

# COSTTREND CONSULTING, INC.



## Government Contracting Alert

October 2015

### Expressly Unallowable Costs

In a recent decision (ASBCA Nos. 57576), the Armed Services Board of Contract Appeals (ASBCA) rejected the Defense Contract Audit Agency's (DCAA's) overly broad interpretation of what costs are expressly unallowable under the Federal Acquisition Regulation (FAR) Part 31 cost principles. The key issue in this case was if costs directly associated with expressly unallowable costs were just unallowable or expressly unallowable under FAR 31 and subject to FAR 52.242-3, Penalties for Unallowable Costs.

The DCAA found that the Raytheon Company (Raytheon) had not excluded any of the bonuses/incentive compensation (B/IC) paid to employees involved in expressly unallowable activities in their Incurred Cost Submission (ICS). Based on DCAA's ICS findings, Raytheon calculated its unallowable B/IC using the total B/IC paid to each employee and the percentage of time each employee spent on unallowable activities. Raytheon found that from Fiscal Year (FY) 2002-2009 there was about \$11 Million (M) in B/IC costs that should have been tracked as unallowable and not claimed for recovery in Raytheon's ICS. Relying on Raytheon's B/IC calculations, the Corporate Administrative Contracting Officer (CACO) issued a final decision stating that Raytheon not only owed the \$11M in unallowable B/IC but also \$5M in penalties and \$4M in interest, totaling \$20M. The underlying basis for the CACO's final decision was that the B/IC was expressly unallowable under FAR Part 31 and Cost Accounting Standard (CAS) 405, Accounting for Unallowable Costs. Raytheon appealed, asserting that these costs were not expressly unallowable and it did not owe the penalties and related interest.

In order to make its ruling, the ASBCA looked at the FAR and CAS definitions of expressly unallowable costs, which is "an item or type of cost which under the express provisions of an applicable law, regulation, or contract, is specifically named and stated to be unallowable." The ASBCA went on to note that such costs must be identified as "unallowable in direct and unmistakable terms". Relying on this definition of expressly unallowable costs, the ASBCA ruled that certain B/IC paid to employees were not expressly unallowable under FAR 31.205-1, Public Relations and Advertising Costs, FAR 31.205-22, Lobbying and Political Activity Costs, and FAR 31.205-27, Organization Costs. According to the ASBCA these cost principles did not specifically name B/IC as unallowable, instead they either named salary as unallowable (and per ASBCA, B/IC is not salary), or used general terms such as "associated with" or "in connection with".

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Just as crucial was another ASBCA finding and ruling. In that finding, B/IC costs related to Legal activities were found to be expressly unallowable under FAR 31. According to the Board, FAR 31.205-47 defines unallowable legal costs in part as the “costs of employees, officers, and directors.” The ASBCA ruled that the definition of “cost of the employees” included not just salaries but also other types of compensation such as B/IC. Therefore, B/IC was expressly unallowable and subject to penalty and interest.

Even though this Raytheon Case has some favorable expressly unallowable wording for the contracting community, thus far, it has not stopped DCAA from continuing their ICS audit practice of treating all directly associated costs as expressly unallowable costs and levying penalties and interest on such costs. To date DCAA has not updated its two Memorandum for Regional Directors (MRD) on identifying expressly unallowable costs, 14-PAC-022(R) and 14-PAC-021(R), which *conflict* with the Raytheon Case’s definition of expressly unallowable costs. Until new instructions are issued and DCAA changes its audit practice, contractors need to be aware that what DCAA determines to be expressly unallowable under FAR 31 and CAS 405 (if applicable) may not be accurate or legally binding.

If DCAA incorrectly classifies costs as expressly unallowable, CostTrend recommends that contractors:

- 1) Cite this Raytheon Case in their ICS report rebuttals and prepare/include an Attachment with the proper expressly unallowable cost calculations subject to penalty and interest amounts.
- 2) Work directly with the Defense Contract Management Agency to resolve any improper expressly unallowable interest and penalty calculations.
- 3) Consider pursuing litigation if the improperly classified expressly unallowable costs are material in amount.