Cost Impact Calculations: A Significant Raytheon Decision In The ASBCA

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In Raytheon Company, Space & Airborne Systems, the Armed Services Board of Contract Appeals on May 7 issued a significant ruling on motions and cross motions for summary judgment on the subject of cost impact and voluntary cost accounting changes. The ASBCA earlier dismissed three companion appeals for lack of jurisdiction, on Raytheon motion that the Government failed to assert the claims within the six-year limitations period of the CDA. Raytheon Co., Space & Airborne Sys., ASBCA No. 57801, 57802, 57804, 57833, 13 BCA ¶ 35,319, at 173,373. In the latter three cases, Raytheon had provided both notice of the accounting change and at least a preliminary cost impact more than six years before the Government issued any contracting officer final decisions, and the Board ruled these Government claims to be untimely. That left ASBCA No. 57801 for decision on the merits.

The remaining appeal involved three voluntary revisions to Raytheon Cost Accounting Standards disclosure statement, the most significant of which Raytheon made in 2004. The 2004 revision included four unrelated accounting practice changes, all made on the same day and effective on the same date. Two years later, Raytheon submitted a general dollar magnitude (GDM).

As reported by Raytheon, the first of the four changes resulted in an increased allocation of cost to flexibly-priced contracts, and a decreased allocation of cost to fixed-price contracts. Added together under the Government’s cost impact theory, this yields a cost impact of $594,300. The remaining three 2004 changes resulted in a combined decreased allocation of $660,800 to flexibly-priced contracts, and an increased allocation of $518,200 to fixed-price contracts, for a total negative cost impact (under the Government cost impact theory) of $1,179,000. The four changes combined would result in a negative cost impact of $584,700, such that Raytheon would have no cost impact liability.

At issue in the appeal was whether the GDMs of the four simultaneous, but unrelated voluntary changes should be combined, resulting in no “cost impact” to the Government. The Defense Contract Audit Agency disagreed with netting the four changes, and asserted a “cost impact” to the Government of $772,590 for the first of the four changes alone. DCAA did so by summing the increased and decreased allocations (both of which it characterized as “increased cost to the Government”), and adding an arbitrary 30 percent to account for its own inability to complete a full audit. DCAA did not address the other three changes, and concluded that each one taken by itself resulted in
“decreased costs” to the Government. Raytheon’s divisional administrative CO added compound daily interest to the DCAA figure and issued a COFD claiming $1,176,600.6

The voluntary changes in 2005 and 2007 followed a similar pattern.7

The issues relevant to this article as determined by the ASBCA may be summarized as follows:

(1) Whether, prior to a 2005 Federal Acquisition Regulation revision outlawing the practice, increased costs to the Government on some contracts may be netted against decreased costs to the Government on other contracts among a group of simultaneous but unrelated accounting practice changes?

(2) Whether in any one accounting practice change, increased allocations to flexibly-priced contracts (increased cost to the Government) may be added to decreased allocations to fixed-price contracts (also increased cost to the Government, in the Government’s view) for a total increased cost to the Government? And would such a result violate the “aggregate cost” rule?

Simultaneous Unrelated Cost Accounting Changes

The Board first noted that, prior to April 2005, neither the CAS statute and its implementing regulations, nor the applicable FAR provisions addressed the issue of netting the impact of simultaneous unrelated accounting practice changes.8 The Government argued that various statutory and regulatory references intimated that the drafters favored considering each accounting practice change as a separate event not to be combined with any other such change. Raytheon cited other provisions to the contrary. The ASBCA instead referred to an abortive change in the CAS regulations in 1995–96 that, if enacted, would have resolved the issue. Because the change had been abandoned, the CAS Board never “filled the gap” in the statute by issuing defining regulations.8

Next, following an earlier Boeing10 decision, the Board explained that an established practice existed in the Government prior to 2005 to allow the offset of simultaneous changes. The Board cited a 1976 Department of Defense CAS working group item specifically supporting the offsetting,11 as well as contemporaneous editions of the DCAA Audit Manual and the DCMC 1990 Contract Administration Manual.12 The Board concluded that

