

Pacific Northwest Consultants, LLC

Special Interest Articles

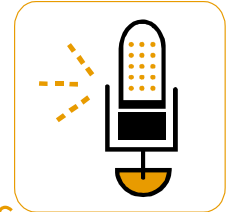
How does your timekeeping system measure up? See Page 2.

Will your consulting costs pass the Government's scrutiny? See Page 4

Are you using the best G&A base? See Page 5

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Pacific Northwest Consultants

Welcome to the first issue of Government Contracting Update from Pacific Northwest Consultants, LLC.

PNWC is dedicated to providing Federal Government contract consulting, litigation support, and training services. Our primary business philosophy is to provide affordable consulting and training services to help Government contractors grow their Government business, increase profits,

and comply with Government contracting rules and regulations.

PNWC's consulting and training services cover all aspects of Government contracting including forward pricing, incurred cost, terminations and equitable adjustments, cost accounting standards and defective pricing allegations. We assist in developing adequate internal control systems including timekeeping, accounting, estimating,

billing systems and company-wide ethics programs.

PNWC staff has extensive teaching experience. They have developed and presented training classes covering all aspects of Government contracting.

Incurred Cost Proposals

For contractors with cost reimbursable contracts and fiscal years ending December 31st, the June 30th deadline for submitting annual incurred cost proposals is quickly approaching.

DCAA has developed "ICE" (Incurred Cost Electronically), an electronic version of the Model Incurred Cost Proposal found in Chapter 6 of DCAAP 7641.90. ICE provides contractors with a standard user-friendly

submission package that will assist them in preparing adequate incurred cost proposals in accordance with FAR 52.216-7, "Allowable Cost and Payment." This tool can be downloaded free from DCAA's website, <http://www.dcaa.mil/>.

Our staff has extensive experience in working with ICE and can assist you in preparing and supporting an adequate claim. We can help ensure that all allowable, allocable, and

reasonable costs are considered and can help avoid pitfalls caused by inadvertently including unallowable costs in your submission to the government.

See Page 3 for more information.

Did you know that for small contractors, the chances of a DCAA audit increase from about 33% to 100% if significant exceptions are found in a previous audit?



"...the Government considers the risks associated with accurate recording, distribution, and payment of labor so significant and devotes significant audit resources to floorchecks."

Timekeeping Systems

Labor costs are usually the most significant costs charged to Government contracts and usually comprise the base, or the largest element in the base, used for allocating indirect costs. Unlike other costs, labor is not supported by third party documentation. That is why the Government considers the risks associated with recording, distribution, and payment of labor so significant and devotes significant audit resources

to "floorchecks" at contractors with cost reimbursable contracts.

A good timekeeping system should have, at a minimum,

1. Effective procedures for labor authorizations and approvals to facilitate the proper accumulation and recording labor costs to cost objectives;

2..Effective procedures for timekeeping to reasonably

assure that labor hours are accurately recorded and that corrections to timekeeping records are documented, authorized, and approved; and

3. Effective procedures for labor distribution to reasonably assure the proper recording of labor costs to cost objectives.

For more information, contact Paul Cederwall at Cederwall@pacificnwc.com

Automated Timesheets

There are scores of timekeeping products on the market today, priced to meet any budget. We've seen very basic systems - some based on Microsoft Excel or Access - to fairly expensive products with lots of features. Generally, the more features that are built into an automated system, the easier it is to implement the procedures described in the article above.

One product that has really

caught our attention is Web TimeSheet 6.5 from Replicon Inc. (see it at www.replicon.com).

While this is not an endorsement of the product or a recommendation, it's a product that you should definitely take a look at if you are considering a new timekeeping system.

Because it is Web based, it can be accessed from anywhere - good for

companies with remote centers and employees.

It integrates with most popular accounting software including ACCPAC, Quickbooks Great Plains and Peachtree. In addition, the company claims that it complies with all DCAA requirements.

Cost is about \$100 per employee. Annual maintenance is about \$20 per employee.

A Case Study

A Department of Energy Contractor's Performance Fee was reduced because it failed to implement effective timekeeping practices.

Specifically, Government auditors found that

contractor employees were not provided with approved work authorizations prior to working on certain tasks.

Without approved work authorizations, contractor employees had no way to

ensure that the tasks they were working on corresponded to the charge number they used to record their time. Thus the risk of charging to the wrong task was increased.

