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GC Newsletter



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We again invite you to visit our website where you can access previous issues of this bi-monthly GCNewsletter, copies of the periodic GCAlert, our express notification of significant happenings in the government contracting arena of an immediate nature, and White Papers and presentations on various subjects of interest.

Visit www.GaffeyCPA.com

If you have any questions or comments relative to our website or the articles included in this issue of the Government Contracting Newsletter please contact us.

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Business Tool for Success - Indirect Expense/Overhead Rate Structures //

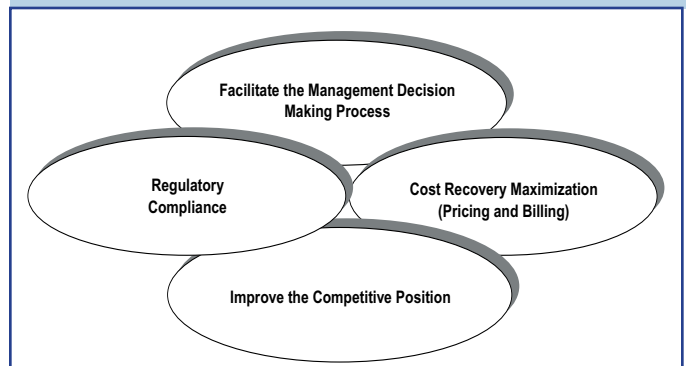
One of the least appreciated and most maligned tools in management's toolbox is the indirect expense or overhead rate structure. The indirect expense rate structure of an organization, whether for-profit or not-for-profit, whether service-oriented or a manufacturer or some combination of both should mirror the operational organization. A company's indirect rates have a pervasive effect on all of their contracts, on the level of revenue and profit realized and on the volume of cash flow. For these reasons indirect expense rates should be considered both a strategic and a tactical element of your business plan. It is more than just a by-product of the accounting and budgeting system. Your indirect rate structure must play a major role in supporting your strategic business model and must not be inconsistent with your businesses operating model.

Indirect rate structures are influenced by many factors and must reflect as accurately as possible the most –

- efficient operating structure of the organization,
- competitive allocation of costs to the organizations final cost objectives,
- realistic projections of the anticipated future direction of the organization,
- proper identification of the “true” cost of an organizations final cost objectives,
- meaningful information upon which management can base its decision making process,
- favorable cost recovery and cash flow scenario.

With all of this an organization's indirect rate structure must be compliant with all applicable Government regulations and the requirements established by the contract or award.

“ Your indirect rate structure must play a major role in supporting your strategic business model . ”



The ultimate goal of your indirect expense rates should be to: (1) facilitate the management's decision making process; (2) identify opportunities to maximize cost recovery; (3) improve the organization's competitive position; and (4) maintain contract and/or regulatory compliance.

Indirect expenses including fringe costs, overhead costs and general and administrative expenses can represent well over two-thirds of a company's product or service cost. Management needs to know what something truly costs before they can make an educated decision regarding how it is to be handled. Do we want to continue delivering a particular line of service or product? Are we making money on it? What does it cost us? All questions requiring a good indirect cost structure and cost allocation system.

Cost recovery is the second reason for having a good indirect cost structure. We need to make sure we are pricing all of our allowable/recoverable costs into our products or services. Are we billing all of the costs incurred? Are we allocating them to the right products or services where they can best be recovered?

The third reason for having a good indirect cost structure

is associated with the organization's competitive position. Are you selling goods and services for the right price? Is your most popular good or service losing money due to a flawed indirect cost allocation model? Without knowing the true costs of your products or services, you do not know whether pricing adjustments are required or if marketing initiatives should be abandoned, revised or emphasized.

Lastly regulatory compliance generally dictates the existence of a good cost allocation plan and representative indirect cost structure. If you do not have a good cost allocation plan, the odds are that you are not in compliance with the applicable regulatory requirements of the Federal Acquisition Regulation (FAR), the agency FAR supplements, the Cost Accounting Standards (CAS) or the applicable Office of Management and Budgets (OMB) circulars.

