

Costs, Pricing & Accounting



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Costs, Pricing & Accounting

Major Topics Addressed

- DCAA Activity and Audit Guidance
- Cost Accounting Standards Developments
- Significant Legal Decisions on Cost, Pricing and Accounting Matters
- Pricing Developments and Activity

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DCAA incurred cost backlog: Conquered

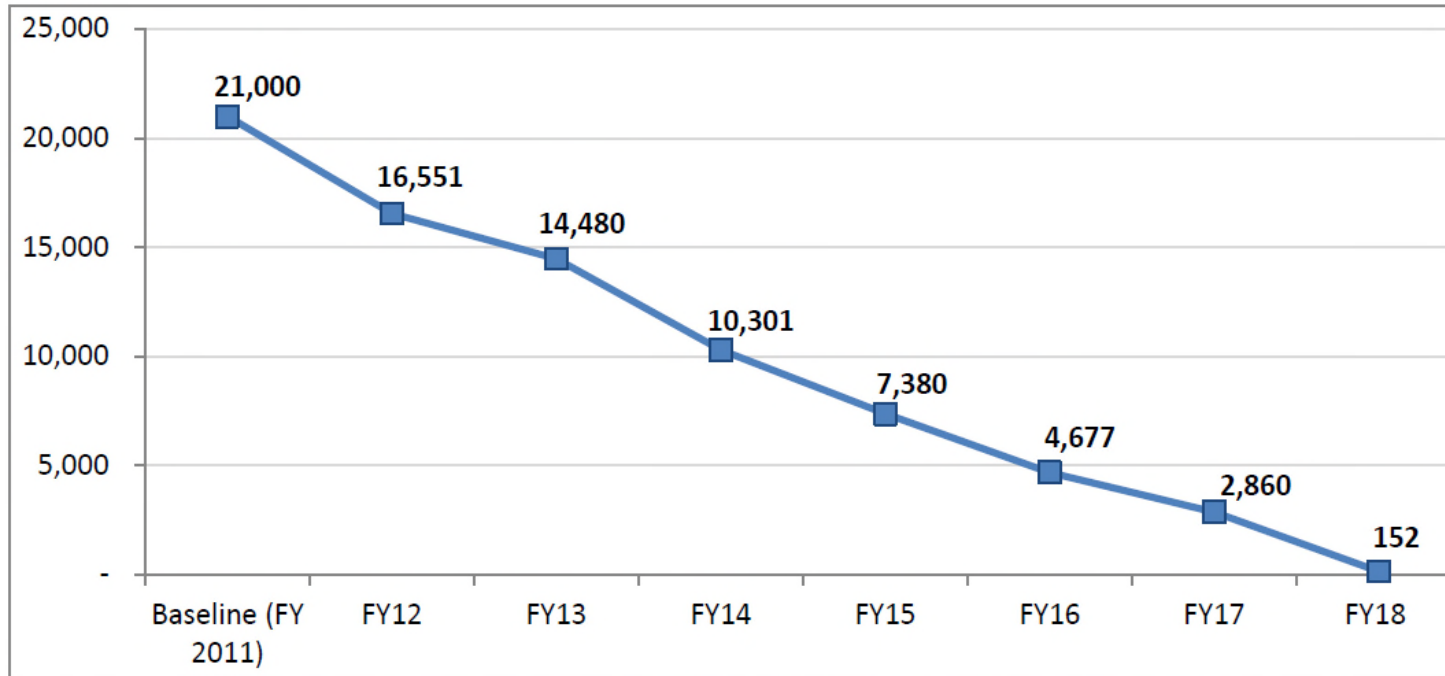
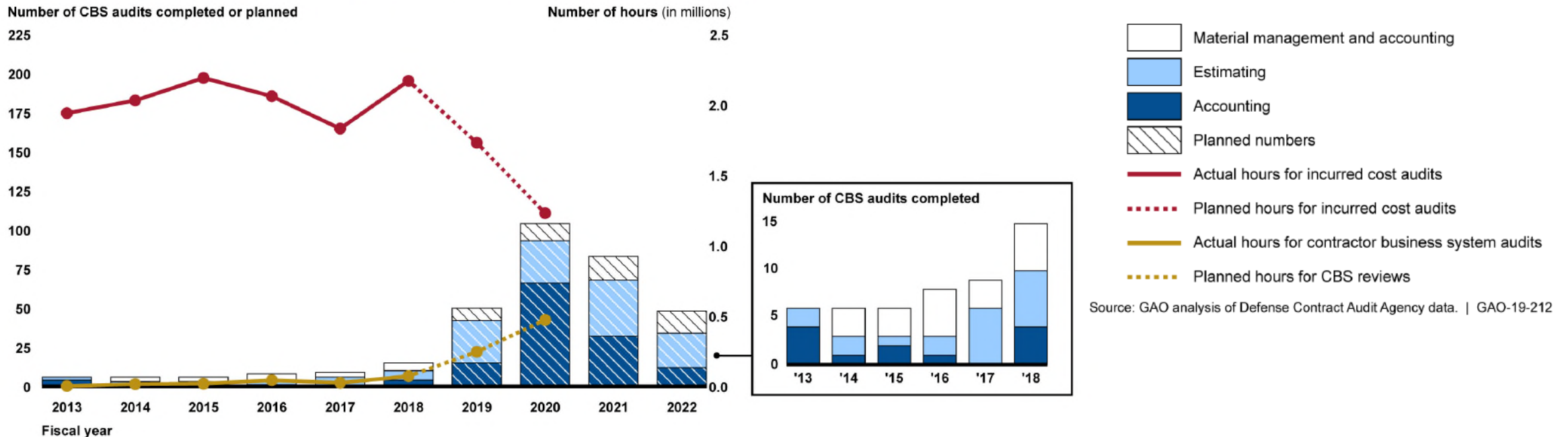


