

28th Annual Ounce of Prevention Seminar

Welcome

Predicting the Future: Federal Contracting in an Election Year

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ACCOUNTING AND PRICING DEVELOPMENTS

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Discussion Overview

- Business Systems Audits and Penalties
- New Restrictions on Allowability
- Significant Cases (CAS Offsets, Executive Compensation, Statute of Limitations)
- Changing Rules on “Commercial items”
- Pension Harmonization Rules
- Notable DCAA Audit / Policy Guidance

Business Systems Audits and Penalties

DFARS CONTRACTOR BUSINESS SYSTEMS FINAL RULE TAKES EFFECT

- The interim Contractor Business Systems rule took effect on May 18, 2011
 - Interim rule covered six contractor business systems: accounting, estimating, purchasing, earned value management, material management and accounting, and property management systems.
 - Compliance enforcement mechanism (DFARS 252.242-7005) required contracting officers to withhold a percentage of payments under certain conditions.
 - Applied the clause to all contracts subject to the Cost Accounting Standards in keeping with the 2011 NDAA definition of “covered contracts,” effectively exempting small businesses.

Business Systems Audits and Penalties

- On February 24, 2012, DoD issued a final rule adopting the interim rule, with changes.
 - The final rule amended the enforcement clause to clarify that the CO will discontinue withholding payments and release any payments previously withheld, if based on the evidence submitted by the contractor, the CO determines that there is a reasonable expectation that the contractor's corrective actions have been implemented and are expected to correct the significant deficiencies.
- Commentary accompanying the final rule also clarifies that CO is not limited to withholding against only those contracts and invoices that could be affected by the system deficiency.
- DCMA has published guidance on its web site with useful information about the process it follows for withholding, including limitation of withholding to contracts valued at more than \$50M.

New Restrictions on Allowability

- Independent Research & Development Costs
 - Final DFARS rule, issued January 30, 2012, provides that, as a condition of allowability for IR&D costs, “major contractors” must submit to DoD at least annually technical descriptions of the IR&D projects that the contractor claims as allowable.
 - “Major contractors” are those that allocate more than \$11 million annually to “covered contracts”
 - “Covered contracts” excludes fixed price contracts without cost incentives
 - Voluntary reporting is encouraged for all other contractors.
 - Reports will be exempt from disclosure under the Freedom of Information Act.

New Restrictions on Allowability

- Executive Compensation
 - Allowability cap on compensation set at \$763,029 for 2012
 - 2012 National Defense Authorization Act extends the cap beyond the top five executives to all defense contractor employees
 - Certain exemptions for scientists and engineers that possess needed skills
 - Purported application of the new limits to all contracts after 1/1/12 is almost certainly unenforceable

Significant Cases

CALCULATION OF INTEREST DUE ON INDIRECT COST CLAIMS

- ASBCA addressed for the first time in a comprehensive way the payment of contractor certified claims and CDA interest related to disputes about allowable indirect costs.
- Recovery of the principal amount of the contractor's claim must be accomplished through the normal indirect cost rates, not in a lump sum.
- Contractor entitled to recover interest on the amount due on the principal amounts actually paid, beginning on the date the certified claim was submitted until payment of the indirect costs was made on each contract covered by the claim.

Appeal of SRI International, ASBCA No. 56353 (Oct. 5, 2011)

Significant Cases, cont'd

USE OF PART-YEAR PENSION FUND RETURNS IN FORWARD PRICING ESTIMATES VIOLATES CAS 412

- GD's use of actual, intra-year pension fund returns in its forward pricing estimates of pension costs violates Cost Accounting Standard 412-50(b)(4).
- ASBCA rejected GD's argument that the Government's interpretation of CAS 412 would prohibit GD from using the most current data, and thus is in conflict with the Federal Acquisition Regulation requirement to use accurate, complete and current cost or pricing data.
- ASBCA found no conflict between the CAS and FAR cost or pricing data requirements because, although the FAR requires *submission* of accurate, complete and current cost or pricing data, "it does not dictate the relative importance of submitted data or how that data will be used in cost estimation, negotiation and pricing."

Appeal of General Dynamics Corp., ASBCA No. 56744 (June 21, 2011)

Significant Cases, cont'd

EXECUTIVE COMPENSATION

- Appellant appealed decisions finding unreasonable executive compensation and demand for payment of \$589,600.
- ASBCA rejected DCAA's disallowance of executive compensation, based primarily on the credibility of differing expert opinions.
- Board concluded that the standard DCAA analysis was statistically invalid, at least in part because the Government's expert -- who had a mail-order PhD from a South African "university" -- was not credible.

Appeals of J.F. Taylor, Inc., ASBCA Nos. 56105, 56322 (January 18, 2012)

Significant Cases, cont'd

FAR 31.205-33(f) DOES NOT REQUIRE DISCLOSURE OF PRIVILEGED INFORMATION

- Dispute regarding allowability of legal fees under FAR 31.205-33.
- Government argued that Parsons-UXB consented to disclosure of privileged information by seeking reimbursement from the Government for attorneys fees.
- ASBCA concluded that “FAR 31.205-33(f)’s requirements for supporting a claim for attorney fees incurred in relation to the contract do not extend to privileged information.”