Developing a good indirect cost structure that is dynamic and that accurately reflects the strategic and tactical goals of the organization requires addressing many structural alternatives such as but not necessarily limited to:

- Determining what functions are to be identified as direct costs and those that are to be identified as indirect. The larger the direct cost allocation base the lower the indirect expense rate.
- Determining the basis for indirect cost allocation. If you have a large subcontractor involvement you might want to consider allocating general and administrative costs over what is known as a "value-added" direct cost base to most accurately assign costs to final cost objectives.
- Deciding whether the indirect cost structure should be complex (e.g., multiple expense pools and allocation bases) or simple (e.g., single expense pools and single allocation bases). Smaller more complex pool structures are more volatile and subject to changing conditions that may or may not be pertinent. Single rate pools are more easily understood, more consistent over time but tend to smear costs across products or services in what is referred to as the "peanut butter effect."
- Establishing on-site (home office) rates and off-site (client site) rates to more accurately allocate company facility costs and provide for a lower off-site indirect rate.
- Establishing a material-handling rate to apply to large material purchases or other direct costs on contracts

where labor and/or subcontract efforts are not significant. Keeps the indirect cost pool allocated to direct labor at a lower level.

- The allocation and recovery of Home or Corporate Office expenses allocated to the various business centers can recover costs generally not included in an indirect cost structure.
- Determining the most equitable allocation process for "service centers" (e.g., reproduction, graphics, information technology, facilities, communication services, etc.) to interim or final cost objectives.

Other considerations center around auditability and flexibility. The more complex the indirect rate structure the harder it is to understand and therefore to audit. The more complex structures are also more sensitive to changes in the business structure, the adding or deletion of operational centers and the changes in product or service composition. Simplified structures can accept changes with minimal impacts on the overall rates and are easily understood for auditing purposes. The trade off? Simplified indirect rate structures might not provide accurate product or services costing.

A final distinction must be made between the cost of a product or service and its price. Cost is the appropriate allocation and accumulation of actual or estimated costs against a final cost objective. Price is a management decision reflecting an anticipated return on investment (e.g., profit), the desire to be or play in the marketplace, negotiation and competitive pressures. Price may be determined based on cost and it may not. It is a decision of management that should be made knowing the actual "true" cost of the given product or service.

Sam Davidson, a principal with Gaffey & Associates, PLC, provided this article. If you would like to discuss your indirect expense rate structure and the maximization of indirect expenses recovery you can contact him at 703-748-5816 or via email at samuel.davidson@gaffeycpa.com.

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Real Estate Best Practices - What Companies Doing Business with the Government Should Know //

Find space close to where I live. Keep the rent low. Do a short term because I'm going to grow. Sound familiar? Each of the above are well known goals for technology and government service companies faced with a real estate decision. Many view their real estate as some type of chore that comes up every few years that they simply want to get out of the way so they can go back to running their business. However, companies seeking to adhere to best practices should consider how multiple aspects of real estate impact their business.

One of the initial considerations for any executive is lease versus buy. For any company, all of the classic reasons for owning (building equity, depreciation, fiscal and operational control) are initially attractive, and the problems include minimal flexibility, initial investment and property management responsibilities. For government contractors, the Federal cost standards and practices may pose additional challenges regarding restrictions on passing through certain rental costs as reimbursable or allowable expenses when financed ownership of the underlying asset (building or space) is present.

Emerging companies face additional pressure to implement prudent business practices. Depending on the company's growth strategy, the contractor may be seeking a mentor-protégé relationship, outside funding or an acquisition. Each of these strategies will cause the company to thoroughly examine business practices, including those pertaining to real estate. Subcontractors are subject to audit by their prime contractors, and overpaying in rent (particularly when the company executive is the landlord) may raise concern.

