

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --)
)
Kearfott Guidance & Navigation Corporation) ASBCA No. 55626
)
Under Contract Nos. DAAB07-85-C-F103)
 DAAK10-84-C-0256)
 N00030-85-C-0063)
 N00030-87-C-0014)
 N00030-87-C-0058)
 N00030-88-C-0146)
 N00030-88-G-0066)
 N00030-89-C-0058)
 N00030-90-C-0011)
 N00030-90-C-0017)
 N00030-90-C-0037)
 N00030-90-C-0038)

APPEARANCE FOR THE APPELLANT:

Stephen D. Knight, Esq.
Smith Pachter McWhorter PLC
Vienna, VA

APPEARANCES FOR THE GOVERNMENT:

E. Michael Chiapas, Esq.
DCMA Chief Trial Attorney
Robert L. Duecaster, Esq.
Trial Attorney

OPINION BY ADMINISTRATIVE JUDGE FREEMAN

Kearfott Guidance & Navigation Corporation (hereinafter "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.

FINDINGS OF FACT

A. The Contracts and Kearfott's Asset Write-Up Amortization Costs

1. Six of the captioned contracts are cost plus fixed fee (CPFF) or cost plus incentive fee (CPIF) contracts with the FAR 52.216-7, ALLOWABLE COST AND PAYMENT (APR 1984) clause. Three of the contracts are fixed-price incentive (FPI) contracts with the FAR 52.216-16, INCENTIVE PRICE REVISION-FIRM TARGET (APR 1984) clause. Three of the contracts have a mixture of CPFF and FPI line items and have both of the cited clauses. (Bd. corr. file, app ltr. dtd. 28 Mar. 2011)¹ All of the contracts were entered into before 23 July 1990 and have not been administratively closed (*i.e.*, there has been no final payment on the CPFF and CPIF contracts and line items and no total final price agreement on the FPI contracts and line items) (compl. and answer ¶ 1; tr. 17).

2. Prior to 4 October 1988, Kearfott was a division of The Singer Company engaged in the manufacture of inertial guidance and navigation systems primarily for the United States armed forces. On 4 October 1988, The Singer Company sold the entire stock of Kearfott to Astronautics Corporation of America (R4, tab 100B at 7). As part of the acquisition process, there was an independent appraisal of the fair market value of Kearfott's tangible and identifiable intangible assets as of 30 September 1988 (tr. 18-26).

3. The tangible assets consisted of real estate, improvements to leased property, machinery and equipment, tooling, office furniture and equipment, vehicles and construction in progress. The identifiable intangible assets at issue in this appeal were computer software, business backlog, and a three-year no-compete agreement with The Singer Company. (R4, tab 100A at 34, 58, 63)² The values of the tangible and identifiable intangible assets determined by the independent appraiser were accepted by Kearfott's outside auditor for financial reporting purposes and by the Internal Revenue Service (IRS) for tax purposes (tr. 21-22).

4. When the stock purchase was completed in October 1988, there was a "write-up" of the assets on Kearfott's books and records to reflect the purchase price paid for the assets (tr. 66-67). Beginning in October 1988, the monthly tangible asset write-up amortization costs were entered on Kearfott's books and records as an operating cost. As such they were included in Kearfott's indirect cost rate calculations and its incurred cost

¹ In a 14 March 2011 post-hearing order, the Board directed the parties to confer and stipulate which contracts included the Allowable Cost and Payment clause, the Incentive Price Revision clause, or both. Appellant's letter of 28 March 2011 is the parties' jointly agreed response.

² A fourth identifiable intangible asset is not at issue in this appeal. In this opinion the term "identifiable intangible assets" refers only to the three assets named above.

submissions for its government contracts during the asset amortization period. These costs subsequently became the subject of a government claim. (See finding 7 below)

5. Beginning in October 1988 and ending on 31 May 1994, the monthly identifiable intangible asset write-up amortization costs were entered on Kearfott's books and records in an income statement account (Account No. 71050) entitled "Miscellaneous Deductions." This income statement account was not part of the operating cost accounts and the costs accumulated in that account were overlooked when Kearfott prepared its indirect cost rates and incurred cost submissions for its government contracts during the asset amortization period. (R4, tab 121 at 2; tr. 49-50, 114, 184-85)

6. Effective 23 July 1990, a newly promulgated FAR 31.205-52 barred recovery of amortization costs incurred for a business combination as follows: "When the purchase method of accounting for a business combination is used, allowable amortization, cost of money, and depreciation shall be limited to the total of the amounts that would have been allowed had the combination not taken place." 55 Fed. Reg. 25,530 (June 21, 1990).

