

THE INTERACTION BETWEEN THE PAYCHECK
PROTECTION PROGRAM AND FEDERAL
ACQUISITION RULES: WHAT IT MEANS FOR
GOVERNMENT CONTRACTORS

HEARING
BEFORE THE
SUBCOMMITTEE ON CONTRACTING AND
INFRASTRUCTURE
OF THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES
ONE HUNDRED SEVENTEENTH CONGRESS
FIRST SESSION

HEARING HELD
MARCH 23, 2021



Small Business Committee Document Number 117-007
Available via the GPO Website: www.govinfo.gov

U.S. GOVERNMENT PUBLISHING OFFICE

43-803

WASHINGTON : 2021

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CONTENTS

OPENING STATEMENTS

Hon. Kweisi Mfume	Page 1
Hon. Maria Salazar	2

WITNESSES

Mr. Greg Bingham, Partner, HKA, Washington, DC	5
Ms. Susan Moser, Partner, Cherry Bekaert, Tysons, VA	7
Ms. Robin Greenleaf, PE, Chief Executive Officer, Architectural Engineers, Boston, MA, testifying on behalf of the American Council of Engineering Companies (ACEC)	9
Mr. Carlos A. Penin, PE, President, CAP Engineering, Coral Gables, FL	10

APPENDIX

Prepared Statements:	
Mr. Greg Bingham, Partner, HKA, Washington, DC	23
Ms. Susan Moser, Partner, Cherry Bekaert, Tysons, VA	30
Ms. Robin Greenleaf, PE, Chief Executive Officer, Architectural Engi- neers, Boston, MA, testifying on behalf of the American Council of Engineering Companies (ACEC)	35
Mr. Carlos A. Penin, PE, President, CAP Engineering, Coral Gables, FL	40
Questions for the Record:	
None.	
Answers for the Record:	
None.	
Additional Material for the Record:	
AIA - American Institute of Architects	41

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TUESDAY, MARCH 23, 2021

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON CONTRACTING AND INFRASTRUCTURE,
Washington, DC.

The Subcommittee met, pursuant to call, at 12:00 p.m., via Webex, Hon. Kweisi Mfume [chairman of the Subcommittee] presiding.

Present: Representatives Mfume, Golden, Newman, Salazar, Stauber, Meuser, Fitzgerald, Andy Kim, Schneider, and Hagedorn
Chairman MFUME. Ladies and gentlemen, good afternoon since it is technically a few minutes after noon.

I want to call this meeting to order officially and I want to make some important announcements which also are requirements.

Let me begin by saying that the standing House and Committee rules and practices will continue to apply during these remote hearings. All members are reminded that they are expected to adhere to these standing rules, including the rules that cover decorum.

House regulations, as most of you know, require members to be visible through a video connection throughout the entire proceeding, so to the extent possible, please keep your cameras on. Also, please remember to remain muted until you are recognized in order to minimize background noise. If you have to participate in another proceeding that might be going on simultaneously, please exit this one and then log back in if you can later.

In the event that a member encounters technical issues that prevent them from being recognized for their questioning, I will move to the next available member of the same party and I will recognize that member at the next appropriate time if he or she is able to correct the problem.

Again, I know all of you have busy schedules. I appreciate everybody taking time to be here. I am going to formally introduce our witnesses in just a few moments but let me just underscore the fact that this hearing on the Subcommittee on Contracting and Infrastructure for the 117th Congress is our first. And for our opening hearing I thought it was very important to examine an issue that is a priority for government contractors and that is the interplay

between the Federal Acquisition Regulation, also known as the FAR, and the Paycheck Protection Program, also known as PPP.

The FAR serves as a primary set of rules governing all executive agencies and their acquisitions of goods and services. And so today we will focus on part 31 of Far, which helps contractors determine which costs are, in fact, reimbursable.

Specifically, we will be taking a look at an aspect of the credit cause, which can impact Federal contractors who have taken advantage of the Paycheck Protection Program. Congress created the PPP to help, as we know, small businesses, meet payroll costs and other expenses. These loans were designed to be fully forgivable if small businesses spent loan proceeds on these purposes.

However, Federal contractors, mainly those with false reimbursable contracts, may find themselves owing the government a credit if the PPP loan has been forgiven and it was used to pay for costs that were under a government contract.

So this is by far some of the virtue of FAR credits and the motion of the credit clause, which is included in these type of arrangements and more specifically I should say, in these type of contracts.

In April 2020, shortly after PPP's launch, the Department of Defense issued guidance stating that the loan amounts could constitute credits. In essence, the government's position has been to take a credit that is due to avoid duplication of payments. With that said, some small contractors will argue that this is antithetical to the PPP program's intent which is to help struggling firms during a time of crises.

Contractors contend that if the government forces them to repay portions of the loan through credits, then the PPP loan was not truly forgivable.

So today, we will have an opportunity to examine the varying positions on this critical issue, and during the hearing it will be very important to note that the Defense Contract Audit Agency has issued additional guidance on the treatments of credits. And while there is certainly room for more guidance, this one represents, I think, an important first step because it clarifies that when a contractor receives PPP loan forgiveness, only the amount of the loan forgiveness allocable to a government contract results in a credit.

So moreover, it clarifies other matters that help ensure appropriate application of credits of which we will learn more about today in the hearing that is now beginning.

It is clear that this is a complex issue with significant ramifications for small government contractors. I hope that today's hearing will allow us to dive deep into the subject and to better understand all sides of the issue, as well as available guidance that might come to us or that might shed light on this subject just as the new guidance did today.

This hearing is an essential first step in coming to a resolution that does not inflict further harm on the small businesses already suffering from this pandemic across the country.

So again, I want to thank the witness for joining us here today, and now I would like to yield to the Ranking Member, Ms. Salazar of Florida for her opening statement.

Ms. SALAZAR. Thank you, Chairman.

It is undeniable that small business contractors play a critical role in the Federal sphere. As you have said, these businesses are innovators. They drive down the costs by promoting competition and their flexibility allows them to be agile and adaptable, while continuing to deliver excellent results often faster and cheaper than their larger counterparts.

That is why protecting these essential members of our workforce is critical to maintain Federal operations at a best and optimal level.

But they are not immune, and they have not been immune to the far-reaching effects of the COVID-19 pandemic. Indeed, small businesses everywhere, specifically in District 27, have suffered from the governmental imposition of endless lockdowns and restrictions. And many have suffered from cuts to billable hours, widespread project cancellations, significant disruptions in cashflow, and interruptions in their ability to perform on the contract.

I have spoken to many of my small business contractors in District 27 in South Florida that I represent in Congress, and many of them have shared their concerns, including my constituent, Mr. Carlos Penin, who is here with us today as a witness.

Many small contractors have turned to their Paycheck Protection Program (PPP), anticipating they may be able to receive loan forgiveness provided they comply with the criteria that has been established by the government.

But apparently, the rules have changed. When the Department of Defense (DOD) issued in April 2020 a memorandum applying Federal Acquisition regulations cost principles to the PPP forgiveness, DoD had classified forgiveness of the PPP loan as a credit allowed under contract. Now, the DoD has dictated that the contractor must give this amount back to the government.

According to the Department of Defense, this application of the Federal Acquisition Regulation may be necessary to prevent against potential abuse by contractors who are seeking a windfall by billing the government twice. This activity is known as double dipping, and we are here, elected in Congress, to prevent exactly that and to help safeguard taxpayers' money.

However, the contracting community has raised several concerns with the DoD's strategy. Some contractors argue that the DoD's disposition contradicts congressional intent on the PPP. Others have taken the view that this unfairly impacts certain contract types triggering a requirement for payment of the PPP for some contractors but not for others.

So many take issue with the DoD's change of rules expressing their concerns and that they were surprised. This was a surprise decision which was made unilaterally without their consent. Now as we know, the deadline for forgiveness is around the corner and they must decide what to do with their loan. For some, PPP may be a welcome and necessary supplement to their existing cashflow, but for others it may not be worth the trouble, particularly in light of how application of the Federal Acquisition Regulation credit may negatively affect future revenues.

So I hope, and I am sure you do, Chairman, through the insight of our distinguished panelists, we will be able to gain a better un-

derstanding of the DoD's stated policy, its potential effects on small contractors, and identify flexible solutions in a bipartisan fashion.

Thank you for your time, and I yield back, Chairman.

Chairman MFUME. Thank you very much. The Ranking Member yields back. And I want to thank her for her comments and thank again all of you who are here joining us.

By the way, if Committee members have an opening statement prepared, we would ask that they be submitted for the record.

And while I am at it, I am going to ask unanimous consent that every member has 5 legislative days to revise and extend their remarks.

I would like to just take a moment to explain how this remote hearing will proceed. Each witness will have 5 minutes to provide a statement and each Committee member will receive 5 minutes for questions. Please ensure again that your microphone is on when you begin speaking and that you return to mute when, in fact, you are finished.

So I would now like to now introduce our witnesses. Our first witness today is Greg Bingham, a partner at KHA and a co-lead of their Government Contracts group. He is a forensic accounting and quantum expert with over 33 years of experience in the field of business consulting primarily for government and construction contractors. Mr. Bingham is an authority on government contracts, having served as an adjunct professor at the George Washington University, and among his professional memberships, Mr. Bingham is also a member of GW's Government Contracts Advisory Board. He holds a Bachelor of Science degree in Electrical Engineering and an MBA degree as well. Welcome, Mr. Bingham.

Our second witness is Ms. Susan Moser. Moser. I am getting that wrong but I will say Moser until I am corrected. And if I am wrong, please forgive me. Ms. Moser is a partner at Cherry Bekaert and the leader and founder of their Government Contracting Services Group. Ms. Moser has 36 years of professional experiences and advises contractors in multiple areas. She also serves as a regional market leader of the Cherry Bekaert's Virginia, D.C., and Maryland practices, and is a board member of the Northern Virginia Chamber of Commerce. She holds a Bachelor of Science degree in Engineering—in accounting, excuse me—and is a certified public accountant and a certified information technology professor. Thank you very, very much, Ms. Moser. Again, forgive me if I am mispronouncing your name.

Our third witness today is Ms. Robin Greenleaf. Ms. Greenleaf has more than 30 years of professional experience and is the chief executive officer and founder of the Architectural Engineers in Boston. She is a professional engineer and an LEED accredited professional. Ms. Greenleaf holds a Bachelor of Science in Civil Engineering and a Master of Science in Structural Engineering. She is the Co-Chair elect of the American Council of Engineering Companies. Welcome again, Ms. Greenleaf.

Our final witness before I yield back, and Mr. Penin. Please bear with me because I am just making sure that I have a bio on you. I did not see one here. Okay.

Ms. SALAZAR. Chairman, I have it here.

Chairman MFUME. I have it. Oh, no, I do not. You do have it?

Ms. SALAZAR. Yes. Yes, I do.

Chairman MFUME. Please, please, please introduce him, would you?

Ms. SALAZAR. All right. Absolutely. Thank you. Thank you, Chairman.

I would like to welcome our final witness who is from my district, District 27 in Florida, Mr. Carlos Penin. Mr. Penin is the president and founder of CAP Engineering. CAP is a minority-owned consulting firm specializing in providing engineering services for government clients. Under his leadership, CAP Engineering has earned a stellar reputation for the professional management of its infrastructure projects and this has resulted in 30 years of dependable services to satisfy government clients. Mr. Penin has an extensive resume with over 40 years of direct project experience and managerial expertise. Among his many accomplishments, Mr. Penin worked on several major architectural and engineering projects in South Florida, including Joe Robbie Stadium, the widening of the Julia Tuttle Causeway and the reconstruction of SW Eighth Street. Lastly, I would like to congratulate Mr. Penin on his recent appointment by Florida Governor Ron DeSantis to the South Florida Regional Transportation Authority Governing Board. I wish you well in your new role, and thank you for all that you have done, not only for our district, District 27, but for the United States and for this magnificent country who opened its arms to you and to your family when you were a little boy. Same case with me, and that is why we are so grateful, and I am delighted to have you here talking to us and explaining, and giving us your experience in this last 40 years.

Now I yield back, Mr. Chairman. Thank you.

Chairman MFUME. Thank you, Ms. Salazar. Hopefully, we will make a great one-two punch throughout the 117th Congress and I appreciate you stepping up and doing what you could in terms of properly introducing Mr. Penin. And Mr. Penin, thank you very much, as with all the witnesses again for being here today.

Madam Salazar, I am going to move to start introducing or calling for remarks of the witnesses unless you have a question or comment or observation at this point.