(t)he government has repeated the same arguments it made in Boeing and has put all of its eggs in the “Boeing is wrong” basket. Because the government has not identified any material fact in dispute, we enter summary judgment for Raytheon on Revision 1.14

Next, in calculating the cost impact of the four simultaneous changes, Raytheon argued that decreased allocation to fixed-price contracts may not be included. According to Raytheon, in attempting to do so “the government is seeking a double recovery . . . because it seeks recovery for not only the increase in costs allocated to flexibly-priced contracts but also the corresponding decrease in costs allocated to fixed-price contracts”18 (emphasis added). Raytheon argued that such double recovery violates 41 U.S.C.A. § 1503(b). The Government disagreed, asserting that adding the two together was entirely proper, since—individually considered—both constitute “increased cost to the Government.” The Government added that a decreased cost allocation to fixed-price contracts is required because otherwise the contractor would receive enhanced profit under the fixed-price contract caused by decreased cost allocation.

Siding with Raytheon, the Board held that including the decreased allocations to fixed-price contracts would violate the statutory prohibition against exceeding the aggregate increased cost to the Government. The Board concluded:

Accordingly, we hold that under § 1503(b) the government may recover the increased costs allocated to
flexibly-priced contracts, but it may not also recover those same costs when they are removed from the allocation to fixed-price contracts, and [we] grant Raytheon summary judgment on this issue.16

**Determining Cost Impact under the CAS and FAR Rules**

**The Definitional Issue**

It would be hard to identify an area of legal/accounting complexity to rival that of determining cost impact of accounting practice changes and noncompliances.17 Beyond the mere issue of complexity lies the fog of confusion created by the imprecise use of phrases such as “cost increase” and “increase in the aggregate.” Both the complexity and the confusion are well illustrated by the Board’s Raytheon decision.

The phrase “cost increase” is perhaps the most vexing. Without an appropriate modifier, it can mean “cost increase to the contractor” or “cost increase to the Government.” Similar problems exist with “increased cost” and “decreased cost.” Moreover, a “price” increase or decrease to the contractor may become a “cost” increase or decrease to the Government. To attempt to introduce some clarity for purposes of this article, the following phrases are used with the attached meanings:

“Increased cost” and “cost impact” always mean increased cost to the Government. This increased cost may potentially occur in two ways: (1) as additional cost allocated to flexibly-priced contracts, or (2) as decreased cost allocated to fixed-price contracts.18 Increased or decreased “allocation of cost” refers to the changes in the levels of cost assigned to contracts, caused by a unilateral cost accounting change or a CAS noncompliance.

“Aggregate cost” refers to the process of netting increased costs and decreased costs on individual contracts or classes of contracts to determine the final cost impact.

**Cost Impact Must Begin at the Contract Level**

The process of determining cost impact must begin with individual contracts, although there is latitude for estimating contract impact in calculating GDM. This is made clear by the CAS statute, the CAS Board regulations, the CAS clause and the FAR.19 The CAS statute states,

A contract price adjustment undertaken under section 1502(f)(2) of this title shall be made, where applicable, on relevant contracts . . . The Federal Government may not recover costs greater than the aggregate increased cost to the Federal Government, as defined by the Board, on the relevant contracts.20

The CAS Board regulations are similarly clear:

An adjustment to the contract price or cost allowances . . . may not be required when a change in cost accounting practices or a failure to follow Standards or cost accounting practices is estimated to result in increased costs being paid under a particular contract by the United States. This circumstance may arise when a contractor is performing two or more covered contracts and the change or failure affects all such contracts. The change or failure may increase the cost paid under one or more of the contracts, while decreasing the cost paid under one or more of the contracts.21

The CAS clause similarly provides in ¶ (a)(2):

. . . the Contractor in connection with this contract, shall:

(2) . . . If any change in cost accounting practices is made, . . . the change must be applied prospectively . . . . If the contract price or cost allowance of this contract is affected by such changes, adjustment shall be made . . . .

