TAKEAWAYS FROM 10 YEARS OF LUNCH AND LEARNS

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AGENDA

1. Prime vs Subcontractor
2. Ethics and conflicts of interest
3. Service Contract Act
4. Joint Ventures and Small Business
5. Bid protests
6. Cybersecurity
7. Audit Readiness
AGENDA

8. Business systems
   • Accounting System
   • Purchasing
   • Estimating
   • Property
9. G&A Bases
10. Advanced Indirect Rates
11. Achieving Full Cost Recovery
12. Closeouts
13. The Gauge Report
PRIME AND SUBCONTRACTING
PRIME CONTRACTOR TAKEAWAYS

• Understand Differences between Federal and Commercial Contracting
  – Policy and Procedures, the need for Controls
  – FAR and CAS
  – Ethics and Conflicts of Interest
  – Business Systems
  – Service Contract Act and other wage requirements

• Small vs. “Other than Small”
  – Set Aside Procurements
  – Mentor Protégé Agreements
  – Joint Ventures
PRIME CONTRACTOR TAKEAWAYS

• How to Subcontract in Federal Environment
  – Flowdown Clauses
  – Teaming Agreements
  – Small Business Plans and Programs

• How to Grow in the Federal Environment
  – Winning New Business
  – Market trends
  – Industry Changes
  – Mergers and Acquisitions
  – Finders, Minders and Grinders
  – Business Plans
  – Gaining an edge with approved Business Systems
SUBCONTRACTOR TAKEAWAYS

• Understand Differences between Federal and Commercial Subcontracting
  – Federal Flowdown Clauses
  – Oversight and Audit by Prime Contractor
  – Closeout requirements
  – Small Business Plans

• How to be a Subcontractor in Federal Environment
  – Teaming Agreements
  – Joint Ventures and Mentor Protégé Agreements
  – Responsibility requirements (financial, technical, business systems, good standing with feds, etc.)
ETHICS AND CONFLICTS OF INTEREST
ETHICS AND CODE OF CONDUCT

• FAR 3.1003, 4 and FAR 52.203-13 &14
  – Contracts over $5,000,000 and a performance period of more than 120 days
  – Includes Subcontracts
  – Unless extended by CO, within 30 days of the contract award, the contractor must have a code of business ethics and conduct written and provided each employee working on the project with written confirmation of training

In the event of a violation of law, a contractor’s failure to have a program in place will be evidence used to determine punishment—the same standard currently in place for judges to use in sentencing companies found guilty of violating federal law.
CONFLICTS OF INTEREST (COI)

• Personal Conflicts of Interest (PCI) FAR 3.11

  – Applies to contractor and subcontractor personnel who perform an acquisition function closely associated with inherently governmental functions
  – PCIs can develop when a person has personal or family financial or other interests that could cause them bias in making business decisions
  – Mitigation is typically removal of person from project or increased oversight on all decisions
CONFLICTS OF INTEREST (COI)

• Organizational Conflicts of Interest (OCI) FAR 9.05
  – Potential for OCI typically exists when a business relationship could create incentives or self-interest affecting performance of an existing Government contract or pursuit of a procurement in process
  – 3 types of OCI
    • Unequal Access to Non-Public Information
    • Biased Ground Rules
    • Impaired Objectivity

Disclose and Mitigate!
SERVICE CONTRACT ACT
THE SERVICE CONTRACT ACT (SCA)

• Applicability
  • All Federal contracts over $2,500 performed in the US the primary purpose of which is to furnish services to the US Government
• Contracts with SCA clause must contain DOL-issued Wage Determination
• Any employee on an SCA contract may complain to DOL and THEY WILL INVESTIGATE

• Exemptions from the SCA
  • Employees subject to a bona fide collective bargaining agreement
  • Employees who are exempt from FLSA coverage
FAIR LABOR STANDARDS ACT (FLSA)

Applies to
• Any enterprise involved in interstate commerce and with at least $500k annual revenues
• Hourly & Salaried Employees