Ms. SALAZAR. You can proceed with all the witnesses. Thank you, Chairman.

Chairman MFUME. Thank you.

Mr. Bingham, you are now recognized for 5 minutes, sir.

STATEMENTS OF GREG BINGHAM, PARTNER, HKA; SUSAN MOSER, PARTNER, CHERRY BEKAERT; ROBIN GREENLEAF, PE, CHIEF EXECUTIVE OFFICER, ARCHITECTURAL ENGINEERS; CARLOS A. PENIN, PE, PRESIDENT, CAP ENGINEERING

STATEMENT OF GREG BINGHAM

Mr. BINGHAM. Thank you. Thank you. This is quite an honor to get to testify here today.

As you mentioned, the FAR, the Federal Acquisition Regulation is the primary set of rules used by the U.S. Government Executive

Branch agency. The FAR has 53 parts and FAR 31 is dedicated to cost principles and procedures.

A key part of FAR 31 is what is the composition of total cost of a contract and that is key to this credit issue. The cost of a contract is the sum of allowable direct costs, allowable indirect costs, less any allocable credit. And so there is more about this credit point in the credit clause, which is at FAR 31.201-5. Examples of credits are things like state tax refunds.

This credit clause is not new. It has been in the FAR since the FAR began in 1984. It was in the Armed Services Procurement Regulation as early as 1948 in essentially the same form as it is today.

The impact of the FAR credits clause is different on cost reimbursement contracts than on fixed price contracts. If a contractor incurs \$1,000 in cost generally speaking on a cost reimbursement contract, they will be reimbursed \$1,000. Any event that reduces the allowable cost incurred on a contract will reduce the amount reimbursed under a typical cost reimbursement contract. And a credit is an example of something that would reduce the cost on a cost reimbursement contract.

The impact of the credit clause is different on fixed price contracts. In fixed price contracts, the invoicing and payment provisions generally focus on the contractor demonstrating they have provided some specified product or service and requesting payment of a predetermined price. And so if the contractor incurs more cost or less cost, they still get that predetermined price on a fixed price contract.

So a credit will reduce a particular contract's cost and reduce the amount paid on a cost reimbursement contract but not on a fixed price contract.

As an example, let's say Contractor A works solely with the Federal government and holds only fixed price contracts. Contractor A has a PPP loan worth \$1 million forgiven in 2020. There would be no repayment to the government for any of the forgiven loan in this example. Contractor B works solely with the Federal government and holds only cost reimbursement contracts. Contractor B had a PPP loan worth \$1 million forgiven in 2020. Contractor B would repay the government for this loan under this scenario.

There are different types of costs. The major categories of cost are direct and indirect. And direct costs are for people that are actually working on contracts. Sometimes the labor of people working on contracts is referred to as touch labor because the mechanic's hands are actually touching the car or on the assembly line people are actually performing the work. Indirect costs are for costs that are not working on the contractor and more for the growing concern of the company. And so typical indirect costs are things like facility rent or the salary and benefits of the office administrator that works in the office and benefits all contracts, does not work on any particular contract but on all contracts.

Indirect costs are often expressed in terms of an indirect cost rate. So an indirect cost rate is the ratio of indirect costs to direct costs. So remember numerator, denominator, top of the ratio, bottom of the ratio. You have got indirect costs on top and the direct

costs on the bottom in a typical example. And so it might be expressed as something like 5 percent.

For years that have already passed, a company can determine all of the direct costs and indirect costs that were incurred in this prior year. And so in a typical process, after these costs are audited by the government, the company and the government negotiate a final settlement of what was the indirect cost rate for that prior year. There are things called forward pricing rates. And so for years that are not yet completed, as 2021 is now not completed, and for years which have not yet commenced, government contractors often develop estimates of the total amount of indirect and direct costs that will be incurred over the course of the year.

It should not be assumed that future years will have exactly the same indirect cost rate as a prior year. There can be nonrecurring events and the forgiveness of a PPP loan in 2020 may well be a nonrecurring event. Maybe an event that occurs in 2020 that you do not anticipate will occur in future years. And if that is the case, then the indirect rates for 2021 and future years should not be based at all, solely or blindly on whatever the experience was in 2020.

And with that I will—

Chairman MFUME. You probably looked at the clock and started wrapping up, but we have exhausted the amount of time for you. If you would let us get through the others I am sure there are going to be some questions directed your again. And again, I appreciate your understanding.

Mr. BINGHAM. Certainly. Certainly. Thank you for this opportunity.

Chairman MFUME. Sure. Sure.

The question is now for Ms. Moser. Ms. Moser, again, I know I have said it several times, if I am mispronouncing your name, please correct me because with a name like mine I cannot afford to do that.

Ms. MOSER. Thank you.

Chairman MFUME. You are mute.

STATEMENT OF SUSAN MOSER

Ms. MOSER. Thank you. Chairman Mfume, Ranking Member Salazar, and members of the Committee, thank you for the opportunity to speak today.

My name is Susan Moser and I would like to take this opportunity to talk about the government's guidance on PPP forgiveness and its impacts on contractors today and moving forward.

As was previously mentioned, the interaction between the FAR and PPP was first addressed in April 2020 when DoD answered a frequently asked question and made clear that DoD expected PPP loan forgiveness would result in a credit to the government on flexibly priced contracts. Subsequent to this guidance, confusion began as most companies have a mix of flexibly priced and firm-fixed price contracts and many contractors plan to only seek forgiveness of certain costs which could be a mix of direct and indirect costs.

While the impact of PPP forgiveness on flexibly priced contracts has been made clear, the contractor community needs clarity

around how to handle forgiven costs under other contract arrangements, including contracts with state transportation agencies. To date, agencies have issued limited guidance with conflicting information that contractors are struggling to understand and apply. DCAA did issue guidance, revised guidance in January of 2021 that confirmed that credits should be recorded based on how costs were recorded when incurred. DCAA also stated that a PPP loan forgiveness credit should be allocated to the accounting period in which it is received.

The guidance is contrary to generally accepted accounting principles and at least two decisions by the Court of Federal Claims and its predecessor court. For most companies, forgiveness for costs incurred in 2020 will occur in 2021.

I would also like to note that the impact of the Employee Retention Credit creates the same challenges for contractors. Much of the concern regarding guidance has come from architecture and engineering or A&E firms doing business with state transportation agencies who receive funding from the Federal Highway Administration. These contracts carry many FAR requirements. There is concern with potential draft guidance being considered by the Highway Administration that would require all PPP forgiveness credits to be applied to indirect costs. Accounting for credits in this way is inconsistent with FAR Part 31 and would result in reduced indirect cost rates for the year in which the credit is applied, but could also apply throughout the life of multiple year contracts awarded in the year in which the reduced rates were established, potentially resulting in reduced indirect rates for multiple years.

Understandably, many A&E firms are concerned with the implications of this anticipated guidance. Most states' Department of Transportation agencies require A&E firms to have an indirect rate audit conducted by a CPA firm. Our firm performs many of these types of audits.

State DOTs are trying to get guidance from the Federal Highway Administration, but absent that are advising to rely on existing regulations in determining credits.

There are three areas where guidance could assist contractors. First, standardizing the period in which the PPP credit should be reported and included in any indirect rate audit. The credit should be included in the same year costs were incurred.

Second, I recommend that any contractors that are receiving PPP funds disclose in the notes to their indirect rate audit the calculated rate both with and without forgiveness considered.

Lastly, inform procurement agencies, particularly transportation, the rates included in indirect rate audits should be used in negotiations, but that final prices can and should incorporate consideration of the impact of PPP forgiveness. Specifically, while the rate including PPP forgiveness can be used in year one of a multiple year contract, subsequent years should be renegotiated using rates that are not impacted by the PPP credit. Contracting agencies should also incorporate business judgment in negotiating a price that is fair and reasonable to both parties.

These recommendations, I believe, align with generally accepted accounting principles, the FAR Cost Principles and would help alleviate negative financial impacts in subsequent years. Further,

this would reduce confusion while also ensuring contractors receive the benefit originally intended by the CARES Act but without the potential to “double dip” and allow some contractors to receive a greater benefit than companies who do not contract with the government.

Thank you very much for your time today.

Ms. SALAZAR. Mr. Mfume, you are muted.

Chairman MFUME. I was thanking all the witnesses for their testimony so far and reminding people that we all have their written testimony. If they have it nearby I would urge that you hold on to it because there may be some questions, comments and observations that go directly back to that.

I would like to recognize Ms. Greenleaf at the current moment. Ms. Greenleaf, you have 5 minutes. The floor is yours.

STATEMENT OF ROBIN GREENLEAF

Ms. GREENLEAF. Thank you very much, Chairman Mfume, and Ranking Member Salazar. Thank you for the opportunity to testify before the Subcommittee today.

My name is Robin Greenleaf. I am the CEO of Architectural Engineers, Inc., a woman-owned engineering firm in Boston. We have 33 employees who provide mechanical and electrical engineering services to Federal, state, and local agencies and private companies and owners. I am also the Chair-elect of the American Council of Engineering Companies and I have the privilege of serving as National Chair starting in April. It is an honor to represent my colleagues here today.

I cannot overstate how important this issue is to small business engineering firms across the country right now. My 2020 experience is typical of hundreds and hundreds of my colleagues in the industry. We relied on the PPP loan to keep our entire staff on the payroll even in the face of significant business disruptions and revenue loss. And the program was successful. It met its intended objective.

But now those of us who contract for government clients are facing the imposition of a credit under the FAR and we think this is completely misguided. Congress already made clear that forgiven PPP loans are not to be treated as income for tax purposes and then further clarified that covered expenses are deductible. In the same way, forgiven PPP loans ought not to count as income under the FAR. This was emergency relief to support employers and businesses ought to be able to take full advantage of the program.

There are numerous challenges with this policy that I want to highlight for you. One, if this credit is applied to reduce our overhead rate as opposed by the Federal Highway Administration, we are going to be working at a discounted rate, not only in the coming year but potentially for several years. Many of our clients lock in the indirect cost rate over the life of a multi-year contract. On my \$594,000 PPP loan on which we just received forgiveness last week, I am looking at 32 percent drop in my overhead rate resulting in the loss of at least \$129,000 per year. Only about 15 percent of my firm's work is with public agencies using our FAR rate. For firms that do predominately DOT work, it is easy to see how the losses will far exceed the value of the loan.

This leads to my second point. The impact of the credit will fall most heavily on small, minority-owned, and women-owned firms that needed the assistance the most and have come to perform a higher percentage of government contracting.

I have documented a few examples in my written testimony and I hear from more colleagues every day. And so the basic outcome of this policy is that our state and local clients will be benefitting from the PPP, not us. We are passing the loan through to them through discounted billing rates. If unchanged, the application of this credit will create a disincentive for women-owned firms, minority-owned firms, DBEs, and other small businesses to compete for work for public agencies. It will derive the government of qualified engineering services and will hamper efforts to expand small business and DBE contracting opportunities.

Let me also say that the inequity here with our counterparts in the infrastructure market is frustrating. Other contractors working on Federal aid projects are not subject to these same requirements. Fixed price contracts are not impacted by the FAR credits clause. While my rates are reduced, other businesses working on the same infrastructure projects have been able to retain the full benefit of the PPP. This uneven treatment does not seem fair or equitable.

There is a real sense of urgency in the industry to get this issue resolved. Firms that already received forgiveness are starting the annual audit process and seeing the impact of the credit on their rates. Some business owners are already questioning whether they can continue to keep all their employees that they supported with the PPP loan. Those that have not yet applied for forgiveness are coming up on the 10 month deadline to start repaying those loans. Banks are pressuring them to decide whether to apply for forgiveness. Our small business owners need to make critical business decisions about the impact on their rates and projected revenues and employment ramifications.

At a time when the industry is very eager to work with your colleagues to deliver a robust infrastructure-based economic recovery agenda, your prospects for these opportunities are dimmer because of this credit holding us back.

Thank you for the opportunity to testify.

Chairman MFUME. Thank you very much, Ms. Greenleaf.

Mr. Penin, you are now recognized for 5 minutes.

STATEMENT OF CARLOS A. PENIN

Mr. PENIN. Good afternoon, Chairman, Ranking Member Salazar, all congressional members of the Subcommittee on Contracting and Infrastructure and everyone present.

