

Government Contracts Blog

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DCAA Implements Federal Circuit Decision Requiring Interest Compounded Daily On Adjustments For CAS Noncompliances

By [*W. Bruce Shirk*](#)

Albert Einstein supposedly said that “the most powerful force in the world is compound interest.” Whether or not the great man actually said that, DCAA is now prepared to show contractors just how powerful compounding can be.

Cost Accounting Standards (“CAS”) have always required that

- When a contractor is noncompliant with CAS and
- The noncompliance causes the government to pay increased costs, then
- The contractor must pay interest on the amount of the required adjustment, with
- Interest commencing on the date the violation first caused the government to pay the increased costs and continuing until the contractor makes full payment of the adjustment amount, and with
- Interest computed at the rate specified in the Internal Revenue Code, 26 U.S.C. § 6621.

41 U.S.C. § 422(h)(4); FAR 52.230-2(a)(5).

The CAS are silent as to whether the interest is simple or compound, *i.e.*, whether the contractor must pay interest only on the principal amount of the adjustment or pay interest on both the principal and on the interest itself. The “price adjustment” requirement that is perhaps most analogous to a CAS noncompliance is the seemingly ubiquitous price reduction for defective cost or pricing data. Like the CAS statute, the Truth in Negotiations Act (“TINA”) references § 6621 of the Internal Revenue Code as to the *rate* of interest to be applied to contract adjustments required by TINA. 10 U.S.C. §2306. The regulations implementing TINA prescribe simple interest. FAR 52.215-10(d).

The difference between simple and compounded interest is significant. For example, simple interest on \$10,000,000 at a rate of 5% over five years yields a total of \$12,500,000; interest compounded daily on the same amount at the same rate over the same period yields a total of \$12,838,289.00. This is an increase of \$338,289.00 in the interest, and it represents a 13.5% increase in the interest payable. But rates are low at the moment – the Treasury rate through December 31, 2010 is only 4%. However, as recently as 2007 the Treasury rate was 8%; in the mid-1990s it ranged between 8% and 10%; and within the last two decades it has reached 11%. In periods of higher rates, the impact of compounding obviously becomes more pronounced and someone required to pay compound interest will surely feel that incremental “pinch.”

Get ready for the pinch. On March 25, 2010, DCAA issued Memorandum To Regional Directors ("MRD") 10-PAC-011(R) requiring interest on price adjustments for CAS noncompliances to be *compounded daily*. The guidance set forth in this MRD was formally incorporated into the DCAA Audit Manual effective May 13, 2010.

The new requirement for “calculating daily compound interest” is based on the September 14, 2009 decision of the Federal Circuit in *Gates v. Raytheon*, 584 F.3d 1062 (Fed. Cir. 2009). The dispute in *Raytheon* stemmed from the contractor’s “*failure to pay interest on*” some \$15,000,000 that the parties had agreed the contractor owed under CAS 413-12(c)(50) with respect to pension surpluses following the closing of two business segments. As is frequently the case in such circumstances, negotiation of the amounts owed were complicated, disputatious and lengthy, extending over a period of some six years. The contracting officer found that the contractor’s failure to pay the \$15,000,000 when the segments closed constituted a noncompliance with CAS 41-50(c)(12) that caused the government to pay increased costs on which the contractor owed interest to compensate for the delay.

The rationale of the Federal Circuit in *Gates v. Raytheon* involves two steps. First, the CAS statute “*establishes the interest rate by reference to 26 U.S.C. § 6621,*” a proposition with which no one can take exception. Second, according to the federal Circuit, another provision of the tax code – 26 U.S.C. § 6622(a) – “*relatedly*” requires daily compounding. Therefore, the court concludes, § 6621 requires compound interest. The court thus appears to conflate “rate” prescribed in § 6621 with the compounding requirement of § 6622.

The contractor, with the support of an *amicus* brief filed by NDIA, has requested rehearing *en banc*, so the possibility remains, however remote it may be from a statistical perspective, that the court will have second thoughts about the decision. But DCAA is not waiting for the process to play out. *Gates v. Raytheon* is on the books, and now it is in DCAA’s books – just another weapon in the arsenal available to the government to “up the ante” on the settlement of any claim in which the term “CAS noncompliance” finds its way into the final decision. Think about that the next time you decide to defer filing, to request or grant an extension, to engage in fruitless ADR, or to decline aggressively to push the government to get the case ready for trial. “Time Is on My Side” was a breakthrough single for the Rolling Stones and, with cases like *Gates v. Raytheon*, it is an increasingly apt anthem for the government’s cadre of contracting personnel.

Authored by:

[W. Bruce Shirk](#)

(202) 741-8426

bshirk@sheppardmullin.com