

Emerging *Small* Businesses:

To Grow Your Business,

You Must Plan for Growth



Emerging small businesses must plan for growth by ensuring systems and processes are able to support growth projections.

BY THOMAS A. MARCINKO

To Grow Your Business, You must Plan for Growth.

Most small business executives intuitively grasp the truth of this statement as it relates to operations and business development. After all, one or both of these functions is most likely the “sweet spot” of the typical small business. However, small business executives do not always realize that most of the procurement laws, *Federal Acquisition Regulation (FAR)* requirements, and “back office” system requirements are pegged to the size of the contractor. In other words, the administrative requirements imposed on contractors increase commensurate with the size of the contractor. The more successful a small business is, the more regulations it will become subject to. If nothing else, the larger a company gets, the more its processes need to be documented. The systems, policies, procedures, and, often, undocumented processes that served the small business well as it entered the government market are frequently insufficient as the business grows.

Many small contractors discover this fact when they fail an audit or cannot bid on a contract they are otherwise well positioned for because they don't meet one or more of the mandatory system requirements. Obviously, this is not the best time to learn that one or more of your systems or processes needs to be upgraded. Nor is it typically the best time to implement or upgrade a system.

System upgrades hurriedly implemented in response to a crisis are usually more expensive in the long run and are of lesser quality than planned upgrades that anticipate the requirement. In addition, planned system upgrades based on a solid understanding of the regulatory requirements tend to impress the government customer. Unfortunately, many small businesses make a bad first impression with their potential new customer when their initial interactions demonstrate a naïveté concerning government contracting requirements.

The purpose of this article is to summarize the most significant regulatory requirements that small businesses must meet as they grow to become mid-size firms. The summary will include a brief description of the requirement and what triggers its application. The objective is to provide the small

business owner/executive with the knowledge he or she needs to ensure systems and processes are able to support the business's growth projections.

Accounting System

The accounting system is one requirement that is not triggered by the size of the contractor or the contract, but by the contract *type*. Firm-fixed-price and commercial-type contracts do not require the contractor to demonstrate that it has an adequate accounting system. On the other hand, an adequate accounting system is a hard and fast prerequisite for the award of any cost reimbursement contract. Fixed-price/price re-determination contracts, fixed-price incentive contracts, progress payments based on cost, and most termination for convenience settlements and undefinitized change orders also require the contractor to have an adequate accounting system.¹ Though it is a less formal requirement, labor hour or time-and-materials (T&M) contracts also require an adequate accounting system, at least to the extent of a timekeeping and labor distribution system, and other direct costs must comply with the cost principals outlined in FAR Part 31. Further, even a T&M contract may require an incurred cost submission and an indirect rate audit.²

For smaller contractors, the adequacy of the accounting system is usually determined during a pre-award survey based on the factors listed on Standard Form 1408.³ These factors require appropriate accounting for direct, indirect, and unallowable costs, among other things. Most small businesses use one of the readily available, off-the-shelf financial accounting software packages with little or no written policies and procedures. However, even with manual intervention and workarounds, these financially-oriented accounting packages will rarely meet the Standard Form 1408 requirements.

Auditable Supporting Cost Data

This is a subset of an adequate accounting system. Many small businesses win most of their initial work based on commercial pricing, as in a General Services Administration (GSA) Schedule contract or via commercially priced subcontracts and small prime contracts. However, there will invariably come a time when the contractor wants to bid on a contract that requires the submission of cost or pricing data or other than cost or pricing data. In other words, the proposed costs will be subject to an audit.

Significantly, this requirement is not limited to proposals for cost reimbursement contracts. Fixed-price and T&M contracts awarded through negotiation frequently require the submission of auditable supporting cost data. Thus, even if the contractor is not required to have an approved accounting system *per se*, the accounting system must still be able to produce auditable supporting cost data by cost element. Such data includes the costs associated with:

- Direct labor,
- Material,
- Subcontracts,
- Fringe benefits,
- Overhead, and
- General and administrative expenses.

These costs must be presented such that they can be supported by the company's

accounting records. As stated previously, many of the financial accounting systems used by small businesses do not produce auditable supporting cost data.