Figure 4 – Incurred Cost Backlog FY 2011 - FY 2018

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DCAA renews commitment to business system audits:

Figure 3: Number of Hours and Audits Related to Contractor Business Systems Completed and Planned by Defense Contract Audit Agency (DCAA) Fiscal Years 2013-2020, and Hours Related to Incurred Cost Audits



Source: GAO analysis of Defense Contract Audit Agency data. | GAO-19-212

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DCAA also renews commitment to post-award (TINA) audits:

- Plans to perform 60 TINA audits in FY20
- Up from 20 in FY19, 21 in FY18, and 26 in FY17

Headwinds for contractors:

- General community-wide atrophy of TINA experience
- Uptick in once-routine audits, or are contractors now presumed fraudsters?
 - Shay Assad, the Pentagon's former director of defense pricing and contracting, said evaluations during his tenure showed that essentially 100% of the contracts examined at one top-25 defense contractor had suspect pricing.
 - "If one looks deep enough there is some element of fraud typically lurking," he said.
(*Pentagon Plans to Triple Audits Amid Surge in Defense Spending*, Bloomberg, September 13, 2019)
- Defective pricing, or false claim?

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DCAA lightens its workload with the help of independent CPA firms

- IDIQ contracts awarded to four CPA firms
 - Kearney & Company
 - Clifton Larson Allen
 - Reed & Associates
 - Booth Management Consulting
- Only incurred cost audits (for now); all selected by DCAA HQ
- Large and small contractors (but none with CADs) in all Regions
- 100 audits awarded in FY19
- Early reactions/feedback: mixed reviews

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Breaking new ground: quantified materiality

- DCAA MRD 19-PAS-003(R) and Chapter 2 of the Section 809 Panel's Professional Practice Guide
- Adopted over a year earlier than required by Congress
- Introduces a formula to calculate a threshold materiality amount
- Qualitative (i.e., professional judgement) considerations still apply
- Still nascent in practice; will be used in audits of contractor CY18 incurred costs (ICPs submitted June 30, 2019)

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Cost Accounting Standards Board developments:

Staff Discussion Paper re: Conformance of CAS to GAAP

- Issued March 13, 2019
- Preliminary analysis of CAS 408 & CAS 409
- Comments provided by May 31, 2019

Industry Reactions

- Generally agreed with CASB Guiding Principles & Roadmap
- Cautioned against tedious line-by-line reconciliation of CAS to GAAP
- Encouraged the CASB to instead evaluate GAAP's ability to achieve CAS Objectives of cost accounting uniformity and consistency
- Discouraged extending CAS administration to GAAP compliance
- Encouraged CASB to re-prioritize its work to focus on more impactful matters

