With investigations and harsher consequences on the rise, strong compliance processes addressing the complexities of the Service Contract Act are a must.

PIT

By Aaron RADDOCK
and Albert P. CORVIGNO

AVOIDING the COMPLIANCE FALLS of the SERVICE CONTRACT ACT

The McNamara-O'Hara Service Contract Act of 1965 (SCA) applies to contracts over $2,500 entered into with the United States or the District of Columbia for the purpose of furnishing services (e.g., security, janitorial, or cafeteria services) through the use of service employees. The definition of a "service employee" includes any employee engaged in performing services on a covered contract other than a bona fide executive, administrative, or professional employee.[1] The main tenet of the SCA requires contractors and subcontractors to pay their service employees no less than the minimum monetary wages and fringe benefits found prevailing in a particular locality in accordance with the applicable wage determination or collective bargaining agreement.

While fairly simple on its face, many service contractors do not fully appreciate the inherent complexities of complying with the SCA. With many nuances and unanswered questions, the SCA is actually one of the more onerous rules to comply with, especially when considering the relative brevity of the underlying statute.

A BRIEF HISTORY

The SCA became effective in 1966, and was later amended in 1972 and again in 1976 before leaving us, by and large, with the legislative framework and implementing regulation we have today. The intention of the act was to remove wages as a bidding factor in the competition of federal service contracts (something that it has basically accomplished) and to provide labor protection to service employees akin to that of the Walsh-Healey Public Contracts Act (PCA) and the Davis Bacon Act (DBA) for manufacturing and construction workers, respectively.

The SCA aimed to solve the human dilemma caused by new contractors underbidding an incumbent contractor and then paying the incumbent's employees a lower wage to perform the work, wreaking havoc on towns dependent on the particular contract as a major source of income. And this matter of protection persists on the government's agenda today, as evidenced by the "Non-displacement of Qualified Workers" rule; one of the few changes made since 1976. This rule became effective January 18, 2013, via Executive Order 13495.[2] The new rule seeks to provide service workers with further protection by requiring prime contractors and subcontractors to offer incumbent service employees a right of first refusal to employment on follow-on services contracts.

CURRENT ENFORCEMENT ENVIRONMENT

In addition to the new rule this past January, there have also been fairly recent changes in the degree of oversight. The Department of Labor (DOL) has increased its number of audits and investigators. Following American Recovery and Reinvestment Act

funding, DOL added roughly 180 full-time investigators. Many of these investigators are relatively new, yet operational in the field. Investigators have always audited complaints, but are now initiating self-audits as well. The audits are going deeper to include the full scope of the contract (e.g., SCA and DBA violations) and subcontractors as well. In the last fiscal year, DOL performed over 850 investigations (of which over 630 resulted in violations), collected almost $45 million in SCA back pay from contractors, and issued 19 debarments.[3]

THE CONSEQUENCES—A HARSH REALITY

Coupled with increased audit scrutiny are severe consequences of noncompliance. In addition to paying an employee everything that is owed to him or her, other penalties for noncompliance may include:

- Withholding payments on active federal contracts,
- Contract termination (and subsequent payment for any government repro-curement costs),
- Personal liability for corporate officials,
- Debarment from all government contracts for a three-year period, and
- False Claims Act liability.

What's more, contractors may also face penalties due to overtime violations under the Contract Work Hours and Safety Standards Act (CWHSSA). Like the SCA, the CWHSSA and several other statutes are also enforced by the Wage and Hour Division within DOL.

The penalties employed for violations are at the sole discretion of DOL, not the contracting officer or contracting agency administering the service contract. Additionally, penalties have been harsher as of late. Investigators are less likely to negotiate a settlement than several years ago, and are issuing violations and debarments at a significantly higher rate.

THE PITFALLS OF SCA COMPLIANCE

To avoid these penalties, it is imperative to have robust compliance processes to handle SCA requirements. However, before a company can avoid or manage risks, it must identify them. Many contractors are unable to recognize key risks because they do not have personnel with strong knowledge of the SCA and the many challenges that can arise. To help, the following are some of the more common pitfalls we have seen when advising contractors on remediating DOL findings, calculating back pay, and/or implementing compliance controls.