My name is Carlos Penin. I arrived from Cuba in 1962 at the age of six. I think I am giving away my age. I am a proud Cuban American who pursued a career in engineering and ended up fulfilling my American dream of starting my own business. The company that I started, CAP Engineering is a small, minority-owned business that has been in operation in the city of Coral Gables, District 27, for almost 33 years. Today, I am addressing this Committee as the founder and president of my company representing my employees, but also as a former president of ACEC Florida, the organiza-

tion that represents member engineering firms in the state of Florida.

In Florida, we have hurricanes, and I have survived multiple hurricanes during our company's history, sometimes multiple hurricanes in the same years. The devastation from this pandemic has been far worse and nobody could have even predicted it, nobody saw it coming, and the severe impact that it has had.

In the early months of the pandemic, we applied for and received assistance from the PPP. The assistance that we received was applied as intended to help keep our loyal staff employed so that they, in turn, could keep their families fed, safe, and healthy.

The interpretation of the Federal Acquisition Regulation, the FAR clause, would reverse the benefits received from the PPP and could have a negative impact for our company and any company that pursues Federal or state contracting for years to come.

As Robin so well pointed out, if the PPP loan forgiveness is unallowed and therefore subtracted from the indirect labor cost, then in our case our overhead rate would be reduced by approximately 25 percent. If we had multiple year contracts, the lower overhead rate would be applied for multiple years and for multiple contracts. This reduction would be higher than the original loan amount that we received, thus negating the original intent of the PPP loan which was to help companies such as ours keep our employees and thus help our families.

I ask you to please consider our industry's request that this unintended consequence be eliminated. And as good engineers, we are supposed to finish on time and under budget and I yield back with 2 minutes and some seconds left over in my presentation. Thank you very much.

Chairman MFUME. Thank you, and my thanks to all of the witnesses.

We are going to begin the open session of questions and comments with members who are present today. And I would like to recognize myself for 5 minutes.

Mr. Bingham, could you go back and elaborate on what the credit clause is and how it is supposed to work and how a Federal contractor is bound by the principle clause?

Mr. BINGHAM. Certainly. A key issue for reimbursement of cost and just cost accounting generally is what is the cost recorded on a contract. And the cost recorded on a contract is direct cost plus indirect cost and less any credit. So the issues that are being discussed here relate—when people talk about paying their employees, that may well be a direct cost. It is hard to know if there are indirect employees but it could well be direct cost of performance. If they talk about paying for facilities cost or their indirect personnel, then that would be, you know, part of their indirect cost. But the credits, wherever the credits, wherever the loan money is spent, that is where the credit should go. If a company uses the loan for a particular contract, only to reimburse employees on a particular cost, then the credit should go to that particular contract, not other contracts, not on overhead. If the credit went all to facility cost and overhead, then the forgiveness should go only to overhead.

I hope that helps you understand that in determining the cost on a contract, the credit has to be reduced from wherever the loan was spent. That is where the reduction occurs.

Chairman MFUME. Okay. And Ms. Moser, I am just going to stay on the matter regarding these credits. You mentioned in your testimony that DCAA issued guidance on how the credits should, in fact, be applied. Could you take a moment and expand on the major points of that guidance and how it really works in practice?

Ms. MOSER. Yes. I would be happy to.

So DCAA issued its guidance in January which had a number of different areas that they addressed. The first area is they were clear, and this is consistent with the earlier DoD guidance and consistent with the testimony we just heard, that loan forgiveness proceeds should be applied in the same manner in which the original cost was occurred. So just as we heard before, if direct salaries were used and it could be for commercial work or on direct cost reimbursable work, that portion of the credit should go back to that where it was originally incurred. If it was included in the overhead, that is where it should be incurred. So that was pretty straightforward and I think consistent with FAR.

DCAA's guidance suggested or stated that—and DCAA, when they issue guidance, they are actually issuing guidance to their auditors. The general public and contractors certainly use that as a reference but they are issuing guidance to their auditors. But they also stated that when the credit is received is the year in which it should be applied. So that creates some inconsistency as companies have incurred the loan forgiveness of PPP during 2020 and they are going to get proceeds or forgiveness in 2021. That matching, that inconsistent matching, I believe is not correct.

They also did address a number of other areas in their guidance including guidance on contractors doing forward pricing. So a forward pricing rate agreement is a forward looking forecast of rates that is used for certain types of contracts. It is typically used in negotiating fixed price task orders or change orders. So they did include in their guidance that consideration should be given to—2020 we have all acknowledged was an unusual year with unusual circumstances. And costs incurred and credits incurred in this year should be considered in looking at forward looking. Just because historical reference is not necessarily the prediction of what the future rates would be. So those were the specific areas they addressed.

Chairman MFUME. Thank you very much, Ms. Moser.

My time has expired. The Chair will recognize the Ranking Member, Ms. Salazar.

Ms. SALAZAR. Thank you, Chairman.

I think I want to use my 5 minutes. Maybe I can ask the same question to the different witnesses. And I would start with Mr. Penin and then I can ask Ms. Moser.

I think that the main concern the government has is to avoid the double dipping. So if you were in our position, what would be your recommendation? I am sure Mr. Penin, Ms. Moser, I am sure that all of you do not want that happening. We do not want to have to pay twice. So in which way could we be able to be fair to you but at the same time not pay you double?

We will start with you, Mr. Penin.

Mr. PENIN. Thank you very much for the question, Ranking Member Salazar.

That is more of an accounting function. I do not think that it is double dipping. We used the loan for what it was intended to be used, which was to save our employees, and we did that. When we sought the PPP funding, we looked at it as the lifeline to get to the other side of the pandemic and that, as we have heard oftentimes, that goalpost kept moving on us over and over again. So it was a vital opportunity for us to be able to stay alive, stay afloat during this last year.

As far as the FAR and how that is used, as I mentioned in my testimony before, that has a negative impact on the bottom line because what happens is it gets applied to the indirect labor cost, and therefore, it pushes our multiplier down. And in some cases as we will experience in my company, it will put us at 25 percent below what we are currently doing today.

So we see this as a loan, a forgivable loan that has carried us through last year. It is not reoccurring but the unintended consequence could reoccur for multiple years to come. I hope that answers your question.

Ms. SALAZAR. Sure. Yes. Thank you.

Why do we not then ask Ms. Moser? Ms. Moser?

Ms. MOSER. Yes. So the FAR incorporates the cost principles into certain types of contracts. So specifically, the flexibly priced contracts, cost-type contracts, time and materials contracts. And I do not think waving the credits clause carte blanche related to PPP is the appropriate thing to do because it could lead to unintended consequences and it could provide a situation where contractors that have only flexibly-priced contracts would double dip. Basically, they are billing the government for all of their costs incurred and then they are getting the forgiveness. And so I do not think people want that to happen, certainly not as a tax payer. I think the challenge is that the cost principles are referenced in many other types of contracts and a lot of what we are hearing is regarding state transportation contracts. And so my recommendation is not a waiver of the FAR credits clause; it is really about issuing better guidance and explaining the situation so that contractors negotiating with state transportation agencies, for example, have all of the information about the impacts that, you know, the rate needs to be calculated as the rate is consistent with the FAR, but how that rate is utilized in subsequent years I think is really where the guidance is needed. So, you know, the timing of the guidance from DCAA I think is a problem and then I think the lack of guidance or concerns about proposed guidance that might be issued from the Highway Administration—that is really where I think the focus is.

When guidance is issued by audit agencies, they do not seek public comments. And with lots of proposed regulations, there is public comment and an opportunity for people to weigh in. And I think, you know, that certainly could be helpful to this process to improve upon.

Ms. SALAZAR. So it is not necessarily an accounting issue according to what you are saying but it is just clarification?

Ms. MOSER. So I think the accounting in terms of how the credits clause should be applied is clear and does not require a change. I think it is the application of how those rates are utilized in subsequent years' contracts.

Ms. SALAZAR. Thank you. I yield back.

Chairman MFUME. Thank you, Ranking Member.

The Chair would like to recognize Representative Golden from the state of Maine. Mr. Golden?

Mr. GOLDEN. Thank you, Mr. Chair.

I think I will start with Ms. Moser. And I wanted to ask if there are other examples out there in addition to the PPP program where we have COVID-related Federal assistance for which a contractor might have to provide the government with a credit. And if the answer is yes, could you also elaborate a little bit about why?

Ms. MOSER. Yes. I would be happy to.

I think the most immediate additional assistance is the employee retention credit. So when the employee retention credit was first incorporated into the CARES Act, companies that received PPP loans were not eligible for the employee retention credit. So for most contractors, you know, PPP was that lifeline, that immediate assistance that they were seeking so they really didn't focus on the employee retention credit. With the legislation that passed in December, that made available the employee retention credits for companies that also received PPP loans.

The employee retention credit is a credit against payroll taxes. So it is consistent with the credits clause—so a company that is a contractor that has flexibly priced contracts, cost contracts. If they are eligible to receive an employee retention credit, it is a reduction against the payroll taxes that they pay. So it would be treated consistently if they originally recorded the payroll taxes say in 2020 when they paid them, it would go to a fringe. Usually that is an indirect expense considered a fringe benefit. When you receive the credit, it should be applied back the same in a similar manner. So it is a very similar situation.

Mr. GOLDEN. Thank you. I think that is helpful.

Ms. Greenleaf, you testified that engineering firms particularly have difficulty compared to other contractors that also do business with state departments of transportation. And I wanted to ask you if you could elaborate a little bit further on that. And secondly, I wanted to ask if you felt that should Congress mandate DOT to issue guidance that would ensure that indirect cost rates were trued up based on what a firm's real indirect costs were for the year impacted by the credit, would that address ACEC's concerns?

Ms. GREENLEAF. To answer your first question, I think that the engineering firms in general, many of us work for state DOTs. And so the guidance, the draft guidance that has come out from Federal Highway at this point is taking a very hardcore approach to how to deal with the PPP credit. So it is one reason why we were pushing back so hard on this issue.

We are part of a very narrow band of impacted professionals that are feeling the pressure from the FAR credit clause. It does not extend far beyond just those of us who work for state DOTs. And so based on that, that is why we are wanting to just see the loan be completely forgiven and not have to apply the credit.

So having said that, I am going to need to ask you to repeat your second part of your question and then I will come right back to you.

Mr. GOLDEN. Yes. If Congress were to mandate that the Federal Department of Transportation issue guidance that would ensure that indirect cost rates were more accurately reflecting a firm's real indirect costs for the year impacted by the credit, would that in any way address the concerns of your organization?

Ms. GREENLEAF. I do not know that it does. The reason for that is that the state DOTs, and that is largely who we are talking about, are inconsistent across the country in their ability to do the truing up on an annual basis. And I can tell you from personal experience in Massachusetts that the work that I do here, we are put in what is the equivalent of multi-year contracts. The overhead rate does not change. It is very difficult to get an audit to request the change. And I think that based on that what we could expect is just a lot of inconsistency across the DOT's abilities to do the truing up and to do annual audits.

Mr. GOLDEN. That is very helpful.

I see I only have 10 seconds left so I will yield back the 8 seconds.

Chairman MFUME. Thank you very much, Representative Golden.

The Chair would now recognize Mr. Stauber. Did we lose him? Okay, maybe he will jump back in. Okay, Mr. Stauber is out.

Ms. Salazar, I do not see any other members from your side of the aisle. Am I missing someone?

Ms. SALAZAR. Yeah, they had other Committee meetings going on at the same time. And myself, I have to go to Foreign Relations. But I am staying here with you until you have finished with all the testimonies.

Chairman MFUME. Thank you. Mr. Fitzgerald is here though, and I would like to recognize Mr. Fitzgerald for 5 minutes. Thank you, sir.

Mr. FITZGERALD. Thank you. Thank you. Just real quick to Mr. Carlos Penin.

I understand today we are kind of focused on the PPP stuff, but in the COVID bill that recently passed it did include some language on section 36.10 that authorizes agencies to address contractor employee salaries. I was wondering if you had any comments on that. You know, it is kind of related to catastrophic events and what my understanding is. I do not know more than that about it. But I just wonder if you could provide any insight into the impact that that may have.

Mr. PENIN. Thank you for the question, Congressman Fitzgerald. I am not familiar with the new legislation and I am not going to be helpful to you on that. I have not read it.

Mr. FITZGERALD. Very good. Yeah, it is kind of a struggle and I think a lot of us have been caught off guard because of the legislation just signed into law. But I would urge the Chair and the Ranking Member, I think it is something that we need to probably take a look at and hopefully, because it seems to be boiling up right now. So thank you, and I will yield back. Thank you.

Ms. SALAZAR. Chairman?