7. Following the promulgation of FAR 31.205-52, the government sought to recover Kearfott's tangible asset write-up amortization costs that had been included in its government contract indirect cost rates after 4 October 1988. In our decision of 24 September 2004, we held that Kearfott was entitled to claim tangible asset write-up amortization costs of business combinations only on contracts entered into before 23 July 1990. *Kearfott Guidance & Navigation Corp.*, ASBCA Nos. 49271, 49532, 51873, 52521, 04-2 BCA ¶ 32,757 at 162,026, 162,028-29, *recon. denied*, 05-1 BCA 32,845.

8. By letter dated 12 April 2005, the administrative contracting officer (ACO), Peter Campisi, sent to Kearfott the government's "revised Indirect Rates and Cost of Money Factors for FY 1989 through FY 1997, including the 338 Asset Write-up costs, for the applicable contracts issued prior to July 23, 1990." The attached schedule was headed: "Indirect Rates and Cost of Money Factors for FYs 1989 through 1997 Including Asset Write-up Costs." Neither the letter nor the attached schedule stated that the rates and factors shown therein were "final." Neither the letter nor the attached schedule included a general release barring revision of the rates and factors on any grounds. (R4, tab 101)

9. The 12 April 2005 letter requested Kearfott to "acknowledge acceptance of these rates by signing and dating this letter and returning it to [the ACO]." On 25 April 2005, Kearfott's Vice President of Finance, Stephen Givant, signed the 12 April 2005 letter "Accepted" and returned it to the ACO. (R4, tab 101; tr. 13-14) At hearing, Mr. Givant testified that:

The reason I signed it [the letter] is that it was sent to me by Mr. Campisi, the then ACO, and both he and I were under the impression that these figures included all of the company's asset write-up costs, both for tangible assets and intangible assets.

So we were of the opinion that these were the rates that we would work with.

(Tr. 47)

10. Mr. Campisi did not testify at the hearing. We find the above testimony of Mr. Givant credible and un-rebutted. On that testimony, we find that the government in sending and Kearfott in accepting the letter and schedule of rates and factors attached thereto were both acting under the common understanding that those rates and factors included all of Kearfott's asset write-up costs.

11. At sometime in mid to late June 2005, Mr. Givant discovered that the indirect cost rates and FCCOM factors in the government's 12 April 2005 letter included only the tangible asset and not the identifiable intangible asset write-up amortization costs (tr. 48-51). On 11 July 2005, Mr. Givant met with the ACO (Mr. Campisi) and a DCAA auditor (David Gotlib) to explain the omission and how it came about. Mr. Givant testified as to the results of this meeting as follows:

Q. [C]ould you discuss what action items resulted from the meeting with Mr. Campisi?

A. [Mr. Campisi]...indicated that he understood how something like that could happen. Mistakes are made and he indicated that if we would simply submit to him, a formal overhead rate proposal, if you will, with a certification that included the costs that we had identified as having been omitted, he would have them reviewed by DCAA.

And so, we agreed to do that and he indicated that if the cost bore-out, in other words, if these were real costs and they tied back to the books, that he would adjust the rates according[ly].

(Tr. 53-54)

B. Kearfott's Claim

12. On 29 July 2005, Kearfott submitted to the ACO a proposal for "Final G&A Rates and Cost of Money Factors for Fiscal Years 1989-1994" that included the identifiable intangible asset write-up amortization costs (R4, tab 103). On 4 August 2005, the ACO referred Kearfott's 29 July 2005 proposal to the DCAA for "audit evaluation" (R4, tab 104 at 1).

13. On 13 February 2006, a DCAA memorandum advised the ACO that, "the \$36,983,000 of intangible asset amortization costs for software, backlog and covenant not to compete, now being submitted in the contractor's revised G&A rates and G&A facilities capital cost of money factors are not allocable to Government contracts." The stated reasons were that: (i) 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 (ii) "KG&N 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." (R4, tab 121 at 1, 2)

14. In a 1 March 2006 memorandum to the ACO responding to the 13 February 2006 DCAA memorandum, Mr. Givant, among other things, reminded the ACO of:

[T]he recent correction of a Defense Contract Management Agency error in connection with the finalization of facilities capital cost-of-money factors for fiscal years 1990 through 1999. In 2005 – years after final rates were established for those fiscal years – when you brought to our attention the fact that reductions in the cost-of-money factors were warranted, we immediately agreed to modify the overhead rate agreements to make the appropriate adjustments.

