

THE NEWSLETTER FROM THE BDO GOVERNMENT CONTRACTING PRACTICE

BDO KNOWS: GOVERNMENT CONTRACTING



John Van Meter, Managing Director, Government Contracting Advisory Services at BDO

BDO EXECUTIVE SEMINAR: CURRENT STATE OF THE GOVERNMENT CONTRACTING INDUSTRY

On Oct. 30, 2014, BDO co-hosted its first Texas-based Executive Seminar for Government Contractors with the Public Contracting Institute at the Hilton DFW Lakes Executive Conference Center.

Jim Johnson, Assurance Office Managing Partner of BDO's Dallas office, kicked off the day, with sessions led by industry professionals, including Rich Rector of DLA Piper, Dan Salas of DCMA, John Hagan of BB&T, Keith Graf with the Office of the Governor of Texas and many more. Panelists discussed various topics, with the following key themes emerging from the day's discussion:

M&A Activity: Despite a challenging environment for government contractors, 2014 is generating the highest volume of

M&A activity since 2010. Investors are most interested in cybersecurity, big data analytics, managed services, Special Forces, healthcare, intelligence and specialty IT services such as cloud computing. Over the past two years, a number of large aerospace, defense and government services companies have amassed a large amount of cash reserves. With the federal budget environment somewhat stabilized, these companies are now comfortable revisiting an M&A strategy.

Issues with Incurred Cost Audits: DCMA recognizes the government contracting community's frustration with the large number of open incurred cost audits, preventing contractors from formally closing contracts and potentially using the unspent funds remaining on such contracts. As a result,

DID YOU KNOW...

The Department of Labor's rule raising the minimum wage for federal contracting employees to \$10.10 per hour will go into effect Jan. 1, 2015, according to a **Federal Register** notice.

According to **Nextgov.com**, nearly 40 percent of publicly disclosed fiscal year (FY) 2014 federal contracts were awarded in October 2013 or September 2014.

The Navy, Army and Air Force were the top spenders on public contracts in FY 2014, reports a **GovTribe** analysis.

The Department of Justice requested a cybersecurity budget increase of \$7.6 million for 2015, totaling \$722 million, according to **FierceGovernment**.

President Obama's 2015 IT budget request proposes \$79 billion, which is \$2.4 billion less than this year's IT spending of \$81.4 billion, reports **InformationWeek**.

According to a **Bloomberg Government** analysis, spending on federal contracts fell from \$516 billion in FY 2012 to \$462 billion in FY 2013.

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SEMINAR

DCMA is focusing on a number of initiatives that could streamline the process.

DCAA's New Criteria: According to a 2013 DCAA report to Congress, there are \$16 billion of questioned costs on FY 2013 audits (e.g., incurred costs, forward pricing and other audits). In the same report, DCAA states that it plans to eliminate the current backlog of old audits by 2014 and become completely current by 2016. Therefore, DCAA has developed new criteria for determining risk that will potentially scope out a large number of audits and allow some contractors to close back years without undergoing audits for them.

Best Practices for Incurred Cost

Submissions: The panelists discussed best practices for audits of incurred cost submissions, such as ensuring that schedules within the incurred cost proposal package are properly reconciled and complete, retaining documentation while the incurred cost audits are open and preparing for the start of the incurred cost audits by becoming familiar with DCAA audit guidance.

Business Systems Experiences: Panelists also commented on their experiences with business systems challenges. According to the speakers, the key to a successful business systems audit is involving senior management in the analysis and remediation of the systems prior to the start of the audit, developing a comprehensive plan to prepare and making sure that all stakeholders meet the deadlines stated in the plan.

Following the seminar, Boon Consulting Group hosted a cocktail reception where attendees and other industry professionals were able to network and discuss topics featured throughout the day.

In an industry as dynamic as the government contracting space, it's important for contractors to remain cognizant of changing regulations and compliance issues. As such, through its Executive Seminars, BDO aims to provide contractors insights into emerging opportunities and challenges within the procurement space so that they can successfully manage and grow their businesses.

IRS EXAMINATION PROCESS – WHAT YOU NEED TO KNOW

By Sarah Masoom, tax senior manager and Jeff Schragg, tax partner, BDO USA

WITH JUST WEEKS REMAINING BEFORE THE NEW TAX SEASON OPENS, THE IRS WAS HIT WITH \$350 MILLION IN BUDGET CUTS.



This is in addition to earlier slashes to the IRS budget of more than \$1 billion since 2010, resulting in nearly 13,000 employee layoffs. While IRS examinations (audits) may have stalled, it is important to know how the examination process for business taxpayers works. With a reduced IRS labor force, business taxpayers will need to have open and clear lines of communication with IRS examiners in case they undergo an IRS examination to ensure a fast and efficient resolution.

