

I Did it My Way

Written by Nick Sanders

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We were going to write a long, involved post about December's KBR decision at the ASBCA, but their website is down indefinitely. So that plan didn't happen. This is Plan B. Plan B is a discussion about small businesses, entrepreneurship, and contract compliance.

We do a lot of work with small businesses, those government contractors who start from nothing and build themselves up to a position where they can perform effectively on subcontracts, and perhaps start thinking about going after a prime contract of their own. We do not focus exclusively on small businesses, but the largest contractors already have their full-time compliance teams—so it tends to be the smaller contractors that seek consulting advice.

Each of these businesses starts with a single person, or perhaps a small team. They have a vision of what the market needs and the value they can add. They spend time developing infrastructure. They spend time recruiting. They spend time marketing. And eventually they win a couple of contracts—almost always firm, fixed-price contracts awarded under competitive conditions. (Which are some of the lowest-risk contracts from a compliance perspective.) With respect to service providers, they land T&M subcontracts with fixed hourly billing rates. Since they are small companies, risks associated with T&M contracts are fairly low as well.

The point is, they start small, with low-risk contracts, and that gives them a solid foundation for developing experience and past performance credentials. The experience and past performance credentials enable them to bid on larger, more lucrative, contracts.

But what works for low-risk contracts doesn't always work for higher-risk contracts, such as the cost-type contracts that typically come with SBIR Phase II awards. For that matter, any prime contract awards that are not awarded on a competitive basis are probably going to be subject to cost analysis—which means submission of cost or pricing data (whether or not certified) in a prescribed format. Thus, as small contractors progress into more lucrative contracts—which have higher compliance risks both on the front end and the back end—they need to evolve their back office policies, procedures, and practices.

Many small business government contractors don't evolve their infrastructure, their back offices, to keep pace with the compliance risks of their newer contract awards. They end up with a mismatch between the needs of their newer contract requirements and the capabilities

of their administrative staff. That's when consultants can add some value.

But the real issue is not the knowledge or expertise of the team; the real issue is that the actual practices may need to change to match the compliance requirements of the newer contracts. The company may need to make fundamental changes to the way in which it does business.

For example, many small businesses operate on a "cash basis" accounting. That is fine for low-risk contracts, but it really doesn't work for cost-type contracts. Contractors anticipating going after cost-type contracts (either as a prime or as a subcontractor) need to move toward "accrual" accounting. That is a fundamental change with far-reaching ramifications to many aspects of the business.

For another example, many small businesses use Quickbooks. Many small businesses have a bookkeeper to enter transactions into Quickbooks and run reports. That's fine for smaller, low-risk contracts but, at a certain point, companies need to move away from Quickbooks and find another piece of accounting software more suited to the compliance needs of the higher-risk contracts.¹ Some companies will need to move on from their bookkeeper—who may have been in place for years and is now treated like a member of the family—because they need to tap into the expertise of a CPA with government contracting experience.

Sometimes the first inkling of an issue surfaces when DCAA comes in to perform a pre-award accounting system review. The company fails the pre-award review and misses out on an opportunity for which it had been preparing, perhaps for several years. Sometimes a company will pass the pre-award review, but then fail the post-award review, which leads to problems such as demands for repayment of allegedly overbilled costs. In extreme cases, claims of bad accounting or misbilling can lead to allegations of violations of the False Claims Act—which can (and have) killed otherwise successful entities.

Many small business move forward with their new business capture strategy, completely unaware that they also need a back office strategy to go with it.

One problem is that the business may have become accustomed to how it has operated over time. It may not understand the need for change—or it may not want to change. *"If the wheel*

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ain't broke, why fix it?

" may be the reply to the consultant who recommends changes to business practices in order to better assure compliance with new contract terms.

This is especially true with respect to labor accounting.

We have experience with one small business—a very successful small business—that has incentivized its staff by paying higher labor costs on direct-billed work than it does on IRAD or other indirect billed work. The owner very much believes in his “innovative” way of doing business. The owner has resisted all recommendations (made by multiple consultants) to change the company’s payroll and labor accounting practices to pay a single rate for all staff hours. When the company failed its DCAA pre-award accounting system survey, it came as a complete surprise. When the company lost out on a large prime contract award because of the failed accounting system survey, that came as a surprise as well. However, regardless of the facts, the small business refused to change and thus it is stuck receiving FFP task orders, mostly as a subcontractor.

And that’s not the only labor accounting issue we’ve had to address in the past few years.

The point of this article is that companies grow and the compliance requirements grow as well. Companies that want cost-type government contracts need to be prepared to account for costs, including labor costs, in a manner that supports billings and audits of billings. This may require change to long-standing (and long-cherished) practices that no longer work in the new risk environment. Companies that refuse to change risk adverse audit findings—or worse.

¹Yes, Quickbooks can be made to work for higher-risk contract types as well. With enough work it can meet all contracting requirements. Yet in our experience too many contractors don’t know how—or simply cannot—make Quickbooks do what it needs to do. For that matter, we are not recommending any particular accounting software in this article.