



Thank you for joining us!

The presentation will begin shortly.



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Advantages & Strategic Considerations for GovCons with Commercial Clients

Wednesday, October 2, 2024



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Housekeeping

Additional Information

| | |
|---|--|
| Learning Objective To provide government contractors with an overview of strategic considerations when dealing with commercial clients. | Instructional Delivery Methods Group Internet-based |
| Recommended CPE 1 CPE Credit | Recommended Fields of Study Specialized Knowledge |
| Prerequisites None required | Advance Preparation None |
| Program Level Basic | Course Registration Requirements None |
| Refund Policy No fee is required to participate in this session. | Cancellation Policy In the event that the presentation is cancelled or rescheduled, participants will be contacted immediately with details. |
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Agenda

- Advantages of GovCons with commercial clients
- DCAA's perspective on dual-focused businesses
- Risk of DCAA audit
- Impact on GovCons with commercial divisions
- Benefits of a consolidated G&A
- Considering a more complex business structure
- Structuring for a sale
- Final Thoughts
- Q&A



Advantages

GovCons with Commercial Clientele



Polling Question #1

Do you have concerns about adding commercial contracts?

- A. *Yes*
- B. *No*
- C. *Unsure*

Advantages

Diversified Revenue Streams

- **Reduces dependency on a single sector**
- **Government benefits:**
 - Government work provides stability during economic downturns and in general
 - Government pays on time with only unallowable write-downs
- **Commercial endeavors:**
 - Commercial endeavors are often more profitable
 - Little to no compliance requirements
 - Less administrative burdens
 - No proprietary disclosures
 - Potentially less ramp up time
 - Overall reduced bureaucracy

Advantages

Innovation and Cross Pollination

- **Government benefits:**

- R&D funding: Many government contracts allocate significant funding for R&D. This allows companies to pursue projects they might not otherwise be able to afford.
- Diverse project opportunities: Government projects often address complex, large-scale challenges that require novel solutions, therefore helping to drive innovation.
- Access to advanced technology: Government contracts can offer access to cutting-edge technologies or facilities, enabling companies to work on state-of-the-art innovations.

- **Commercial markets:**

- Often drive innovation and new technologies at a quicker pace
- Benefits of being exposed to technology (as highlighted above) can also be applied to commercial work in many cases.
- Enhanced reputation (by working on both commercial and gov con) can increase competitiveness

Advantages

Innovation and Cross Pollination

- **Enhanced Market Competitiveness:**

- Dual client base broadens company's expertise, making it more competitive
- Meet varied client requirements
- Delivering high-quality outcomes in different environments enhances marketability and reputation
- Increases sustainability

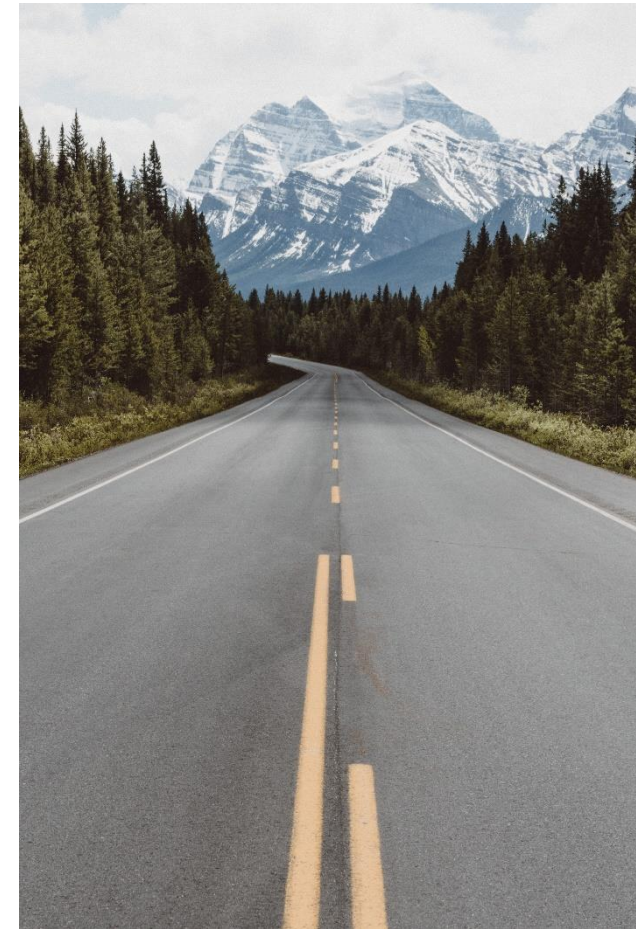
- **Improved Resilience and Flexibility:**

- Government projects involve longer life cycles and strict regulations
- Commercial projects have quick turnarounds and more agility
- Adapt to different project demands and timelines

DCAA's Perspective

Dual Focus Business

- **Pivotable Role:**
 - Ensuring government contractors adhere to acquisition regulations
- **GovCons Must Navigate Several Key Areas:**
 1. Compliance and Internal Controls
 2. Cost Allocation and Pricing
 3. Specialized Audits and Accounting System Reviews