To this end, the Large Business and International (LB&I) division of the IRS released updated guidance on Feb. 28, 2014, for examiners of Information Document Requests (IDRs). This recent directive supersedes any prior directives in this regard. The update and clarification was necessary to ensure that the procedures governing IDR issuance and enforcement were easily and clearly understood. The LB&I states that it is aiming to "emphasize the importance of both the IRS and taxpayers engaging in robust discussions that include:

- The issue that is the subject matter of an IDR,

- What information is necessary to evaluate that issue and why,
- What information the taxpayer has and how long it will take to provide it, and
- How long it will take the IRS to review the information for completeness and respond to the taxpayer"

There is a specific focus on increasing meaningful communication between the IRS and taxpayers in advance of the issuance of an IDR, with the goal to increase efficiencies for both parties.

SUMMARY OF THE DIRECTIVE

Step One, Issuing IDRs: The LB&I now has 12 specific procedures that examiners are *required* to follow when issuing IDRs. These 12 steps are to ensure clear, specific and regular communication between the IRS examiners and taxpayers.

Step Two, Enforcement of IDR: The new IDR Enforcement Process involves three graduated steps: (1) a Delinquency Notice, (2) a Pre-Summons Letter and (3) a Summons. This process is mandatory and has no exceptions. The directive outlines the procedures that

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IRS EXAMINATION PROCESS

examiners have to follow in each of these steps. Again, the focus here is to establish clear and concise communication with taxpayers.

Note: before the enforcement process is triggered, an examiner has the authority to grant a taxpayer an extension of up to 15 business days if one of two situations occurs:

1. **Taxpayer Fails to Respond.** If a taxpayer fails to respond by the IDR due date, the examiner or specialist should – within five business days of the due date – find out the reason for the taxpayer’s lack of response to determine if an extension is warranted. If an extension is warranted, the examiner or specialist may grant the taxpayer an extension of up to 15 business days from the time the extension is determined and communicated to the taxpayer.
2. **Taxpayer Provides Incomplete Response.** If a taxpayer responds, but the examiner or specialist determines that the response is not complete, the examiner or specialist should find out why the response is partial and determine within five business days whether an extension is warranted. If an extension is warranted, the examiner or specialist may grant the taxpayer an extension of up to 15 business days from the time the extension is determined and communicated to the taxpayer.

In addition to the directive discussed above, the LB&I division also issued a Transfer Pricing Roadmap in February 2014 which provides audit techniques and tools to assist with the planning, execution and resolution of transfer pricing examinations.

Overall, taxpayers should seek the assistance of proactive and experienced tax professionals to guide them through an IDR or other IRS examination processes. With the assistance of these professionals, taxpayers can better manage the audit and communication with IRS employees, leading to an easier and smoother examination process.

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WHAT HAS THE GOVERNMENT CONTRACTING PRACTICE BEEN UP TO?

Members of the Government Contracting practice have been quite busy the past two months, working to bring to fruition a variety of projects and initiatives for our clients and prospects.

We kicked off the fourth quarter with another BDO Executive Seminar for Government Contractors. We invited attendees to join us in Grapevine, Texas, on Oct. 30 for a daylong conference, featuring panelists from various organizations working closely with contractors, such as DCMA, DLA Piper and Raytheon. Industry professionals commented on the current state of the procurement industry, M&A activity and business system challenges. Read our full-length recap on page XX for more details.

In addition to the Executive Seminar, the Government Contracting practice extended its presence in the life sciences sector by attending the Biomedical Advanced Research and Development Authority (BARDA) conference in Washington, D.C., from Oct. 15 to 17. Attendees discussed opportunities for contractors to help develop medical countermeasures, such as vaccines, therapeutics and diagnostics for both government and commercial markets, and participated in individual meetings on procurement requirements for medical countermeasures and best practices for responding to solicitations. After the conference, BDO and its life sciences partners – Latham BioPharm Group, BakerHostetler LLP and American Research Capital – hosted a private dinner reception where industry leaders shared their insights on procurement best practices.

The Government Contracting practice also partnered with BDO's Nonprofit & Education practice to host the a webinar on the upcoming implementation of the OMB's Uniform Guidance, "Are You Ready for the Supercircular?" This session took place on Nov. 6 – both as a webinar and live event in select BDO offices. The presentation, led by Andrea Wilson of BDO and Peter Eyre of Cromwell & Moring's Government Contracts Group, outlined how the Supercircular will impact organizations' grant operations, the increased requirements of subcontractor monitoring and procurement and solutions for the recovery of indirect costs.