Exempt categories include:
• Executive
• Administrative
• Professional
• Paid at least $913 per week on a salary basis (as of 2016)

Nonexempt Employee
• Covered by all FLSA requirements and is eligible for compensated overtime at 1.5 times normal rate
JOINT VENTURES AND MENTOR PROTÉGÉS
JOINT VENTURES

• Two Types:
  – Populated
  – Unpopulated

• Successful JVs
  – Are a separate legal entity
  – Operate under a written agreement with...
    • Clear written understanding of JV purpose and Client interactions
    • Clear Member roles on operations, contracts, books/records and finances
    • Clear processes for voting, termination, disputes
    • Whose Business Systems will be used

WATCH OUT FOR AFFILIATION RULES!
MENTOR PROTÉGÉ AGREEMENTS

• Allows a large business to JV with a small business and the JV remains small as an exemption to the Affiliation Rules

• A Mentor Protégé Agreement must be in place and approved by SBA prior to forming the JV which must follow SBA agreement guide

• The JV must perform 51% of the work, Protégé must perform 40% of the work, but the Mentor can own up to 40% of the Protégé

• The JV must submit annual reports to the SBA on how work is being performed
BID PROTESTS
BID PROTESTS

• Win or Lose always ask for a debrief from the agency Contracting Officer
• Agency level protests are rarely successful, Court of Federal Claims protests are expensive, so go straight to the Government Accountability Office (GAO)
• File your Protest as soon as possible to ensure automatic stay of award
• Bid Protests are now filed electronically on the GAO website
• Winning Protester can recover Attorney, Consultant and Expert Witness Fees at GAO but must file claim for reimbursement
Top Cybersecurity Threats are:
- Third Party Attacks (individuals looking for bitcoin)
- Nation-State Attacks (Russia, China, etc.)
- Threats from 3rd Party Providers
- Insider Threats (excessive administrative/access rights)

Up to 98% of Fortune 500 companies have been breached
Leadership and annual training at all levels are critical to have secure cyber
National Institute of Standards and Technology (NIST) 800-171 now applies to Prime and all subcontractors who have access to Controlled Unclassified information
News Flash: Pentagon to require Cybersecurity Maturity Model Certification (CMMC)
## NIST CYBERSECURITY BEST PRACTICES

<table>
<thead>
<tr>
<th>Identify</th>
<th>Protect</th>
<th>Detect</th>
<th>Respond</th>
<th>Recover</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identify and control access to business information</td>
<td>Limit employee access to data and information</td>
<td>Install and update: Anti-Virus; Spyware; Malware</td>
<td>Develop a plan for disasters and information security incidents</td>
<td>Make full backups of important business data/information</td>
</tr>
<tr>
<td>Conduct background check</td>
<td>Install surge protectors and UPS</td>
<td>Maintain and monitor logs</td>
<td>Make increment backups of important business data/information</td>
<td>Make improvements to processes/procedure/techniques</td>
</tr>
<tr>
<td>Require Individual use accounts</td>
<td>Patch operating systems and applications</td>
<td>Detect</td>
<td>Consider cyber insurance</td>
<td>Create policies and procedures for information security</td>
</tr>
<tr>
<td>Create policies and procedures for information Security</td>
<td>Secure Wireless access points and Networks</td>
<td>Protect</td>
<td>Make improvements to processes/procedure/techniques</td>
<td>Protect</td>
</tr>
<tr>
<td></td>
<td>Set up web and email filters</td>
<td>Protect</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Identify: Identify and control access to business information; Conduct background check; Require Individual use accounts; Create policies and procedures for information Security

Protect: Limit employee access to data and information; Install surge protectors and UPS; Patch operating systems and applications; Secure Wireless access points and Networks; Set up web and email filters

Detect: Install and update: Anti-Virus; Spyware; Malware; Maintain and monitor logs

Respond: Develop a plan for disasters and information security incidents

Recover: Make full backups of important business data/information; Make increment backups of important business data/information; Consider cyber insurance; Make improvements to processes/procedure/techniques

