In Part 1 of this analysis of the recent Raytheon victory at the ASBCA, we outlined the issues—which involved multiple appeals covering multiple issues across multiple years at both the Raytheon Corporate Home Office and its Missile Systems business unit. We also discussed the first major issue: the allowability of Raytheon's premium class airfare. Here's **a link** to the ASBCA decision, in case you want to review the 100+ page decision. (Hint: you really should.)

In Part 2, we are going to discuss two related issues: the allowability of Raytheon's "Corporate Development" and "Government Relations" costs.

Government Relations Costs

Most large government contractors maintain some sort of "government relations" function. The term encompasses a number of activities, but prominent among them is lobbying—*i.e.*, the effort to influence senior military officers and Congress folks to fund programs that are important to the contractor. FAR 31.205-22 makes lobbying and other political activity costs unallowable, but provides exceptions for certain specified activities. Among the exceptions is the effort to provide Congress with technical and factual information related to performance of one or more of the contractor's contracts.

As one of the very largest defense contractors, Raytheon maintained a robust "Washington Office," staffed with roughly 20 employees—though not all of those employees were traditional "lobbyists." Because this is a sensitive area, Raytheon maintained policies and procedures to help its employees determine what activities were allowable and what activities were unallowable. In addition, Washington Office employees received training to help them properly record their time.

Raytheon collected the unallowable costs and "withdrew" them from its indirect cost rate calculations. That is to say, Raytheon didn't claim the costs that had been identified as being unallowable. Raytheon's methodology was described by the Board as follows:

For the lobbying cost withdrawal calculation, Raytheon established a ratio of unallowable hours worked by the Government Relations employees to their total hours worked. The ratio's

numerator was the total number of unallowable hours reported by the lobbyists. The denominator was the total number of work hours available during a given year to the employees who reported unallowable hours, based upon a 40-hour work week less vacation and holidays. Dividing the numerator by the denominator yielded a percentage—the lobbying disallowance factor. Raytheon applied this factor to what it deemed to be Government Relations' recoverable expenses (including the salary and fringe benefits paid to its lobbyists and their administrative staff) to determine the costs associated with unallowable lobbying activities under FAR 31.205-22.

As can be seen from the above description, Raytheon did not engage in what is popularly called "total-time accounting." Total-time accounting is the recording of *all* hours worked, including uncompensated overtime. Once all labor hours are recorded, the contractor has some options about how to account for the uncompensated overtime, but Raytheon didn't bother with any of that—because it told its employees not to account for any hours in excess of 40 per week. There is no regulatory requirement that mandates total-time accounting, but many smaller contractors have felt the pressure from DCAA auditors to implement it. This decision makes it clear that Raytheon's practice of "accounting for labor costs as a function of time paid, rather than time worked" is an acceptable method of labor accounting.

Moreover, Raytheon's time sheets for salaried, exempt, indirect personnel *didn't record hours worked* ; they recorded only exception hours such as paid time off and hours associated with unallowable activities (e.g., lobbying). It was assumed that, unless an exception was being recorded, all labor costs for those indirect employees would simply be equal to the amount of their salary, and that amount would be recorded in the employees' home cost centers. No doubt this saved Raytheon some labor processing time and, once again, neither the government nor the ASBCA indicated there was anything wrong with this approach to labor accounting.

What DCAA did have a problem with was the amount of unallowable lobbying that Raytheon had identified and withdrawn from claimed indirect cost. Unsurprisingly, DCAA thought Raytheon's withdrawal (which was about 50% of all government relations costs) was too low. In the words of the ASBCA, "Essentially, DCAA viewed some of Government Relations' activities as related to lobbying and expressly unallowable and Raytheon viewed them as allowable." In Raytheon's view, activities such as "planning and administrative matters; human resources issues; conferences; external and internal matters that had nothing to do with trying to influence legislation; interpreting existing law for Raytheon headquarters or business divisions; budget analysis after a statute had been enacted; and examining international issues" were completely allowable and claimable. DCAA (and subsequently DCMA) disagreed.

DCAA was not consistent in the amount(s) it believed represented unallowable activities. New specialist auditors were brought in, and those auditors developed a "strategy" to question 100 percent of all Raytheon's government relations costs. The ASBCA wrote—

The auditors questioned all of cost center 90206's costs due to an alleged lack of adequate records. They deemed the employees in question to be lobbyists and stated that Raytheon 'cannot justify the lobbyists[,] time was allowable'. They speculated that employees other than those interviewed might have assisted lobbyists with the creation of white papers or with technical information; many of those employees had trouble remembering their activities during FY 2007; and, because they did not normally take part in lobbying activities, they might not have known how to record their time. We have not been directed to any evidence to support this speculation.

(Internal footnotes and citations omitted.)

