THE GOVERNMENT CONTRACTOR®

THOMSON REUTERS

Information and Analysis on Legal Aspects of Procurement

Vol. 57, No. 30 **August 12, 2015**

Focus

¶ 242

FEATURE COMMENT: ASBCA Rules On Critical Issues Regarding Changes In Cost Accounting Practices

Raytheon Co., Space & Airborne Sys., ASBCA 57801 et al., 2015 WL 4134791 (May 7, 2015) (publicly released July 8, 2015)

In *Raytheon Co., Space & Airborne Systems*, the Armed Services Board of Contract Appeals took up challenges to several long-standing practices employed by the Government in assessing cost impacts under the Cost Accounting Standards. The Board examined Government claims of impacts resulting from changes in contractor cost accounting practices, including multiple changes made effective the same day.

The Board's decision addressed the Government's claims against Raytheon to recover allegedly increased costs paid resulting from a series of accounting changes Raytheon implemented for various administrative reasons. The Government asserted that these unilateral changes increased the costs to the Government on these contracts, and claimed that Raytheon must reimburse the Government for these increases, as stated in the Federal Acquisition Regulation and CAS. Raytheon challenged both the Government's assertions of entitlement and the Government's method of calculating these impacts.

In deciding these issues, the ASBCA made several notable determinations, two of which were of particular importance, and addressed several controversial Government assertions. First, the ASBCA ruled that the Government's practice of counting decreases on fixed-price contracts as increased costs paid constitutes double-counting, contrary to the CAS statute. Second, the ASBCA declined to declare FAR 30.606(a)(3)(ii) invalid. This is a regulation the FAR Council promulgated in 2005, providing that simultaneous changes instituted by contractors should be treated separately, disregarding decreases, and recovering increases—i.e., prohibiting the offset of such changes. The ASBCA also addressed issues of desirable and material changes to contract accounting.

These issues have real impact on the operations of contractors as they seek to comply with federal accounting rules while protecting their own interests.

The Government Is Prohibited from Double-Counting—In assessing costs against Raytheon, the Government claimed that Raytheon should be charged for both the amount of the decrease from the fixed-price contracts *and* the increase to flexibly priced contracts, despite the fact that both changes represented the same costs. The Government claimed that its hands were tied by the CAS, which contains definitions of increased costs for both reductions in fixed-price contracts and increases in fixed-price contracts. Decision at 27, citing 48 CFR § 9903.306(b). The levy on Raytheon from both sides was an example of a long-standing practice by the Government aggressively seeking maximum recovery arising from accounting changes.

The Board examined the practical consequences of the Government's position, and found that the Government's separate treatment of the two types of contracts ignored the reality of what was happening, in that it counted the same change twice and sought recovery of twice what it was due:

> Raytheon provides a simple example to illustrate what it views as the unfairness of the government's position. It posits a world where the Revision 1 change applies only to two contracts, one fixed-price, one flexibly-priced, both at one million dollars. It then reduces the allocation to the fixed price contract by $300,000

> as a result of the property accounting change and increases the flexibly-priced contract by the same amount.... Under this scenario, if no adjustments are made to the contracts, the government would pay $2.3 million for goods and services for which it expected to pay only $2 million.

Decision at 26. Thus, under the hypothetical, the Government paid only $300,000 more as a consequence of the change in cost accounting practice, but sought a recovery of $600,000. The Government's double-counting tactic "runs afoul of the prohibition in 41 U.S.C. § 1503(b)" against recovering greater than the aggregate increased cost paid by the Government. Decision at 27. The ASBCA described the Government's practice as "the very definition of a windfall." Id.

This ruling has potentially extensive consequences, as the Defense Contract Audit Agency routinely calculates related changes such as these as separate, and seeks to recover for both changes. The DCAA Contract Audit Manual, for example, advises DCAA auditors that "each organizational change must be evaluated separately to determine whether a change in cost accounting practice has occurred." DCAM § 7-1811 at 7158. Accordingly, contractors should revisit cost impact calculations that followed the Government's preexisting demanded practice, as it will result in vastly overstated recoveries for the Government, contrary to the CAS statute.

Offsetting Multiple Unrelated Changes in Cost Accounting Practices—Relying on and expanding the underlying rationale of its recent decision in *The Boeing Co.*, ASBCA 57549, 13 BCA ¶ 35,437; 53 GC ¶ 337, the ASBCA also held that contractors could "offset" increased costs paid as a result of changes in cost accounting practices against decreased costs paid for other changes in cost accounting practices made effective the same date, if the changes were made before a 2005 amendment to the FAR, at new § 30.606(a)(3)(ii), prohibiting that practice. The ASBCA expanded on the *Boeing* rationale by explaining that the preexisting practice of the Government was to allow such offsets. Decision at 11–13.