(R4, tab 122 at 2) Mr. Givant also recounted this incident in his testimony at hearing as follows:

In the case of Mr. Campisi [the ACO], just recently, relative to this point in time, there had been a situation where he had re-issued a letter to reflect some cost of money factors, which had not been attended to initially. So we updated those numbers.

So I wanted to point out to him that to some extent, as he recognized, these rate letters, if you will, such as the April 12, 2005 letter, were not a final rate agreement.

These were letters that reflected as of the moment, our best view of what the rates were and going back with other ACO's, we had the same situation. One or the other parties would discover a mistake, a transposition, a number in the wrong place, and we'd go back and fix them. That was the practice.

Q. In the example cited...did Kearfott recover less money on contracts as a result of the adjustment that the Government sought on cost of money factors?

A. Yes, I believe it did.

(Tr. 88-89)³

15. By letter dated 8 May 2006, ACO Campisi advised Kearfott that re-opening the rates previously negotiated was not warranted, citing substantially the same reasons in the 13 February 2006 DCAA memorandum. This letter did not deny the revision of the 1990-99 final rate letters alleged in Kearfott's 1 March 2006 memorandum. (R4, tab 123) On 25 May 2006, Kearfott submitted a certified claim in the total amount of \$8,779,000 for price adjustments to include the identifiable intangible asset write-up amortization costs in the G&A rates and FCCOM factors applicable to the captioned contracts for FYs 1989-1994 (R4, tab 124).

16. By final decision dated 10 October 2006, ACO Edward Engleman denied Kearfott's 25 May 2006 certified claim on the grounds that: (i) "Kearfott elected not to allocate those costs to Government contracts and has consistently followed that practice in estimating, accumulating and reporting costs under the affected contracts;" and (ii) "the agreement of the parties on the rates was arrived at in all respects as contemplated by the terms of the contracts and...the finality of the negotiation should stand as is" (R4, tab 12 at 6-7).⁴ This appeal followed.

³ This testimony was also un-rebutted at hearing (*see* finding 10 above).

⁴ At hearing ACO Engleman testified that considerations of reasonableness, allocability or allowability of the costs in question played no role in his decision to deny the claim (tr. 137).

C. The Bookkeeping Entry: Mistake or Established Accounting Practice?

17. Kearfott contends that the bookkeeping entry assigning the costs in question to an income deduction account rather than an operating cost account was a mistake and not an established accounting practice. The government contends that it was an established accounting practice because “[m]onth after month, for seventeen years [1989-2005] [Kearfott] deducted those costs from its profits and never allocated the costs to its Government contracts” (gov’t reply br. at 39).

18. At hearing, Mr. Givant testified that the bookkeeping entry was a one-time decision made in October 1988 with the amortization schedule set “up-front” after which the monthly charges flowed automatically to the account over the five-year amortization period ending 31 May 1994 (tr. 81-82, 114). There was no 17-year period of amortization costs for then identifiable intangible asset write-ups. Rather, as of 31 May 1994, the assets had a zero balance (R4, tab 121 at 2).

19. In response to allegations in the 13 February 2006 DCAA memorandum, and repeated by the ACO in his letter of 8 May 2006, that Kearfott did not mistakenly omit, but deliberately chose to exclude, the amortization costs at issue from all proposals and incurred cost submissions to the government, Mr. Givant testified:

I don’t see how he could possibly conclude that it was anything but a mistake. These were tens of millions of dollars in good costs, that were omitted from the rate, and yet he’s saying...that they were intentionally omitted, that we were making a gift to the Government of these dollars. It just didn’t stand to reason.

(Tr. 93)

20. At hearing, the lead DCAA auditor (Mr. Gotlib) agreed that the identifiable intangible asset write-up amortization costs as entered on Kearfott’s books and records “did not enter as an operating expense within cost accounting systems.” He further testified that “it’s possible” that the entry was a mistake. (Tr. 184-85) At hearing, the DCAA supervisory auditor on Kearfott’s claim agreed that: “DCAA is not asserting that Kearfoot [sic] has an established cost accounting practice, with respect to intangible asset amortization costs that it is now trying to change” (tr. 130-31).