Cost Accounting Standards

The government has promulgated 19 cost accounting standards (CASs) that govern the accumulation and allocation of costs for government contractors.⁴ The standards range from general requirements for consistency to very specific rules governing the treatment of certain costs. Contractors may be subject to full or modified CAS coverage depending on the nature and dollar amount of their contracts.

Fully CAS-covered contractors must submit a

disclosure statement to the government that describes their cost accounting practices to demonstrate compliance with the standards. Once the disclosure statement is approved by the government, the contractor must follow its disclosed practices. Any changes to the accounting practices must be approved by the



I know you'll like what we came up with.

Get your best GEICO rate on auto insurance as an NCMA member.

- ✓ Visit **geico.com** for your FREE, no-obligation rate quote.
- ✓ Be sure to select NCMA when asked for your affiliation.
- ✓ New customers report an average savings of \$500 when they switch.

Go to geico.com, call 1-800-368-2734 or contact your local office.

GEICO
geico.com



Average savings amount based on national GEICO New Policyholder Survey data through August 2008. NCMA is compensated for allowing GEICO to offer this auto insurance program to NCMA members. Discount amount varies in some states. Discount is not available in all states or in all GEICO companies. In New York a premium reduction is available. One group discount applicable per policy. Government Employees Insurance Co. • GEICO General Insurance Co. • GEICO Indemnity Co. • GEICO Casualty Co. Some discounts, coverages, payment plans, and features are not available in all states or in all GEICO companies. These companies are subsidiaries of Berkshire Hathaway Inc. GEICO: Washington, DC 20076. GEICO Gecko image © 1999-2008 © 2008 GEICO



government and may require a cost impact proposal. A *disclosure statement* is one of the most complicated and important documents produced by a contractor. It addresses direct and indirect costs, indirect pools, basis of allocations, and service centers, among other things. Once approved, it significantly reduces the contractor’s accounting flexibility going forward. Changes to the disclosed accounting practices are not simple to make and may be costly.

Large businesses are subject to full CAS coverage once they have been awarded in excess of \$50 million of negotiated contracts in one year. If this threshold is reached incrementally, the contractor has at least 90 days to submit a disclosure statement. However, any non-CAS-covered contractor who proposes to perform a negotiated contract valued in excess of \$50 million is required to submit a disclosure statement as part of the proposal.

Purchasing System

According to the *FAR*, the purpose of a Contractor Purchasing System Review (CPSR) is to “evaluate the efficiency and effectiveness with which the contractor spends government funds and complies with government policy when subcontracting.”⁵ The CPSR consists of an examination of the contrac-

tor’s purchasing policies and procedures, as well as an audit of selected procurement or subcontract files. The contracting officer either grants or withholds approval of the purchasing system based on the CPSR. A CPSR is recommended for contractors that exceed \$25 million in annual sales to the government, though the contracting officer may also consider the volume, complexity, and dollar value of the subcontracting.

The general requirement to have an approved purchasing system is admittedly a little loose. However, some solicitations—especially those that anticipate significant subcontracting—require the prime contractor to have an approved purchasing system.

Estimating System

Both the *FAR* and the *Defense Federal Acquisition Regulation Supplement (DFARS)* address estimating systems. The *FAR* requires review and approval of a contractor’s estimating system when it is appropriate to do so and does not include any specific standards that must be met.⁶ Again, this is a relatively loose requirement. Conversely, the *DFARS* requires contractors who receive in excess of \$50 million of Department of Defense (DOD) contract awards in a year, for which cost and pricing data was required (\$10 million per year under certain circumstances), to have

an approved estimating system.⁷ The *DFARS* lists approximately 20 attributes that an estimating system needs to possess in order to be considered acceptable.

