

# Final Rule on Contractor Business Systems Issued

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February 24, 2012

On Friday, February 24, 2012, the Department of Defense (DoD) issued a rule, adopting as final (77 Fed. Reg. 11,355), its May 18, 2011 interim rule defining contractor business systems and authorizing contracting officers (COs) to withhold a percentage of payments, under certain conditions, when a contractor's business system contains a "significant deficiency." (See our previous alert discussing the interim rule). Effective immediately, the final rule responds to and implements several changes based on comments DoD received in response to the interim rule.

Among other changes, the final rule:

- Revises Defense Federal Acquisition Regulation Supplement (DFARS) 242.7502(g)(2)(ii) and (iv) to remove specific examples of alternatives that COs should consider to mitigate the risk of accounting systems deficiencies on proposals where the deficiency impacts negotiations, "so COs do not misinterpret these as being appropriate for mitigating all accounting system deficiencies."
- Amends the business systems clause at DFARS 252.242-7005 to clarify that the clause applies only to contracts that are subject to Cost Accounting Standards (CAS), since the CO is not likely to know when drafting the solicitation if the contract will be subject to CAS. Thus, the clause will be self-deleting if CAS does not apply.
- Amends the business systems clause at DFARS 252.242-7005 to clarify that if, based on the evidence submitted by the contractor, the CO determines that there is a reasonable expectation that the contractor's corrective actions have been

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implemented and are expected to correct the significant deficiencies, the CO will discontinue withholding payments and release any payments previously withheld.

- Amends the business systems clause to require the CO to reduce any withholding by at least 50% if, within 90 days of notification by the contractor that it has corrected the significant deficiencies, the CO has not made the required determination regarding the corrective action.
- Adds University Associated Research Centers to the list of entities to which the business systems rule at DFARS 252.242-7005 does not apply.
- Relocates the criteria for maintaining an acceptable estimating system from DFARS 215.407-5-70(d) to DFARS 252.215-7002.
- Deletes DFARS 242.302(a)(4) and adds an additional contract administration function to approve or disapprove contractor business systems to DFARS 242.202(a)(S-74).

In response to various criticisms levied against the definition of "significant deficiency" and the process by which the CO is to determine if a "significant deficiency" exists, DoD declined to make any changes based on its view that the rule incorporates specific criteria for each business system that defines the aspects of the system that "materially affect the ability of DoD to rely on information produced." Therefore, significant deficiencies will be based on the contractor's failure to comply with those criteria, which "must be determined on its own set of facts and ultimately decided by the contracting officer."

The final rule confirmed that the revisions to the DFARS set forth in the business systems rule do not apply to existing contracts that do not include the business systems clause unless the contractor and the Government agree to bilaterally modify the contract.