* (1) The Contracting Officer will provide an initial determination to the Contractor, in writing, on any significant deficiencies. The initial determination will describe the deficiency in sufficient detail to allow the Contractor to understand the deficiency.

(2) The Contractor shall respond within 30 days to a written initial determination from the Contracting Officer that identifies significant 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 significant deficiencies;
- (ii) The adequacy of any proposed or completed corrective action;
- (iii) System noncompliance, when the Contractor's existing EVMS fails to comply with the earned value management system guidelines in the ANSI/EIA-748; and
- (iv) System disapproval, if initial EVMS validation is not successfully completed within the timeframe approved by the Contracting Officer, or if the Contracting Officer determines that the Contractor's earned value management system contains one or more significant 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). When the Contracting Officer determines that the existing earned value management system contains one or

more significant deficiencies in one or more of 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.

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

(j) *Withholding payments.* If the Contracting Officer makes a final determination to disapprove the Contractor's EVMS, and the contract includes the clause at 252.242-7005, Contractor Business Systems, the Contracting Officer will withhold payments in accordance with that clause.

(k) With the exception of paragraphs (i) and (j) 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)

■ 17. Revise section 252.242-7004 to read as follows:

252.242-7004 Material Management and Accounting System.

As prescribed in 242.7204, use the following clause:

MATERIAL MANAGEMENT AND ACCOUNTING SYSTEM (MAY 2011)

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

(1) *Material management and accounting system (MMAS)* means the Contractor's system or systems for planning, controlling, and accounting for the acquisition, use, issuing, and disposition of material. Material management and accounting systems may be manual or automated. They may be stand-

alone systems or they may be integrated with planning, engineering, estimating, purchasing, inventory, accounting, or other systems.

(2) *Valid time-phased requirements* means material that is—

(i) Needed to fulfill the production plan, including reasonable quantities for scrap, shrinkage, yield, etc.; and

(ii) Charged/billed to contracts or other cost objectives in a manner consistent with the need to fulfill the production plan.

(3) *Contractor* means a business unit as defined in section 31.001 of the Federal Acquisition Regulation (FAR).

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

(5) *Significant deficiency* means a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes.

(b) *General.* The Contractor shall—

(1) Maintain an MMAS that—

(i) Reasonably forecasts material requirements;

(ii) Ensures that costs of purchased and fabricated material charged or allocated to a contract are based on valid time-phased requirements; and

(iii) Maintains a consistent, equitable, and unbiased logic for costing of material transactions; and

(2) Assess its MMAS and take reasonable action to comply with the MMAS standards in paragraph (e) of this clause.

(c) *Disclosure and maintenance requirements.* The Contractor shall—

(1) Have policies, procedures, and operating instructions that adequately describe its MMAS;

(2) Provide to the Administrative Contracting Officer (ACO), upon request, the results of internal reviews that it has conducted to ensure compliance with established MMAS policies, procedures, and operating instructions; and

(3) Disclose significant changes in its MMAS to the ACO at least 30 days prior to implementation.

(d) *System criteria.* The MMAS shall have adequate internal controls to ensure system and data integrity, and shall—

(1) Have an adequate system description including policies, procedures, and operating instructions that comply with the Federal Acquisition Regulation and Defense Federal Acquisition Regulation Supplement;

(2) Ensure that costs of purchased and fabricated material charged or allocated to a contract are based on valid time-phased requirements as impacted by minimum/economic order quantity restrictions.

(i) A 98 percent bill of material accuracy and a 95 percent master production schedule accuracy are desirable as a goal in order to ensure that requirements are both valid and appropriately time-phased.

(ii) If systems have accuracy levels below these, the Contractor shall provide adequate evidence that—

(A) There is no material harm to the Government due to lower accuracy levels; and

(B) The cost to meet the accuracy goals is excessive in relation to the impact on the Government;

(3) Provide a mechanism to identify, report, and resolve system control weaknesses and manual override. Systems should identify operational exceptions, such as excess/residual inventory, as soon as known;

(4) Provide audit trails and maintain records (manual and those in machine-readable form) necessary to evaluate system logic and to verify through transaction testing that the system is operating as desired;

(5) 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. A 95 percent accuracy level is desirable. If systems have an accuracy level below 95 percent, the Contractor shall provide adequate evidence that—

(i) There is no material harm to the Government due to lower accuracy levels; and

(ii) The cost to meet the accuracy goal is excessive in relation to the impact on the Government;

(6) Provide detailed descriptions of circumstances that will result in manual or system generated transfers of parts;

(7) Maintain a consistent, equitable, and unbiased logic for costing of material transactions as follows:

(i) The Contractor shall maintain and disclose written policies describing the transfer methodology and the loan/pay-back technique.

