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## Costs

The Armed Services Board of Contract Appeals' decision is significant both for its legal holding that increased costs from a contractor's voluntary accounting changes must be material to be recovered by the government and for how it evaluated whether the contracting officer properly exercised and documented her discretion in making such a determination.

### Tackling the Four-Headed Monster of Cost Accounting



BY PHILIP J. DAVIS AND GARY S. WARD

This year, the Armed Services Board of Contract Appeals issued a decision holding that the government could recover increased costs caused by a contractor's voluntary accounting practice change only if the contracting officer (CO) affirmatively determines the amount of those costs is material. *Raytheon Co., Space & Airborne Sys.*, ASBCA No. 58068, 2016 WL 4764637 (Aug. 9, 2016). The contracting officer in this case had attempted to sidestep the materiality requirement in two ways: (1) the government argued that the contracting officer was not required to consider whether the amount was material; and (2) the contracting officer asserted that she deemed the costs to be material simply because they would increase the cost to the government.

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The board's decision is significant both for its legal holding that the costs must be material and for how it evaluated whether the contracting officer properly exercised and documented her discretion in making such a determination. The contracting officer's assertion that she had read the regulations was not enough to convince the board that she gave the relevant factors fair consideration.

### Increased Costs Must Be Material

Most contractors would agree with how the board described its task at hand: "to once again unravel the complexities presented by the four-headed monster" of Federal Acquisition Regulation (FAR)-mandated contract Cost Accounting Standards (CAS) clauses, the CAS statute, CAS rules and regulations and FAR Subpart 30.6. During the course of its opinion, the board wrestled with the intersection of these various provisions to address the question before it — **whether** and **how** "materiality" is to be addressed in the context of voluntary cost accounting changes that result in increased costs to the government.

In looking to the first three heads — the CAS clauses (FAR 52.230-2 and -6), the CAS statute (41 U.S.C. § 1502) and the CAS regulation on materiality (48 C.F.R. § 9903.305) — the board found that none clearly mandated or explained a materiality test for voluntary accounting changes. For example, the board characterized the reference to materiality in one of the CAS clauses as “oblique[],” noting that the clause provided that the contractor must submit a cost impact proposal after a contracting officer determination of materiality. The board also noted that the clauses offered at least some support for the government’s position that materiality was not relevant because FAR 52.230-2 provided that “no agreement may be made under this provision that will increase costs paid by the United States.” The board next noted that the CAS statute contained a similar prohibition on the government paying “any increased costs.” Looking at the general CAS provisions on materiality, the board explained that the “application of the criteria are mandatory” by their terms at least where they are “appropriate,” but that “it is not entirely clear that the CAS Board intended this regulation to be applied to costs arising from voluntary cost accounting changes,” particularly because the CAS Board did not insert a materiality test into the regulations specifically addressing voluntary accounting changes.

Nevertheless, the board gave controlling weight to the mandatory language in FAR 30.602, the fourth head of the monster. This provision requires COs to evaluate a contractor’s general dollar magnitude proposal and to conclude the cost impact process with no contract adjustments if the CO determines that the cost impact is immaterial. This provision also requires the CO to document her determination if she concludes that the cost impact is immaterial and to make any determination concluding that the impact is material “based on adequate documentation.” It was this provision, FAR 30.602, that the board found made the materiality factors in § 9903.305 mandatory. As the board explained, “[t]he contracting officer violated the requirements of FAR 30.602 by failing to consider the criteria in 48 C.F.R. § 9903.305 in determining whether the amounts at issue were material.”

### Exercising Discretion Requires More than Reading the Regulations

The decision is also a rare instance of the board finding that a CO abused her discretion. Because COs have discretion in determining whether an amount is material under § 9903.305, the board addressed, as a factual matter, whether the CO actually exercised any discretion. In her final decision, the CO did not specifically state whether she found the amount to be material. Three years later, the CO prepared an affidavit stating

that she considered the materiality criteria in § 9903.305. In particular, she stated that she considered the costs to be material because they increased costs to the government, and that she considered the other factors inapplicable. In a deposition shortly after preparing this affidavit, the CO was unable to articulate how she applied any of the factors in § 9903.305. The board considered each of these pieces of evidence but ultimately found that the CO did not properly consider the factors in § 9903.305. In so holding, the board recognized that the CO had testified that she read § 9903.305 but dismissed this as not good enough. The board reasoned that merely “reading the regulation” was not “the same thing as a fair consideration of the factors contained in that regulation.” The board also noted that the CO’s discretion in evaluating the factors in § 9903.305 “does not extend to simply disregarding them.” The board thus placed COs on notice that there is a significant risk that their decisions will be overturned if they do not adequately articulate and document the basis for determining whether the amount at issue is material.

### What’s Next?

While this decision is a welcome win for contractors, it still leaves some questions unanswered. In particular, the board noted that it was not addressing whether its holding is consistent with the underlying CAS statute’s language barring payment of increase costs. The statute declares that the CAS Board “shall require contractors . . . as a condition of contracting with the Federal Government to . . . agree to a contract price adjustment . . . for **any increased costs** paid . . . by the Federal Government because of a change in the contractor’s . . . cost accounting practices.” 41 U.S.C. § 1502(f)(2). While the board did not take on this issue in this decision as the government did not argue it, the board’s previous decision in the same appeal suggests that it would have likely still sided with the contractor. In that decision, the board explained that to be consistent with the CAS statute, “the CAS Board’s materiality regulation should be understood as an attempt to identify factors that assist in determining whether the amount of money at issue is significant enough for it to be worthwhile to recover.” *Raytheon Co., Space & Airborne Systems*, ASBCA No. 57801, 15-1 BCA ¶36,024. Because the CO’s position in this case was simple, the board also did not have to clarify just how far it would go in evaluating how COs weigh the relevant factors.

Since we had to wait this long for a definitive decision on whether the materiality factors even apply, don’t hold your breath for any more decisions on this issue in the immediate future. While it may make for an interesting legal issue, contractors are rarely incentivized to litigate over amounts they could reasonably claim to be immaterial.