For changes in cost accounting practices after the 2005 FAR change, the ASBCA held that the FAR provision was valid and applicable. The ASBCA held that the CAS Board's exclusive authority under the CAS statute applies only to the institution of regulations that govern the "measurement, assignment and allocation of costs to contracts." The ASBCA held that the CAS Board's exclusive authority in other aspects of CAS was unclear. The ASBCA also held that the CAS Board acquiesced in the issuance of FAR 30.606, because the administrator of the Office of Federal Procurement Policy, who was also the chair of the CAS Board, was aware of the FAR initiative to address the issues in 2002 and endorsed that action; a later OFPP administrator abandoned the CAS Board's own effort to implement regulations on the subject; and in the 10 years since FAR 30.606's existence, neither the OFPP administrator nor the CAS Board has ever attempted to rescind FAR 30.606(a)(3)(ii). Decision at 14–20.

Interestingly, the ASBCA did not address arguments that the CAS statute itself prohibits the Government from recovering more than increased costs paid in the aggregate. 41 USCA § 1502(f); see also *Gen. Elec. Co. v. U.S.*, 84 Fed. Cl. 129, 148 (2008); 50 GC ¶ 386. Nor did the ASBCA consider arguments that the logical extension of its decision in Boeing requires the same result, because the CAS statute never changed in 2005.

For multiple changes in cost accounting practices that simultaneously affect contracts both before and after the FAR change, the ASBCA held that affected contracts predating the FAR change are subject to the *Boeing* standard, while affected contracts entered into after the FAR change are subject to FAR 30.606.

Desirable Changes—The ASBCA held that the determination of whether a change is desirable, and therefore not subject to the restriction on increased costs paid, is discretionary and must be subject to an assessment of whether the contracting officer abused his or her discretion. The ASBCA applied a high "bad faith" standard to assess the Government's determinations in the *Raytheon* case.

Raytheon asserted that the ASBCA's previous decisions required a more searching determination, citing *Lockheed Martin Corp.*, ASBCA 53822, 07-2 BCA ¶ 33,614, aff'd, *Donely v. Lockheed Martin Corp.*, 608 F.3d 1348 (Fed. Cir. 2010), which stated,

> [A]n increase in costs alone was not a sufficient basis for determining that the changed practices were not desirable and that the relevant factors for assessing desirability "may include" the extent of active government involvement in, and support for, the decision to institute the changed practices; the degree to which the changed practice increased the accuracy and precision of the cost measurement, assignment and/or allocation

> process; the degree to which the changed practice increased the visibility, management and/or controllability of the cost in question; and, any other short or long term benefit to the government.

The ASBCA, however, dismissed this statement as merely dicta, and held that it was not "bad faith" or "an abuse of discretion" for the Government to rely upon increased cost alone in assessing the desirability of a change. Decision at 22–23.

Interest—Citing the CAS statute and *Gates v. Raytheon Co.*, 584 F.3d 1062, 1070 (Fed. Cir. 2009); 51 GC ¶ 362, the ASBCA held that compound daily interest applies to changes in cost accounting practices. The ASBCA also held, however, that the calculation of interest should not run as if the entirety of the cost impact occurred on the first day of the change implementation. Decision at 28.

30-Percent Increment—In calculating the supposed impact of the Raytheon changes, the DCAA did not conduct full audits of all of Raytheon's submitted cost estimates, but merely applied percentage "increments" to certain contractor estimates, increasing them to account for unnamed risks. Raytheon challenged this practice as improper and likely to result in windfall recovery, while the Government asserted that the increments were necessary due to missing data in the Raytheon submissions. The ASBCA declined to rule on this issue at the summary judgment stage, due to its conclusion that material facts were in dispute. Decision at 27–28.

Materiality—Similarly, the ASBCA held that it could not decide the question of whether the Government improperly concluded that the amounts at issue were material because of the ASBCA's separate determination that the Government had grossly overstated the cost impacts due to double-counting. Decision at 24–25.

Conclusion—In the *Raytheon* decision, contractors will welcome the elimination of the Government's "double-counting" approach. On the other hand, many contractors have objected to the restrictions of FAR 30.606(a)(3)(ii), and would have welcomed action by the ASBCA invalidating it.

This case is a follow-on to *Raytheon Co., Space & Airborne Sys.,* ASBCA 57801 et al., 13 BCA ¶ 35,319; 55 GC ¶ 185, wherein the ASBCA denied three of the consolidated Government claims based on the statute of limitations.

✦

This FEATURE COMMENT was written for THE GOVERNMENT CONTRACTOR by* Paul E. Pompeo and Stuart W. Turner *of Arnold & Porter, LLP. Mr. Pompeo is a partner in the Government Contracts and National Security Practice, and currently serves as vice chair of the Procurement Division for the National Defense Industrial Association. Mr. Turner is counsel in the Government Contracts and National Security Practice. The authors represent Raytheon Co. in the matters that are the subject of this FEATURE COMMENT.

