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ASBCA Decision Helps Define a CAS Cost Impact “Not Good” for Government Contractors

By Michael Steen, CPA, Senior Director at Redstone Government Consulting, Inc.

In ASBCA Nos 57801, 57803 and 58068 at issue were a number of CAS cost impacts associated with “voluntary” (aka unilateral) changes in cost accounting practices which were effective at the start of the contractors fiscal year. In this case, there were multiple sets of concurrent changes at the start of contractor fiscal years including changes effective in January 2004, January 2005 and January 2008. Of particular significance, the first two sets of changes (2004 and 2005) pre-date a very significant change to FAR 30.606 in April 2005; a change which finally (and unfortunately for contactors) addressed cost impacts vis-à-vis multiple concurrent changes in a cost accounting practices. As stated in FAR 30.606 in April 2005, cost impacts cannot combine multiple concurrent changes unless each change (individually) results in increased costs on affected CAS covered contracts. Although it has never been stated by the FAR Council, that constraint effectively eliminated any contractor option to present concurrent changes in a singular cost impact because the only way one can determine if individual changes result in increased costs is to compute the cost impact separately for each change. The changes to FAR 30.606 single-handedly eliminated all logical and rational flexibilities which had previously been used to timely resolve CAS administrative issues; hence, contributing to the backlog of unresolved CAS administrative actions. Regardless, as demonstrated by ASBCA decisions, the inflexible and contractor unfriendly FAR 30.606 “is what it is”.

As stated in FAR 30.606 in April 2005 and reconfirmed by the recent ASBCA decision, cost impacts for multiple concurrent unilateral changes are a one way street wherein the government recovers the aggregate cost impact for changes which increase costs and the contractor gets absolutely no recognition for changes which decrease costs. For example if two concurrent, but otherwise unrelated changes result in increased costs of $10 million for change #1 and decreased costs of $9 million for change # 2, the government will demand repayment of $10 million for change #1 while graciously accepting the $9 million. reduction for change #2.

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The $10 million is meant to keep the Government whole (as if the accounting changes never occurred); however, the additional $9 million seems to create an inequitable windfall for the government; unfortunately the intent of FAR 30.606 as interpreted by the ASBCA.

In terms of other contractor complaints, the ASBCA also rejected the contractor assertion that the FAR Councils had over-stepped its authority; specifically, the contractor assertion that only the CAS Board had the authority to define cost impacts including offsets for multiple concurrent cost accounting practice. As noted by the ASBCA, the Chairperson of the CAS Board is the OFPP Administrator who is authorized to rescind or deny the promulgation of any regulation that is inconsistent with a cost accounting standard. The OFPP Administrator is also responsible for prescribing government-wide procurement policies that are implemented in the FAR; hence, the OFPP Administrator has always had the authority to rescind the April 2005 change to FAR 30.606. As noted by the ASBCA decision, it is significant that the OFPP Administrator has for nearly 10 years declined to use his or her authority to rescind FAR 30.606 (which he or she implicitly endorsed when it was implemented in 2005). Of passing interest, the discussion in the ASBCA decision notes that the CAS Board continues to (sort of) debate the outstanding issue of combining cost impacts for multiple concurrent changes including the November 2009 minutes of the CAS Board statement, "The CASB agrees that the issue of whether the cost impacts arising from multiple accounting changes taking place for the same event can be combined into a single cost impact is of the highest priority". Similar wording was in the CAS Board minutes from June 2011, but nothing has ever been forthcoming from the CAS Board (which had also contemplated addressing the issue in 2000, but subsequently abandoned the project because of a lack of staffing to address it). It remains to be seen why the CAS Board would continue to include it as an open item considering i) the FAR Council addressed it in April 2005 and ii) the OFPP Administrator is (apparently) responsible for both CAS and FAR; hence, he or she could have rescinded FAR 30.606 at any-time (which would overcome the CAS Board's inability to address an issue of the "highest priority").