Appeal of Parsons-UXB Joint Venture, ASBCA No. 56481, 11-2 BCA ¶ 34806 (July 22, 2011)

Significant Cases, cont'd

STATUTE OF LIMITATIONS

- DCMA sought \$6 million from Boeing in increased costs alleged to have been incurred by the government as a result of a voluntary accounting change.
- ASBCA dismissed a government claim on the ground that the CO's final decision was barred by the statute of limitations, because it was not issued within six years of the CO having knowledge of the existence and amount of the claim.
- Board rejected the argument by the government that the claim was equitably tolled by Boeing's conduct.

Appeal of the Boeing Company, ASBCA No. 57490 (January 6, 2012)

Significant Cases, cont'd

STATUTE OF LIMITATIONS

- Lockheed appealed final decision and claim by the government for \$29,000,000 for alleged noncompliance with CAS 418, CAS 420 and FAR 31.205-18(a).
- Government contended that appellant's claimed IR&D costs were unallowable because they were required in the performance of the contract.
- Appellant moved to dismiss arguing that the claims were time barred by the CDA six year statute of limitation.
- Board denied LM's motion, finding that appellant had not presented sufficient evidence that the government knew of the noncompliance resulting in overbillings prior to 6-year window.

Appeal of Lockheed Martin Corporation, ASBCA No. 57525 (March 28, 2012)

Significant Cases, cont'd

STATUTE OF LIMITATIONS

- Parties entered into an advance agreement in 1999 regarding the allowability of costs associated with Raytheon's acquisition of Hughes Aircraft. Advance agreement tentatively authorized Raytheon to invoice \$105M for such costs, subject to future Government audit.
- In 2003, DCAA issued an audit report concluding that \$4.75M of these costs were unallowable and Raytheon reimbursed the Government for this amount.
- After a DOD Inspector General Report criticized DCAA, it subsequently issued a second audit report in 2008, which concluded that \$25M of these costs were unallowable.
- Raytheon argued that the \$25M claim was barred by the statute of limitations. Specifically, Raytheon asserted that 1999 "was the year in which all events had occurred to establish the cause of action that defendant might have had against Raytheon."
- Government argued that its "claims accrued in March 2004 at the earliest, when it completed the initial audit and assessment of Raytheon's costs."
- Court of Federal Claims sided with Raytheon, finding that the Government "had been aware of all the information on which it based the \$25 million government claim for nine years before the [CO] issued his decision in 2008." As a result, the Government's claim was barred by the Contract Disputes Act's six-year statute of limitations.

Raytheon Co. v. United States, No. 09-306C (April 2, 2012)

Changing Rules on Commercial Items

- DoD issued a final rule on March 12, 2012, amending DFARS to require higher-level approval for commercial item determinations for acquisitions exceeding \$1 million when the determination is based on “of a type” or “offered for sale” language contained in the definition of commercial item.
- The rule also clarifies approval requirements for determinations for acquisitions of services exceeding \$1 million using Part 12 procedures but which do not meet the definition of a commercial item.
- More changes are coming – stay tuned.



Truth in Negotiations Act

CAS APPLICABILITY THRESHOLD REVISED

- Interim rule issued on August 11, 2011 revised the threshold for CAS applicability from “\$650,000” to “the Truth in Negotiations Act (TINA) threshold, as adjusted for inflation.”
- CAS threshold now \$700,000.
- Any future changes to the TINA threshold will automatically apply to the CAS applicability threshold. 76 Fed. Reg. 40817 (July 12, 2011).

FINAL RULE ON TINA INTEREST CALCULATIONS

- Final rule on August 4, 2011 amended the FAR clauses on price reduction for defective pricing to require compound interest for Government overpayments as a result of defective cost or pricing data.
- The final rule replaced the term “simple interest” as the requirement for calculating interest for Truth in Negotiations Act cost impacts with the phrase “Interest compounded daily as required by 28 U.S.C. 6622.” 76 Fed. Reg. 39242 (July 5, 2011).

Pension Harmonization Rule

- The CAS Board issued final revisions to CAS 412 and 413 on December 27, 2011, aligning CAS requirements with Pension Protection Act (PPA) nearly two years later than the statute required.
- “Harmonized CAS” requires recognition of costs at the greater of the traditional CAS method or a method that is similar to PPA.
- Effective Date
 - Harmonized CAS effective February 27, 2012.
 - Most changes feathered in gradually over a 5-year transition period.

Pension Harmonization Rule, cont'd

- Contractors will be entitled to an equitable adjustment on contracts priced prior to 2/27/12 to reflect the impact of the changed requirements -- because of the long transition period, the amount of equitable adjustments is likely to be modest.
- DCMA typically has no funds of its own to pay for CAS adjustments due to the contractor, but one possible alternative to cash payment might be to “bank” the adjustment (plus imputed interest) for use to offset current or future liabilities that the contractor may have to the Government.

Notable DCAA/DCMA Audit and Policy Guidance

- Guidance on Ineligible Dependents costs: DoD has taken the position that (1) it will continue to disallow ineligible dependent costs as unreasonable; (2) it encourages contractors to voluntarily refund any increase in price received as a result of including these costs in negotiated prices; (3) it may pursue defective pricing claims; and (4) it plans to amend the DFARS to make these costs expressly unallowable and, thus, subject to penalties (Shay Assad Feb. 17, 2012 memo).