Pitfall #1—Not Properly Determining SCA Applicability

The seemingly simple question of whether the SCA applies tends to challenge even the savviest of contractors. To find the answer, start with the following:

- Does the contract exceed the $2,500 threshold?
- Is the principal purpose of the contract to furnish services?
- Does the contract contain the SCA clause (*Federal Acquisition Regulation* (*FAR*) 52.222-41) and one or more incorporated wage determinations?

Answering the first two questions appears straightforward, though certain types of services are exempt.[4] However, under indefinite delivery/indefinite quantity or task order contracts, you must aggregate any purchase orders from the same customer in a given year for purposes of determining whether the threshold is met.[5] As a result, where the guaranteed minimum contract value is less than $2,500, SCA applicability may be unknown for a period of time.

The last question, regarding the inclusion of the SCA clause and one or more wage determinations, is where things can really start to get dicey. It is not uncommon for an awarded contract to contain FAR 52.222-41, but no incorporated wage determination. Without a wage determination, there is little to comply with except to pay the minimum wage in accordance with the Fair Labor Standards Act. In the case of a subcontract, many times the prime contractor has flowed down a set of standard terms and conditions without regard for the clauses applicable to each individual agreement. However, if the contract is for services generally covered by the SCA and no wage determination has been incorporated, then it is best to contact the contracting officer/prime contractor in writing to request a wage determination via contract modification. Failure to make this effort to comply can be viewed unfavorably by DOL and will not prevent DOL from requiring retroactive SCA payments in the event a wage determination should have been incorporated.

On the other hand, you may encounter a situation where the SCA clause is not found in the contract, but it should be. The ability to recognize these situations underscores the necessity of having knowledgeable employees trained on the SCA because the Christian Doctrine may apply. The Christian Doctrine, derived from the 1963 case *G.L. Christian & Association v. United States*, holds that mandatory government contract clauses, if excluded from the contract (either by omission or as a result of negotiation), are actually still a part of the contract. If you believe the SCA clause has been omitted in error, it is best to start a dialogue with the contracting officer.

Sometimes contracting officers are hesitant to adjust contracts to include or exclude the SCA clause or wage determination, even when it is the right thing to do. To prepare for this, it is important to document all communication with the contracting officer to demonstrate a good-faith effort to comply if and when DOL becomes involved. Some contracting officers may not be particularly knowledgeable on the SCA and may be uncomfortable making contract changes as a result. Contractors looking for an alternative solution can turn to DOL or the Department of Defense labor advisor, as may be applicable.

Pitfall #2—Failing to Recognize Other Applicable Labor Laws

SCA compliance may not be the extent of your compliance obligations with respect

to related labor laws. As discussed, the SCA was designed to fill the gap left unaddressed by the PCA and the DBA. Because SCA coverage does not supersede or supplant the PCA or DBA, these labor laws may also apply to certain labor activities in an SCA-covered contract.

The DBA covers "any contract of the United States or District of Columbia for construction, alteration, and/or repair, including painting and decorating of public buildings or public works" exceeding $2,000.[6] The PCA covers any contract "for the manufacture or furnishing of materials, supplies, articles, and equipment in any amount exceeding $10,000."[7]

The SCA does not apply to contracts principally for construction subject to the DBA; however, if a service contract contains a substantial and segregable[8] element of construction work, that component of the contract will likely require compliance with the DBA and not the SCA. An example might include a Department of Defense base maintenance and operations contract where the principal purpose of the contract is support services (e.g., janitorial services, snow removal, etc.), but where painting and building repair also comprise a portion of the contract scope and, thus, are covered by the DBA. *Defense FAR Supplement* 222.402-70 provides a helpful illustration of substantial and segregable work.

