One of our pet peeves is Government's tendency to want to reopen "final" indirect cost rates—i.e., rates that have been audited and negotiated and agreed-to by both Government and contractor as suitable for closing-out flexibly priced contracts. It's not that we are against such an occurrence in all situations. For example, the Courts have held that "finalization" of indirect cost rates is no bar to revision when a CAS 413 segment closing pension adjustment is being calculated. We're okay with that (kind of) even though at least one attorney passionately argued that "final means final" in the original series of Teledyne decisions that framed much of how that complex adjustment is supposed to work.

But DCAA wants more. In their view—and to be fair it's the view of the FAR Councils as well—any CAS noncompliance must address the cost impacts of all "affected contracts" regardless of whether those impacts take place in "closed" years where indirect rates have been finalized. For example, see our series of articles on how DCAA (and DCMA) wants to treat the "expressly unallowable" costs associated with ineligible healthcare plan dependents. In our view, the Government's position is—shall we say?—extreme and untenable. We await a good legal decision that imposes rationality, equity, and plain old common sense on the patently irrational, unfair, and bizarre interpretation taken by the FAR Councils in the mid-2000's during their poorly conceived rewrite of FAR 30.6.

Recently, the ASBCA addressed a similar problem in a decision that we want to share with our readers. The decision was entitled Kearfott Guidance and Navigation Corporation, ASBCA No. 55626, dated June 10, 2011, and it can be found **here**. (Readers please note that Kearfott was represented by Stephen Knight of the law firm, Smith Pachter McWhorter. We've mentioned Steve's work before, with approval if not outright admiration.)

The case was summarized by Judge Freeman as follows—

Kearfott … appeals a final decision denying its claim for inclusion of mistakenly omitted allowable costs in the calculation of indirect cost rates and facilities capital cost of money (FCCOM) factors in a letter agreement. The government contends that the omission was deliberate, the costs not proven to be allowable, and the letter agreement final. We find the omission inadvertent, the costs allowable, the letter agreement reformable for mutual mistake, and sustain the appeal.

Basically, Kearfott and the DoD agreed to rates for the period 1989 through 1997 to address a previously litigated issue as to whether Kearfott could claim the costs of "writing-up" its assets. The parties executed an agreement but—quite importantly—the agreement never had the word "final" in it. It's pretty obvious the parties understood the indirect rates in the agreement to represent the final rates for the years in question … but they never explicitly said so.

A couple of months after executing the agreement, Kearfott realized that the rates it has agreed-to omitted costs associated with its intangible assets, such as software development and a covenant not to compete. DCMA had Kearfott submit a "Final" indirect cost rate proposal for the period 1984 through 1994, which was to be audited by DCAA. (We have no idea what happened to indirect rates for 1995 – 1997.)

DCAA performed its audit and opined (via memorandum) that the costs of the intangible assets were "not allocable" to Government contracts because—

… the 12 April 2005 letter agreement was 'negotiated in good faith and with both parties clearly aware that amortized intangible asset costs were not included'; and … '[Kearfott] did not mistakenly omit the amortization of intangible asset costs; they were aware of their existence and chose to exclude them from all proposals and incurred cost submissions for the subject years.'

First of all, we have a bit of a problem with DCAA's "opinion" as quoted above. We don't see much accounting or audit testing in that opinion; what we see is DCAA trying to do the Contracting Officer's job. But let's move on ….

A year later, the DCMA Administrative Contracting Officer (ACO) told Kearfott that he was not going to reopen the previously negotiated rates, "citing substantially the same reasons" as were contained in the DCAA memorandum opinion.

Our readers should focus on the DCAA logic: it was DCAA's opinion that Kearfott did not make a mistake, and that it was the company's established cost accounting practice to exclude such costs from its indirect rate calculations. We've seen that logic before and we've always

responded that, “a mistake is not a cost accounting practice.” In his decision, Judge Freeman said the same thing. He wrote—

… we find that the bookkeeping entry assigning the identifiable intangible asset write-up amortization costs to an income deduction account and not to an operating cost account was a mistake and not an established accounting practice or otherwise a deliberate decision to omit these costs from the indirect cost rates and FCCOM factors applicable to government contracts.

The Judge also found that Kearfott’s intangible asset costs were reasonable and allowable, as well as being allocable to the company’s government contracts. Moreover, the Judge found that the indirect rate agreement was “reformable” because of a mutual mistake. To do otherwise would be to give the Government a windfall to which it was not entitled.

The Judge sustained Kearfott’s appeal. Kearfott's indirect cost rates would be revised.