Incurred Cost Proposals

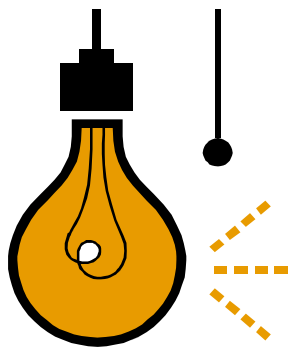
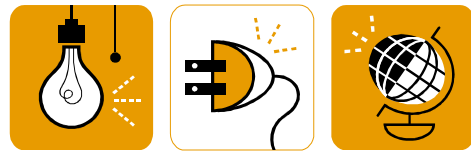
If you are required to submit an incurred cost submission, you have six months after the end of your fiscal year to have an adequate proposal in the hands of DCAA and the ACO. Thus, if your fiscal year ended 12/31/2005, the final deadline is 6/30/2006.

Preparing an adequate submission requires a proactive attitude and knowledgeable staff as to the information and format required for the presentation. Information as to the format and general types of data required can be found in the DCAA Information for Contractors guide. Go to the DCAA website for this guide, www.dcaa.mil. DCAA provides an electronic model (ICE) that may be used for the presentation.

If your proposal is due 6/30/06, then you should have already begun the process of gathering necessary information, and have dedicated an employee (or consultant) with this responsibility.

Time is Running Out!

Timely submission your annual incurred cost proposal is not only critical to the annual settlement of your incurred costs on flexibly-priced contracts, but is also a high priority with DCAA and the ACO. DCAA has an initiative to have all contractors' "current" with their submission of incurred cost proposals. DCAA has an additional initiative to have all contractors submit their incurred cost proposals electronically. Failure to timely submit an adequate incurred cost proposal could result in a government unilateral indirect cost rate determination. Avoid this potential unwanted action by ensuring timely submission of an adequate incurred cost proposal.



What is Cost or Pricing Data?

The various "procurement reforms" over the past few years has added a variety of tools by which contracting officers can base contract awards. However, a fair number of contract awards are still made on the basis of cost or pricing data and contractors are required to certify that the cost or pricing data submitted to the government is current, complete, and accurate.

Cost or Pricing Data means all facts that, as of the date of price agreement, prudent buyers and sellers would reasonably expect to affect price negotiations significantly.

Cost or pricing data are factual, not judgmental, and are verifiable. While they do not indicate the accuracy of the prospective contractor's judgment about estimated future costs or projections, they do include the data forming the basis for that judgment.

Cost or pricing data are more than historical accounting data; they are all the facts that can be reasonably expected to

contribute to the soundness of estimates of future costs and to the validity of determinations of costs already incurred. They can include such factors as

- Vendor quotations
- Nonrecurring costs
- Changes in production methods,
- Data supporting projections of business prospects
- Unit cost trends
- Make/buy decisions
- Management decisions that could have a significant bearing on costs

For more information, contact Terry Nuzzo at Nuzzo@pacificnwc.com or 206-508-1849.

Relocation Costs



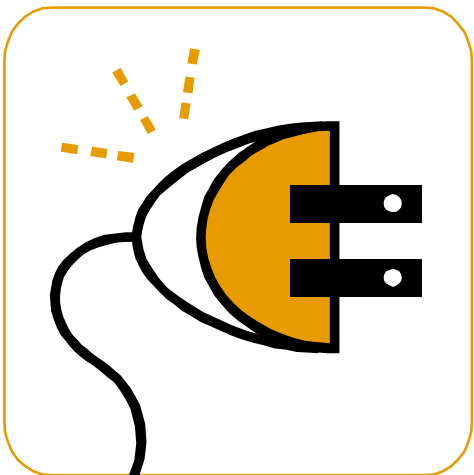
FAR 31.205-35, Relocation Costs, was recently revised to add three additional types of relocation costs that may be reimbursed on a lump-sum basis in lieu of actual costs.

These three additional items are i) costs of finding a new home; ii) costs of traveling to the new location; and iii) costs of temporary lodging.

The specific FAR language

still requires adequate support by data on the individual elements comprising the build-up of the lump-sum amount to be paid based on the circumstances of the particular employee's relocation.

DCAA's guidance on how to assess the adequacy of that support is at <http://www.dcaa.mil/mmr/05-PAC-074.pdf>



Consulting Costs

Costs for outside consulting services are closely scrutinized by Government auditors. The FAR cost principle covering these costs (31.205-33) requires extensive support and documentation.

The Government's evaluation is conducted in two phases. First, the government needs to assess whether the services are allowable under government contracts. FAR 31.205-33(c) lists certain

costs that are specifically unallowable. If not specifically unallowable, Section (d) lists eight factors that a contracting officer must consider in determining allowability.