DCAA's Perspective

Dual Focus Business

- **Compliance and Internal Controls:**

- DCAA requires rigorous policies and procedures to ensure proper use of funds

- Timekeeping
- Estimating
- Allocation of cost both direct and indirect
- Budgeting and indirect rates
- Expense reimbursements
- Travel
- CPFF invoicing
- Purchasing material
- Subcontracting
- Allowable, reasonable and allocable cost

DCAA's Perspective

Dual Focus Business

- **Cost allocation and pricing:**

- DCAA scrutinizes cost allocation practices to ensure that commercial, fixed price or T&M government contract costs are not mischarged to cost reimbursable contracts.
- Proper segregation of cost and funds by contract, CLIN / SLIN and delivery order.
- Proper delineation of direct cost versus indirect cost.
- Indirect allocation of fringe, overhead and G&A.
- Timekeeping and labor distributions for time to direct, indirect overhead, G&A, B&P and IR&D and PTO.
- Prepare detailed cost and pricing data
- Forecast indirect rates to multiple outyears
- Developing a bill of material
- Obtaining subcontractor pricing

DCAA's Perspective

Dual Focus Business

- **Specialized Audits and Accounting System Reviews:**
 - Annual incurred cost audits to settle indirect rates
 - Proposal audits to determine the accuracy of projected direct and indirect expenses
 - Accounting system reviews
 - Periodic reviews of public vouchers
 - Close-out of cost reimbursable contracts
 - Business system reviews for estimating and contract purchasing/subcontracting
 - CAS compliance and CAS Disclosure Statement reviews
 - Defective pricing determine if a fixed price contract cost or pricing data was overstated and not disclosed to the government on the date of the agreement of price.

Risk of DCAA Audit

Contract Control Environment

- The matrix below provides the chances of being audited by DCAA.

| Level of Audit Risk | Dept. of Defense Contracts? | Cost Reimbursable Contract? | Subcontractor? |
|----------------------------|------------------------------------|------------------------------------|-----------------------|
| Highest | Yes | Yes | No – Prime |
| Medium | No | Yes | No – Prime |
| Low to None | No | No | Yes |

Impact on GovCons

With Commercial Divisions

- **The impact on government contractors with commercial divisions:**
 - Regulatory compliance,
 - Cost segregation,
 - Resource allocation, and
 - Cultural and operational differences.



Polling Question #2

Are you excited for fall?

- A. Yes*
- B. No*
- C. Unsure*

Impact on GovCons

With Commercial Divisions

| | |
|----------------------------------|---|
| Regulatory Compliance | Balancing compliance with stringent government regulations while pursuing commercial opportunities is a significant challenge. Contractors must implement robust internal controls that include compliance mechanisms to manage these dual requirements without stifling commercial innovation. |
|----------------------------------|---|

Impact on GovCons

With Commercial Divisions

Cost Segregation

Meticulously tracking and allocating costs between government and commercial projects through project cost reporting is complex but essential. Specialized accounting systems and thorough training for financial personnel are necessary to ensure compliance. Direct costs are assigned to contracts whereas indirect costs are converted to multi-tier indirect rates that provide a measure of administrative expense loaded on direct project cost.

Impact on GovCons

With Commercial Divisions

| | |
|----------------------------|--|
| Resource Allocation | Contractors must allocate their workforce, technology, and capital effectively to meet the demands of both sectors without compromising quality or delivery timelines. |
|----------------------------|--|

Impact on GovCons

With Commercial Divisions

Cultural and Operational Differences

The cultural and operational differences between government and commercial clients can pose challenges. Government projects often require strict adherence to formal processes and detailed documentation, while commercial clients may prioritize speed and innovation. The most significant governmental requirement is tracking time and effort so utilizing accounting software to capture total time reporting is mandatory. Balancing these expectations requires adaptable business practices.

Benefits of Consolidated G&A

With Commercial Divisions

- A consolidated G&A expense structure offers several advantages for government contractors and commercial clients. The government's expectation is that contractors will utilize a single rate for both governmental and private projects because it provides for cost efficiency, simplified compliance, and improved decision-making.



Benefits of Consolidated G&A

With Commercial Divisions



COST EFFICIENCY

A consolidated G&A structure reduces administrative overhead by eliminating duplication of functions. Shared resources and streamlined processes lead to cost savings and improved operational efficiency and lower G&A rates which is DCAA's expectation.



SIMPLIFIED COMPLIANCE

Consolidating G&A functions focuses compliance with the Federal Acquisition Regulation (FAR) and CAS that facilitates DCAA's oversight. A unified approach to cost allocation and financial management reduces the risk of errors and enhances transparency.



IMPROVED DECISION-MAKING

With a consolidated G&A, contractors can make more informed decisions based on comprehensive financial data. This holistic view of the business supports strategic planning and resource allocation that leads to sustainability.