However, there's far more to analyze than rent to properly assess the prudence of a company's real estate. While a good accountant can determine how appropriate real estate costs are for a particular company and a good attorney can provide guidance on the ramifications of legal clauses within a lease or contract, a commercial real estate broker focused on the area and the industry can benchmark all aspects of the company's facility solution to the market to ensure that the company is observing sound strategic, financial, operational and cultural best practices.

Strategically, companies should consider their short and long term growth strategies in determining the proper lease structure and flexibility requirements. Expansion, contraction, renewal and termination options all have value for emerging companies. A termination right may be attractive for a potential acquirer, and a renewal right can insulate a company from market pressures and avoid a disruptive relocation. At the same time, contraction options mitigate losses from unsuccessful contract bids and provide a cost-recovery mechanism when employees are pulled to customer site locations, while expansion options can allow the company to grow while minimizing operational disruption. Companies should also view their facility as a strategic marketing tool, especially if customers and partners visit them. Building signage and customized build out will add to expenses, but may satisfy a strategic objective that can pay dividends over time. There is also a flip side to this in that sometimes presenting a "humble" appearance resonates with your customer signaling that you are a prudent manager and not one charging them too much because you live in a "high rent district".

The financial implications of a facility go beyond the rental rate. Examining the optimal working environment is key prior to getting started. Evaluating alternatives such as private offices, open workstations, or some combination will have an impact on the amount of space required which naturally translates into the overall cost. Oh, and don't forget the furniture. Many a budget has been blown when not incorporating this component into the space configuration and cost decisions. Make sure they are line items in any comparison matrix you use to select your facility.

On the operational side, performing due diligence on facility options is important to ensure that the company conforms to all government security requirements and provides for an efficient flow between business units. Certainly, companies leasing space for government employees per the provisions of a contract must adhere to government facility requirements, but contractors themselves are facing increasing security requirements under the Unified Facilities Criteria. Standards such as redundant systems, Secured Compartmentalized

Information Facility (SCIF) space and access controls are not uncommon for companies managing sensitive information for the government. In addition to security requirements, the company should organize and plan a facility such that it provides the flexibility for growth while keeping key business units together for optimal workflow.

Clearly, fulfilling contracts with employees at the customer site is advantageous to staffing within the facility not only because of lower real estate costs, but there are also other non real estate related benefits such as obtaining security clearances for staff. In some instances it's easier to obtain a security clearance while working in a government facility. For employees servicing contracts that need access to the company facility, shared space (otherwise known as "hoteling") is a more economically efficient alternative to designated space for each employee; however, this cost-savings technique may not align with the company's culture. In an area with only 2% unemployment, companies cannot only focus on financial and operational efficiency to succeed; they must also provide an attractive environment for their employees. With skilled (and particularly cleared) personnel in strong demand, companies need to offer incentives to attract and retain top talent. Salaries and benefits are one aspect, but offering employees a challenging platform to utilize their skills along with a comfortable environment with the desired amenities can have a strong psychological impact. Something as simple as not having to pay for convenient parking or having a good place to eat lunch can reduce the potentially high cost of turnover.

Real estate can be viewed as a simple exercise of finding space, but more strategic government contractors utilize a process that aligns real estate with their business goals and then benchmarks their solution to the market on a regular basis. Annual operating expense reviews, market updates and efficiency studies are all important checkups to ensure that your real estate is properly positioned to enhance your business.

This article was provided by Mike Norris, a senior associate at Scheer Partners Inc. (www.scheerpartners.com), a leading provider of commercial real estate consulting services. He can be reached via email at mnorris@scheerpartners.com.

ALTERNATE WORKPLACE ARRANGEMENTS (AWA) – IMPLEMENTATION GUIDELINES//

Effective March 17, 2006 the GSA laid down federal agency real property guidelines for the establishment of teleworking/telecommuting alternate workplace arrangements. These guidelines can and should be addressed by private organizations implementing AWA.