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Recover: Make full backups of important business data/information; Make increment backups of important business data/information; Consider cyber insurance; Make improvements to processes/procedure/techniques
AUDIT READINESS?
AUDIT READINESS TAKEAWAYS

• The greatest occupational hazard as a government contractor
• Documentation, Documentation, Documentation
AUDIT READINESS TAKEAWAYS

• Assess the **major areas** of cost and determine the strength and accessibility of the documentation
• Read the FAR for **sensitive areas** of costs:
  – Bonuses (FAR 31.205-6)
  – Executive Compensation (FAR 31.205-6)
  – Parties and Corporate Events (FAR 31.205-13)
  – Relocation (FAR 31.205-35)
• Prior to submitting an ICS, compare your ICS to the DCAA adequacy checklist
• Compare the business systems criteria to your applicable policies and procedures
BUSINESS SYSTEMS
ACCOUNTING SYSTEM

• Contract set up: DO Make sure you have internal controls
• Data Entry: DO Make sure you have adequate descriptions on all adjustments
• Controls: DO NOT override controls unless it is in accordance with policy and procedures and DOCUMENTED
• Timesheets: DO NOT override timesheet controls
• Cost treatment: DO NOT treat like costs dis-alike
ESTIMATING SYSTEM

• Document your market research and Go-No/Go decision
• Document who is assigned to the proposal and what they will be doing and when it will be due
• Document ALL reviews and approvals
• Document all corrections of errors and omissions (a log will do)
• Document the source of all your pricing and/or costs
• Make sure your subcontractor and supplier’s pricing is fair and reasonable (i.e. do a price analysis)
PROPERTY MANAGEMENT SYSTEM

• Have a general Property Management System Policy and Procedures Manual
• **AND** generate a specific Property Management Plan for property to be managed under a specific contract
• Ensure both Prime and Subcontractor personnel who are to handle/be responsible for Government Property are trained in the management of that property
• Conduct annual reviews of your Property Management System and report findings to Management
PURCHASING SYSTEMS

• Always conduct market research for commercial items or services and document your findings
• Make sure your Policy and Procedures are current with the most recent DCMA Guidebook
• Ensure adequate training for all personnel who are part of the Purchasing System and document that training
• In an adequate price analysis, words are more important than numbers. Provide written detail on why the subcontractor’s price was found fair and reasonable, even when competed
• If a Prime fails to follow Public Law requirements when purchasing (TINA, CAS, FFATA, etc.), they will fail the government’s purchasing system audit
G&A BASES TAKEAWAYS

CAS 410 - ALLOCATION OF BUSINESS UNIT
GENERAL AND ADMINISTRATIVE EXPENSE
(48 CFR PART 9904.410)

- **Total Cost Input**: All costs excluding G&A pool costs
- **Value-Added**: Total Cost Input less subcontract and materials
- **Single Element**: A factor that represents the total activity of the Business Unit
### G&A Base Takeaways

#### G&A Base Comparison Using TCI and Value Added

<table>
<thead>
<tr>
<th>General Ledger Summary</th>
<th>Amount</th>
<th>Total Cost Input</th>
<th>Value Added</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Labor</td>
<td>1,000,000</td>
<td>1,000,000</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Direct Material</td>
<td>250,000</td>
<td>250,000</td>
<td></td>
</tr>
<tr>
<td>Subcontracts</td>
<td>1,750,000</td>
<td>1,750,000</td>
<td></td>
</tr>
<tr>
<td>Other Direct Costs</td>
<td>200,000</td>
<td>200,000</td>
<td>200,000</td>
</tr>
<tr>
<td>Unbillable Other Direct Costs</td>
<td>50,000</td>
<td>50,000</td>
<td>50,000</td>
</tr>
<tr>
<td>Fringe Benefits on Direct Labor</td>
<td>400,000</td>
<td>400,000</td>
<td>400,000</td>
</tr>
<tr>
<td>Allowable Overhead Costs</td>
<td>1,000,000</td>
<td>1,000,000</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Unallowable Overhead Costs</td>
<td>100,000</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td>Allowable G&amp;A Costs</td>
<td>1,100,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unallowable G&amp;A Costs</td>
<td>200,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit for Sale of Surplus Material*</td>
<td>(50,000)</td>
<td>(50,000)</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>6,000,000</td>
<td>4,700,000</td>
<td>2,750,000</td>
</tr>
</tbody>
</table>