FAR pt. 30 likewise makes this clear.22

**Aggregating Individual Contract Cost Impacts**

Although cost impact thus necessarily starts with a contract-by-contract process even at the GDM level, the regulations allow the aggregating of negative and positive cost impacts among all of the contracts affected by the change:

The contractor and the contracting officer may enter into an agreement . . . covering a change in practice proposed by the Government or the contractor for all of the contractor’s contracts for which the contracting officer is responsible.24

The Government will not require price adjustment for any increased costs paid by the United States, so long as the cost decreases under one or more contracts are at least equal to the increased cost under the other affected contracts, provided that the contractor and the
affected contracting officer agree on the method by which the price adjustments are to be made for all affected contracts.26

The Board’s “Aggregate Cost” Holding

Raytheon argued that, in the case of a voluntary change, increased allocations to flexibly-priced contracts cannot be added to decreased cost allocations to fixed-price contracts for what it argued would be a “double” cost impact. It posited a simple hypothetical of just two contracts—one cost type and one fixed price. In the hypothetical, a cost allocation increase to the cost contract was exactly balanced by a decreased allocation in the same amount to a fixed-price contract.

The underlying premise of the Raytheon hypothetical was that these were the same costs. Raytheon thus argued that the impact to the Government was solely the amount of the increased allocation to the cost contract, that there was no impact on the fixed-price contract, and that any adjustment to the price of the fixed-price contract would violate the aggregate cost rule because it would give the Government a double cost recovery from the re-allocation of the same cost. This argument and its illustration were highly appealing. The Board accepted this argument and so ruled. The Board stated,

Accordingly, we hold that . . . the government may recover the increased costs allocated to flexibly-priced contracts, but it may not also recover those same costs when they are removed from the allocation to fixed-price contracts, and [we] grant Raytheon summary judgment on this issue.26

Raytheon and the Board were of course correct, if we assume that the price of the fixed-price contract remains firm and is not required to be adjusted. And in fact, the decreased allocation of cost to the fixed-price contract by itself did not have any impact on the Government because the contract price is fixed. But Raytheon’s argument and the Board’s holding beg the question whether the price of a fixed-price contract must or should be reduced when a cost impact calculation decreases the cost allocated to that contract such that, had the change been known at the time of negotiations, it can be argued that the contract price would have been lower.27 And here, the CAS regulations

(b) If the contractor under any fixed price contract, including a firm fixed price contract, fails during contract performance to follow its cost accounting practices or to comply with applicable Cost Accounting Standards, increased costs are measured by the difference between the contract price agreed to and the contract price that would have been agreed to had the contractor proposed in accordance with the cost accounting practices used during contract performance.29

If we are required to apply this provision to voluntary changes, the actual net impact to the Government in the Raytheon hypothetical would be the sum of the two cost allocations, as the Government argued. Thus, if this paragraph of the regulation applied, the Board’s holding was very likely wrong. The Board in this regard appears to have credited Raytheon’s argument that cost impact is a zero-sum game, and that every increased allocation of cost is matched somewhere by a decreased allocation of cost within a closed data universe. Raytheon’s hypothetical was carefully constructed to illustrate this contention.

But the “zero-sum” underpinning of Raytheon’s argument does not appear to be valid, except in very rare situations in which precisely the same cost could be traced as migrating from a fixed-price contract to a flexibly-priced contract. In the more normal situation, the contract mix affected by a single accounting practice change may include both non-CAS covered contracts, and even some commercial contracts, to which adjustments in cost allocation would be made as a result of the accounting practice change. However, none of such cost allocations would pertain to CAS-covered contracts, and thus the assumed perfect balance of allocation between a flexibly-priced and fixed-price CAS-covered contract would not occur.

Moreover, as noted earlier, each contract must stand on its own. Thus, if the regulations require that decreased allocations to fixed-price contracts shall be included in cost impact, there is no issue from the regulatory standpoint.

Did the Board Ruling Reach the Correct Result for the Wrong Reason?