Chairman MFUME. Yes.

Ms. SALAZAR. I think we do have Congressman Meuser with us. Is that correct? So we can recognize him?

Chairman MFUME. I see him. Yes. Yes.

We will first recognize Ms. Newman for her 5 minutes and then we will come back to Representative Meuser.

Ms. Newman?

Ms. NEWMAN. Thank you, Chairman. And thank you, Ranking Member Salazar.

This is a very timely issue in my district. Dozens of small businesses have come forward to talk about this with us, so I am so glad for the testimony today. And thank you to all the witnesses. It has been very helpful to dimensionalize this for me.

I have a couple of questions and I think I would like Ms. Moser and Mr. Penin to answer them. And I will go to Mr. Penin first.

So it clearly seems like there is an issue here that can be addressed, and I do not think it has to be brain surgery. What is your recommendation? Does it need to be a clarification of rules? Is it regulatory? Or do you think it requires congressional intervention? And I will go to Mr. Penin first.

Mr. PENIN. Thank you very much, Congresswoman Newman. And thank you for your concerns for your district as well. I think that for us it is probably a clarification of the language and how it is being applied more so than an act of Congress. I am trying to keep it simplified because, you know, if you started getting too many people involved, you know, it starts to muddle the situation. But I would think that it is something that can be handled as long as there is a clarification of the interpretation. And I think that that would be the easiest way of handling it. And it certainly would serve our purpose on the industry side to have that resolved.

I hope that answered your question.

Ms. NEWMAN. Yes. Yes. And then I need to go to Ms. Moser. From a technical standpoint, or from an accounting perspective, what would your remedy be?

Ms. MOSER. Yes, thank you.

So I agree with Mr. Penin. I do not believe that there is legislative action that is needed to rectify this situation. I think that could end up with unintended consequences. I really think it is an issue of clarification on guidance.

The DCAA, as I mentioned, their guidance is issued to auditors. So, while I disagree and I think it is an incorrect guidance on the timing of the application, ultimately contracting officers make those recommendations. The DCAA is making recommendations to its auditors; contractors if they do not agree with that, ultimately, it is up to the contracting officer to make a decision on that.

I think the biggest issue, and I think what we have really heard here today is really related to Federal Highway Administration and that guidance because that does flow down to, as you heard, the state agencies. And I think that is really where the majority of the angst and the concern is that without additional guidance and recommendations to state agencies there is going to be unintended consequences longer term than just this year.

Ms. NEWMAN. So just to clarify that, Ms. Moser, you are saying that the clarification should be some recommendation from Con-

gress with regard to the PPP program but then also instruct the state and local agencies as such as well, both steps?

Ms. MOSER. Well, I do not think necessarily that Congress has, other than trying to get the agencies to issue the guidance, I think that is really what is needed. And then really it is the guidance that they issue because all of the state agencies are looking to Federal Highway Administration for guidance. So I think really the guidance is needed with clarity from the Highway Administration.

Ms. NEWMAN. Thank you for clarifying that.

I yield back. Thank you, Chairman.

Chairman MFUME. Thank you very much.

I would like to at this time recognize the gentleman from Pennsylvania, Mr. Meuser.

Mr. MEUSER. Thanks, Mr. Chairman. Thank you all to the testifiers. Appreciate it. It is an important subject, clearly. Very financially important situation that needs clarification. No question.

So I ask, and I will start with Ms. Moser and I will also ask others as well, what was understood by you at the time that you submitted for what was described as a forgivable business loan? Was it understood that this was to be completely forgivable under the conditions of retaining your employees?

Ms. MOSER. Hi, since you asked me to address first, so I am an advisor. I am a partner in an accounting firm and so I advise clients, so I was not applying for a PPP loan. You know, I think like just with most of our clients at the time, you know, it was a lifeline, and so I think most companies, you know, had no idea what was going to happen and so did apply. That was generally our recommendation.

Mr. MEUSER. Right.

Ms. MOSER. Obviously, there has been much guidance since then but I think that the forgiveness issue is really for contractors. There has been much analysis and angst, frankly, on whether they should or should not apply for forgiveness, again, depending on really their contract nicks in terms of how that is going to—

Mr. MEUSER. So you advise that, yes, they should take loans under the understanding of the requirements for PPP and therefore, it would be forgivable if they met those requirements?

Ms. MOSER. Yes, generally if they met the requirements. Yes.

Mr. MEUSER. Mr. Penin, is that what you understood from the original language of the provision in the legislation?

Mr. PENIN. Congressman Meuser, thank you very much. Yes, that was our understanding. And as I mentioned in my testimony, this was our lifeline. And then the interpretation came after the fact. And I think that is kind of where we are today. It was an interpretation given after the fact and that is kind of what surprised a number of us in passing the torch.

Mr. MEUSER. And I realize there are many, many dynamics. In fact, there is facing a business, any business, engineering contract, whatever it might be, particularly with a pandemic coming along, particularly even in my state where outdoor construction was shut down for a while with state contracts, contracts with employees not able to come in out of fear, out of having COVID, out of family members, out of children at home. So it was a very upheaved period. And I am certainly on the side of small business.

But let me ask you this. If there is a guaranteed revenue stream that would be ascertained and made clear, the whole idea behind PPP was to sustain a small business during a loss of revenue period for the purpose of not losing them over the short term and the long term and not having them go on unemployment.

Now, that being the case, is all your business by the way contracted this way or is it just a percentage? Is it 50 percent of your revenue comes from the contracts that are affecting the potential PPP?

Mr. PENIN. Yes, sir. I assume that question is for me. Yes, sir. I would say that the majority of our work comes from government contracting. We are a small company. Most of that is as a sub-consultant to larger state and national or international companies. But it passes down to us because we still have to go through our FDOT in our case audit. And that is where this interpretation is going to be implemented. So yes, sir, most of our business is government-based. The long-term contracts are essential for small businesses because of the stability that it provides.

Mr. MEUSER. Right. I am just trying to get to where the revenue loss—did you suffer revenue loss during this time period?

Mr. PENIN. Yes. Yes, we did. Yes. We kept our employees. We kept our employees but we had tremendous losses in revenue because, I mean, we came to a screeching halt.

Mr. MEUSER. Okay. Well, that pretty much answers my question then and should uncover any doubts that the original intent of this PPP should be upheld.

What about the second round of PPP, did you apply for that?

Mr. PENIN. We have not applied for that. We have not applied for that.

Mr. MEUSER. Okay. Very good.

Mr. Chairman, I do not have any more questions. I yield back. Thank you.

Chairman MFUME. Thank you, Mr. Meuser.

We are going to start the second round of questioning, and I will lead that off by asking Mr. Bingham if he would help put some context into this discussion. I think we all know what the purpose or the stated purpose of FAR 31 is, but can you tell me when the principles of FAR, part 31 kick in? Is there a certain requirement, number of requirements, or something else that you might be able to share with us in terms of its implementation?

Mr. BINGHAM. Yes. Yes. Thank you for the question.

The requirements of FAR 31 kick in when there is a sole source or when there is procurement of a cost reimbursement contract or a sole source procurement where it is a situation where the contractor has to provide cost information, you know, the cost estimate to the government customer. And so it is under circumstances of that nature. If a contractor, if there are sealed bids, in other words, there was adequate competition, then the government buyer is supposed to base its decisions on the price offered by various competent contractors and not get into what their cost history is or what their indirect costs are or their direct costs, any of that type of information. That is the way they are intended to focus it.

And I will just add to the discussion about the indirect cost rates. The intended approach in the FAR with regard to future indirect

cost rates is not that you just take the indirect rate for a past year and assume that it will be matched going forward. That would be contrary in my interpretation to both the FAR and the audit guidance from the DCAA, for example. And so the issues seem to be related to this idea that some agencies, some state-related agencies are just forcing the situation where whatever the past indirect rate was, that indirect rate will be all that is allowed in some future year.

I hope I answered your question.

Chairman MFUME. You did, but I am going to ask you to step out on a limb and tell us how you would fix this if you had the ability to do so overnight.

Mr. BINGHAM. Yeah, I think I agree with Ms. Moser in the idea of guidance. I think if the state departments of transportation, if they did more what the Federal government auditors do, the DCAA auditors do looking at the guidance there, you know, it is in FAR 42 and 44, I believe, and then not this recent DCAA memorandum to regional directors but back to the DCAA's contract audit manual on how you audit indirect rates and how you audit forward pricing rates, these indirect rate that are going into the future. If they follow that type of guidance, my impression is that would solve a lot of this. I do not think they are following that type of guidance right now. I think it sounds like they are imposing that the same past indirect rate must be used going forward. So that would be my "I am out on a limb." That is about as far out on the limb as I will go. Thank you.

Chairman MFUME. Well, thank you, sir.

I want to yield to the Ranking Member, Ms. Salazar.

Ms. SALAZAR. This question is for Mr. Bingham and for Ms. Moser as well and Mr. Penin, three of you.

If by any chance this interpretation of the FAR stance and the DoD does not change, they cease the way that they do business with you, in which way not only will it affect your decision to continue working with the government, or will you then decide to seek other work in the private sector alone? How will this change your future is basically what I would like to hear from you?

And we will start with you, Mr. Penin.

Mr. PENIN. thank you very much for the question.

If the interpretation of the FAR stands, it will adversely affect our multiplier and therefore, our ability to continue to work on government contracts.

I mentioned earlier, in our case, in our particular case it would be approximately 25 percent of our multiplier would be affected. We would go from 1.25 to 1.0 and that is a huge impact on our business. The minority companies and small businesses rely on the government because of the long-term contracts that we can obtain from government. In this case, if this rate were to go on for further years then we would be punished by the same percentage for multiple year contracts and in some cases it would impact multiple contracts. So for us that would be a deterrent from pursuing government contracts.

The private sector is on a rebound. Whether we would concentrate on that alone would have to be a financial decision that I am not 100 percent sure right now that I can make but we see

that if we cannot rely on one. You know, we have to be resilient. That is what makes us survive. I told you we have been in business for 32 years. So we will look for whatever opportunity we can to get to next year and the next year and so forth and so on. But I would say that it would certainly impact our ability to, and our desire to contract with government under those conditions. Thank you.

Ms. SALAZAR. Ms. Moser?

Ms. MOSER. So again, I do not contract directly with the government. I just advise companies that do. So I am really not in a position to address the issue.

Ms. SALAZAR. What would be your advice to those clients? What would be your advice?

Ms. MOSER. So, again, I really think the issue, if the Federal Highway Administration issued guidance, each of the state agencies, and our firm does these indirect rate audits for many engineering firms and deals with many state auditors, the state DOT agencies are looking for guidance. We have reached out to all of them. They are asking for guidance from Federal Highway Administration so I think absent any guidance then they feel like they do not really have a choice on what they do. So I really think Highway providing guidance and recommendations on what is the purpose of the indirect rate audit and how should it be used going forward into future—

Ms. SALAZAR. I am going to interrupt you so I can give the opportunity to Ms. Greenleaf, which I did not recognize and then to Mr. Bingham.

Ms. GREENLEAF. Thank you for the—

Ms. SALAZAR. You have 2 minutes. Yeah.

Ms. GREENLEAF. Thank you for the opportunity to respond.

I think the one point I would like to make is when I took my PPP loan, it was really under enormous duress. Our business was disrupted. We had to work remotely. And the idea that we would end up as part of a very, very small sector of the entire PPP universe that would not be able to take full advantage of the PPP loan and the original intent is what is driving my being here today. So, I agree with what Ms. Moser is saying about good guidance coming from a possible [inaudible] step in the right direction, but I think for ACEC, what I would like to drive home is that we would like to be treated like every other company that took a PPP loan out.

Ms. SALAZAR. Just 1 minute 35 seconds to Mr. Bingham.

Mr. BINGHAM. Thank you for this opportunity to respond. I will just say, and I am an advisor to companies as well, but I think the guidance in FAR 42-7 and the DCAA's guidance on this point about the indirect rates, that you do not blindly accept their past year as the future year and forecast that into the future. I think if a government entity was telling me that they were going to force me to have the same rate in the past as the future, I think I may be able to read them passages from FAR 42-7 in the DCAR manual to show them why that is inappropriate. Thank you.

Ms. SALAZAR. Thank you. And I would like to recognize Member Stauber. He just joined as Chairman.

Chairman MFUME. Yes. Yes. I will do that in his turn. He actually, for the record, was with us earlier and stepped away so we are glad that you are back, Ms. Stauber.

The Chair at this point will recognize the gentlewoman from Illinois, Ms. Newman, for the second round.

