Three years ago, the Armed Services Board of Contract Appeals (ASBCA) sustained Lockheed Martin's protest of a Contracting Officer's final decision. In doing so, the Court ruled on whether Lockheed Martin's $9.5 billion CPAF contract for F-22 engineering and manufacturing development (EMD) met the CAS and FAR definitions of an "affected CAS-covered contract". This was a critical ruling, because "affected" contracts must be included in contractors' cost impact studies when determining contract costs impacts associated with CAS noncompliances and voluntary accounting changes.

FAR 30.001 defines the term "affected CAS-covered contract" as follows—

'Affected CAS-covered contract or subcontract' means a contract or subcontract subject to Cost Accounting Standards (CAS) rules and regulations for which a contractor or subcontractor—

(1) Used one cost accounting practice to estimate costs and a changed cost accounting practice to accumulate and report costs under the contract or subcontract; or

(2) Used a noncompliant practice for purposes of estimating or accumulating and reporting costs under the contract or subcontract.

The CAS Administration regulations at FAR 30.604 and 30.605 require a contractor to submit "information on the estimated overall impact" with respect to

the situations noted above, "on affected CAS-covered contracts and subcontracts". The requirements (and the definition) are repeated in the CAS contract clauses, notably 52.230-6 (Administration of Cost Accounting Standards).

Clearly, only affected CAS-covered contracts, as defined in the regulations, are to be included in the contractor's cost impact analysis, whether the analysis is a "general dollar magnitude proposal" (GDM) or "detailed cost-impact proposal" (DCI) to the "cognizant Federal Agency official". The problem the ASBCA had to resolve was whether Lockheed Martin's F-22 contract was an "affected" contract, or not. Although the exact cost impact to the contract was uncertain, including the contract in the analysis would mean that Lockheed Martin would owe the Government somewhere between $10 and $15 million.

The facts—briefly—include a program replan and rebaseline effort based on the changing Government funding profile (which increased program costs by more than $1 billion), and a "should-cost" review of Lockheed Martin's overhead (which recommended movement of some personnel from indirect to direct-charging). Lockheed Martin agreed with the recommendation, which was a change to its disclosed cost accounting practices, and it negotiated program budgets based on those changed cost accounting practices. The Court was impressed with Lockheed Martin's efforts to fully disclose its changes to the

Government, noting that the impacts to the F-22 EMD program were "thoroughly discussed and negotiated" and that the discussions were "unusually comprehensive".

The Government argued that LockMart and its Air Force customer "understood that they were negotiating a contract change proposal and did not price the equivalent of a new contract" and therefore the contract was not completely repriced by the negotiations. Because the contract was not completely repriced, it was still an "affected" contract for purposes of calculating the cost impact analysis. The Court was unimpressed by the Government's arguments, stating—

The government contentions are based on superficial, mostly irrelevant generalizations relating to the intent, scope and technical revisions of the rephase modifications and negotiations that miss the point. They do not convincingly and substantively address the critical issues inherent in the definition of 'affected contract,' *i.e.,* what accounting practices were used in estimating the price of the F-22 contract as rephased. The essential questions are whether the negotiating parties (LASC and the Air

Force) knowingly repriced the contract using the changed practices rather than the practices used in pricing the original contract and whether the scope of that repricing
effort was sufficiently comprehensive to justify a conclusion that the impact of the changed practices were fully incorporated in the contract price as rephased
. … The critical issue is whether the cost impacts of the changed practices were fully integrated into the pricing structure for the entire contract as rephased
or solely the discrete technical revisions to the work.

The **ASBCA found** for Lockheed Martin and the Government appealed to the Court of Appeals, Federal Circuit.

The **Federal Circuit** was similarly unimpressed with the Government's arguments. For example, the Appellate Court found—

The government contends that a contract must be an 'affected contract' if the accounting changes were integrated into the contract price and the final estimated costs were not reduced to compensate for those additional expenses. However, the Board did not determine that additional accounting costs were tacked on to the contract estimate; it found that the parties created a wholly new cost estimate incorporating all of the additional expenses. Because those costs were consistently estimated and accrued, the Board concluded that the F-22 contract was not an 'affected contract.' Based on the Board's detailed findings and analysis of the rephase negotiations and the rules applicable to changes in accounting practices, we uphold the Board's conclusion that the statutory and regulatory provisions governing 'affected contracts' were inapplicable to the rephased
F-22 contract.

The Federal Circuit also dealt with the Government's contention that the F-22 Contracting Officer lacked authority to agree to accept additional contract costs stemming from LockMart's change in cost accounting practice. The Court wrote—

Because the PCO properly exercised the author-ity to negotiate and integrate the additional accounting costs into the modified contract, no adjustment was

required under the relevant regulations, and the DACO's authority to perform that adjustment was not necessary.

In addition, the Court noted—

… the government disputes the Board's finding that the Air Force validly agreed to the additional accounting costs. The government points to the clause in the rephased
contract stating that
'
[a]ward of this contract does not constitute a determination [that Lockheed's practices are CAS compliant],
'
and reserving the government's right to an adjustment if Lockheed's practices are ultimately determined to be non-compliant. That clause, however, does not create a right to an adjustment or demonstrate a disagreement over contract costs. It merely indicates that the Air Force was not waiving whatever adjustment rights it may
have had. Because the
rephased
F-22 contract was not an
'
affected contract,

,

the government did not have any adjustment rights to retain.

To sum up, the Appellate Court upheld the ASBCA's finding that a contract that has been repriced using the changed cost accounting practices should not be included in a contractor's cost impact analysis. Once the contract's estimated cost and/or price had been renegotiated to include the cost impact, it was no longer an "affected contract" and was properly excluded from the various cost impact analyses negotiated between the CFAO and the contractor.

This is an important series of court decisions that should be studied by serious practitioners of the art of complying with the Federal Cost Accounting Standards.