An independent basis exists for sustaining the
Board’s ruling on this point. In the opinion of highly qualified commenters, the CAS regulations make clear that cost impact on fixed-price contracts is limited to impacts deriving from CAS violations, and has no application to voluntary accounting changes. There are good reasons for this. Opening up the prices of negotiated fixed-price contracts is a serious remedy, heretofore reserved for defective-pricing cases that involve contractor culpability in failing to disclose relevant cost or pricing data prior to contract price agreement. Similarly, CAS violations—failure to follow disclosed accounting practices or applicable standards—involve contractor culpability deserving of a punitive remedy. However, no culpability attaches to voluntary accounting changes, which CAS expressly authorizes.

It seems clear that the CAS Board recognized this difference when it issued its regulations addressing cost impact. 48 CFR 9903.306(a) addresses cost impact both as related to voluntary accounting changes and CAS violations. However, this section of the regulation addresses only cost paid:

(a) Increased costs shall be deemed to have resulted whenever the cost paid by the Government results from a change in a contractor’s cost accounting practices or from failure to comply with applicable Cost Accounting Standards, and such cost is higher than it would have been had the practices not been changed or applicable Cost Accounting Standards complied with.

(Emphasis added.) Fixed-price contracts do not involve “cost paid.” The only relevant term for such contracts is “price.” However, paragraph (a) nowhere addresses price. The CAS Board discusses price adjustment only in the paragraphs of the regulation that exclusively deal with CAS violations: (b) and (c). It seems clear that the CAS Board’s intent was to prescribe a punitive remedy exclusively for CAS violations:

(b) If the contractor under any fixed price contract, including a firm fixed price contract, fails during contract performance to follow its cost accounting practices or to comply with applicable Cost Accounting Standards, increased costs are measured by the difference between the contract price agreed to and the contract price that would have been agreed to had the contractor proposed in accordance with the cost accounting practices used during contract performance.

(c) The statutory requirement underlying this interpretation is that the United States not pay increased costs, including a profit enlarged beyond that in the contemplation of the parties to the contract when the contract costs, price, or profit is negotiated, by reason of a contractor’s failure to use applicable Cost Accounting Standards, or to follow consistently its cost accounting practices.

(Emphasis added.)

The FAR, however, has attempted to eliminate the CAS Board’s distinction and extend the “decreased price” rule to permissible unilateral accounting practice changes. This ignores the fact that such changes are not violations of CAS and do not merit punitive treatment. Thus, FAR 30.604(h)(3) provides,

(h) Calculating cost impacts. The cost impact calculation shall—

(3) For unilateral changes—

(ii) Determine the increased or decreased cost to the Government for fixed-price contracts and subcontracts as follows:

(A) When the estimated cost to complete using the changed practice is less than the estimated cost to complete using the current practice, the difference is increased cost to the Government.

(B) When the estimated cost to complete using the changed practice exceeds the estimated cost to complete using the current practice, the difference is decreased cost to the Government.

(Emphasis added.)

The question remains whether the FAR rule infringes the exclusive jurisdiction of the CAS Board. Although allocability issues are the exclusive province of the CAS Board, the prescription of required cost adjustments for accounting changes under flexibly-priced contracts is not necessarily an allocation issue. The Board, indeed, suggested the contrary in rejecting Raytheon’s challenge to the 2005 FAR revision eliminating the aggregation of cost impacts from simultaneous unrelated accounting practice changes.

In March 2005 the FAR Council issued FAR 30.606, which disallowed the practice of combining the impacts of unrelated accounting practice changes issued simultaneously. Raytheon argued that this provision
usurped the exclusive regulatory domain of the CAS Board. The ASBCA responded that some of the statutory grants of regulatory power to the CAS Board were exclusive and others were not. Although the CAS Board had exclusive jurisdiction to regulate regarding the “measurement, assignment, and allocation of costs,” the matter of regulating cost impacts was outside this definition.