(ii) The costing methodology may be standard or actual cost, or any of the inventory costing methods in 48 CFR 9904.411–50(b). The Contractor shall maintain consistency across all contract and customer types, and from accounting period to accounting period for initial charging and transfer charging.

(iii) The system should transfer parts and associated costs within the same billing period. In the few instances where this may not be appropriate, the Contractor may accomplish the material transaction using a loan/pay-back technique. The “loan/pay-back technique” means that the physical part is moved temporarily from the contract, but the cost of the part remains on the contract. The procedures for the loan/pay-back technique must be approved by the ACO. When the technique is used, the Contractor shall have controls to ensure—

(A) Parts are paid back expeditiously;

(B) Procedures and controls are in place to correct any overbilling that might occur;

(C) Monthly, at a minimum, identification of the borrowing contract and the date the part was borrowed; and

(D) The cost of the replacement part is charged to the borrowing contract;

(8) Where allocations from common inventory accounts are used, have controls (in addition to those in paragraphs (d)(2) and (7) of this clause) to ensure that—

(i) Reallocations and any credit due are processed no less frequently than the routine billing cycle;

(ii) Inventories retained for requirements that are not under contract are not allocated to contracts; and

(iii) Algorithms are maintained based on valid and current data;

(9) Have adequate controls to ensure that physically commingled inventories that may include material for which costs are charged or allocated to fixed-price, cost-reimbursement, and commercial contracts do not compromise requirements of any of the standards in paragraphs (d)(1) through (8) of this clause. Government-furnished material shall not be—

(i) Physically commingled with other material; or

(ii) Used on commercial work; and

(10) Be subjected to periodic internal reviews to ensure compliance with established policies and procedures.

(e) *Significant deficiencies.* (1) The Contracting Officer will provide an initial determination to the Contractor, in writing, of any significant deficiencies. The initial determination will describe the deficiency in sufficient detail to allow the Contractor to understand the deficiency.

(2) The Contractor shall respond within 30 days to a written initial determination from the Contracting Officer that identifies significant 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 significant deficiencies;

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

(iii) System disapproval if the Contracting Officer determines that one or more significant deficiencies remain.

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

(g) *Withholding payments.* If the Contracting Officer makes a final determination to disapprove the Contractor's MMAS, and the contract includes the clause at 252.242–7005, Contractor Business Systems, the Contracting Officer will withhold payments in accordance with that clause.

(End of clause)

■ 18. Add section 252.242–7005 to read as follows

252.242–7005 Contractor Business Systems.

As prescribed in 242.7001, use the following clause:

CONTRACTOR BUSINESS SYSTEMS (MAY 2011)

(a) *Definitions.* As used in this clause—
Acceptable contractor business systems means contractor business systems that

comply with the terms and conditions of the applicable business system clauses listed in the definition of "contractor business systems" in this clause.

Contractor business systems means—

(1) Accounting system, if this contract includes the clause at 252.242–7006, Accounting System Administration;

(2) Earned value management system, if this contract includes the clause at 252.234–7002, Earned Value Management System;

(3) Estimating system, if this contract includes the clause at 252.215–7002, Cost Estimating System Requirements;

(4) Material management and accounting system, if this contract includes the clause at 252.242–7004, Material Management and Accounting System;

(5) Property management system, if this contract includes the clause at 252.245–7003, Contractor Property Management System Administration; and

(6) Purchasing system, if this contract includes the clause at 252.244–7001, Contractor Purchasing System Administration.

Significant deficiency, in the case of a contractor business system, means a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes.

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

(c) *Significant deficiencies*. (1) The Contractor shall respond, in writing, within 30 days to an initial determination that there are one or more significant deficiencies in one or more of the Contractor's business systems.