Once allowability is determined, the costs must be adequately supported. Section (f) contains 3 specific documentation requirements that must be met; detailed agreements, detailed invoices, and work products.

Interest Rate – Cost of Facilities Capital (CAS 414)

The cost of money rate to be used in computing the cost of money factors is determined by the Secretary of the Treasury under Public Law 92-41.

The rate is published

semiannually in the Federal Register. The rate published in December is applicable to the period from January 1 through June 30. The rate published in June is applicable to the period from July 1 through

December 31.

The interest rate established for the period January 1, 2006 through June 30, 2006 is 5.125 percent. This represents a significant increase from 4.5 percent

for the prior six month period.

Be sure to update your cost of money factors in order to get all that you're entitled to.

Improving Contract Profitability

Are you finding that some of your government contracts are profitable, while others are a losing proposition? What causes one contract to be profitable while another unprofitable? By analyzing the proposed costs and actual cost incurred on a contract, you should be able to identify the cause of cost overruns. Some cost overruns occur because of poor estimating practices or poor cost controls. However, cost overruns could also occur because of changed contract performance conditions which were not anticipated in the original contract solicitation.

If you find that poor estimating practices are the source of the cost overruns, you should perform a comprehensive estimating system review and implement corrective actions to ensure that estimating problems don't plague future contract profitability. If poor cost controls are the source of the cost overruns, you should identify and implement effective budget and cost controls to ensure costs are better managed.

If you are experiencing changed contract performance conditions that were not anticipated

based on the solicitation requirements, you should consider submitting an equitable adjustment proposal. This can be a time consuming process; however, an equitable adjustment to the contract price is the only way to recover increased contract costs due to changed conditions.

Contractors are often limited to what they can do on a previously unprofitable contract; however, steps can be taken to prevent this unwanted condition from happening on future contracts. But don't wait, the time to act is now!



Are You Losing Money On A Government Contract?

What's the Best G&A Base?

A company recently asked the benefit to changing from a total cost input (TCI) base to a value-added (VA) base for allocating G&A costs. A government customer had suggested the change.

The regulations (specifically CAS 410) permit three methods for allocating G&A total cost input (TCI), value added (VA), and single element. The base selected must be representative of the total activity of the business unit.

Traditionally, many have assumed that the TCI base is that base which is most representative of the total

activity of the business unit. There is a landmark case, Ford Aerospace, that successfully challenged this tradition and sustained the use of VA based on the contractor's study that found most of the expenses in the G&A pool were more related to labor and labor related activities than they were to material related costs and issues. The VA base is typically used when there is a high degree of variability in the material or subcontract cost over time or across different products or customers.

Under TCI, the higher material price will attract an even higher allocation

of G&A expenses when there may not have been any additional benefit or value provided from any additional services rendered by the G&A expense pool.

Although a value added G&A rate will be higher than one using a TCI base, some customers may appreciate greater stability in their rates. Using a VA base may help provide that stability when dealing with significant material and subcontract costs that are prone to change.

For more information, contact Bill Vermie at vermie@pacificnwc.com.

"The base selected must be representative of the total activity of the business unit."



"It offers direct links to FAR, DFARS and other FAR Supplements."

Smart Stops on the Web

AKSS: AT&L (Acquisition, Technology & Logistics) Knowledge Sharing System. <http://akss.dau.mil/>

AKSS calls itself the central source for current information on acquisition initiatives. It provides a means to link together various sources of information and reference assets from various disciplines into a single

integrated centralized information.

The site provides links to original sources for mandatory and discretionary policies, directives and instructions. It offers direct links to FAR, DFARS and other FAR Supplements including links to the latest DFAR updates.

It also includes links to

many other government guidebooks and handbooks including current version of the DCAA Audit Manual.

Although designed primarily for government acquisition personnel, it is available to everyone. If you haven't visited this site, it's well worth your time to explore this wealth of treasure.

SBA 8a Contractors

The SBA reviews 8(a) firms annually for compliance with program eligibility requirements. Among the documentation required to be submitted are;

A certification that the firm meets the 8(a) BD program eligibility requirements;

A certification that there have been no changed circumstances which could adversely affect the

Participant's program eligibility;

Personal financial information for each disadvantaged owner;

A record from each individual claiming disadvantaged status regarding the transfer of assets for less than fair market value to any immediate family .

A record of payments, compensation, and distributions (including loans, advances, salaries, and dividends) made by the Participant to each of its owners, officers and, directors.