Allowability of Settlement of Litigation Costs – Tecom

- Decades of case law allowed contractors to recover the cost of settling third party litigation.
- The general rule collapsed in 2009 after the Federal Circuit decision in *Geran v. Tecom*, 566 F.3d 1037 (Fed. Cir. 2009)
- *Tecom* involved the costs of defending and settling a lawsuit alleging employment discrimination where the contract at issue incorporated FAR 52.222-26, “Equal Opportunity.”
- *Tecom* held: because an adverse judgment that the contractor had violated Title VII of the Civil Rights Act of 1964 would breach the underlying contract, the costs of defending and settling such a lawsuit were unallowable—unless the contracting officer determined that Title VII plaintiff had “very little likelihood of success on the merits.”
 - The Circuit provided no insight into the meaning of “very little likelihood of success on the merits.”
- *Tecom* included qualifying language suggesting its rule may not apply “where neither the contract nor the FAR dictates the treatment of specific costs.”

Allowability of Settlement of Litigation Costs – Bechtel

- Bechtel stemmed from a DOE Contracting Officer final decision disallowing costs that Bechtel incurred defending two discrimination lawsuits brought by former employees on a contract that included FAR 52.222-26, “Equal Opportunity.”
- Bechtel appealed to COFC:
 - Bechtel did not challenge the contracting officer's determination with respect to the likelihood of success on the merits of the third-party claims.
 - Bechtel argued that *Tecom* should not apply because the contract contained a DEAR clause that contemplated DOE reimbursement of third-party litigation settlement costs (remember the qualifying language from *Tecom*).
- The Court of Federal Claims rejected this argument, finding the settlement costs unallowable under *Tecom*. The COFC followed the analytical steps of *Tecom*.

Allowability of Settlement Costs – Bechtel

Bechtel appealed, and the Federal Circuit affirmed:

- Unanimous decision authored by Judge Dyk, author of *Tecom* majority.
- Recognized that the *Tecom* rule could be displaced by contract language; but, rejected Bechtel's contention that the DEAR clause at issue in this case did so.
- Reason: the DEAR clause provided reimbursement only to the extent not disallowed by other contract provisions, and the Bechtel contract contained the same clauses at issue in *Tecom* (FAR 31.204 and 52.222-26).
- Conclusion: because the contractor abandoned its arguments regarding the "little likelihood of success on the merits" prong of the *Tecom* test, the defense costs were unallowable
- Panel opinion noted it was bound by *Tecom* and added that it saw no reason to recommend reconsideration of *Tecom*.
- Panel did not address "likelihood of success on the merits" standard

Expressly Unallowable Costs – Raytheon

- Unallowable v. Expressly Unallowable:
 - Some costs are “unallowable”, others are “expressly unallowable”
 - An “expressly unallowable” costs is a “particular item or type of cost which, under the express provisions of an applicable law, regulation, or contract, is specifically named and stated to be unallowable.”
 - Expressly unallowable costs are subject to penalty
- FAR31.205-22 designates as unallowable costs “associated with” various types of lobbying any political activities.
- ASBCA precedent held that compensation and bonus and incentive compensation costs “associated with” lobbying activities are not expressly unallowable because compensation and BAIC are not “specifically named and stated” as unallowable under FAR 31.205-22.

Expressly Unallowable Costs – Raytheon

- In *Raytheon*, the Federal Circuit held that salary costs associated with lobbying are expressly unallowable under FAR 31.205-22 under the “associated with” language.
- Even though salary is not “specifically named and stated” in FAR 31.205-22, the Circuit reasoned:

“Costs unambiguously falling within a generic definition of a “type” of unallowable cost are also ‘expressly unallowable.’ Here, salaries of in-house lobbyists are a prototypical lobbying expense.”
- Implications:
 - What other costs are “associated with” lobbying and political activity?
 - How might this impact other Cost Principles and CAS provisions that use “associated with” and similar language?
 - What other costs “unambiguously” fall within a generic definition of a type of unallowable costs, or are prototypical expenses of an unallowable costs?
 - Expect heightened audit scrutiny
 - Potential CAS 405 considerations