Similarly, contracts may arise that include both SCA and PCA compliance obligations. Again, these are contracts that are principally for services, but also contain a significant manufacturing or supply requirement.[9] These multifaceted contracts can create additional compliance burdens and it is important to have clarity on the regulations that apply. If it is ever unclear, communicate with the contracting officer or DOL.

Pitfall #3—Obtaining the Wrong Wage Determination

Where the SCA applies, the wage determination establishes the contractor's compliance criteria. Wage determinations are generally created for specific localities, but may instead pertain to a specific industry or even a specific contract. Regardless, the only wage determination to follow is the one incorporated into the contract by the contracting officer. Some contractors may wrongly believe that they are responsible for selecting the wage determination to comply with from those posted on **WDOL.gov**. However, DOL also publishes this disclaimer on its website when selecting a wage determination: "CAUTION: Users should note that the only wage determinations applicable to a particular solicitation or contract are those that have been incorporated by the contracting officer in that contract action."

Contractors, trying to do the right thing, will often pull a wage determination off the DOL website and comply with it. This may happen as a result of the inclusion of the SCA clause but omission of a wage determination, a published wage determination revision that has not yet been incorporated into the contract, or because the contract is similar to another contract that contains SCA requirements. Unfortunately, by complying with a wage determination that is not a formal part of the contract, contractors may be hurting themselves. The ability to recover increased costs stemming from a newly incorporated wage determination or wage determination revision only applies where the wages and benefits paid on the date of incorporation are less than those stipulated in the new wage determination. In other words, a contractor that previously raised wages to satisfy a wage determination they obtained from other sources loses the opportunity to recover that cost increase. If the contractor has already increased wage and/or benefit payments at the time the contracting officer incorporates the wage determination, no wage or benefit adjustment is necessary and, thus, no contract price change is permitted.

Pitfall #4—Not Understanding Who is Covered by the SCA

The SCA does not distinguish between independent contractors or full-time, part-time, or temporary employees; all service employees are covered by the act. Often, companies incorrectly assume that part-time and temporary employees and independent contractors are either exempt or someone else's responsibility, when, in actuality, SCA compliance is the responsibility of the prime contractor.

Additionally, in evaluating an employee's SCA coverage, the respective job description is the primary determining factor. To apply the exemption for bona fide executive, administrative, or professional employees, the employee/independent contractor must pass the "duties test" and also the "salary level and basis tests"[10] (referring to the mode and amount of payment). For example, an employee who receives a high level of pay but also meets the description of a "service employee" is still covered under the act.

Prime contractors are also responsible for the compliance of covered subcontractors, and need to take steps to monitor subcontractor compliance. While the SCA clause contains a mandatory flowdown requirement, simply flowing the clause down to subcontractors does not absolve the prime contractor's SCA responsibilities to the federal government. In addition to a contractual obligation to comply, prime contractors should consider compliance mechanisms such as audit rights, certifications, and appropriate indemnifications in each of their subcontract agreements.

Pitfall #5—Mapping Employees to the Incorrect SCA Labor Category Classification

In addition to employee coverage, it is equally important to determine the proper labor category classification as the associated wage requirements vary. Again, this critical task seems easy, but in practice is quite challenging.

DOL maintains a "Directory of Occupations" to provide guidance on the functions and tasks associated with each job description. Contractors must determine the functions and tasks each employee will perform under the contract's statement of work to map the individual to an appropriate labor category consistent with the Directory of Occupations. For those companies using internal labor descriptions to make this determination, it is critical to ensure the internal

KEY INGREDIENTS FOR COMPLIANCE

- ☑ Include the right people.
- ☑ Train your employees.
- ☑ Implement internal controls.
- ☑ Minimize complexities.
- ☑ Use cash or equivalents.
- ☑ Understand the request for equitable adjustment process.
- ☑ Keep excellent records.
- ☑ Involve the experts.
- ☑ Perform self-assessments.
- ☑ Foster employee trust.

documentation is current and reflective of that employee's role on each SCA-covered contract to which they are assigned.