In addition, among those grants of authority that were not exclusive was the provision authorizing the CAS Board to issue regulations defining “aggregate increased cost to the Federal Government.” The Board noted that the Office of Federal Procurement Policy administrator is empowered to strike down any regulation inconsistent with a cost accounting standard, but had not taken such action with respect to the FAR 30.606 revision since its enactment 10 years ago. The Board further cited events between 2000 and 2005 suggesting that the CAS Board may have actually desired the FAR drafters to take on the provision of guidance on the “cost impact process.” The Board concluded,

We hold that FAR 30.606 does not impermissibly intrude on authority reserved exclusively for the CAS Board. We reach this conclusion because we do not read the grant of authority to the CAS Board in Sec. 1503(b) as being so broad that it prevents the FAR Council[] from issuing regulations that provide guidance to contracting officers who may be faced with an accounting change that affects hundreds of contracts.

The circumstances are not quite the same in the case of FAR 30.604(h)(3). Here, the FAR rule does not “fill a void” left by the CAS Board, but directly contradicts the only reasonably permissible reading of §§ 9903.306(a), (b) and (c). The regulatory history of CAS also appears to support the view that the CAS Board considered the punitive features of 9903.306(b) and(c) as importantly distinct from the nonpunitive “cost adjustment” provision of 9903.306(a).

Moreover, the Board’s statement that the OFPP administrator, although chair of the board, is not the same as the board. Like all such similar bodies, the CAS Board can only act as a board, and no one individual may act in its name.

Conclusion

To characterize CAS issues as complex seems an understatement, and among the murkiest issues are the rules governing cost impact. In Raytheon, the ASBCA did its best to untangle the cost impact issues arising out of voluntary accounting practice changes. The Board was certainly correct in approving the pre-2005 netting of increased and decreased costs to the Government arising out of simultaneous but unrelated accounting changes. The Board was also correct in holding that decreased cost allocations to fixed-price contracts are not to be counted as cost impact of voluntary accounting changes. However, the Board appears to have done so for the wrong reason, and the basis of its holding in this regard will only add to the confusion already existing.

**ENDNOTES:**

2 The Board decision predated the U.S. Court of Appeals for the Federal Circuit Sikorsky decision holding that the Contract Disputes Act limitations period is not jurisdictional. See Sikorsky Aircraft Corp. v. U.S., 773 F.3d 1315 (Fed. Cir. 2014).

3 Raytheon Co., Space & Airborne Sys., ASBCA No. 57801 et al., 15-1 BCA ¶ 36,024, at 175,947.

4 I use “increased allocation of cost” and “decreased allocation of cost” in lieu of “Increased costs” and “decreased costs,” which can easily be confused with the ultimate issues of increased or decreased cost to the Government under the CAS regulations and clause.

5 Raytheon Co., 15-1 BCA ¶ 36,024, at 175,947.

6 Id. at 175,948.

7 Id. at 175,948–49.

8 Id. at 175,951 (citing The Boeing Co., ASBCA No. 57549 et al., 13 BCA ¶ 35,427, at 173,787).

9 Raytheon Co., 15-1 BCA ¶ 36,024, at 175,952. The Board noted that the statute was utterly silent on the point.

10 The Boeing Co., ASBCA No. 57549 et al., 13 BCA ¶ 35,427, noted that prior to April 2005 federal policy favored the aggregating of all simultaneous uni-
lateral changes at a single segment for a determination of net increased cost to the Government. ¶ 173,786. A 2005 FAR change applied only to contracts entered into after its effective date. Moreover, nothing in the CAS regulations prohibited the practice. ¶ 173,786–787.

11CAS working group item 76-8 (Dec. 17, 1976).

12Id. The Board also cited a CO’s memorandum endorsing the practice, and a proposed FAR revision in 2000 that would have codified the practice.

13Raytheon Co., 15-1 BCA ¶ 36,024, at 175,953. The Board added that the finding was “fact specific” and that the Government had not come forward with any contrary evidence that might have mandated a factual hearing.

14Id.

15Id. at 175,960.

16Id. at 175,961.


