

Contractor successfully challenges disallowed research, compensation costs

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In *Voxtel, Inc.*, ASBCA No. 60129¹ (March 9, 2023), the Armed Services Board of Contract Appeals (ASBCA) issued a decision that presents a primer on the resolution of indirect cost rate disputes. The ASBCA granted the contractor's appeal in part, finding that its claimed executive compensation and independent research and development (IR&D) costs were allowable, but that certain rental costs related to the "fit-up" of a leased facility were unallowable.

ASBCA held that the Government failed to meet its burden of proving that the [contractor's] K-1 amounts were unallowable, because the FAR does not limit allowable compensation to amounts shown on a W-2.

The Defense Contract Audit Agency (DCAA) performed "adequacy" and "nomenclature" reviews of Voxtel's indirect cost rate proposals (or incurred cost proposals, "ICPs") for fiscal years 2007 to 2009, but did not conduct audits. The Contracting Officer (CO) then issued a final decision unilaterally setting indirect rates and finding that the ICPs included unallowable executive compensation, IR&D, and rental costs. The contractor appealed.

Regarding executive compensation costs, the Government disallowed purported salary for the contractor's sole owner, who was also its president and CEO, because the amounts were reported as shareholder distributions on IRS Form 1120 S, Schedule K-1, rather than income on a W-2. The Government alleged that the K-1 amounts represented distributions of profits, unallowable under FAR 31.205-6(a)(6)(iii).

Voxel countered that if the W-2 wages were the CEO's only salary, then his hourly rate of pay would not match his position in the company, his educational background, and his experience and abilities.

The ASBCA held that the Government failed to meet its burden of proving that the K-1 amounts were unallowable, because the FAR does not limit allowable compensation to amounts shown on a W-2.

The Government disallowed IR&D costs based on the (erroneous) determination that the costs were direct contract costs and, therefore, unallowable as indirect IR&D.

After the final decision was issued, Voxtel submitted additional information supporting the indirect nature and reasonableness of the costs, including data and testimony.

The decision is a reminder that the Government bears the burden of proving that a contractor's costs are unallowable under a cost principle.

Although the ASBCA noted that this additional evidence was "long overdue, not always easily understood, and in some instances contradictory," the cumulation of evidence was persuasive and sufficient to show that the contractor's IR&D costs were properly treated and reasonable.

Finally, the Government disallowed rental expenses because the contractor lacked documentation covering the "fit-up" amounts in excess of the agreed-upon monthly rent amounts. An email exchange with the landlord, dated years after the fact, was insufficient to show that the lease was amended to cover retrofitting the leased space.

The ASBCA held that not only did Voxtel lack supporting documentation, the contractor could not show that it was reasonable to make the payments without a written agreement.

We commend the *Voxtel* decision to any contractor involved in ICP audits or anticipating the disallowance of indirect costs, as a useful example of how such disputes can be resolved. The decision is a reminder that the CO's findings of fact are not binding on the ASBCA, and the Government bears the burden of proving that a contractor's costs are unallowable under a cost principle.

Contractors can and should continue to collect and present helpful evidence to support cost allowability even after a CO issues a final decision.

Notes

¹ <https://bit.ly/3LxFmUP>

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