Ms. Newman? Are you back with us?

Okay, so let's do this. I will go to the gentleman from Minnesota, Mr. Stauber.

Mr. STAUBER. Thank you, Mr. Chair. And thank you for all the witnesses. I really appreciate your time.

You know, at a time when our small businesses are trying to recover from the crisis, for small contractors, the continued changes in guidance and memorandums from government agencies have caused a lot of headaches and confusion.

Mr. Penin, what is your reaction or your thoughts to the government's motive of prevention of double dipping?

Mr. PENIN. Thank you very much, Congressman.

I do not believe that double dipping applies, and I say that simply because when we applied for the PPP loan and we processed our paperwork for forgiveness, we consider that as a self-standing item and not something that we were going to be penalized for later.

Mr. STAUBER. Okay. Thank you.

My next question is for Ms. Greenleaf. Given your position with ACEC, what are you seeing from this particular group of businesses? Are many of them seeking loan forgiveness or not? And have any of your members decided to forgo forgiveness or even give the loans back due to this confusion?

Ms. GREENLEAF. Yeah, I think that is a great question, and thank you for asking it.

I think our members are waiting to see what comes out of Federal Highway for final guidance. For me, I did apply for forgiveness and my firm did receive it, but I have been checking with colleagues and it is a very inconsistent approach. People would like to apply for forgiveness. They would like to understand the ramifications if they do. Some of the smaller firms like mine, I may have to make some business decisions about who my clients might be for the next year or two and point out that on top of the need to really reach a conclusion that we can all make decisions from is the fact that the administration is trying to push a very, very large and serious infrastructure bill out over the summer and we are the firms that will be hopefully having a part in designing all of these new transportation projects that may come out. And yet, if what we were trying to do is knowing that we are getting into these at a potentially greatly reduced rate. It is a very, very difficult position to be in.

Mr. STAUBER. Thank you. And then Ms. Greenleaf, again, could you speak to how this could impact small businesses working on state and local transportation projects?

Ms. GREENLEAF. So a firm like mine, we have already done the math. I know what the reduction in overhead rate and corresponding hourly rates will be if I choose to continue to work for our state DOT. And you know, for me they are a very valued client and I want to find a way to continue supporting them. Many of the

larger projects at the state level are comprised of very large teams, so it could have very large engineering firms that are driving the projects. The team is very diverse and there might be, you know, 10 firms just like mine that are all seeking to gain experience on large projects. So it is a big impact.

Mr. STAUBER. You know, I look forward to discussions on the infrastructure project. I certainly hope it is bipartisan and I certainly hope that the minority has input on it because I think it has a potential to be really good legislation. We know that it has been needed and we just want to have input on it.

So Mr. Chair, thank you very much and I yield back to you.

Chairman MFUME. Thank you very much, Mr. Stauber.

I am going to attempt to go to Ms. Newman again. I do not know if she has her speaker system on. I have seen her go by her camera a couple of times. And Ms. Newman are you there?

I guess she is not.

The Chair recognizes Mr. Fitzgerald.

Mr. FITZGERALD. Thank you, Mr. Chair. I have no further questions at this time. I would yield back. Thank you.

Chairman MFUME. Okay. And Ms. Salazar, any further comments from you?

Ms. SALAZAR. I think that we have gathered a lot of information between you, we definitely will fit and figure out how we can make this work for the private sector with more clarification as some of them have said and with the accounting process having been reviewed. And I think that is our duty and our job to make it easy for them, for the private sector and at the same time avoid any type of double dipping which that is what we are here for.

So I am looking forward to working with you, Mr. Chairman. I yield back.

Chairman MFUME. Well stated, and the feeling is mutual.

I want to thank you again. I want to also thank all of our witnesses who have made time to be with us. Your expert testimony, in my opinion, has been invaluable and given the members of this Subcommittee a greater understanding of how this complex issue impacts small businesses. Small contractors as we all know have been devastated by this pandemic. And so it is important that we ensure that they are not inflicted with any further harm, and at a minimum we must ensure consistency in the application of the rules that govern Federal contracting.

So I look forward to working with today's witnesses and Subcommittee members to find a path forward so that we might be able to come up with an equitable solution for these small businesses.

And I would ask, as I have mentioned earlier, unanimous consent that members have 5 legislative days to submit statements and supporting materials for the record.

Without objection, it is so ordered.

If there is no further business to come before the Committee, we officially stand adjourned. Thank you all. Have a good day.

[Whereupon, at 1:21 p.m., the subcommittee was adjourned.]

APPENDIX

The Interaction Between the Paycheck Protection Program and Federal Acquisition Rules: What It Means for Government Contractors

U.S. House of Representatives Committee on Small Business,
Contracting and Infrastructure Subcommittee

23 March 2021

Testimony by: Greg S. Bingham

Thank you, Chairwoman Velázquez, Ranking Member Luetkemeyer, and members of the subcommittee. It is an honor to provide testimony at this hearing.

Credentials

- Partner and Co-Leader of HKA's Government Contracting practice.
- Specialize in cost accounting for government contractors, with over 35 years' experience consulting on issues arising from the Cost Principles set forth in Federal Acquisition Regulation ("FAR") Part 31 and the Cost Accounting Standards ("CAS"), as well as the contract pricing and evaluation guidance found in FAR Part 15 and oversight of subcontractors found in FAR Part 44.
- My testimony on government contract cost issues has been accepted by courts and boards across the United States.
- Frequently lecture on government contract cost accounting issues. I was an adjunct professor at the George Washington University Graduate School of Business for several years, where I taught the Pricing and Cost Issues in Government Contracts course. I am also a member of the George Washington University's Government Contracts Advisory Board.
- Currently chair the Contract Finance Committee of the National Defense Industrial Association.
- Until recently, I chaired the Audit Committee of the Capital Area Food Bank.

FAR and FAR 31 Background

The FAR is the primary set of rules used by all US Government executive agencies in their acquisition of goods and services with appropriated funds.¹ It sets uniform policies and procedures, including the terms and conditions to be used in federal contracts, which ultimately will bind federal contractors.

There are agency supplements to the FAR. For example, the Department of Defense is also governed by the Defense FAR Supplement (“DFARS”), and the Department of Transportation is governed by both the FAR and the Transportation Acquisition Regulations.

The FAR is divided in 53 parts. FAR Part 31 is dedicated to cost principles and procedures. Generally, it applies to the pricing of contracts whenever cost analysis is performed, the determination of reimbursable costs in cost-reimbursable contracts and the calculation of indirect cost rates.²

The composition of the total cost of a contract is essentially the sum of allowable direct and indirect costs, less any allocable credits.³

FAR 31.201-5 defines a credit as “the applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor...credited to the Government either as a cost reduction or by cash refund...” Typical examples of credits include purchase discounts, income from sale of scrap, rental income, and refunds of various state and local taxes such as franchise, personal property, and income taxes.⁴

The FAR composition of total cost and credits provisions are not new. They have been part of the cost principles since the Armed Services Procurement Regulation (“ASPR”) was first published in 1948. A later version of the ASPR, known as the Defense Acquisition Regulation, was replaced by the FAR in 1984.⁵

¹ See FAR, “Foreword,” available at: <https://www.acquisition.gov/sites/default/files/current/far/pdf/FAR.pdf>. See also FAR 1.000-1.101.

² See FAR 31.100- 31.110.

³ FAR 31.201-1 (Composition of total cost).

⁴ DCAA Contract Audit Manual Section 6-608.2(d)(5) (Miscellaneous Income and Credits).

⁵ See Manos, Government Contract Costs & Pricing (2nd Edition, 2009) at 13 and 173.

Contract Types

There are many different types of contracts. As stated in FAR 16.101(b), “[t]he contract types are grouped into two broad categories: fixed-price contracts ... and cost-reimbursement contracts...”

On **cost-reimbursement contracts**, the amount paid to the contractor depends primarily on the allowable costs incurred by the contractor.⁶ If the contractor incurs \$1,000 in allowable costs, generally speaking, the contractor is reimbursed \$1,000 plus some amount of fee, which is not addressed here. Any event that reduces the allowable costs incurred on a contract (including a credit) will reduce the amount reimbursed under a typical cost-reimbursement contract.

A **fixed-price contract** generally provides “for a price that is *not* subject to any adjustment on the basis of the contractor’s cost experience...”⁷ In fixed-price contracts, the invoicing and payment provisions generally focus on the contractor demonstrating that it provided some contractually specified product or service, and requesting payment of the predetermined price for the delivered product or service. Events that reduce the allowable costs incurred on a contract (including a FAR 31.201-5 credit), will not reduce the amount reimbursed under a typical fixed-price contract.

A credit which reduces the contractor’s allowable costs incurred reduces the amount paid to the contractor on a cost-reimbursement contract, *but not on a fixed-price contract.*

The impact, if any, of a credit associated with a PPP loan will depend on how the PPP loan funds were spent by the company. Any credit associated with PPP loan forgiveness should apply to contract costs in the same manner in which the PPP loan funds were originally spent by the contractor. For example, if a portion of the forgiven PPP loan was used to pay facility rent, the cost of facility rent should be credited. If that rent is part of an indirect cost pool, then the indirect cost pool would be reduced by the credit. If instead, a business used the PPP loan to pay its employees for work performed for commercial customers, the labor cost accounts associated with those commercial contracts would be credited.⁸

⁶ FAR 16.301-1.

⁷ FAR 16.202-1 (Firm-fixed-price contracts, Description) (emphasis added).

⁸ See e.g., DCAA Memorandum for Regional Directors dated 11 December 2020 with SUBJECT: “Audit Alert on Coronavirus Legislations and Regulations”.

PPP Loan Example

Contractor A works solely with the Federal Government, and holds only firm-fixed-price contracts. Contractor A had a PPP loan worth \$1,000,000 forgiven in 2020. There would be no repayment to the Government for any of the forgiven loan because FAR Part 31 does not apply to any of Contractor A's contracts.

Contractor B works solely with the Federal Government, and holds only cost-reimbursement contracts. Contractor B had a PPP loan worth \$1,000,000 forgiven in 2020. At the time the loan was forgiven, Contractor B would repay the Government for the forgiven loan because FAR Part 31, and therefore the credits provision of FAR Part 31, applies to Contractor B's contracts.

Because of the application of FAR Part 31 to Contractor B's contracts and not Contractor A's contracts, Contractor A would experience an increase in cash of \$1,000,000 in comparison to Contractor B, due to the forgiveness of the PPP loan.⁹

Direct and Indirect Costs

Costs can be segregated into direct and indirect cost classifications. The costs incurred on each contract include both direct and indirect costs. These terms are defined in the FAR.

*"Direct cost means any cost that is identified specifically with a particular final cost objective. Direct costs are not limited to items that are incorporated in the end product as material or labor. Costs identified specifically with a contract are direct costs of that contract..."*¹⁰

*"Indirect cost means any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective."*¹¹ Contracts are typically final cost objectives. Indirect costs are typically accumulated into "pools" and allocated to "base" costs which the indirect costs were incurred for the benefit of, or which caused the indirect cost to be incurred.¹²

⁹ For purposes of simplicity, the impact of taxes has not been considered in this illustration.

¹⁰ FAR Part 2 (Definitions of Words and Terms) (emphasis added).

¹¹ FAR Part 2 (Definitions of Words and Terms).

¹² See, e.g., 48 CFR § 9904.418-40 [Cost Accounting Standard 418] - Fundamental requirements. ("Pooled [indirect] costs shall be allocated to cost objectives in reasonable proportion to the beneficial or causal relationship of the pooled costs to cost objectives ...")

"*Indirect cost rate* means the percentage or dollar factor that expresses the ratio of indirect expense incurred in a given period to direct labor cost, manufacturing cost, or another appropriate base for the same period (see also "final indirect cost rate")."¹³

General and administrative expense ("G&A") is a typical indirect cost. G&A costs normally include costs associated with running the business, such as costs for back-office functions (e.g., accounting and human resources) and C-level executives. In many companies, G&A is pooled and allocated to all other company costs (i.e., all costs other than G&A) on an annual basis. For example, if a company incurred G&A costs of \$1 million in 2020, and all other costs incurred at the company were \$50 million, the G&A rate would be 2% (i.e., $\$1\text{M} / \$50\text{M} = 2\%$). For every dollar of non-G&A company costs, 2 cents would be added for G&A.