We can help prepare the documentation and support the annual review.

Contact Bill Vermie at vermie@pacificnwc.com.

Need Training?

PNWC provides specialized training in a variety of government contracting areas. Our standard training modules generally take 3 to 4 hours while our extended training modules are designed for two days. Both qualify for CPE. PNWC's training modules include:

Truth in Negotiations (TINA)

FAR Allowable Costs

Billing Systems

Labor Systems (includes Timekeeping)

Estimating Systems

Ethics for Government Contractors

Terminations and Claims (coming soon)

PNWC can modify any of these packages or develop additional modules to fit your specific needs.

Please contact training@pacificnwc.com



Financial Capability

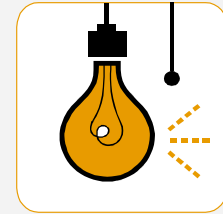
Prior to the award of any contract, the government will assess a potential contractor's financial capability. Sometimes this is performed by analysts within the contracting organization and other times by DCAA. After contract award, DCAA has a program to continuously monitor contractor's financial capability and to conduct financial capability audits when risks are identified. These

assessments are required by FAR 9.104-1(a) and DFARS 232.072.

Contractor financial difficulties may disrupt production schedules, cause inefficient use of resources, and result in contract nonperformance.

The financial capability audit places emphasis on evaluating the contractor's current financial condition and trends, near-term cash

flows, and near and long-term ability to obtain funds outside the normal course of operations. While the evaluation of historical financial data during the financial condition risk assessment can identify unfavorable adverse financial conditions, the audit focus is on the contractor's ability to maintain future cash flows to sustain performance on its Government contracts.



Any audit opinion that says your financial capability is less than adequate, could jeopardize your future government work

Reports on Financial Capability

There are three possible opinions that an auditor will express on a contractor's financial capability.

When an audit discloses no financial distress and no indications of significant long-term problems, the report will state that the financial capability is generally adequate.

When a contractor is experiencing financial distress but management can, through extraordinary action, provide adequate funds to continue performing, the audit report will state that the company is in an unfavorable financial condition. This report will summarize management's plans to

mitigate the conditions.

When a contractor is experiencing financial distress and there is reasonable doubt that the contractor will be able to obtain necessary funds to continue performance on Government contracts, the auditors will issue an adverse opinion.

What to do when finances aren't great

As stated above, the focus of an audit is to determine whether there are sufficient financial resources to perform the contract in the near term (usually one year). The auditor will likely request you to prepare a projected monthly cash flow forecast. This forecast should identify sources of revenue and all expenses. If there is a shortage of revenue to cover expenses, you will need to identify how the shortage is to be

covered. Possible sources of revenue might include lines of credit, personal loans from stockholders, liquidation of assets, plans to defer or reduce expenses, and plans to restructure debt.

The auditor will most likely scrutinize these plans in detail. The auditor will also assess whether projected revenues and expenses are consistent with historical trends. If not, be prepared

to explain significant deviations.

Any audit opinion that is less than "adequate" could jeopardize your chances of securing a government contract. Don't dwell on historical data. Put your efforts in preparing a sound business plan for managing future work.

For more information email Paul Cederwall at cederwall@pacificnwc.com



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Ron Sabado at the summit of Mt. St. Helens.

Small Companies need Ethics Programs Too.

It may be surprising to learn that the overwhelming majority of companies suspended or debarred from government contracting are smaller firms.

Some smaller businesses defer setting up an effective ethics program under the assumption that costs for

such programs are prohibitively high.

The Defense Industry Initiative on Business Ethics and Conduct (DIIE) has developed a tool kit to help defense contractors develop an ethics program. This tool kit is available at www.dii.org.

This kit will help contractors identify risk areas (e.g. sloppy timekeeping, business courtesies, supplier kickbacks, and environmental protection), develop procedures to detect and prevent occurrences, ensure compliance and conduct training.

Meet our Staff

Each issue, we profile one of our professional staff.

Ron Sabado, CPA, CMA, is on the accounting faculty of Highline Community College. Prior to joining Highline, he was an audit manager for the Defense

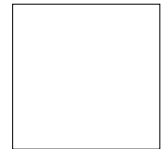
Contract Audit Agency.

Ron graduated from the University of Washington in 1973 with Bachelor of Arts in Business Administration and from Central Michigan University in 1999 with

Master of Science in Administration.

In 2002, Governor Gary Locke appointed Ron to the Wash State Board of Accountancy. Ron is currently its chairman.

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We're on the Web!
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www.pacificnwc.com