Government Property

Larger and more complex contracts frequently require the contractor to utilize government property. In such cases, the *FAR* requires contractors to establish and maintain a written property control system, as well as complete records.⁸ Per the *FAR*, the review and approval of a contractor’s property control system shall be accomplished by the agency responsible for contract administration at a contractor plant or installation.⁹

Compliance Program

Contracts or subcontracts valued in excess of \$5 million require the contractor to have a written code of business ethics and conduct, as well as a compliance program. A few of the more important required elements include the promotion of ethics training, a fraud hotline and posters, and a fairly sophisticated set of internal controls designed to detect illegal or improper conduct.¹⁰

Regulatory Requirements Planning Matrix

Requirement	Trigger
Adequate Accounting System	Award of any cost-type contract or other contracts that require the determination of actual costs.
Auditable Supporting Cost Data	Award of a negotiated contract where cost or pricing data or other than cost or pricing data will be required.
Cost Accounting Standards & Disclosure Statement	Award of more than \$50 million of negotiated contracts in one year.
Approved Purchasing System (CPSR)	Exceeding \$25 million of annual sales to the government or required for a specific contract.
Approved Estimating System	Exceeding \$50 million of annual sales to the government.
Approved Government Property System	Award of a contract that requires the contractor to possess government property.
Code of Conduct & Compliance Program	Award of a contract in excess of \$5 million and 120 days.
Earned Value Management System	Award of any major acquisition typically defined as a cost reimbursement contract valued at over \$20 million.
Affirmative Action Plan	Contractor exceeds 50 employees and has at least one contract in excess of \$50,000.

The time crunch before a large proposal is due is not a good time to implement a new accounting system, prepare a disclosure statement, implement an EVMS, etc.

Earned Value Management

Earned value management (EVM) is not just for the big guns anymore. The FAR requires that EVM be used on all major acquisitions. Most agencies require EVM on all cost reimbursement contracts valued in excess of \$20 million and authorize its use on smaller contracts as appropriate.¹¹ Even subcontractors may have to utilize EVM. In addition, some agencies—such as DOD, NASA, and GSA—require a validated EVM System (EVMS) on cost reimbursement contracts that exceed \$50 million. An EVMS can be time-consuming and expensive to implement and operate.

Affirmative Action

All contractors with 50 or more employees and a government contract of \$50,000 or more must have a written affirmative action program.¹² Separate plans are required for each office that meets this criterion. The Department of Labor's Office of Federal Contract Compliance Programs will review the contractor's affirmative action program to ensure compliance with the FAR and Executive Order 11246. During a compliance review, a compliance officer examines the contractor's affirmative action program; checks personnel, payroll, and other employment records; interviews employees and company officials; and investigates virtually all aspects of employment in the company.

Summary

The time crunch before a large proposal is due is not a good time to implement a new accounting system, prepare a disclosure statement, implement an EVMS, etc. Don't discover after it's too late that your corporate infrastructure or back office systems will prevent you from winning a contract that your operational capability and business development savvy have positioned you to win. For instance, if your growth plan includes winning cost reimbursement contracts, then it needs to include implementing an adequate job cost accounting system. If your growth plan includes winning contracts valued at over \$5 million, then it needs to include adopting a code of conduct and a compliance program.

The matrix in the **TABLE** on page 22 summarizes the points made in this article and may be used as a guide to help small businesses anticipate the increased requirements they will encounter as they grow. By ensuring that all requirements are addressed in the growth plan, the planned growth is much more likely to happen. **CM**

ABOUT THE AUTHOR

THOMAS A. MARCINKO is a senior consultant with Aronson & Company in its Government Contract Solutions Practice. He is a member of the Florida Bar and NCMA's Potomac Chapter. He can be contacted at tmarcinko@aronsoncompany.com.

Send comments about this article to cm@ncmahq.org.

Discuss this article with your peers online! Just go to www.ncmahq.org/cm0109/Marcinko and click on "Join Discussion."

ENDNOTES

1. See FAR 16.104(h); 16.205-3(b); 16.206-3(b); 16.301-3(a)(1); 16.403-1(c)(1); 16.403-2(c)(1); 16.601(b)(2); and 49.105(c)(9).
2. See FAR 52.232-7(a)(5); 16.601(C)(3); 52.232-7(b)(4); and 52.216-7.
3. FAR 9.106-4(a).
4. FAR Part 30 and 48 Code of Federal Regulations (CFR) Chapter 99.
5. FAR 44.3.
6. FAR 15.407-5.
7. DFARS 215.407-5-70.
8. FAR 52.245-1(b).
9. FAR 45.105.
10. FAR 3.10.
11. FAR 34.2.
12. FAR 22.804.