21. On the foregoing findings 18-20 and the evidence cited therein, 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.

D. Allowability of the Identifiable Intangible Asset Write-Up Amortization Costs

22. The Allowable Cost and Payment and the Incentive Price Revision clauses of the captioned contracts respectively invoke FAR Subpart 31.2 and FAR Part 31 for the determination of allowable costs under their respective cost-reimbursement and total negotiated cost provisions. The relevant FAR Subpart 31.2 provisions are the following:

31.201-2 Determining allowability.

(a) The factors to be considered in determining whether a cost is allowable include the following:

- (1) Reasonableness.
- (2) Allocability.
- (3) Standards promulgated by the CAS Board, if applicable; otherwise, generally accepted accounting principles and practices, appropriate to the particular circumstances.
- (4) Terms of the contract.
- (5) Any limitations set forth in this subpart.

....

31.201-3 Determining reasonableness.

A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business...In determining the reasonableness of a specific cost, the contracting officer shall consider—

- (a) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance;
- (b) The restraints or requirements imposed by such factors as generally accepted sound business practices, arm's-length bargaining, Federal and State laws and regulations, and contract terms and specifications;
- (c) The action that a prudent business person, considering responsibilities to the owners of the business, employees, customers, the Government and the public at large, would take under the circumstances; and

(d) Any significant deviations from the established practices of the contractor that may unjustifiably increase the contract costs.

31.201-4 Determining allocability.

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it –

- (a) Is incurred specifically for the contract;
- (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
- (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

FAR (1984 ed.). For those of the captioned contracts awarded after 30 July 1987, an amended version of FAR 31.201-3 is applicable. However, the amended version includes no changes that substantively affect this decision.

23. At hearing, the lead DCAA auditor on Kearfott’s claim agreed that the acceptance of the appraised values of the tangible and identifiable intangible assets by the outside auditor and the IRS “shows the legitimacy and reasonableness of the costs at issue” (tr. 188-89). He further testified as to the allowability of the amortization costs in question as follows:

Q. You would agree, would you not, that the costs at issue in this appeal are not expressly unallowable, are they?

A. They are not expressly unallowable.

Q. Nor are they mutually agreed to be unallowable, are they?

A. That is correct.

Q. Nor are they specifically designated as unallowable, at least prior to ACO’s final decision, correct?

A. Correct.

Q. Nor are they directly associated costs, such as to be treated as unallowable, is that correct?

A. That is correct.

Q. Nor is there anything in FAR Part 31 that disallows these costs, based on a cost principle, is that correct?

A. Leading up to --

Q. Prior to July 23, 1990?

A. Correct.

Q. So, prior to July 23, 1990, FAR Part 31 did not disallow these costs as unallowable costs, correct?

A. That is correct.

Q. Okay, nor are you aware of any contract provision which disallows these costs, standing independently?

A. That is correct.

....

Q. You would agree, would you not, that it's possible that the intangible asset amortization costs at issue here are both allocable and allowable?

A. They can be both allocable and allowable.

Q. Okay. So you're agreeing with me, right?

A. Yes.

(Tr. 171-72, 202)

24. The supervisory DCAA auditor on the Kearfott claim also testified that she was not aware of any specific cost principle in FAR Part 31, prior to 23 July 1990, that disallows for government contract purposes the identifiable intangible asset amortization costs (tr. 125-26).

25. On the beneficial relationship (allocability) of the amortization costs at issue to the government contracts and the overall operation of the business, Mr. Givant testified as follows:

Without the software, the company couldn't have performed any contracts for the Government or anyone else. I mean, there would have been people, there would have been machinery, equipment, but the computers, in a sense, run the business.

As far as the contract back-log, those were Government contracts and as I said, you can buy a business that has no contracts, but then you're starting from scratch and the likelihood of you getting the first contract is very difficult.

So, that back-log position accompanied [sic] in such a way that it could take on the next contract. It had economies of scale. It had, you know, production that was ongoing...

....

...[A]s far as the covenant not to compete [is concerned], that really enabled Kearfoot [sic] to function, not worry that the former parent company, which had access to all of the trade secrets...[T]hey could have gone out and taken...some of the lucrative repair work and the projects that were coming along the way.