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

(d) *Withholding payments*. (1) If the Contracting Officer issues the final determination with a notice to withhold payments for significant deficiencies in a contractor business system required under this contract, the Contracting Officer will withhold five percent of amounts due from progress payments and performance-based payments, and direct the Contractor, in writing, to withhold five percent from its billings on interim cost vouchers on cost, labor-hour, and time-and-materials contracts until the Contracting Officer has determined that the Contractor has corrected all significant deficiencies as directed by the contracting officer's final determination. 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, and the Contracting Officer, in consultation with the auditor or functional specialist, determines that the Contractor is effectively implementing such plan, the Contracting Officer will reduce withholding directly related to the significant deficiencies covered under the corrective action plan, to two percent from progress payments and performance-based payments, and direct the Contractor, in writing, to reduce the percentage withheld on interim cost vouchers to two percent until the Contracting Officer determines the Contractor has corrected all significant deficiencies as directed by the Contracting Officer's 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 increase withholding from progress payments and performance-based payments, and direct the Contractor, in writing, to increase the percentage withheld on interim cost vouchers to the percentage initially withheld, until the Contracting Officer determines that the Contractor has corrected all significant deficiencies as directed by the Contracting Officer's final determination.

(3) *Payment withhold percentage limits*.

(i) The total percentage of payments withheld on amounts due under each progress payment, performance-based payment, or interim cost voucher, on this contract shall not exceed—

(A) Five percent for one or more significant deficiencies in any single contractor business system; and

(B) Ten percent for significant deficiencies in multiple contractor business systems.

(ii) If this contract contains pre-existing withholds, and the application of any subsequent payment withholds will cause withholding under this clause to exceed the payment withhold percentage limits in paragraph (d)(3)(i) of this clause, the Contracting Officer will reduce the payment withhold percentage in the final determination to an amount that will not exceed the payment withhold percentage limits.

(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.

(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 will take one of the following actions:

(i) If the Contracting Officer determines that the Contractor has corrected all significant deficiencies as directed by the Contracting Officer's final determination, the Contracting Officer will, as appropriate, discontinue the withholding of progress payments and performance-based payments, and direct the Contractor, in writing, to discontinue the payment withholding from billings on interim cost vouchers under this contract associated with the Contracting Officer's final determination, and authorize the Contractor to bill for any monies previously withheld that are not also being withheld due to other significant deficiencies. Any payment withholding under this contract due to other significant deficiencies, will remain in effect until the Contracting Officer determines that those significant deficiencies are corrected.

(ii) If the Contracting Officer determines that the Contractor still has significant 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.

(iii) If, within 90 days of receipt of the Contractor notification that the Contractor has corrected the significant deficiencies, the Contracting Officer has not made a determination whether the Contractor has corrected all significant deficiencies as directed by the Contracting Officer's final determination, or has not made a determination whether there is a reasonable expectation that the corrective actions have been implemented, the Contracting Officer will reduce withholding directly related to the significant deficiencies covered under the corrective action plan by at least 50 percent of the amount being withheld from progress payments and performance-based payments, and direct the Contractor, in writing, to reduce the percentage withheld on interim cost vouchers by at least 50 percent, until the Contracting Officer makes a determination whether the Contractor has corrected all significant deficiencies as directed by the Contracting Officer's final determination, or has made a determination whether there is a reasonable expectation that the corrective actions have been implemented.

(iv) At any time after the Contracting Officer reduces or discontinues the withholding of progress payments and performance-based payments, or directs the Contractor to reduce or discontinue the payment withholding from billings on

interim cost vouchers under this contract, if the Contracting Officer determines that the Contractor has failed to correct the significant deficiencies identified in the Contractor's notification, the Contracting Officer will reinstate or increase withholding from progress payments and performance-based payments, and direct the Contractor, in writing, to reinstate or increase the percentage withheld on interim cost vouchers to the percentage initially withheld, until the Contracting Officer determines that the Contractor has corrected all significant deficiencies as directed by the Contracting Officer's final determination.

(End of clause)

■ 19. Add section 252.242–7006 to read as follows:

252.242–7006 Accounting System Administration.

As prescribed in 242.7503, use the following clause:

ACCOUNTING SYSTEM ADMINISTRATION (MAY 2011)

(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) *Significant deficiency* means a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes.