Things become particularly challenging where an employee performs in multiple functions or tasks that align with more than one labor category. In this case, the SCA requires that the employee's wages reflect the applicable pay for each function. Wise contractors design timekeeping systems with capability for employees to identify labor categories associated with specific activities, thus maintaining a record of time spent and applicable wages earned in each labor classification. Absent these records, an auditor will require the contractor to pay wages associated with the highest-wage-rate labor category applicable to the employee, regardless of the time actually worked in that role.

Instances also occur where the functions an employee performs may not be adequately addressed by DOL's Directory of Occupations. In these cases, contractors are required to obtain a "conformance" from DOL. A contractor should submit Standard Form 1444 (requiring the employee's signature) to the contracting officer proposing a reasonable basis for arriving at the wages due. This process should take place following award and within 30 days of starting work on the contract. The contracting officer will, in turn, submit the form to DOL for a final decision. Failing to seek a conformance may result in adverse DOL findings.

Pitfall #6—Not Distinguishing Between Wages vs. Health and Welfare

In addition to wages, a wage determination also contains fringe benefit requirements consisting of health and welfare, vacation, and holiday, at a minimum. While the DBA allows contractors to offset overpayments in wages or health and welfare with underpayments in the other, the SCA does not. In other words, under the SCA, if a contractor pays an employee $1.50/hour more than the required wages, but 25¢ less than the required health and welfare, the contractor is noncompliant because the overpayment in wages does not offset the underpayment of fringe benefits. To comply with this requirement, contractors must show that the wages and health and welfare requirements are separately fulfilled.[11] This means accounting for these costs separately and ensuring any "cash payments in lieu of benefits" are shown separate from wages on the employee's paycheck remittance advice.

Pitfall #7—Incorrectly Identifying a "Fringe Benefit" under the SCA

For a fringe benefit to satisfy the requirements of an SCA wage determination, the fringe benefit must be "bona fide." A "bona fide" fringe benefit:

- Is a legally enforceable obligation,
- Is communicated in writing to employees,
- Provides benefits not required by law under a defined formula, and
- Is paid via an independent party or administrator to a fund or plan.[12]

Contractors unfamiliar with the SCA are often quick to assume one or both of the following: 1) a "competitive benefit package" will meet or exceed SCA requirements; and/or 2) anything contained in the fringe benefits pool of a contractor's indirect cost structure is a "bona fide" benefit. Neither necessarily hold true. Federal and state unemployment taxes, for example, since they are required by law, are not "bona fide" benefits.

This raises an interesting question regarding the impact of the Patient Protection and Affordable Care Act (PPACA) on fringe benefit requirements given the mandate for individual healthcare coverage. In the future, SCA health and welfare compliance across the country may look similar to that of Hawaii, as will be described in the next section. DOL is unlikely to comment on this issue until the PPACA takes full effect in 2014.

Pitfall #8—Navigating Health and Welfare Compliance in Hawaii

Performing SCA-covered contracts in Hawaii introduces unique complications with the

SCA's health and welfare requirements. Unlike the one health and welfare rate (currently $3.71 per hour) found in wage determinations for all other states, Hawaii wage determinations generally have two health and welfare rates (currently $3.71 and $1.50 per hour).[13] The reason for this is the Hawaii Prepaid Health Care Act, which requires employers to furnish healthcare to most Hawaii employees. In recognition of mandated employer-paid healthcare and the exclusion of a generally "bona fide" fringe benefit, the lower rate seeks to equalize employer benefit requirements across the country while maintaining a consistent level of labor protection. Any employee who receives the mandated healthcare coverage is due the lower health and welfare rate, while the balance of the employee population receives the standard rate.

When fulfilling the lower health and welfare requirement, employers cannot count the cost of furnishing mandated healthcare coverage. In executing fringe benefit calculations, many employers will simply remove all medical costs for applicable employees. However, in doing so, contractors may unnecessarily impact their bottom line. Employers often provide different levels of coverage (e.g., single, family, etc.) and the mandated benefit only covers the individual. Therefore, an employer may identify the mandated benefit, or the cost of single coverage, and apply any remaining benefit provided against the health and welfare requirement. Nevertheless, just like in any other state, only benefits provided apply against health and welfare compliance obligations. An employee who opts out of benefits must receive cash in lieu of payments or other "bona fide" fringe benefits to satisfy SCA requirements.