(Tr. 25-26)

26. On the evidence of the independent appraisals and the acceptance of those appraisals by Kearfott's outside auditors for financial reporting purposes and by the IRS for tax purposes (finding 3), the cited testimony of the DCAA auditors assigned to evaluate the claim (findings 23, 24), and the testimony of Mr. Givant on the beneficial relationship of those costs to the government contracts and the overall operation of the business (finding 25), we find that the amortization costs at issue were reasonable both in nature and amount, such as would be incurred by a prudent person in the conduct of a competitive business, that they benefited the performance of the government contracts or were otherwise necessary for the overall operation of the business, and that they were in all other respects allowable costs for the determination of the G&A rates and FCCOM factors for the fiscal years 1989-1994.

DECISION

We have found above that Kearfott's identifiable intangible asset write-up amortization costs at issue in this appeal were omitted from the calculation of the G&A rates and the FCCOM factors applicable to the captioned contracts for the period 4 October 1988 through 31 May 1994, by reason of a bookkeeping entry mistake and not by reason of an established accounting practice (findings 18-21). We have further found above that the costs in question are allowable costs for determination of the G&A rates and FCCOM factors for the captioned contracts pursuant to their payment clauses and the FAR Subpart Part 31.2 cost principles specified therein (findings 22-26). These findings dispose of the government's contentions that the omission was a deliberate established accounting practice and that the costs were not proven to be otherwise allowable.

There remains for decision whether the rates and factors in the 12 April 2005 letter agreement were final and not subject to revision. We have found that the parties entered into the letter agreement on the mutual understanding that all of Kearfott's asset write-up amortization costs had been included in the computation of those rates and factors (findings 9, 10). We have also found that the letter agreement and the schedule of rates and factors did not anywhere state that those rates and factors were "final." Nor did the letter agreement or attached schedule include any release provision barring revision of the rates and factors on any grounds. (Finding 8)

In *The Boeing Co.*, ASBCA No. 52256, 02-1 BCA ¶ 31,811 at 157,216, we granted reformation of a contract modification amount to include inadvertently omitted allowable FCCOM, where the parties had entered into the modification with the mutual mistaken understanding that the agreed amount included all of the allowable costs. We granted reformation in *Boeing*, notwithstanding a general release by the contractor in the modification "for any further equitable adjustment." *Id.* at 157,211 (finding 39). In *Boeing* we noted that: "To bar reformation in this case would allow [the government] to become an unintended beneficiary of \$459,794.00, to which it is not entitled." *Id.* at 157,216. Kearfott's case here is the same as that of the contractor in *Boeing* to the extent that in both cases the contractor and the government entered into a cost agreement on a mutually mistaken understanding that it included all allowable costs. Kearfott's case for reformation, however, is stronger than that of the contractor in *Boeing* because Kearfott's letter agreement was not a final contract close-out modification and contained no general release term as was the case in *Boeing*.

We sustain the appeal.

Dated: 10 June 2011

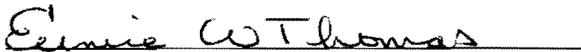


MONROE E. FREEMAN, JR.

Administrative Judge
Armed Services Board
of Contract Appeals

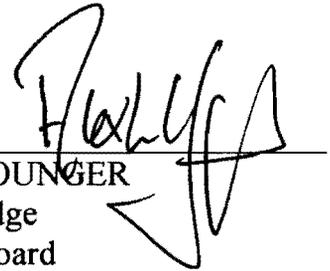
I concur

I concur



EUNICE W. THOMAS

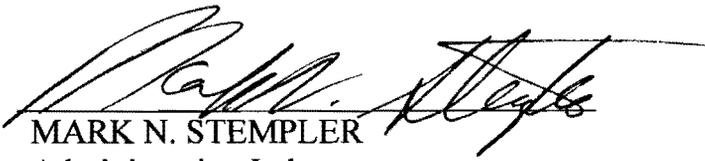
Administrative Judge
Vice Chairman
Armed Services Board
of Contract Appeals



ALEXANDER YOUNGER

Administrative Judge
Armed Services Board
of Contract Appeals

I concur



MARK N. STEMPLER

Administrative Judge
Acting Chairman
Armed Services Board
of Contract Appeals

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA No. 55626, Appeal of Kearfott Guidance & Navigation Corporation, rendered in conformance with the Board's Charter.

Dated:

CATHERINE A. STANTON
Recorder, Armed Services
Board of Contract Appeals