In fact, "While DCAA's initial audit report recommended changing Raytheon's total disallowance factor from 53.3% to 65.9%, during her testimony [the DCAA auditor] disavowed that report." Subsequently, "[the auditor] based her ultimate conclusion that all of cost center 90206's costs should be disallowed on the fact that she did not find documentation 'either way' on whether the costs were allowable or not, or claimed or not." So basically, the auditor who had spent hours upon hours reviewing Raytheon's claimed costs and the source documents let herself be overruled by the new auditors—to the point where she knew nothing, nothing at all.

For the record, we'll note that these audits took place more than a decade ago, and so the lack of ability to discuss procedures and to provide sufficient evidence for conclusions—or even the lack of ability to reach a consistent conclusion—should in no way have any implications for DCAA's 2020 and 2021 audit quality. Readers are **reminded** that DCAA recently passed its external peer review of its audit quality system where it was noted that only 50% of all selected sample audits had deficiencies, many of which were repeat findings from previous external peer review audits. The other 50% were just fine.

Perhaps it was the flawed DCAA audit methodology that led the ASBCA to find that "DCMA has not met its burden to prove that the Government Relations costs at issue are unallowable lobbying costs and thus has also not met its burden to prove that Raytheon violated CAS 405 regarding those costs." As the Board wrote, "[the DCAA auditor's] conclusion, as self-described, is unsupportable and underscores the fact that DCMA has not met its burden of proof."

Corporate Development Costs

What even is Corporate Development, anyway? The Board answered that question by quoted from another Raytheon appeal.

Raytheon's Corporate Development department was responsible for working with its business units in strategic development and growth opportunities, including strategic analysis of a business' capabilities to market its products and services to the government and function in government work. Where there were gaps in business' capabilities, Corporate Development would work with them to determine the right ways to fill the gaps, either through, *inter alia*, internal investment, research and development, licensing of intellectual property (IP), partnerships or acquisitions. This process was known as 'gap analysis.' Working with Raytheon's businesses on M&A and divestitures was not Corporate Development's primary role but was part of its work to find strategic growth initiatives.

How did it work?

Corporate Development made proposals for acquisitions or divestitures to the Acquisition Council which, in 2007 and 2008, consisted of senior Raytheon leaders, including the Chief Executive Officer, Chief Financial Officer, General Counsel and Vice President of Corporate Development. Raytheon declared its intentions regarding potential acquisitions and divestitures through the Acquisition Council. Corporate Development did not know which route Raytheon was going to follow until after the Acquisition Council made its decision. Occasionally, even after an Acquisition Council decision, Raytheon would change course based upon information developed during the acquisition or divestiture process

(Internal citations omitted.)

As was the case with Government Relations, Raytheon maintained robust policies and procedures to help its Corporate Development folks distinguish allowable gap analysis activities from unallowable Merger & Acquisition (M&A) activities. According to those policies and procedures: "Unallowable acquisition costs commence with the submission of an indicative

offer. Unallowable divestiture costs commence when the decision to "go to market" with the offering materials is made." This policy statement, and others, articulated Raytheon's "bright-line" rule between allowable and unallowable activities. The Board wrote, "Raytheon asserts that its 'bright line' rules accurately reflect the relationship among FAR 31.205-12, -27 and -38(b)(4), in accordance with *Raytheon I*, and it posits that all 'planning' is not unallowable, pointing to allowable economic or market planning."

Timekeeping was consistent with the bright-line rule. Based on the timekeeping, Raytheon withdrew approximately 50% of its Corporate Development costs as being unallowable, while claiming the other 50% as allowable expenses. In what may be becoming a familiar refrain in this series of articles, DCAA disagreed and asserted that 100% of all Corporate Development costs were unallowable. The CACO agreed with DCAA and told Raytheon that not only were the costs unallowable, they were *expressly* unallowable—meaning that Raytheon owed the government penalties and interest. For grins, the CACO threw in a CAS 405 noncompliance, as well.

Would you be surprised to learn that the Board thought Raytheon's bright-line policy was reasonable and that the government had failed to meet its burden of proof? Right. In much the same way as they decided the Government Relations issues, the Board wrote:

DCMA has not carried its burden to prove by a preponderance of the evidence that the amount of unallowable hours withdrawn by Raytheon's personnel, which is supported by documentation and credible witness testimony (see, e.g., findings 41-45, 57-58, 60), from its CY 2007 and 2008 incurred cost proposals was inaccurate, nor that any of the included Corporate Development costs were unallowable, let alone expressly unallowable and subject to penalties. Thus, DCMA has also not met its burden to prove that Raytheon violated CAS 405 regarding those costs.

(Internal footnotes omitted.)

And for grins, the Board wrote "Raytheon's 'bright-line' policy represents a reasonable reading of the FAR provisions governing organization, economic planning, market planning and selling costs and, applying the *General Dynamics* standard, it was not unreasonable for Raytheon to treat the costs at issue as allowable." Thus, if you are looking at developing a similar policy to help your employees navigate between allowable planning activities and unallowable M&A activities, you really ought to review this decision and get into the details of what Raytheon's

policy said.

Okay, that's Part 2. We still have other aspects of this important ASBCA decision to discuss. Stay tuned for more.