Considering a More Complex Business Structure

Beyond a Single Operating Unit

- **Scale and Complexity Increase**

- Increased scale and complexity of commercial or government contractor business operations grow, managing compliance and resource allocation within a single structure becomes challenging.
- A separate business unit and subsidiary for separate GovCon or commercial activities can provide better focus and control.
- This scenario often happens when a large commercial enterprise purchases a small government contractor.
- To avoid the “tail wagging the dog”, the smaller contractor entity placed in a subsidiary to “fence in” the myriad of demanding compliance and niche accounting requirements not applicable to the large commercial parent entity.

Considering a More Complex Business Structure

Tactical Approach

- **Setting up a subsidiary to box in compliance requirements**
 - Parent company removes the administrative functions of the subsidiary
 - Streamline and provide corporate functions in the form of home office allocations
 - Utilize the principles from Cost Accounting Standard 403 on Home Office Allocations
 - Everything in the subsidiary is subject to audit
 - Every home office allocation is also subject to audit
 - To avoid government review of certain executive functions such as their high compensation and perks, the company may not allocate certain aspects of executive benefits to the subsidiary

Polling Question #3

Do you have commercial contracts?

- A. *Yes*
- B. *No*
- C. *Unsure*

Structuring for Sale

Focus on Preparation over Years



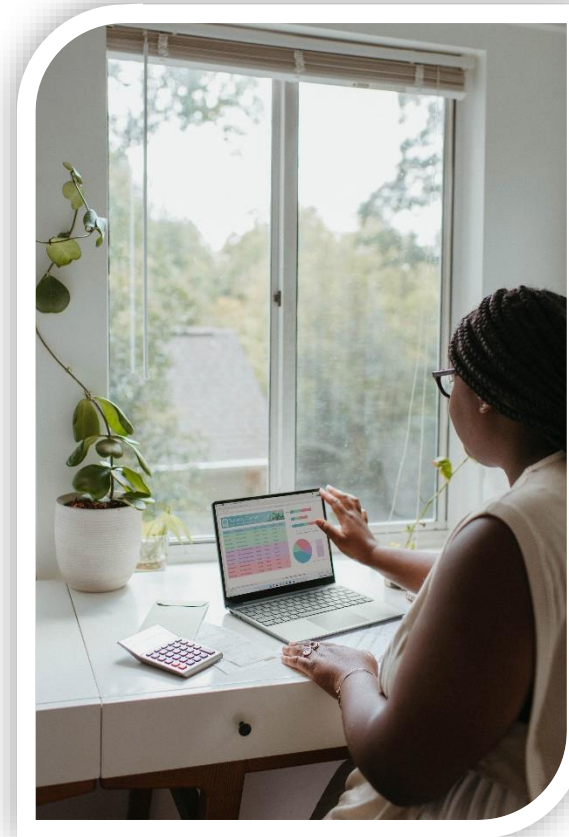
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Structuring for Sale

Maximize Value & Attractiveness to Potential Buyers

- **Items for consideration**

1. Separate business units
2. Streamlined operations
3. Comprehensive financial records
4. Annual audits
5. Assistance with due diligence reviews
6. Developing an ESG program
7. Cybersecurity practices



Structuring for Sale

Best Practices & Maximizing Value & Attractiveness to Potential Buyers

- **Separate Business Units-**

- Establishing separate divisions for government contracting versus commercial work can provide clarity and transparency for potential buyers.
- The separation highlights the strengths and profitability of each division.
- Under this scenario, each division will have a separate overhead for that business line, still having a single G&A.

- **Streamlining Operations-**

- Improve your accounting systems to increase efficiency, reduce waste
- Establishing formal (adhered-to) timely month-end closings to generate timely reports
- Automating CPFF invoicing, labor distribution and indirect rate computations
- Automate as much as you can. Take advantage of technology which has come down in price and gotten more powerful.

Structuring for Sale

Maximize Value & Attractiveness to Potential Buyers

- **Comprehensive Financial Records**

- Maintaining detailed and accurate historical financial records that include documents
- Contract records such contract briefs, profit-loss analysis, ETCs, EACs, cumulative allowable cost worksheets, adjust to actual at year-end invoices, final invoices, contract completions, limitation of cost / limitation of funds.
- Investments in specialized accounting systems, automated A/P, electronic timekeeping

- **Annual audits**

- Yearly financial statement audits performed by independent public accounting firms such as GRF
- Yearly audit reports are helpful in determining business value for sale
- Ensure accuracy of internal financial reports

Structuring for Sale

Maximize Value & Attractiveness to Potential Buyers

- **Assist with Due Diligence**

- One of the key areas to review is prior DCAA audits or other governmental oversight reviews
- Helps to understand the amount of risk of non-compliance with government regs
- Detect outstanding legal or punitive judgements
- Anything that would add to purchaser's liability

- **Establish an ESG Program**

- Reporting on greenhouse gas direct and indirect emissions, including mitigation efforts
- Reporting on website
- DEI policies are attractive to younger generation of buyers who pledge to environmental and social equity

- **Cybersecurity policy and procedures and capabilities**

Questions?

Contact Us



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