Teleworking and telecommuting are used interchangeably and are defined as the “act of performing all or a portion of work functions at an alternative worksite, such as working at home or a telework center, under circumstances that reduce or eliminate the employee’s commute.” To be considered telework, it must “occur at least one day per week on a regular basis and does not include (1) situational telework (unscheduled, project-oriented, non-recurring, and/or irregular telework and/or teleworking that occurs less frequently than once a week on a recurring basis) or (2) full-time mobile work arrangements.”

AWA includes telecommuting, hoteling (non-dedicated, non-permanent workspace assigned by reservation on an as-needed basis), hot desking (non-dedicated, non-permanent workspace assigned on a first come, first served basis), telework centers (providing workspace and support on a fee for use basis) and virtual offices.

Agencies are authorized to provide/procure equipment including computers and related hardware and software, desks, chairs, facsimile machines, printers and etc. as long as it is understood that it is the property of the Government and there is an audit trail indicating the location of the equipment.

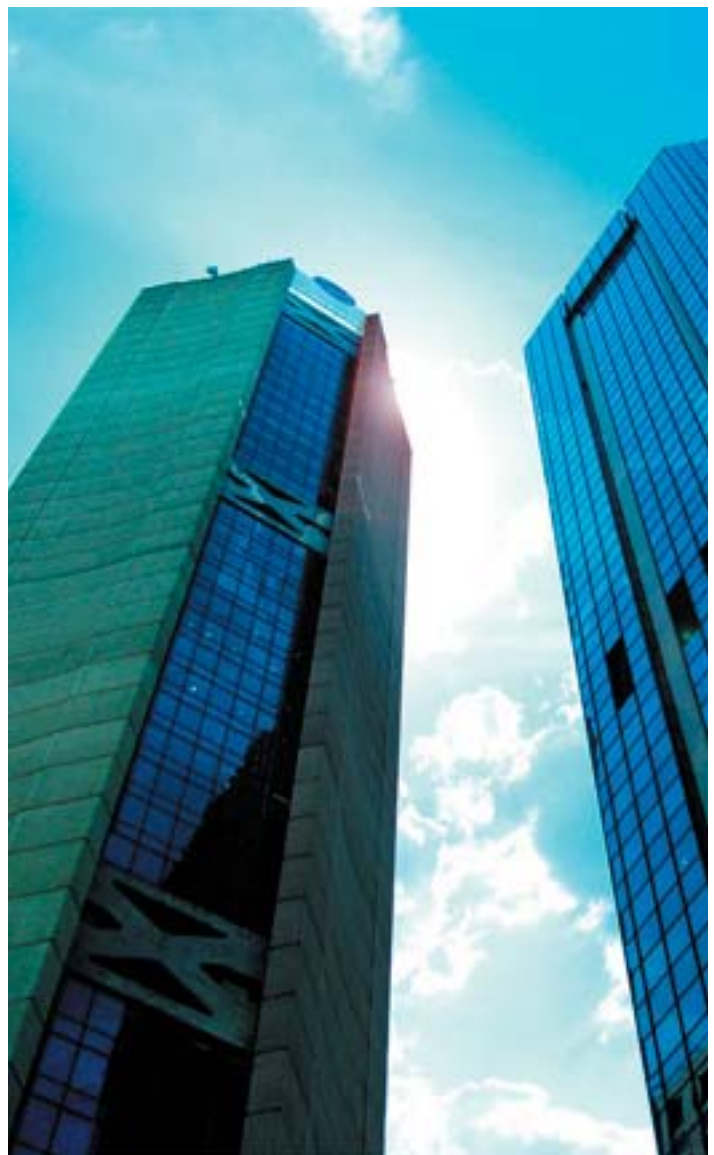
Agencies are also authorized to reimburse employees for the installation of telephone lines and necessary equipment and pay monthly charges if they are in direct support of the agency’s mission. This authority also includes internet services, broadband access, e-mail services, voice over IP equipment and services, desktop videoconference equipment and services and any other telecommunications equipment and service needed by individuals working in home-based AWA.