G&A Rate: 23.40% 40.00%

*Amount credited to government as a direct material adjustment
• For TCI vs Value Added Base - Understand your subcontracts and carefully consider whether they should be in G&A base

• Unallowable indirect costs (fringe or overhead) must be removed from the pool, but remain in the G&A base. They must get their fair share of the G&A costs

• Unallowable G&A and all statutory unallowables must be removed from the G&A pool

• Selection of the best base involves judgments on whether inclusion of certain costs causes "distortions" in allocations. (DCAM)

• The ASBCA ruled there is no preferred allocation base to distribute G&A expenses other than the one which best represents total activity
UNDERSTANDING ADVANCED INDIRECT RATES
ADVANCED INDIRECT RATES TAKEAWAYS

• “Any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective” (FAR 2.101)

• CAS 402 also does not require specific costs to be treated as either direct or indirect. The fundamental requirement is: “All costs incurred for the same purpose, in like circumstances, are either direct costs only or indirect costs only…”

• CAS 418 Equitability requirements:
  – provide for consistent determination of direct and indirect costs
  – provide guidance relating to the selection of allocation measures based on the beneficial or causal relationship between an indirect cost pool and cost objectives.
ADVANCED INDIRECT RATES TAKEAWAYS

Service Centers

- Some costs are attributable to multiple cost objectives.
- Use of Service Centers (intermediate pools) to allocate equitably in a causal/benefit relationship.
- SC allocation base should be the best representation of the causal relationship between costs and cost objectives; based on the use of service - head count, direct labor, number of copies, square footage, etc.
- Costs may be allocated directly to contracts, to indirect cost pools, or to other service centers.
- SC can more accurately allocate costs, but do increase complexity.

<table>
<thead>
<tr>
<th>Service Centers</th>
<th>Allocation Bases</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT Service Center</td>
<td>Head count</td>
</tr>
<tr>
<td>Human Resources</td>
<td>Head count</td>
</tr>
<tr>
<td>Recruiting</td>
<td># of Requisitions</td>
</tr>
<tr>
<td>Facilities</td>
<td>Sq footage or Head Count</td>
</tr>
</tbody>
</table>
ADVANCED INDIRECT RATES TAKEAWAYS

• To accurately assign costs to cost objectives, companies must thoroughly understand how incurrence of costs impacts the incurrence of other costs.

• Develop an allocation structure that works for both internal reporting and government required indirect rate calculation.

• Monitor for changes in cost relationships or business conditions that necessitate a change in cost allocation.
## ADVANCED INDIRECT RATES TAKEAWAYS

### FAR and CAS Requirements for Indirect Rates

<table>
<thead>
<tr>
<th>Indirect Cost</th>
<th>Number of Pools</th>
<th>FAR Requirements</th>
<th>CAS Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intermediate Complexity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fringe/Overhead</td>
<td>Depends</td>
<td>FAR 31.201-4, FAR 31.203</td>
<td>CAS 418</td>
</tr>
<tr>
<td>G&amp;A</td>
<td>One</td>
<td>FAR 31.201-4, FAR 31.203</td>
<td>CAS 410</td>
</tr>
<tr>
<td>Advanced Complexity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Home Office</td>
<td>Depends</td>
<td>FAR 31.201-4, FAR 31.203</td>
<td>CAS 403</td>
</tr>
<tr>
<td>IR&amp;D/B&amp;P</td>
<td>Depends</td>
<td>FAR 31.201-4, FAR 31.203</td>
<td>CAS 420</td>
</tr>
<tr>
<td>Service Centers</td>
<td>Depends</td>
<td>FAR 31.201-4, FAR 31.203</td>
<td>CAS 403/418</td>
</tr>
<tr>
<td>Standard Cost</td>
<td>N/A</td>
<td>FAR 31.201-1</td>
<td>CAS 407</td>
</tr>
</tbody>
</table>
ACHIEVING FULL COST RECOVERY ON GOVERNMENT CONTRACTS
ACHIEVING FULL COST RECOVERY TAKEAWAYS

Keep it simple!