(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 the clause at 252.242–7005, Contractor 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, accounting framework, and organizational structure;

(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 of funds (FAR 52.232–22), 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) *Significant deficiencies.* (1) The Contracting Officer will provide an initial determination to the Contractor, in writing, on any significant deficiencies. The initial determination will describe the deficiency in sufficient detail to allow the Contractor to understand the deficiency.

(2) The Contractor shall respond within 30 days to a written initial determination from the Contracting Officer that identifies significant 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 significant deficiencies;

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

(iii) System disapproval, if the Contracting Officer determines that one or more significant deficiencies remain.

(e) If the Contractor receives the Contracting Officer's final determination of

significant deficiencies, the Contractor shall, within 45 days of receipt of the final determination, either correct the significant deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the significant deficiencies.

(f) *Withholding payments.* If the Contracting Officer makes a final determination to disapprove the Contractor's accounting system, and the contract includes the clause at 252.242–7005, Contractor Business Systems, the Contracting Officer will withhold payments in accordance with that clause.

(End of clause)

■ 20. Add section 252.244–7001 to read as follows:

252.244–7001 Contractor Purchasing System Administration.

As prescribed in 244.305–71, insert the following clause:

CONTRACTOR PURCHASING SYSTEM ADMINISTRATION (MAY 2011)

(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.

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, placing and administering of orders, and expediting delivery of materials.

Significant deficiency means a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes.

(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 Federal Acquisition Regulation Supplement (DFARS);

(2) Ensure that all applicable purchase orders and subcontracts contain all flowdown 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 timely and 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 flowdown 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 flowdown 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) Establish and maintain procedures to ensure performance of adequate price or cost analysis on purchasing actions;

(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; and

(24) Establish and maintain procedures to timely notify the Contracting Officer, in writing, if—

(i) The Contractor changes the amount of subcontract effort after award such that it exceeds 70 percent of the total cost of the work to be performed under the contract, task order, or delivery order. The notification shall identify the revised cost of the subcontract effort and shall include verification that the Contractor will provide added value; or

(ii) Any subcontractor changes the amount of lower-tier subcontractor effort after award such that it exceeds 70 percent of the total cost of the work to be performed under its subcontract. The notification shall identify the revised cost of the subcontract effort and shall include verification that the subcontractor will provide added value as related to the work to be performed by the lower-tier subcontractor(s).

(d) *Significant deficiencies.* (1) The Contracting Officer will provide notification of initial determination to the Contractor, in writing, of any significant deficiencies. The initial determination will describe the deficiency in sufficient detail to allow the Contractor to understand the deficiency.

(2) The Contractor shall respond within 30 days to a written initial determination from the Contracting Officer that identifies significant 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 significant deficiencies;

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

(iii) System disapproval, if the Contracting Officer determines that one or more significant deficiencies remain.

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

(f) *Withholding payments.* If the Contracting Officer makes a final determination to disapprove the Contractor's purchasing system, and the contract includes the clause at 252.242-7005, Contractor Business Systems, the Contracting Officer will withhold payments in accordance with that clause.

(End of clause)

■ 21. Add section 252.245-7003 to read as follows:

252.245-7003 Contractor Property Management System Administration.

As prescribed in 245.107, insert the following clause:

CONTRACTOR PROPERTY MANAGEMENT SYSTEM ADMINISTRATION (MAY 2011)

(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.

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

Significant deficiency means a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes.

(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) *Significant deficiencies.* (1) The Contracting Officer will provide an initial determination to the Contractor, in writing, of any significant deficiencies. The initial determination will describe the deficiency in sufficient detail to allow the Contractor to understand the deficiency.

(2) The Contractor shall respond within 30 days to a written initial determination from the Contracting Officer that identifies significant 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 significant deficiencies;

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

(iii) System disapproval, if the Contracting Officer determines that one or more significant deficiencies remain.

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

(f) *Withholding payments.* If the Contracting Officer makes a final determination to disapprove the Contractor's property management system, leading to a potential risk of harm to the Government, and the contract includes the clause at 252.242-7005, Contractor Business Systems,

the Contracting Officer will withhold
payments in accordance with that clause.

(End of clause)

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