Validity of FAR 30.606 And Expansive Effect of Boeing

- The long-accepted practice for determining the cost impact of multiple changes in cost accounting practices was to offset negative impacts against any positive benefit to the government. Offsetting cost impacts could result in a reduced or no contract adjustment.
- Effective April 8, 2005, the FAR Council promulgated FAR 30.606 to address cost impacts under the CAS.
- FAR 30.606(a)(3)(ii) provides that, when a contractor implements multiple changes at once, the government “[s]hall not combine the cost impacts” of those changes “unless all of the cost impacts are increased costs to the Government.”
- If a contractor implements more than one cost accounting practice change and any one of those changes yields decreased costs to the government, the contractor is not permitted to offset the decreased costs against any increased costs when calculating the cost impact and resultant payment due the government.

Validity of FAR 30.606 And Expansive Effect of Boeing

- Prior ASBCA case had considered and rejected challenges to validity of FAR 30.606 (*dicta*)
- Taking note of the ASBCA's position on FAR 30.606, Boeing launched an innovative, constitutional challenge before the COFC, alongside numerous contract claims, contesting its inability to offset simultaneous cost accounting practice.
 - Illegal exaction and extra-contractual
- COFC dismissed constitutional claim on grounds that Boeing failed to identify a money mandating source of law
- COFC also denied the contract claims, holding that Boeing had effectively waived its challenge to FAR 30.606.
 - Boeing argued that FAR 30.606 was “extra-contractual” because it was not incorporated into the contract either in full text or by reference.
 - The Court noted that Boeing was a sophisticated contractor that entered into numerous contracts with the government after the relevant portion of FAR 30.606 went into effect in 2005 and cannot seek to change the pricing framework for its contract now.
 - COFC held that if there was any ambiguity as to the applicability of FAR 30.606, it was a patent ambiguity requiring that Boeing file a protest or seek clarification before award.

TransDigm Saga

Key Events

- February 2019 – “DoD Inspector General Report on Excess Profits by TransDigm Group, Inc.”
- May 2019 – Committee on Oversight and Reform holds hearing on TransDigm “excess profits”
- May 2019 - TransDigm agrees to “repay” the government \$16.1 million in “excess profits”
- June 2019 – DoD Memo demands uncertified cost and pricing data for all TransDigm contracts before being awarded, even if below the TINA threshold
- June 2019 – Amendments designed to address TransDigm’s contracting practices were included in the 2020 National Defense Authorization Act

Total Time Accounting



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PUBLIC CONTRACTS

Total Time Accounting

- Total time accounting is the concept of recording ***all time*** worked; whether reimbursed or not, whether billable or unbillable.
- Under total time accounting, salaried employees record all hours incurred on a daily or weekly basis so that costs are allocated to contracts based on the actual hours worked rather than on some standard number of hours such as 40 hours per week.

Total Time Accounting

- Key Events

- August 1996 – Director of Defense Procurement disagreed with the recommendation from a DOD IG Audit Report to impose full-time accounting for contractors.
- Prior to March 2015 – When FAR 52.237-10 was included in a contract, it did not *require* the contractor to record uncompensated overtime.
- Prior to March 2015 – DCAA had long taken the position that contractors *should* account for all hours worked, whether compensated or uncompensated.
- March 2015 – A new rule became effective in the FAR that changed the rules for uncompensated overtime dramatically, adding a new paragraph (d) to FAR 37.115-2 and revises paragraph (b) of FAR 52.237-10 to require contractors to apply the adjusted hourly rate (including uncompensated overtime), rather than the hourly rate, to all proposed hours, whether regular or overtime, “whenever there is uncompensated overtime.”

Total Time Accounting

- Timekeeping requirements for Government Contractors (DCAAM Section 7641.90 – Information For Contractors)
 - Detailed instructions for time sheet preparation should be established.
 - Employee recordation of time should be performed daily.
 - All hours worked, whether paid or not, should be recorded. Labor and overhead costs should be affected by total hours worked, not just paid hours worked.
 - Certify that hours worked are reflected in the appropriate cost objective (e.g. contract task).