

ALERT

"Fatally Flawed Statistically and Therefore Unreasonable" Armed Services Board Finds DCAA Executive Compensation Review Methodology Defenseless

January 24, 2012

In a decision dated January 18, 2012, the Armed Services Board of Contract Appeals agreed with the Appellant that the Defense Contract Audit Agency (DCAA) method for analyzing the reasonableness of executive compensation under FAR 31.205-6 was subject to "statistical flaws" which rendered Government affirmative claims of nearly \$600,000 untenable.

The decision in *Appeals of J.F. Taylor, Inc.*, ASBCA Nos. 56105, 56322, addressed J.F. Taylor's challenge to the results of Executive Compensation Reviews (ECR) conducted over four fiscal years leading to final decisions that were appealed in 2007, and a hearing in 2009, culminating in the Board's decision issued last week. The Appellant challenged the DCAA ECR methodology on several grounds, but the statistical validity of the ECR results was the central focus of the appeals. Specifically, among other statistical critiques, the company alleged that the DCAA method: ignored compensation survey data dispersion and employed an arbitrary 10% "range of reasonableness" allowance; ignored differences in survey sizes; and, failed to consider the company's financial performance and other relevant factors that may explain compensation variations. The Board observed that the Government "made no effort at the hearing or in its brief, to respond to [the Appellant's] statistical arguments." The Board then ruled that "we are left with un rebutted evidence that the methodology used by DCAA was fatally flawed statistically and therefore unreasonable." DCAA's methodology, set forth in Defense Contract Audit Manual Section 6-414.4, has been extensively

Practice Areas

Cost Accounting and Cost Allowability
Government Contracts
State and Local Procurement Law

discussed and criticized in other fora.

Because the Board found the DCAA's ECR methodology unreasonable, the *J.F. Taylor* decision is likely to have an impact that extends beyond these appeals. At a minimum, DCAA will need to revise the process by which it evaluates the reasonableness of executive compensation, thereby affecting future reviews. In addition, the validity of past and ongoing executive compensation reviews, carried out using the fatally flawed method, and which resulted in substantial disallowances, could be called into question through the disputes process or otherwise.