

Cost and Pricing 2018

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Agenda

- Cost Allowability
- Cost Accounting Standards (CAS) Update
- Audit Trends
- Statute of Limitations (SOL)

Cost Allowability Update

Cost Allowability

Expressly Unallowable Costs

- Contractors may be subject to penalties for including expressly unallowable costs in FICRPs (FAR 42.709)
 - *Luna Innovations, Inc.*, ASBCA No. 60086, 18-1 BCA ¶ 36,919
 - “Congress adopted the ‘expressly unallowable’ standard to make it clear that a penalty should not be assessed where there were reasonable differences of opinion about the allowability of costs”
 - Reinstates the rule from *General Dynamics*
 - Expressly unallowable cost: alcohol costs, amusement and social activity costs, backpay costs, fines
 - Unallowable cost: employee stock option costs when valued with the Black-Scholes model

Cost Allowability

Expressly Unallowable Costs: Previous Case Law

- *Raytheon Co.*, ASBCA No. 57576, 15-1 BCA ¶ 36,043
 - Long-term compensation costs that include a Total Shareholder Return element, determined expressly unallowable under compensation cost principle
 - Board does not adhere to the *General Dynamics* decision that costs are expressly unallowable only when unreasonable under all circumstances
- Costs are expressly unallowable when contractor's claim is unreasonable under all circumstances (*Gen. Dynamics Corp.*, ASBCA No. 49372, 02-2 BCA ¶ 31,888 (rev'd in part on other grounds))

TAKEAWAY:
inconsistent
Board decisions
regarding
expressly
unallowable
costs create risk

Cost Allowability

Deferred Compensation Costs

- *Quimba Software, Inc., v. United States*, 132 Fed. Cl. 676 (2017)
 - Government delay in paying Quimba under a CPFF contract required Quimba to defer compensation
 - Deferred compensation costs were unforeseeable
 - Deferred compensation costs were allowable under FAR 31.205-6, Compensation for Personal Services: allowable due to an exception in the tax regulations for deferred compensation costs that cannot be paid in the year accrued due to administrative/economic impracticability that was unforeseeable

TAKEAWAY: allows contractors to avoid unallowable deferred compensation costs when the compensation is deferred because the government is untimely

Cost Allowability

Private Settlement Costs

- *Bechtel Nat'l, Inc. v. United States*, No. 17-657C, 2018 WL 1603333 (Fed. Cl. Apr. 3, 2018)
 - *Bechtel* does not alter the *Tecom* and *Boeing* framework regarding allowability of private settlements
 - Standard: very little likelihood of success on the merits
 - *Bechtel* asserted that the contract's inclusion of DEAR 970.5204–31 meant that *Tecom* should not apply (DEAR 970.5204–31 requires CO written approval to proceed with third-party litigation)
 - Affirms *Tecom* standard but somewhat limits its application when there are other relevant contract provisions

TAKEAWAY: the unfortunate *Tecom* framework still stands, but may not always apply

CAS Updates

CAS Updates

Interpretation of CAS 404

- *Exelis, Inc.*, ASBCA No. 60131, 17-1 BCA ¶ 36,679
 - Board denied government's motion for reconsideration
 - Confirmed CAS 404 applies to tangible capital assets
 - Whether a building lease is a capital lease or operating lease is not an issue subject to CAS 404
 - CAS 404 is not supplemented by GAAP provisions
- New GAAP lease standard requires amortization of all intangibles, including operating leases (effective Jan. 1, 2019)

TAKEAWAY: if a contractor improperly accounts for a capital lease as an operating lease, this creates a cost allowability problem, not a CAS problem. The new GAAP standard should not influence CAS treatment of leases

CAS Updates

CAS Board Update

- NDAA FY 2017 revised the CAS Statute, 41 U.S.C. § 15019, and established the Defense Cost Accounting Standards Board
 - CAS Board is directed to ensure consistency between CAS and commercial standards (GAAP)
- The Board did not meet once in 2017
- The Board has not yet become productive or operational

TAKEAWAY: the CAS Board may eventually create change affecting government contractors, but that change seemingly will occur slowly

Audit Trends

Audit Trends

Direct Assist Audits

- DCAA issued guidance in Sept. 2017
- DCAA auditors should proceed with subcontract proposal audits even if contractor cost or price analyses are not yet available

TAKEAWAY: direct assist audits mitigate issues for prime contractors (avoid long waits for DCAA subcontract audits; expedite contract price negotiations)

Audit Trends

Recent Developments

- *L-3 Commc'ns Integrated Sys., L.P.*, ASBCA No. 60713, 17-1 BCA ¶ 36,865
 - Rather than audit and challenge specific costs, DCAA applied a decrement factor
 - L-3 claimed the government failed to provide adequate notice of its claims because the government did not specifically identify unallowable costs
 - The Board held that L-3 had sufficient information to understand the government's claim, and denied L-3's motion to dismiss

TAKEAWAY: this decision sets precedent for permitting unspecific final decisions

Audit Trends

Auditors' New Use of Old Decisional Law

- *Kellogg Brown & Root Servs., Inc. v. United States*, 728 F.3d 1348 (Fed. Cir. 2013)
 - KBR sought unpaid costs and fees
 - Disagreement over the meaning of "reasonable"
 - Reasonableness of specific costs must be examined with particular care when the costs incurred may not be subject to effective competitive restraints; emphasizes reasonableness is an objective standard

TAKEAWAY:
auditors are
using this
decision to
question the
reasonableness
of costs
(environmental
costs; deferred
compensation
costs)

Audit Trends

Recent Developments

- *Kellogg Brown & Root Servs., Inc.*, ASBCA No. 58175, 2018 WL 1556758 (Mar. 15, 2018)
 - CO denied KBR's claim for subcontractor costs asserting KBR did not meet its burden to prove the costs were reasonable under FAR § 31.201-3(a), Determining Reasonableness
 - KBR asserted that it acted reasonably under the totality of the circumstances and cost reasonableness is flexible and depends upon the context
 - The Board agreed with the government and stated "[c]ost reasonableness, when at issue, is a question of fact"

TAKEAWAY:
this decision could allow
auditors to more
frequently question
costs for lack of
"reasonableness"

SOL Update

CDA SOL

Standard

- The CDA SOL requires “each claim by the Federal Government against a contractor relating to a contract [to] be submitted within 6 years after the accrual of the claim” (41 U.S.C. § 7103(a)(4)(A))
- FAR 33.201: a claim accrues “when all events that fix the alleged liability of either the Government or the contractor and permit assertion of the claim, were known or should have been known”

CDA SOL

Recent Development

- *Kellogg Brown & Root Servs., Inc.*, ASBCA No. 56358, 17-1 BCA ¶ 36,779
 - Whether the government's set-off claim was timely asserted within the six-year SOL
 - Board concluded that the Army's notices of withholdings were the equivalent of timely "final decisions;" the "final decisions" did not conform to the usual COFD format or use the required language to inform KBR of appeal rights
 - Appears to relax the requirements for the government to assert a timely set-off

TAKEAWAY: creates uncertainty among the government contracts industry regarding what is required for a government communication to qualify as a timely final decision

Questions?