Utility costs for home-based AWA are not reimbursable, due to the difficulty in determining a fair and reasonable

amount to be reimbursed, as are federal taxes since the federal agencies are exempt.

The costs associated with relocation and re-setup of AWA is the responsibility of the agency if the relocation was required by the agency.

The full text of these guidelines can be seen in the Federal Register dated March 17, 2006 (Volume 71, Number 52), Pages 13845-13848.



GUIDANCE ON THE PROPER USE OF AWARD FEES //

On March 29, 2006, James Finley, the Deputy Under Secretary of Defense for Acquisition and Technology, issued a memorandum addressing the use of award fees. The guidance addressed three major areas of concern expressed by GAO in December 2005 (<http://www.gao.gov/new.items/d0666.pdf>). Compliance with these three areas will have an impact on how you structure your contracts and the compliant recording of program revenues in your books and records.

Link Award Fees to Desired Outcomes – It is imperative that award fees be tied to identifiable interim outcomes, discrete events or milestones.

Award Fees Must Be Commensurate with Contractor Performance – Award fee arrangements must be structured to motivate excellent contract performance. Satisfactory performance should earn considerably less award fee than excellent performance while performance that is less than satisfactory is not entitled to any fee.

Rollover of Award Fees – Award fee rollover provisions should be the exception rather than the rule allowing the contractor to only earn a portion of the rollover fee, even for subsequent excellent performance.

This memorandum is available at <http://www.acq.osd.mil/dpap/policy/policyvault/2006-0334-DPAP.pdf>.

INCENTIVE PLAN – PURCHASE OF U.S. MANUFACTURED CAPITAL ASSETS //

On March 21, 2006 the DFARS was changed to implement Section 822 of the national Defense Authorization Act of Fiscal Year 2004.

Section 822 “requires the Secretary of Defense to (1) establish an incentive program for contractors to purchase capital assets manufactured in the United States under contracts for major defense acquisition programs; and (2) provide consideration for offerors with eligible capital assets in source selections for major defense acquisition programs.

The objective of the rule is to increase the purchase of capital assets (including machine tools) manufactured in the United States and it is expected to have a positive impact on small business manufacturers of machine tools and other capital assets used in major defense acquisition programs, as their sales to DoD prime contractors should increase.

The final rule is effective March 21, 2006 and can be found at <http://a257.g.akamaitech.net/7/257/2422/01jan2006/edocket.access.gpo.gov/2006/06-2645.htm>.

PERFORMANCE-BASED CONTRACTING – A HIDDEN RISK //

In March of 2005 the Services Acquisition Reform Act Advisory Committee of the Office of Management and Budget set a government-wide goal of having 40 percent of contracts be performance-based. In a March 2005 meeting they gave the recommendation to define two distinct categories of performance-based acquisition.

- Transformational use where the government knows the problem or problems to be addressed but places the risk on the contractor to develop a solution that will meet performance goals.
- Transactional use describes acquisitions where the government knows how the work should be approached and sets performance metrics tied closely to the tasks to be performed.

Historically contractors performed to government-dictated specifications and avoided liability for incidences surrounding its products or services based on the “doctrine of sovereign immunity.” With the move to transformational acquisitions where the contractor develops the product or service solution to meet the governments desired results there is a significant realignment of risk and liability.

While most contractors recognize the risk of being able to do what they say they will do and to provide the level of performance that the government requires, many are not recognizing the hidden risk of improper liability coverage. If you have the same level of insurance coverage now as you did five years ago chances are your insurance coverage is not what it should be. Contact your risk assessment advisor immediately.

“...40 percent of contracts
be performance-based...”