For any years that have already passed, a company can determine all of the direct and indirect costs which were incurred. After these costs are audited by the government, and the company and the government negotiate a final settlement, the parties agree to final indirect cost rates for each past year.¹⁴

Forward Pricing Rates

For years which are not yet completed (as 2021 is now), and for years which have not yet commenced, government contractors often develop estimates of the total amount of indirect and direct costs that will be incurred over the course of a year, so that the indirect cost rates for each uncompleted year can be estimated. The indirect cost rate estimates developed for future years are often referred to as forward pricing rates. These rates are used in the development of proposals for work in future years.

It should not be assumed that indirect rates in future years will exactly match the indirect rate in some prior year (e.g., non-recurring events, such as a PPP loan forgiven in a past year, should be analyzed when estimating indirect rates for future years).¹⁵

¹³ FAR Part 2 (Definitions of Words and Terms).

¹⁴ FAR Part 2 (Definitions of Words and Terms) ("*Final indirect cost rate* means the indirect cost rate established and agreed upon by the Government and the contractor as not subject to change. It is usually established after the close of the contractor's fiscal year ...").

¹⁵ See e.g., DCAA Contract Audit Manual, section 9-702.2 ("Evaluation of indirect cost estimates requires consideration of anticipated future operations of a contractor. To determine what may be reasonably expected to occur, the auditor should utilize analyses and projections of historical cost patterns and related data. ... It should not be assumed that historical cost patterns and the results of overhead audits for prior years will continue without change; the auditor must consider contemplated changes which may influence the projections. ..." [emphasis added])

Example Illustrating Impact of a Credit on Forward Pricing Rates

The Contractor incurred G&A costs of \$1 million in 2020. In the same year, the Contractor was forgiven a PPP loan of \$100,000, and processed an associated credit which reduced its 2020 G&A pool from \$1 million to \$900,000. The Contractor calculated its G&A rate for 2020 as 1.8% (i.e., \$900,000 / \$50M), and based solely on its 2020 cost information, erroneously forecasted its G&A rate to be exactly the same for 2021 through 2024. (This approach would be erroneous, unless the Contractor believes and can support that its G&A costs will likely be \$900,000, and its other costs will be \$50 million in each forecasted year from 2021 to 2024. This level of stability is very rare of in my experience.)

The Contractor develops a proposal for a fixed-price contract assuming its contract costs will be \$1 million in each year from 2021 to 2024, and adds 1.8% for G&A to arrive at a proposed contract cost of \$1,018,000 (i.e., \$1M + (\$1M x 1.8%)) for each year from 2021 to 2024. The Contractor is awarded the fixed-price contract, and later experiences a G&A rate of 2% each year instead of 1.8%.

Because the Contractor understated its G&A rate in its proposal, and the contract was fixed-price, the Contractor incurs higher costs and lower profits on the fixed-price contract. Under the same circumstances, except that the Contractor was awarded a cost-reimbursement contract, the Contractor would bill and be reimbursed the higher G&A rates in 2021 through 2024.

FAR 31 Allowability Provisions

It is a basic principle of government contracting that not every cost a contractor incurs will necessarily be reimbursed. For a cost to be reimbursed under FAR Part 31, the cost must be allowable.

FAR 31.201-2 sets forth specific conditions under which costs are allowable for reimbursement. "A cost is allowable only when the cost complies with all of the following requirements: (1) Reasonableness. (2) Allocability. (3) Standards promulgated by the CAS Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances. (4) Terms of the contract. (5) Any limitations set forth in this subpart."¹⁶

¹⁶ FAR 31.201-2 (Determining allowability).

A cost is considered “reasonable” if “it does not exceed that which would be incurred by a prudent person in the conduct of competitive business”, and is thereby “recognized as ordinary and necessary for the conduct of the contractor’s business.”¹⁷

A cost is considered “allocable” if it is “incurred specifically for the contract,” “[b]enefits both the contract and other work...and can be distributed to them in reasonable proportion to the benefits received”, or “[i]s necessary to the overall operation of the business.”¹⁸ Similar to direct and indirect costs, credits must be allocable to the cost objective to which the credit is assigned.

The “standards promulgated by the CAS [Cost Accounting Standards] Board” only apply to contracts and subcontracts which meet certain criteria, of which size is one example. The CAS typically only apply to larger cost-reimbursement contracts or larger fixed-price contracts for which the prices were negotiated based on cost estimates shared with the government buyer. When the standards promulgated by the CAS Board do not apply to a contract, the allowability requirements default to “generally accepted accounting principles and practices appropriate to the circumstances.” Companies who prepare audited financial statements (e.g., all public companies and many private companies) are subject to generally accepted accounting principles and practices appropriate to the circumstances.

“Terms of the contract” typically include other terms and conditions relating to the measurement, assignment or allocation of cost. In some instances, the terms of the contract impose requirements that go beyond those in FAR Part 31.

“Any limitations set forth in this subpart” is where the cost principles under FAR 31.205 come into play.

¹⁷ FAR 31.201-3 (Determining reasonableness).

¹⁸ FAR 31.201-4 (Determining allocability)

The Interaction between PPP and the FAR: What it means for Government Contractors

Chairman Mfume, Ranking Member Salazar, and Members of the Committee, thank you for the opportunity to speak to you today. My name is Susan Moser and I am a partner in Cherry Bekaert, LLP, a national CPA and consulting firm primarily serving small and middle market clients in a number of different industries. I lead our firm's government contracts practice which I founded 20 years ago, after being a client of the firm as a CFO for an 8(a)-government contractor. Today my firm works with over 250 government contractors of various sizes and industries, but the bulk of our clients are small businesses as defined by the Small Business Administration (SBA). As small business government contractors operate within a regulated industry with unique and strict compliance requirements, I have spent the past 20 years helping them understand and navigate the accounting and compliance issues under the Federal Acquisition Regulations (FAR) and various agency supplements.

The Paycheck Protection Program (PPP) was initially enacted as Sections 1102 and 1106 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act. However, those sections were amended by the Consolidated Appropriations Act of 2021 and the American Rescue Plan Act. The PPP program, while tremendously beneficial and necessary for so many small businesses, including many companies who contract with federal and state government agencies, has created much angst, uncertainty and confusion among government contractors, due to ever-changing, and often conflicting guidance from a variety of sources and agencies. The PPP was designed to provide needed assistance to all types of small businesses. However, the reality for many contractors who received a PPP loan and intend to seek forgiveness is a concern that the offered assistance from a practical standpoint, based on the FAR requirements, which I will discuss, will equate to little or no benefit, but instead add to compliance concerns and certainly confusion on how to properly report forgiveness proceeds.

As originally written, a small business could apply for a PPP loan if the company had no more than 500 employees or could meet some alternative size standard test. That size standard has now been reduced to 300 employees, and the alternative size standards generally have been eliminated. As an aside, regardless of which of these standards was used to determine eligibility for a loan, many companies that received a PPP loan would not be considered a small business under the FAR because the FAR uses revenue based size standards to determine size for many procurements.

Under the PPP loan program, if a company receives a loan, proceeds can only be spent on certain expenses. These include, among others, payroll costs, interest on mortgages, rent, and utilities. However, at least 60% of the amount to be forgiven must have been spent on payroll costs. This leads to the interaction with the FAR credits cost principle.

FAR Part 31 contains what are known as cost principles. The cost principles are used for pricing contracts, subcontracts and modifications to contracts and subcontracts whenever cost analysis is performed on a proposal. Part 31 is divided into subparts containing cost principles for various categories of contractors. For our discussion today, I will focus on Subpart 31.2, which contains the cost principles for commercial organizations including small business concerns.

The FAR describes different contract types. Generally, these contract types are classified by how they are priced. Most of these contract types are considered flexibly priced contracts because the amount the contractor is entitled to be paid for performing the contract is not fixed at the time of contract award. Instead, the contractor is paid based on the allowable costs it incurs in performing the contract. In the FAR context, an allowable cost is a cost for which a contractor may be reimbursed for performance of flexibly priced government contracts. The cost principles in FAR 31.2 are used to determine what costs are allowable for flexibly priced contracts, which include cost reimbursement contracts (Cost), time and materials (T&M) contracts and fixed price incentive contracts. Each of these contract types incorporates a FAR clause that specifically makes the cost principles in FAR 31.2 applicable to the contract. In contrast, the cost principles do not determine what a contractor is paid under a firm fixed price (FFP) or fixed price with economic price adjustments (FP-

EPA) contract including FFP and FP-EPA contracts for commercial items. Under this contract type, the contractor is paid the stated contract price regardless of the costs incurred in performing the contract.

In my experience, most contractors have a mix of contract types based on the nature of the service or solution being delivered. The type of contract issued (FFP, T&M, Cost or a hybrid) is determined by the procuring agency depending on a number of factors including level of risk, ability to define the scope and/or outcome, and other factors. The government's preference is to use FFP whenever possible.

For flexibly priced contracts, one of the FAR 31.2 cost principles is known as the credits cost principle. The credits cost principle has been in the FAR since its promulgation on April 1, 1984. Before that, a similar cost principle was included in predecessors to the FAR, the Armed Services Procurement Regulation (ASPR) applicable to DoD and the Federal Procurement Regulation applicable to civilian agencies. Thus, the credits cost principle has been a reflection of government procurement policy for several decades.

The credits cost principle states in pertinent part "[t]he applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund." As noted by the Court of Federal Claims, the credits cost principle is "concerned with assuring that if the Government pays a cost and later that cost is reduced, by whatever means, the Government receives the benefit of that reduction. This is fair and reasonable." It is important to analyze the cost principle in the context of the PPP loan program.

First, the government is only entitled to a cost reduction or cash refund if the contractor receives a credit relating to an allowable cost charged to a government contract that is subject to the cost principles, i.e., a flexibly priced contract. As noted previously, PPP loan proceeds can be used for, among other things, payroll costs, interest on mortgages, rent, and utilities. Generally, payroll costs are considered allowable costs, but may be unallowable in some circumstances. Consequently, PPP loan amounts that were used for payroll costs can be subject to a credit. Interest on mortgages is an expressly unallowable cost. Therefore, no credit is due the government if a contractor receives a credit for this cost. Rent is generally an allowable cost, but in some circumstances, some of the rent may be unallowable. To the extent rent is an allowable cost that cost will be subject to any credit the contractor receives for rent. Finally, utilities are generally an allowable cost that is subject to a credit.

As noted earlier, FAR 31.201-5, the credits cost principle provides that "the applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund."

In cost-reimbursement and T&M contracts, a FAR clause 52.216-7(h)(2) is incorporated that provides that, as a condition to final payment under those contracts, the contractor must give the Government an assignment wherein the contractor promises to "pay to the Government any refunds, rebates, credits, or other amounts (including interest, if any) accruing to or received by the Contractor or any assignee under this contract, to the extent that those amounts are properly allocable to costs for which the Contractor has been reimbursed by the Government. Reasonable expenses incurred by the Contractor for securing refunds, rebates, credits, or other amounts shall be allowable costs if approved by the Contracting Officer."

FAR 31.201-2(a) defines cost allowability: "A cost is allowable only when the cost complies with all of the following requirements: (a) (1) Reasonableness. (2) Allocability. (3) Standards promulgated by the CAS Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances. (4) Terms of the contract. (5) Any limitations set forth in the subpart."

FAR 31.201-2(d) further states: "A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The contracting officer may disallow all or part of a claimed cost that is inadequately supported."

The forgiveness of a PPP loan would meet the definition or example contemplated in FAR 31.2 as a type of credit to which the Government is entitled on flexibly priced government contracts. The next step is to determine how the credit is to be applied to those contracts. If the credit relates directly to an allowable cost chargeable to a government contract, the credit should be applied in the same manner as the cost receiving the credit was applied. For example, if the cost generating the credit was charged to the contract as a direct cost, the credit should be applied as a direct cost of the contract. Conversely, if the cost generating the credit was charged as an indirect cost, the credit should be applied to the same indirect cost pool as the cost. This conclusion is based on the FAR requirement for consistency in the way costs are allocated to contracts. A cost is allocated as a direct cost of a contract if the cost is caused by or benefits only that contract. However, if a cost is caused by or benefits more than one contract, it is to be allocated to those contracts as an indirect cost. If credits are not allocated in the same way as the cost being credited, it may result in the government not receiving the full benefit of the credit to which it is entitled or a contractor being required to provide a larger credit than is warranted.

In the case of a credit received by a contractor (i.e. loan forgiveness) which is related to any allocable cost incurred on a flexibly priced contract, such a credit must be credited back to the government. Essentially, if you are already receiving payment for costs of labor and other indirect costs such as rent, you cannot "double-dip" and receive PPP loan forgiveness and bill the government for these same expenses.