Pitfall #9—Not Maintaining Compliance on Contracts Requiring Travel

Certain contracts may require travel to locations outside the area where the majority of work is expected to take place and for which a wage determination has been issued. Travel locations, whether or not originally contemplated under the contract, are nevertheless covered by SCA requirements.

Coupled with increased audit scrutiny are severe consequences of noncompliance.

Contracting officers should issue a wage determination for any location where work is performed. However, what if a trip only lasts for a day or two? Should the contractor obtain potentially numerous wage determinations for day trip locations? Unfortunately, the SCA regulations do not directly address this issue. Some would argue that if the time spent in a travel location is short and nonrecurring, a contractor could simply comply with the already incorporated wage determination for that time. However, there is a risk of noncompliance with that approach.

We recommend that contractors discuss this circumstance with their contracting officer or DOL if and when it arises—and, of course, maintain documentation of that discussion. Other contractors have avoided (so far) major issues in this area by establishing a clear company policy and keeping records to demonstrate compliance with it.

Pitfall #10—Incorrectly Assessing a "Break in Service"

An SCA wage determination generally requires a contractor to provide a certain number of days or weeks of vacation based on an employee's "continuous years of service." This term represents the length of time an individual performs in a particular capacity on a continuous basis. This includes an employee's time with a predecessor contractor or performing non-SCA-covered commercial work with the current employer. The compliance pitfall arises when contractors attempt to define "continuous service" under a wide variety of real-world circumstances. For example, it is not uncommon for employees to take sabbaticals, be furloughed, be terminated, or take unpaid absences for any number of reasons.

Although this issue is somewhat of a gray area, the rules provide some useful guidance. Contractors must look to the reason for the absence as opposed to the duration of the absence to determine if a break in continuous service has occurred. The rules provide insights into this tricky area with the following examples that do *not* constitute a break in continuous service:

- Absence with permission due to sickness, injury, or other reasons beyond the employee's control;
- Absence for a few days without notice, unless a termination notice has been issued;
- A strike after which the employee returns to work;
- An interim period of three months between contracts, caused by delays in the procurement process, where personnel hired directly by the government performed the necessary services;
- A mess hall closed for three months for renovations (i.e., a temporary layoff); and/or
- A termination and subsequent rehire for purposes of reducing the required vacation benefit.[14]

Some contractors handle this issue on a case-by-case basis (depending on the circumstances), while others try to cover all scenarios in company policy. Contractors addressing the matter in company policy should ensure that the policy complies with the SCA and applicable state labor laws.

ESSENTIAL INGREDIENTS FOR COMPLIANCE

Hopefully, identifying these pitfalls will aid in avoiding them. Nevertheless, armed with these tips, SCA compliance is still anything but simple. The following are some general strategies that every contractor should consider to help achieve compliance:

Contribute to *CM* Magazine!

As a contract management professional, your personal experiences in the field can be valuable to readers. Apply your practical insights, solutions, and encountered problems to their situations. Focus on the lessons learned rather than a chronology of events. Particularly of interest are articles of a "how-to" nature with practical, problem-solving instruction that can be used on the job.

Send manuscripts or queries to:

Kerry McKinnon Hansen
khansen@ncmahq.org

Submission Guidelines

Learn more about the submission process at www.ncmahq.org/contribute.

NCMA
NATIONAL CONTRACT MANAGEMENT ASSOCIATION

- *Involve the right people*—SCA compliance requires input and action from many aspects of the business, including, at a minimum, contracts, finance, legal, human resources, project management, and accounting.

- *Provide employees with thorough training on the SCA*—Understanding the key areas of risk and the interplay of critical processes will help avoid many future compliance challenges.