Unnecessary complexity in indirect structures costs companies due to:

1. Accounting costs
2. Audit support costs
3. Errors caused by overly complex cost allocation processes
4. Estimating processes that have to align with the indirect rate structure
5. Employee productivity decreases due to time spent tracking immaterial costs
6. GIGO (Garbage In/Garbage Out) - If you create a system with a lot of requirements but don’t staff up for that, likely result is bad data in system!
Monitor!

- Review actual indirect rates vs provisionals on a regular basis
- Monitor over/under billings per contract (Schedule I)
- Adjust provisional billing rates if there are significant variances and are no longer representative of final year end rates
  - FAR 42.704(c) and FAR 52.216-7(e) - Billing rates may be revised prospectively or retroactively by mutual agreement of CO or auditor and the contractor at either party’s request to prevent substantial over or underpayment
  - Post rate variances - set materiality ceiling or post automatically
- Submit provisional billing rates request at least annually
ACHTIENG FULL COST RECOVERY TAKEAWAYS

Be Safe!

• Regardless of whether your company is subject to CAS 418, design allocations that would comply with CAS 418
• Document the decisions that have been made and why these comply with FAR Part 31 and CAS 418 requirements
• If subject to full CAS coverage, consider the requirements of CAS 403, 410 and 420 discussed in this presentation
• Monitor actual cost performance and consider whether unexpected variances indicate that a change to accounting practices is needed
• Be able to defend causal benefit relationship
CLOSEOUT

Closeouts are important to prevent:
• Stagnant cash flow
• Questions on collections and financial statements
• Increased administrative costs
• Increased risks on: Disputes and Record Retention
• Government’s premature de-obligation of funds

GAO Report 17-738
• Recommends every agency to develop department-wide oversight for contract closeouts
CLOSEOUT BEST PRACTICES

• Use a closeout checklist for both Prime and Subcontracts
• File timely and adequate Incurred Cost Submissions - Schedule I and Schedule J are critical
• Don’t depend on the Government to keep good records
• Closeout subcontracts and Purchase Orders in “real time” do not wait until end of Prime contract if sub’s work is done earlier
• Start thinking about closeout early and be prepared to audit subcontractors if required (make sure you meet your CO expectations for audit)
• Negotiate with your CO to use quick closeout for those portions of your contract where it can apply

Don’t forget to get a release of claims from your subcontractors BEFORE you submit yours to the Government!
THE GAUGE REPORT TAKEAWAYS

• Financial Benchmarks & Industry Trends for Government Contractors with over 1,500 Contributors

• The 3rd Annual Gauge Report is coming to a theater near you

• Government Contract Compliance
• Accounting
• Utilization
• Growth
• Efficiencies
THE GAUGE REPORT TAKEAWAYS

Biggest Indirect Cost Issues

- Executive Compensation
- Legal Costs
- Rate Composition and Allocations
- Timekeeping
- Employee Morale Costs
- Travel Cost
- Consultant Cost
- Internal Control Deficiencies
- Other

PERCENTAGE OF RESPONDENTS
THE GAUGE REPORT TAKEAWAYS

Fringe, OH, M&H, and G&A Rates for Companies with Revenue Above $101M
THE GAUGE REPORT TAKEAWAYS

Overhead Rate Base

- Location: 20%
- Function: 10%
- Customer: 37%
- Product/Service: 33%

Overall Billable Labor Utilization

- 40–50%: 45%
- 51–60%: 38%
- 61–70%: 9%
- 71–80%: 5%
- >81%: 3%
QUESTIONS & ANSWERS
BUT REMEMBER THERE’S CAKE !!
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