A problem with applying this concept to any credit to which the government is entitled as a result of a PPP loan forgiveness is the multiple uses that can be made of a PPP loan. In most credit situations, the credit is identified with a specific cost element such as direct labor or state taxes. However, PPP loan proceeds can be applied to several cost elements which are accounted for differently and with some cost elements being allowable and others unallowable. Obviously, this can cause some confusion as to how credits are to be computed and credited back (or returned) to the government.

This question of the interaction between PPP and the FAR was first addressed on April 17, 2020, when the Department of Defense updated its Frequently Asked Questions (FAQs) as follows:

Q23: Please confirm that neither the FAR Credits provision, FAR 31.201-5, the credit provision in the Allowable Cost and Payment Clause, FAR 52.216-7(h)(2), nor any other FAR or DFARS provision imposes an obligation on a contractor to credit any amount of [PPP] loan that is forgiven to any flexibly priced government contract or subcontract. I consider a contractor that has received a PPP loan will use the loan proceeds as it would any other funds in its corporate treasury to pay costs of doing business."

A23: I disagree, any PPP loan that has been forgiven necessarily can be treated as though it belongs to the company to use as it pleases. FAR 31.201-1, Composition of Total Cost, states that total cost is the sum of the direct and indirect costs allocable to the contract less any allocable credits. Accordingly, to the extent that PPP credits are allocable to costs allowed under a contract, the Government should receive a credit or a reduction in billing for any PPP loans or loan payments that are forgiven. Furthermore, any reimbursements, tax credits, etc. from whatever source that contractors receive for any COVID-19 Paid Leave costs should be treated in a similar manner and disclosed to the government. (Updated: April 24, 2020)

This early guidance issued by DoD, indicated that DoD had determined that when a federal contractor experiences PPP loan forgiveness, the amount of that forgiveness becomes an allowable cost credit. As an allowable cost credit, FAR credit provisions dictate that the contractor **must** give such credit back to the government. It should be noted, that by analogy benefits received from the Employee Retention Credit would require the same treatment.

Subsequent to this guidance, contractors were more confused because (a) most companies have a mix of flexibly priced and firm fixed price contracts, (b) many contractors planned to only include certain costs in forgiveness applications, and

(c) those costs could be a mix of indirect costs and direct costs (which may have been incurred on firm fixed price contracts or commercial contracts so the credits provision does not apply to those costs incurred). In addition, many contractors applied and received PPP loans did not intend to seek forgiveness for any costs. While the impact of PPP forgiveness on Cost contracts has been addressed, the contractor community needs clarity around how to handle forgiven costs under other contract arrangements, as well as, contracts with state Department of Transportation agencies.

Almost a year after the CARES Act, agencies have issued limited guidance which contain conflicting and confusing information that many contractors are struggling to understand and practically apply.

DCAA issued guidance in the form of a Memorandum for Regional Directors – 20-PIC-006(R)-Revised on January 28, 2021. DCAA did make clear that credits should be recorded based on where the original cost was incurred. They also made clear that contractors may receive loan forgiveness that was based on costs that are not all allocable to government contracts, therefore 100% of the loan forgiveness may not be subject to the credits clause. They also provided guidance on the question of the appropriate accounting period to assign the credit. DCAA issued guidance to its auditors that a credit resulting from PPP loan forgiveness should be allocated to the accounting period in which the forgiveness is received. For most contractors, costs were incurred in 2020, but the forgiveness will be received in 2021. However, that guidance is only to be used by DCAA auditors in the conduct of contract audits. It is not binding on contractors or contracting officers. Moreover, there are at least two decisions by the Court of Federal Claims and its predecessor court that indicate a credit is to be assigned to the accounting period in which the cost being credited was incurred. For example, in *Grumman Aerospace Corp. v. U.S.*, the Court said

Plaintiff's 1968 franchise tax costs having been reduced by a subsequent refund, defendant is contractually entitled to its proper share of that reduction computed on the basis of its 1968 reimbursement of costs.

Without regard to how GAAP and sound accounting logic might treat the refund for income tax accounting purposes, the contract language controls here.

As confusing and conflicting as this issue has been for contractors, the Employee Retention Credit, which was made available to companies who had received a PPP loan as a result of the Consolidated Appropriations Act of 2021 is sure to encounter the same type of challenges for contractors with the interaction of the FAR.

I believe much of the confusion and concern regarding guidance has come from architect and engineering (A&E) firms that do business with state Department of Transportation agencies who receive funding from the Federal Highway Administrations (FHWA), Department of Transportation. There is concern with potential draft guidance being considered by the FHWA that would require all PPP loan forgiveness credits to be accounted for as an indirect cost. This concern flows from the text of 23 USC §112(b)(2)(D), which states "[o]nce a firm's indirect cost rates are accepted under this paragraph, the recipient of the funds shall apply such rates for the purposes of contract estimation, negotiation, administration, reporting, and contract payment...". The concern is that accounting for any credits in this way would result in reduced indirect cost rates for the year in which the credit is applied. Further, the concern is that the reduced rates would apply throughout the life of multi-year contracts awarded in the year in which the reduced rates were established causing contractors to unfairly be subject to reduced indirect cost rates due to PPP forgiveness for multiple years. I have heard this concern in numerous blogs, trade orgs and various meetings, but FHWA has not actually issued any guidance.

As discussed above, I believe this "presumed" guidance is inconsistent with the FAR cost principles. Importantly, the cost principles of FAR Part 31 are to be used when conducting audits of contracts awarded under the authority of 23 U.S.C. §112. Title 23 of the Code of Federal Regulations Section §172.11 clarifies that the phrase "recipient of funds" as used in 23 U.S.C. §112 refers to the agency awarding a contract to the A&E firm. Moreover, I do not interpret the requirement that "contracting agencies shall apply such indirect cost rate for the purposes of contract estimation, negotiation, administration, reporting, and contract payment" as eliminating the use of business judgment in negotiating a price or fee that is fair and reasonable to both parties. Significantly, 23 CFR §172.11(b)(1)(vi) seems to allow for the indirect cost rate applied to a multi-year contract to vary from year to year when it says:



A consultants accepted indirect cost rate for its 1-year applicable accounting period shall be applied to contracts; however, once an indirect cost rate is established for a contract, it may be extended beyond the 1-year applicable period, through the duration of the specific contract, provided all concerned parties agree. Agreement to the extension of the 1-year applicable period shall not be a condition or qualification to be considered for the work or contract award.

Understandably, many A&E firms are concerned with the implications of anticipated FWHA guidance. In addition, as FWHA funds flow down to many state Department of Transportation (DoT) agencies for contract awards, the state contracts carry many of the same FAR requirements and clauses. Most state DoTs require A&E firms to have an indirect rate audit (overhead audit) conducted by a CPA firm. Our firm has expertise in these audits and performs them for many A&E firms. The guidance we have seen from many of the state DoT audit departments indicates they are still trying to get additional guidance from FHWA, but absent that, are making blanket statements to rely on existing regulations and cost accounting standards in determining credits. As a practical matter, my firm plans to apply the applicable credit (which may not be the entire PPP loan forgiveness) for forgiven indirect expenses to the overhead pool (which we believe is consistent with FAR Part 31.2), and include in the footnotes, a statement of what the overhead rate would be with and without the credit. It seems logical that A&E firms should provide credits for forgiven costs in the same manner that costs were incurred; that is, forgiven indirect costs should be credited to the indirect costs pool; forgiven direct costs should be credited to direct costs; no credit should be provided for costs that are not reimbursed by government funds in any way.

I believe there are three areas where guidance would assist government contractors, especially for A&E firms. First, standardizing the period in which the PPP loan forgiveness credit should be recorded as a credit and included in any overhead rate audit. Including this credit in the year in which the costs were incurred regardless of when forgiveness was awarded would align with both existing generally accepted accounting principles and prior court decisions. Thus, PPP forgiveness awarded in 2020 would apply to 2020 costs and 2021 forgiveness awarded prior to the issuance of 2020 overhead rate audits would likewise be included in the 2020 audit and calculated rate.

Second, I recommend that regardless of when or if forgiveness has been applied for or received, any contractor receiving PPP funds should disclose in the notes to the overhead audit statements the calculated overhead rate both with and without anticipated PPP loan forgiveness credits. This same note could also be included as information in annual Incurred Cost Submissions for companies required to submit to federal agencies who have flexibly priced contracts.

Lastly, inform procurement agencies (primarily state DoT agencies) that the rates included in overhead rate audits should be used in negotiations but that final rates can incorporate consideration of the impact of PPP forgiveness. Specifically, while the rate including PPP loan forgiveness may be used in year one of a multi-year contract, subsequent years should be renegotiated using rates that are not impacted by credits for PPP loan forgiveness.

I believe each of these recommendations align with existing generally accepted accounting principles, as well as, existing FAR guidance. Furthermore, guidance incorporating these recommendations would reduce confusion and ensure government contractors receive the benefit originally intended by the CARES Act, but not benefit government contractors more, with a potential "double dip", than companies receiving PPP loan forgiveness who do not contract with government agencies.

Thank you for your attention. I will be glad to answer any questions that you have.



**Statement of Robin S. Greenleaf, P.E.
Chief Executive Officer
Architectural Engineers, Inc.**

On behalf of the American Council of Engineering Companies

**Before the House Committee on Small Business
Subcommittee on Contracting and Infrastructure
hearing on
The Interaction Between the Paycheck Protection Program and Federal Acquisition Rules:
What it Means for Government Contractors**

Tuesday, March 23, 2021

Chairman Mfume and Ranking Member Salazar:

Thank you for the opportunity to testify before the subcommittee today. It's an honor to represent my firm and my colleagues in the nation's engineering industry to you and the members of the subcommittee.

My name is Robin Greenleaf. I am the CEO of Architectural Engineers, Inc. (AEI), a women-owned engineering firm in Boston, Massachusetts.

I am testifying today on behalf of the American Council of Engineering Companies (ACEC) – the business association of the nation's engineering industry. ACEC member firms drive the design of America's infrastructure and built environment. Founded in 1906, ACEC is a national federation of 52 state and regional organizations representing nearly 5,500 engineering firms and 600,000+ engineers, surveyors, architects, and other specialists nationwide.

More than three-fourths of ACEC members are small businesses.

I am the 2020-21 Chair-elect of ACEC and will have the privilege of serving as the National Chair starting in April. I would also like to note that this is a volunteer position.

Firm Profile

I founded AEI in 1985, and we have been certified by the state of Massachusetts as a women business enterprise (WBE) and disadvantaged business (DBE) since 1986. We also hold WBE/DBE status in Connecticut and Rhode Island.

We have 33 employees. Our professional experience includes heating and air conditioning, plumbing, electrical lighting and power systems, instrumentation, and fire protection

engineering. Our project portfolio includes virtually every project type: laboratories, academic facilities, state office, public safety, municipal buildings, airport terminals, courthouses, transportation / infrastructure, commercial high-rise office buildings, corporate headquarters, tenant interiors, residential towers, libraries and museums. Our clients include federal and state agencies, municipalities and towns, and private corporations and owners.

COVID Impacts and PPP Loan

In March of 2020 my state, like so many others, declared a state of emergency due to the pandemic. In mid-March, my firm moved to fully remote operations, and continue to operate remotely today. With 33 employees all doing highly technical work, we committed to providing the same equipment at home as they have in the office to ensure efficiency and seamless transitions no matter where they are located. This was done at significant, unbudgeted expense to the company, but was necessary to maintain operations.

By late March, we had experienced a significant reduction of workload and backlog due to project cancellations and delays, both in our work with our state DOT, airport authorities, and private clients.

In April, we applied for a PPP loan of \$590,000, which was approved and funded in late May. This loan allowed us to keep our entire staff on the payroll, even in the face of significant revenue loss, and allowed us some time to regroup our business plan as we adjusted to working remotely.

FAR Credits

Under current federal guidance, forgiven PPP loans will be subject to the “credits” clause of the Federal Acquisition Regulation (FAR 31.201-5).

To understand what is at stake in this approach, it’s important to understand how public agencies negotiate contracts for professional services. An engineering firm’s overhead or indirect cost rate reflects the cost of doing business and includes items such as rent, facilities, equipment, administrative costs, employee fringe benefits, insurance, and other general business costs that are not directly attributable to any specific project or contract. This rate is used in conjunction with direct costs, such as employee salaries, when negotiating contracts with government agencies. These costs are governed by the cost principles in Part 31 of the Federal Acquisition Regulation. They are audited by an outside CPA firm every year and reviewed by the relevant agency. The audited indirect cost rate is used for a one-year accounting period but is also the rate used for the duration of a contract, which is often multi-year.