Other contractor "losses" within the ASBCA decision, the contractor maintained that the contracting officer failed to consider the "desirability" of the changes and ultimately deemed them not desirable solely because of the unfavorable cost impact to the government. The ASBCA noted that the contractor (when initially disclosing the changes) never pursued a contracting officer determination that the unilateral changes were in fact desirable and that nothing in the regulations preclude the contracting officer from deeming changes not desirable based solely upon the unfavorable cost impact. As noted by the Contractor, there is a prior decision, Lockheed Martin Corp ASBCA No 53822, 07-2 BCA 33614, wherein the Board stated that an increase in costs alone was not a sufficient basis for determining that the changed practices were not desirable. In disposing of its prior statements, the ASBCA noted that the April 2005 FAR 30.606 now includes information for the contracting officer to consider in determining whether a change is desirable and that none of the factors now in FAR were applicable to the recent Raytheon case. Even though FAR 30.606 only refers to "some factors" (three examples), but explicitly states that determining desirability of a change would not be limited to the three examples, it appears that the current ASBCA simply used the three examples (now in FAR) to dismiss its seemingly clear statement in ASBCA No 53822. Translated, no contractor should ever expect a contracting officer to determine that a contractor unilateral change in a cost accounting practice(s) is a desirable change; hence, cost impacts associated with voluntary/unilateral changes will always be a one-way street potentially yielding windfalls to the government (a desirable change opens the door for increased costs to the government; hence, zero likelihood of obtaining that discretionary determination by a contracting officer (unless perhaps that contracting officer is retirement eligible).

The final contractor "loss" or actually a no-decision was related to DCAA's "protecting the taxpayer" by adding 30% to the contractor's computed cost impact. Although the 30% is nothing more than an arbitrary adder meant to compensate for i) inadequacies in the contractor data or ii) the inability of DCAA to audit a complex cost impact proposal; the ASBCA declined to resolve that issue because of the conflicting assertions by the contractor and the government. Although this arbitrary adder should be addressed when the case actually goes to trial, for now it constitutes a significant risk for all contractors that DCAA will assert that it must (arbitrarily) add to contractor computed cost impacts to protect the taxpayer; which begs the question, why not use this strategy in every DCAA audit given that DCAA's stated role is to protect

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the taxpayer. For example, in performing an audit of incurred costs which identifies $100,000 in unallowable costs, why not add $30,000 for unidentified unallowable costs which might have been uncovered had DCAA performed more audit testing? Unfortunately the ASBCA appears to be fueling the fire in terms of "speculative" and wholly unsupportable audit additives with respect to amounts at issue.

To end this article on a positive note, there was one contractor success in the ASBCA decision in the context of defining the aggregate cost impact to the government. DCAA has long maintained that the cost impact is the sum of the increased costs on flexibly-priced contracts plus the increased costs on fixed-price contracts. If a change results in increased costs allocated to flexibly priced contracts, the regulations define that as increase costs to the government. Conversely, if a change results in decreased costs allocated to fixed price contracts, the regulations define that as increased costs to the government. As successfully argued and illustrated by the contractor, DCAA's logic represents double-counting in a situation where a change shifts $300,000 to a cost type contract and the same $300,000 is a reduction of costs allocated to a fixed price contract. DCAA has long maintained (and incorrectly per this ASBCA decision) that the cost impact is $600,000 even though it's the same $300,000 merely shifting from fixed price to cost-type contracts (note the illustration is p.26 of the published decision). At least for now, this appears to answer the question of how to define increased costs in the aggregate in situations where there are cost impacts on flexibly-priced and on fixed-priced contracts (coincidentally another "high priority" project for the CAS Board and another high priority project which is continuously delayed because of a lack of staffing).

It should be noted that the ASBCA decision was in response to motions for summary judgment (by the contractor and the government); hence, there may be additional debate during the actual trial (at least with respect to the 30% arbitrary adder by the DCAA). It remains to be seen if any other aspects of the decision will be revisited during the trial. That said, what we now have is a very clear confirmation that the CAS administrative process (FAR Part 30.600) is a one-sided regulation wherein the government is implicitly hoping that CAS covered contractors will make unilateral changes to cost accounting practices, wherein the end result can only be lower contract costs to the government (reference to multiple concurrent changes where the government recoups amounts for increased costs and graciously accepts the cost reductions for the change(s) which lower costs on government contracts (CAS covered). At least conceptually, CAS is set-up with one thing in mind, to restrict contractors from making any changes to any cost accounting practices as long as the contractor is performing on a CAS covered contract. Apparently the OFPP Administrator sees nothing wrong with a regulation which can and does generate windfall gains (net contract cost reductions) to the government.

Protecting Delinquent Individual Taxpayers vs. Pursuing Delinquent Contractor Taxpayers

By Michael E. Steen, CPA, Senior Director at Redstone Government Consulting, Inc.