THIS AND THAT //

FAR and GSAM Websites

The FAR and GSAM websites have moved to a new location - Acquisition Central at www.acquisition.gov. The FAR and GSAM websites can now be accessed at the following URLs:

FAR: www.acquisition.gov/comp/far/index.html

GSAM: www.acquisition.gov/comp/gsam/gsam.html

Confirmation of HUBZone Certification (FAR Case 2005-009)

The interim rule published at 70 FR 43581, July 27, 2005 is converted to a final rule without change. The interim rule amended FAR 19.703 and the clause at 52.219-9 to clarify that prime contractors must confirm that a subcontractor representing itself as a Historically Underutilized Business Zone (HUBZone) small business concern is certified, consistent with the requirements of 15 U.S.C. 632 et seq., as amended. This change is expected to increase subcontracting opportunities for certified HUBZone small business concerns and ensure accurate reporting of subcontract awards to HUBZone small business concerns under Government contracts. This final rule became effective April 19, 2006.

Fast Payment Procedures (FAR Case 2004-031)

This amendment permits, but does not require, fast payment when invoices and/or outer shipping containers are not marked "Fast Pay", provided the contract includes the "Fast Payment Procedure" clause. If the Fast Payment clause is in the contract, such unmarked invoices will no longer be rejected. Instead, they will be paid using either fast payment or normal payment procedures. In addition, the revision deletes the requirement for marking invoices "No Receiving Report Prepared." This final rule became effective April 19, 2006

Strategic Sourcing

The Coalition for Government Procurement (www.thecgp.org) has pointed out that the Department of Homeland Security (DHS) has recently issued an RFP through the GSA that they are calling strategic sourcing:

GSA Performance Work Statement (PWS) Multiple Award Blanket Purchase Agreement (BPA) in support of the DHS Strategic Sourcing Initiative for Business Oriented Professional and Program Management (PM) Support Services.

"Offerors shall be made aware that although each Task Order will specify any travel and ODC requirements, the Government will not allow for the inclusion of any profit whatsoever on travel and ODC's, and will not allow any G&A or material handling charges based on a percentage of cost, regardless of whether an Offeror's GSA MOBIS schedule may state otherwise. The Offeror shall state in its pricing proposal, its understanding and compliance to this policy"

CAREERS AT GAFFEY & ASSOCIATES, PLC //



The Regulated Industries Group of Gaffey & Associates is looking for individuals interested in becoming a part of our exciting and rapidly expanding public accounting and professional services firm. A college degree is required. Experience in accounting for a regulated industry, financial services or government contract accounting is desired. CPA and/or DCAA experience a plus but not required. Contact Sam Davidson at samuel.davidson@gaffeycpa.com or David Talley at david.talley@gaffeycpa.com.

Thought for the Day

“ The idea is not to block every shot. The idea is to make your opponent believe that you might block every shot. ”

UPCOMING EVENTS //

Institute of Management Accountants Government Contractor Breakfast

May 9, 2006
Breakfast 7:00 AM – 8:00 AM
Presentation 8:00 AM – 9:00 AM
Tyson's West Park Hotel
8401 West Park Drive
McLean, VA 22102

Mr. Stanley Y. Fujii, Assistant District Director/8(a) Business Development of the Small Business Administration, will provide a presentation on the SBA Mentor Protégé Program. Cost is \$20, which includes a full breakfast. One-CPE credit is offered. To make reservations you can either call the 24-hour hotline at 202-462-6227, Option 2 or send an email to William Maxwell, Chapter President at williamomaxwell@yahoo.com.

Don't Miss Our Exhibit at the G-CON Small Business Contracting Symposium!

7:30 AM – 4:00 PM
June 20, 2006
McLean Hilton, McLean, VA 22102

The G-CON Small Business Government Contracting Symposium is a one-day education and networking event for new, established, and emerging government contracting firms. The Symposium, sponsored by the Tyson's Corner Chapter of the National Contract Management Association (NCMA) and the Northern Virginia Government Contractors Council (GovCon), provides the access, information, tools and connections you'll need for your business to become more productive, more profitable, and more competitive. This event helps small businesses become more competitive by providing:

- Access to key government and industry players
- Timely information on contracting issues
- Opportunities to schedule private meetings with representatives from federal agencies

Information and registration can be found at www.gcon2005.com/symposium.shtml.

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