- *Implement controls to facilitate compliance*—Forms and templates (e.g., a pre-bid contract evaluation form) and automated system controls are important for catching SCA compliance requirements early, prompting the right questions, and removing administrative burdens and the likelihood for error.

- *Minimize complexities where possible*—The thorniest SCA compliance scenarios often involve employees:

  - Working part-time,
  - Working on more than one contract (particularly challenging when not all are SCA-covered),
  - Performing in more than one labor classification,
  - Having complicated benefit plans, and/or
  - Working on projects containing different fringe benefit calculation requirements (i.e., the "average" vs. "per person" health and welfare methods).

Limiting complexities will significantly reduce administrative burdens and potential errors.

- *Pay cash or cash equivalents (e.g., 401k contributions) to satisfy health and welfare requirements*—Although this can be more costly and somewhat less impactful with the passing of the PPACA, many contractors use cash or cash equivalents to simplify benefit calculation procedures. Additionally, contributions to 401k plans reduce the tax burden on the contractor through exemption from payroll taxes.

- *Understand the process for pursuing a request for equitable adjustment for newly incorporated wage determinations and wage determination revisions*—Also, avoid taking actions that may limit the ability to obtain an equitable adjustment. It is also important to properly prepare and present your request for equitable adjustment to the contracting officer with adequate documentation to substantiate the adjustment.

- *Maintain excellent records*—When contractors can't affirmatively demonstrate compliance, DOL often assumes noncompliance has occurred. However, consistent application of the rules with proper supporting records puts the contractor in a strong position in the event of an audit or dispute. Keep records of contract documentation, communications, time cards, payroll records, trainings, etc.

- *When in doubt, consult with outside experts*—Working with knowledgeable consultants, attorneys, and outside vendors (e.g., benefit processors) can help ensure compliance where circumstances exceed in-house capabilities or capacity.

- *Perform self-assessments*—Companies are better off finding and correcting potential noncompliances before the government does. Additionally, the old adage about "an ounce of prevention" is usually very applicable to SCA compliance.

- *Resolve compliance issues with employees quickly to build a trusting relationship*—The majority of harsh consequences handed out by DOL arise not from DOL-initiated audits, but from complaints filed by disgruntled employees. Unlike many government regulations, employees covered by the SCA and the DBA are often knowledgeable about these acts as they directly affect employee compensation. **CM**

ABOUT THE AUTHORS

AARON RADDOCK, CFE, CFCM, is a manager in Baker Tilly's Government Contractor Advisory Services practice located in Tysons Corner, Virginia. Raddock assists contractors with a wide variety of government contracting matters, including complex SCA compliance analyses, compliance program implementations, accounting challenges arising out of *FAR* and CAS requirements, and litigation support in connection with complex claims. He is the vice president of membership for the Tysons Corner Chapter of NCMA. He can be reached at **Aaron.Raddock@BakerTilly.com**.

ALBERT P. CORVIGNO is president of MARAL, LLC, a provider of training courses on the Service Contract and Davis Bacon Acts, including training sponsored by the Professional Services Council (PSC). He was the former director of labor relations for Lockheed Martin and currently chairs the PSC's Labor Relations Committee. He can be reached at **acorvigno@marallc.com**.

Send comments about this article to cm@ncmahq.org.

ENDNOTES

1. 29 C.F.R. 541.
2. *See Federal Acquisition Regulation* 52.222-17.
3. Department of Labor, Wage and Hour Division.
4. *See* 29 C.F.R. 4.115.
5. *See* Wage and Hour Division Memo, issued February 15, 2008.
6. 29 C.F.R. 4.116.
7. 29 C.F.R. 50-201.1.
8. 29 C.F.R. 4.116(c).
9. 29 C.F.R. 4.117.
10. 29 C.F.R. 541.
11. 29 C.F.R. 4.170.
12. 29 C.F.R. 4.171.
13. Wage and Hour Division Memo 211, issued June 11, 2012.
14. 29 C.F.R. 4.173.