Recently a number of Democratic Legislators notified the Executive Branch of their concerns with respect to contracts awarded to a contractor which has employed tax-avoidance strategies; in this case, a so-called corporate inversion to reduce its corporate federal taxes. The July 9, 2015 action is consistent with an April 2015 legislative proposal (by the same group) which would prevent federal contract awards to "inverted corporations". Similarly, most of these legislators signed an August 2014 letter to President Obama imploring him to issue an executive order to unilaterally bar federal contract awards to inverted corporations. Many of these same legislators have also been pressing for legislative or executive action to bar federal contract awards to corporations which are delinquent in terms of paying federal taxes. To date, neither the Legislative Branch or the Executive Branch have invoked any law or executive order which would prohibit federal contract awards to tax-avoiding or tax-delinquent companies as both Branches prefer broader tax reform (which appears to be going nowhere soon).

Ironically, many of these same Democratic Legislators are blocking Legislative proposals (sponsored by Republicans) which would address tax-delinquent federal employees and retirees (civilians and military). The Republican-sponsored measure has yet to pass in part because of opposing views that the legislation is inappropriate because in comparison to the overall population, that federal employees and retirees

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have a much lower tax delinquency rate. Additionally, one opposing theory is that it would be more difficult to collect taxes if the employees were fired; hence, the somewhat strange logic of retaining them on the federal payrolls. That same logic would seemingly apply to any illegal activity wherein the government suffers a financial loss, such as travel expense fraud by a federal employee (if that employee is fired, less chance that the government could recover any of the overstated expenses). We are not exactly sure where that "logic" stops in terms of not firing federal employees who would seem to present a continuing risk in terms of additional unpaid taxes, etc.

Ultimately the debate over tax avoiding corporations and/or tax delinquent corporations or federal employees is more emotional than logical. There would be some logic in terms of barring inverted corporations from federal contracts if this corporate strategy was illegal. Strategies to legally reduce corporate taxes are deployed by every corporation which is exercising its fiduciary responsibility to its corporate stock-holders; hence, legal tax minimization strategies are the "rule" rather than the "exception". One example, corporations (government contractors) which have successfully or unsuccessfully utilized the R&D (Research & Development) tax credit. Optimistically, there will never be a law prohibiting government contractors from strategies and actions to legally reduce/minimize their tax liabilities.

DCAA's New Cost Allowability Challenge Bonuses and Incentive Compensation

By Michael E. Steen, CPA, Senior Director at Redstone Government Consulting, Inc.

Although it began to surface in DCAA audit reports two years ago, it has now become a routine cost allowability challenge within DCAA's incurred cost audits (after-the-fact audits of contractor indirect cost rate proposals which also include audit coverage of direct costs on cost type contracts). In this case, the issue involves FAR 31.2205-6(f) which includes two allowability criteria including the requirements i) for an established incentive compensation plan which is consistently followed and ii) the basis for the award is supported. Over the years, virtually every contractor has created an incentive compensation policy (which satisfies the first criterion); however, the documentation supporting the "basis for the award" is now routinely challenged within DCAA incurred cost audits. More ominously, it also appears that contracting officers (ACOs) are deferring to DCAA's embellished interpretation of the non-specific and otherwise undefined regulatory requirements to support the basis for the award on an employee by employee basis. In the view of contracting officers based upon recent communications to contractors (which parrot DCAA expectations), there is a requirement for the following:

- Listing of employees with support for the employee specific amount of the award
- Documentation supporting employee eligibility for bonuses
- Specific evaluation criteria such as performance percentage of salary, specific analysis to correlate the company financial indicators, etc.

Although the Government is "out on a limb" adding explicit/specific but non-regulatory requirements related to documentation (reference to ASBCA cases involving Bearing Point); that doesn't stop DCAA nor the ACO from adding specificity as long as it is (apparently) done to protect the taxpayer. In terms of what's at stake for the contractors, it is the entire amount of the bonuses paid in that year to direct and indirect employees. More importantly, for most contractors, the methods and documentation in an earlier year (now being audited) repeat in later years; hence, the single year issue could be significantly more if/when compounded by DCAA audits in the later year(s). Perhaps most frustrating, even if DCAA is not sustained by the ACO (or not sustained in litigation if it becomes a contract dispute), DCAA's policy appears to be to repeat itself in subsequent year audits (question the dollars in later years for the same reasons as in the earlier years, a DCAA tactic which is "to protect the taxpayer"). Which generates a question, who is protecting the taxpayer from DCAA's "repeat" assertions which do nothing more than add non-value administrative costs to the acquisition process?

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