The most likely implementation of the FAR credit will be a reduction in my firm’s overhead rate to reflect the PPP loan. This is the approach taken in draft guidance presented by the Federal Highway Administration in January and that many State DOTs are adopting as policy.

Summary of Impact to AEI

Approximately 15% of my firm’s work is contracted with public agency clients using a FAR-compliant overhead rate. That includes transit projects administered by the Massachusetts Bay

Transportation Authority (MBTA). We typically contract approximately \$900,000 per year with MBTA. In 2021, we expect that revenues from MBTA should stay about the same.

My firm's current overhead rate is 147%. The PPP credit will reduce our rate to about 115%, which will reduce our billings to MBTA and result in a loss of at least \$129,000 per year. This is not sustainable and will likely result in our making the business decision to not provide services to clients who request proposals during the impacted time period. MBTA contracts can last for years, and to intentionally incur a loss of this magnitude over a multi-year period is not good business.

Industry Impact

My firm is just one small example. This issue is going to affect thousands of small firms across the country much more dramatically.

When you extrapolate the reduction in billing rates across multiple contracts and multiple clients, it's easy to see how the losses grow significantly. One of our affiliate CPA firms ran the numbers for one of his clients who performs predominantly highway-related work for State DOTs. On a \$1.4 million PPP loan, the FAR credit will reduce their rate by 34 points, resulting in a \$1.7 million loss in revenue in one year alone and close to \$7 million in lost revenue over five years, as most of the DOT work is done under multi-year contracts that lock in the billing rate.

The impact of the credit will fall most heavily on small, minority-owned and women-owned firms that needed the assistance the most and who tend to perform a higher percentage of government contracting. Here are some examples we have collected:

A WMBE engineering firm with 43 employees in upstate New York received a \$826,000 PPP loan. They used the funds primarily to keep employees on the payroll. If they are required to provide a credit to their overhead for loan forgiveness, the firm's overhead rate would drop from 159% to 114%. Based on projected labor in 2021, the firm's revenue would drop from \$5.5 million to \$4.5 million – *a loss of more than \$1 million in annual revenue.*

A minority-owned DBE/MBE construction inspection/civil engineering firm with 45 employees in central Ohio received a \$770,000 PPP loan. If they are required to provide a credit to their overhead rate for the loan forgiveness, it will reduce their overhead rate from 1.33 to .94. Given their 2021 workload, they will go from a projected \$350,000 profit on \$4.7 million in revenue to a loss of \$298,000, *a total reduction of \$648,000.* On multi-year contracts, the impact will be even worse. According to the firm, they would have been better off not accepting the PPP loan and laying staff off.

A disadvantaged business and women-owned small business enterprise with 45 employees in southwestern Illinois received a \$700,000 PPP loan. If they are required to provide a credit to their overhead rate for the loan forgiveness, it will reduce their overhead from 172% to 137%. Given their workload, they will *lose approximately \$690,000 in revenue in the next year.* When the PPP loan came out, they made the choice

to keep their engineering field people employed even though projects were delayed due to COVID, and to upgrade their computer equipment so designers could work from home and still access large files.

Mr. Chairman, according to SBA data we have reviewed, 265 Maryland businesses in the "engineering services" NAICS contracting code received PPP loans larger than \$150,000 in 2020. Those firms employ 12,465 people. Not all of those businesses are ACEC members and not all contract with public sector agencies, but it's a good approximation of the scope of impact in your state.

Congresswoman Salazar, there were 561 "engineering services" businesses in Florida that took PPP loans totaling \$357 million in 2020. Those businesses employ more than 25,000 people. Again, not all those companies are the types of firms that contract with the government, but several hundreds of them will be impacted by this issue.

It's important to note that other contractors working on federal-aid projects for state and local agencies are not subject to these same requirements. While my rates are reduced, other businesses working on the same infrastructure projects have been able to retain the full benefit of the PPP. This uneven treatment does not seem fair.

I'd like to point out several anomalies and inconsistencies between the intent of the PPP loan, and the impact on firms having effectively reimburse government clients because of the interpretation of FAR credit clause:

1. For many ACEC member firms who perform a significant volume of DOT work, the net effect will be that they would be repaying almost their entire loan amounts in the first year following application of their reduced overhead (OH) rate. If these firms had opted to repay the loan, they would have had either two or five years to repay, depending on when the loan was funded.
2. The total value of the PPP loan is being applied as a credit to effectively reduce a firm's overhead rate for the entire year contractually, yet the PPP loan amount is calculated based on an expected payroll for an 8 or 24 week period, depending on how forgiveness is calculated. There is no discussion of application of the lowered overhead rate only to hourly invoicing which occurred over the same 8 or 24 week period. If the reduced overhead rate is applied to an entire year of contracting, then the double dipping is on the government's side.
3. The PPP loan funds came from the federal government, yet in many cases, such as my firm, the credit is given to local/state government. This is a one-way flow of funds which puts the local/state government entity in the position of receiving the final benefit.
4. The FAR credit clause is causing the overhead pool to be reduced by the amount that was received under PPP. So, if you received \$100,000, that is what is reducing the pool. This credit clause is targeting government contractors who are working on projects being invoiced on an hourly basis. Government contractors who have fixed priced contracts are not impacted by the FAR credit clause, which is unfair treatment, and puts us at a disadvantage with our competitors.

Conclusion

This is government giving with one hand and taking back with the other. Small businesses like mine were experiencing tremendously difficult circumstances and a very uncertain economic outlook as projects were shut down and offices shuttered in the spring of 2020. Ultimately, according to a recent study from our Research Institute, engineering and design services revenue fell an estimated 7% in 2020, significantly underperforming overall construction activity over the period. As you can imagine, the disruption hit our small businesses the hardest. The assistance provided through the PPP enabled those firms to maintain their payroll and meet other expenses during this very turbulent economic period.

Now those small businesses are facing the imposition of a credit for forgiven PPP loans, which will further inhibit their ability to recover and grow. According to our most recent economic forecast, we expect total engineering and design services revenue will decline further in 2021, falling 4% from 2020 levels. The prospect of firms being forced to credit back the critical PPP assistance in this economic environment is daunting.

There's a real sense of urgency in the industry to get this issue resolved. Firms that already received forgiveness are starting the annual audit process and seeing the impact of the credit on their rates. Those that have not yet applied are coming up on the 10-month deadline to start repaying their PPP loans. Banks are pressuring them to decide whether to apply for forgiveness. Our small business owners need to make critical business decisions about the impact on their rates and projected revenues and the employment ramifications.

If unchanged, this policy will create a disincentive for women-owned firms, DBEs, and other small businesses to compete for work for public agencies. It will deprive the government of qualified engineering services, and it will hamper efforts to expand small business and DBE contracting opportunities.

At a time when the industry is very eager to work with you and your colleagues to deliver a robust infrastructure-based economic recovery agenda, the prospects for those opportunities are dimmer because of this credit holding us back.

Congress already made clear that forgiven PPP loans are not to be treated as income for tax purposes and then further clarified in the year-end omnibus bill that covered expenses are deductible. In the same way, Congress ought to make clear that forgiven PPP loans are not income under the FAR. This was emergency relief to support employers, and our businesses ought to be able to take full advantage of the program.

Thank you again for the opportunity to testify.

Testimony of Mr. Carlos A. Penin, PE

My name is Carlos A. Penin, PE. I arrived from Cuba in 1962 at the age of 6. I am a proud Cuban American who pursued a career in engineering and ended up fulfilling my "American Dream" of starting my own business. The company that I started, C.A.P. Engineering, Inc. (CAP) is a minority owned small business. We are based in the City of Coral Gables, Florida, where we started our operations thirty-two (32) years ago, in 1989.

The resiliency and perseverance that my generation witnessed and learned from our parents helped us survive every blow of nature and the economic downturns outside of our control. In 2020, unlike any other country in the world, the federal government stepped up and came to the assistance of the private sector by offering multiple legislative responses, most importantly the Paycheck Protection Program (PPP) under the Coronavirus Aid, Relief, & Economic Security Act the CARES Act. In part, the Paycheck Protection Program helped us maintain our employees, pay their salaries, protect them from the Coronavirus, and on a limited basis, allowed us to continue to provide services to our clients.

As a small, minority-owned business, we applied for and received assistance from the PPP program. CAP obtained approximately \$130,000 in PPP funding, which was utilized one hundred percent for its intended purpose of paying our employees. There were no layoffs.

Having survived multiple hurricanes during our company's history, including Hurricane Andrew in 1992, the devastation from this pandemic has been far worse. The interpretation of the Federal Acquisition Regulations (FAR), Credits Clause (under FAR 31.201-5) would reverse the benefits received from the PPP and could have a negative impact for years to come.

Due to this interpretation, engineering companies like mine that work for the government and help provide essential services of designing and inspecting for our country's vital infrastructure are now faced with an unintended consequence.

According to the proposed guidance of the Federal government and therefore applied to all DOT contracts the overhead rate will be reduced by the same amount of the PPP loan forgiveness given to the engineering firms. For many engineering firms, including mine, this will result in a reduction in future billing rate and a net loss greater than the PPP assistance I received. If this goes into effect as FHWA has proposed, it could jeopardize the very employees in my firm the loan was intended to save.

This will be the case for many small minority and women owned businesses, which needed the help and that the Paycheck Protection Program was intended to assist but could actually be hurt. This can also lead engineering firms to be disincentivized to compete for work for government agencies, and thereby hamper DOTs efforts to expand the use of small businesses.

The proposed guidance of the FAR, as currently being applied, negates the main purpose for the PPP loans and unintentionally penalizes the small business and people it intended to help.

The PPP loan forgiveness program was intended to provide much needed help to all companies who applied, qualified and received these monies. This Program was never intended to provide a benefit to the Government agencies that we contract with.

Please consider a clarification to the law to ensure that all firms that received the PPP are allowed to keep this critical assistance as originally intended so that together we can continue to assist in the rebuilding and recovery of our great Country.



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Representative Kweisi Mfume
Chairman
House Committee on Small Business
Subcommittee on Contracting and Infrastructure
2361 Rayburn House Office Building
Washington, DC 20515

RE: House Subcommittee on Contracting and Infrastructure Hearing on the
Paycheck Protection Program and Federal Acquisition Rules: What it Means for
Government Contractors

March 22, 2021

Dear Chairman Mfume,

The American Institute of Architects (AIA) submits the following
recommendations to the committee as you consider the interaction between
the Paycheck Protection Program (PPP) and current Federal Acquisition Rules
(FAR).

As it has since its founding in 1857, the AIA exists to represent architects and to
safeguard the health, safety, and welfare of the public. On behalf of the
94,000+ members of the American Institute of Architects (AIA), I write to you
to share AIA's comments for the committee record regarding the impacts of
FAR loan forgiveness for firms who have utilized a PPP loan.

PPP loans have provided an important and critical lifeline to the architecture
profession to maintain payroll and keep businesses running. However, a key
provision within the FAR's "credits" clause (under FAR 21.201-5), meant to
ensure that federal agencies are reimbursed for contract discounts, could
impede the ability for architects to receive full benefits of the PPP loan. AIA
understands that the FAR provision could be interpreted to apply to forgiven
PPP loans for architect-engineer firms who contract with certain federal
agencies, like the Department of Defense (DoD) and state Departments of
Transportation. Under the current FAR guidance, architect and engineering
firms could be forced to pay back some of the PPP loan assistance that they
have previously applied and qualified for.

AIA believes the FAR interpretation is inconsistent with the intent of Congress
define by the Coronavirus Aid, Relief, and Economic Security (CARES) Act. In
fact, the FAR position could mandate contracting firms a refund the amount of
forgiven PPP loans for contract costs. AIA urges the committee to clarify that
the FAR credits clause to not apply to PPP loans, regardless of if a firm is a
public or private contractor. This would help give much needed relief to those
businesses who need it the most – small businesses nationwide.

Thank you for your consideration of AIA's recommendations. If you have any questions, please do not hesitate to contact me at sarahdodge@aia.org.

Sincerely,

A handwritten signature in blue ink that reads "Sarah Dodge". The signature is written in a cursive, flowing style.

Sarah Dodge
Senior Vice-President of Advocacy & Relationships

cc: House Small Business Committee