



Allowability of Contractor Employee Administrative Leave Due to Hurricane Katrina

The Office of the Under Secretary of Defense issued guidance on October 11, 2005 implicitly stating that Government contractors should use reasonableness as a guide in determining the extent to which Government contracts can be charged for administrative leave taken by their employees due to Hurricane Katrina.

The guidance states that such leave is ordinarily a fringe benefit and such leave costs are guided by provisions of FAR 31.205-6. Government contractor management should evaluate the need on a case by case basis, and determine if administrative leave is warranted given individual circumstances.

Whether costs for such leave would be reasonable, and therefore allowable for charging to Government contracts would hinge on factors such as:

- If other companies in the surrounding area were closed as a result of the hurricane, and;
- If Government offices in the surrounding area were also closed

Government contractors whose employees had been performing a contract at a Government facility, where that facility was closed due to the disaster, will almost certainly be allowed to charge to Government contracts a reasonable portion of administrative leave due to the facility closure.



This guidance memo also encourages Government contractors affected by the disaster and applicable Government administrative or procurement offices to negotiate advance agreements regarding administrative leave to alleviate potential disputes on the "reasonableness" of these costs at a later time.

In response to the Under Secretary's memo, DCAA also issued its own guidance memorandum on October 28 setting forth its own parameters for adequate review of administrative leave costs. Among other things, the audit guidance memo encourages auditors to determine the extent to which contractor insurance may cover company payments to employees for extended leave in determining a reasonable amount of company payments to employees for time off.

Facilitating the Audit Process: Minimizing DCAA Time at Your Company

Government contractors relatively new to the procurement process do not always understand that adequately supporting the Government audit process can save time, and minimize misunderstandings.

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There are a few key, critical steps that all contractors can take to facilitate this process, expedite the audit, and avert problems in dealing with the auditors. Those steps include:

- Communicate with the auditor, before the auditor shows up, to fully understand the purpose of the audit; request that the auditor provide you a list of data required, and ensure that you have adequate time to prepare that information before the audit commences
- During the audit, be accessible and available to answer questions and provide information timely
- Do your best to resolve any problem issues that the auditor produces **before** the auditor leaves the premises; this requires continuous communication with the auditor to ascertain if there are unresolved issues that can be overcome during his or her onsite visit
- If not offered by the auditor, request an exit conference to gain a full understanding of the audit results, if those results can be divulged; if the auditor sets forth deficiencies or questioned costs, ask for more time to address those issues before the final audit report is released

Hot Market for Government Contractors

With so much activity in the Mergers & Acquisitions market lately, and in our assistance with due diligence and general consulting, we've made a few notes you, as a government contractor, might find interesting and of some value as you grow your business.

Of course growth is good. But focus is better. Contracts to have buyers will not necessarily generate buyers when the time is right. Focus your efforts; create a niche that makes you different from the pack and better than the mainstream. Buyers typically want to enter a new market for one of two reasons; 1.) The buyer currently does not have a deliverable in the particular market and wants one, because it fills out their product or service offerings, or 2.) The market will allow the buyer to expand, strengthen or enter a new geographic area with a product or service they currently have. In other words, grow their current base.

One area deserving some focus is profit margins and the importance of consistency and amount. The price of any business is about cash flow, not just revenue. Revenue is good, but price is based on how much is taken to the bottom line. Multiples of EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) are fairly consistent; however, multiples of revenue have a much wider margin. As an example, assume two companies have the same amount of revenue, \$20,000,000. Assume Company A has EBITDA on that revenue of 4%, or \$800,000 and company B has EBITDA on their revenue of 10% or \$2,000,000. Both are in the same industry, and an EBITDA multiple of 6X is the industry standard, producing a value for Company A of \$4,800,000, while company B has a value of \$12,000,000. Company A results in a revenue multiple of .24 while Company B has a

revenue multiple of .6, a huge difference, but very real.

One more area of note is product versus hours. If you are a service company, you may have value, but there is little basis to assume your company will ever be worth much more than one times revenue. In other words, there is not much leverage in hours. Products are a different story. Software, patents, and products have the ability to generate a sales price many times more than a dollar or revenue. A warning is in order though, as we have seen companies spend themselves into bankruptcy chasing product development.

There are many more lessons to be learned, watch for future articles.

Uncompensated Overtime

A common issue with Government contractors is the proper treatment of uncompensated overtime for salaried employees (employees exempt from the Fair Labor Standards Act). DCAA allows three methods to contractors for treating uncompensated overtime. In fact, it is recommended that a contractor not pick one method of treatment but have the capability to implement all three methods if necessary.

The first method is to charge government contracts with the average labor rate calculated for each salaried employee. This method is implemented by dividing the total salary for an individual by the total numbers of hours worked by that individual.

The second method is to prorate the employees salary to all contracts in which that employee works. If the employee works seventy-five percent of his/her time on contract one and twenty-five percent to contract two, then seventy-five percent of that individuals salary should be charged to contract one and twenty-five percent of salary to contract two.

Finally, the third method is to charge an estimated / predetermined labor rate to contracts based on the total hours an employee is estimated to work. At the end of the year, the actual labor cost is calculated and the over/under amount of labor charged will be incorporated into the overhead rate, and thus distributed to all contracts.

Training

Government Contract Accounting Systems Compliance

January 18-19, Las Vegas, NV
May 17-18, Washington DC

Instructor is Darryl Walker – event is sponsored by Federal Publications Seminars, LLC.

Future Newsletter Editions

Beason & Nalley welcomes any feedback from the readers of this newsletter. We appreciate any suggestions that you may have as to future content, presentation and format, or interesting developments in the procurement community that would be of interest to our readers. Please provide any feedback or suggestions via our email address at dwalker@beasonnalley.com.

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