18By introducing the reference to fixed-price contracts, I do not mean to pre-judge the issue of whether such contracts are properly involved in determining cost impact of a unilateral change.

19Lockheed Martin Corp. v. U.S., 70 Fed. Cl. 745, 753 n.7 (2006), supports the conclusion that the first step in calculating cost impact from an accounting change is to run the numbers contract by contract. Only then can the “aggregate” test be applied by netting Government cost increases against Government cost decreases.

2041 U.S.C.A. § 1503(b) (emphasis added).

2148 CFR 9903.306(e) (emphasis added).

2248 CFR 9903.201-4(a)(2) (emphasis added).

23FAR 30.603-2(a).

2448 CFR 9903.306(d).

2548 CFR 9903.306(e).

26Raytheon Co., ASBCA No. 57801 et al., 15-1 BCA ¶ 36,024, at 175,961 (emphasis added). The Board’s holding may have derived some support from dicta in Lockheed Martin Corp. v. U.S., 70 Cl. Ct. 745 (2006), a CAS 418 case involving method of allocating costs of Cray computers. The Court held that Lockheed violated CAS 418, and then moved to discussion of cost impact. The court cited the CAS statute, 41 U.S.C.A. § 1502 and 1503, as well as the CAS regulation, 48 CFR 9903.306(e). The Government argued against netting the increased cost to the Government under cost contracts and the decreased cost to the Government (increased allocation of cost) under fixed-price contracts. The Court rejected this argument:

Notably, there is no hint in the preamble [Preamble M, 4 CFR 331.10 (1989)] that this regulation [9903.306(b)] requires a contractor to reimburse the government fully for increased costs under a cost reimbursement contract if the same CAS violation had the effect of decreasing costs [to the Government, by increasing cost allocation to the fixed-price contract] in other fixed-price contracts.

27This is a parallel to the price adjustment provisions of the Truth in Negotiations Act and regulations issued thereunder.

2848 CFR 9903.306(b), (c). As noted in detail below, we believe that these two provisions apply exclusively to CAS violations. However, the Board did not treat them as such.

2948 CFR 9903.306(b) (emphasis added).

30See Manos, supra, note 16, § 60:14, at 28–35.

31See id. § 60:14, at 32. Moreover, in both defective pricing and CAS violation cases, the actions complained of may amount to criminal acts.

32See id. § 60:14.

33See 41 U.S.C.A. § 1502(a)(1) (2012); United States v. Boeing Co., 802 F.2d 1390, 1395 (Fed. Cir. 1986) (holding the CAS allocability rule governed DOD’s contradictory requirements, and quoting the Armed Services Procurement Regulations subcommittee for the proposition that “[s]hould there be a conflict with respect to allocability between the ASPR and the CAS, the former regulation will be superseded”).


35Raytheon Co., ASBCA No. 57801 et al., 15-1 BCA ¶ 36,024, at 175,954.

36The CAS Board has exclusive authority to issue and interpret cost accounting standards, and no agency regulation may contradict or differ from them.

37Raytheon Co., 15-1 BCA ¶ 36,024, at 175,955.

3841 U.S.C.A. § 1503(b)


40Raytheon Co., 15-1 BCA ¶ 36,024 at 175,954.

41Id. at 175,956.

42“[T]he Federal Government may not recover costs greater than the aggregate increased cost to the Federal Government, as defined by the Board, on the relevant contracts subject to the price adjustment.” The ASBCA noted that the CAS Board had never issued a provision defining the phrase “aggregate increased costs.” Moreover, it noted that Congress did not make the authority to issue such a definition exclusive to the CAS Board. Id. at 175,956–57.
See Manos, supra, note 16, § 60.14, at p. 32.

See 3 Admin. L. & Prac. § 9:17 (3d ed.) ("[Rule-making] is the work of a number of individuals and units within the agency. Review of rulemaking then must also recognize the joint effort that emerged as the agency decision. In short . . . an administrative decision is an ‘institutional decision’ and must be understood as the product of a decisionmaking community").