Lastly, the Government Contracting practice also welcomed two new team members: Robert Craig and Andrea Wilson. Both will be managing directors in the Greater Washington D.C. area. Robert has more than 25 years of experience advising clients on federal government contracts management and compliance, and will bolster the practice's government contracts clients and services. Andrea brings more than 17 years of experience working with NGOs and research institutions on grants and contracts, and will be a valuable addition to the practice's grants management services.

With 2015 underway, stay tuned for more updates from the Government Contracting practice!

REGULATORY UPDATES

Proposed DFARS Rules

Case 2014-D009: Advancing Small Business Growth; DoD has proposed to amend the Defense Federal Acquisition Regulation Supplement (DFARS) to clarify that entering into a small contract award may cause a small business to exceed the applicable small business size standard. There are two main scenarios where a small business will exceed the small business size standard:

1. If the estimated annual dollar value exceeds the NAICS code assigned by the contracting officer; or
2. If the estimated annual dollar value exceeds \$70,000,000, if the small business standard is expressed in the number of employees.

In the event that either of the above situations applies, the small business would no longer qualify as a small business as described by the NAICS codes. The Defense Logistics Agency offers help to businesses that are transitioning out of a small business standard.

Case 2014-D025: Inflation Adjustment of Acquisition-Related Thresholds; On Nov. 6, 2014, DoD proposed to amend the DFARS to further implement the U.S.C. statute on inflation adjustment of acquisition-related dollar thresholds. This statute requires an adjustment every five years of acquisition-related thresholds for inflation using the Consumer Price Index for all urban consumers, except for the Construction Wage Rate Requirements statute (Davis-Bacon Act), Service Contract Labor Standards statute and trade agreements thresholds.

Proposed FAR Rule

Case 2014-022: Inflation Adjustment of Acquisition-Related Thresholds; DoD, GSA and NASA have proposed to amend the FAR to further implement the inflation adjustment of acquisition-related dollar thresholds. A statute requires an adjustment every five years of acquisition-related thresholds for inflation using the Consumer Price Index for all urban consumers, except for the Construction Wage Rate Requirements statute (Davis-Bacon Act), Service Contract Labor Standards statute and trade agreements thresholds.



Final DFARs Rules

Case 2013-D016: Limitation on Use of Cost-Reimbursement Line Items; DoD has implemented a final rule prohibiting DoD from entering into cost-type contracts for production of major defense acquisition programs (MDAPs), including entering into cost-reimbursement line items for the production of MDAPs. This rule amends the DFARS to include section 811 of the National Defense Authorization Act for fiscal year (FY) 2013. This rule will affect cost-type contracts entered on or after Oct. 1, 2014.

Case 2013-D029: Payment in Local Currency (Afghanistan); Effective Sept. 30, 2014, DoD issued a final rule amending the DFARS to incorporate into the DFARS policies and procedures concerning payment for contracts for performance in Afghanistan.

Final FAR Rules

Case 2014-001: Incorporating Section K in Contracts; Effective Dec. 26, 2014, DoD, GSA and NASA have issued a final rule amending the FAR to standardize the incorporation by reference of representations and certifications in contracts. The rule revises the language at FAR subpart 4.12, Representations and Certifications, and adds a new clause at FAR 52.204-19 to require the incorporation of representations and certifications in contracts regardless of which contract award form is used. FAR clause 52.212-4 has a new paragraph (v) to cover this issue for commercial items.

Case 2012-032: Higher-Level Contract Quality Requirements; Effective Dec. 26, 2014, DoD, GSA, and NASA have issued a final rule amending the FAR to clarify when to use higher-level quality standards in solicitations and contracts. The rule also updates the examples of higher-level quality standards by removing obsolete standards and adding new industry standards that pertain to quality assurance for avoidance of counterfeit items. The rule requires that higher-level quality standards be given special attention during Contractor Purchasing System Reviews.

DoL Final Rule

RIN 1235-AA10: Establishing a Minimum Wage for Contractors; The Department of Labor (DoL) has finalized the regulations to implement Executive Order 13658, establishing a Minimum Wage for Contractors. With this new rule, the minimum wage paid by those contractors to workers performing on covered federal contracts will be raised to \$10.10 per hour beginning Jan. 1, 2015. Starting Jan. 1, 2016, and annually thereafter, the minimum wage will be determined by the Secretary of Labor.

Defense Procurement and Acquisition Policy (DPAP) Memo: Blending Rates for Revised Contractor Compensation Limitations

On Oct. 24, 2014, DPAP issued a memorandum on the use of blended rates to implement multiple compensation caps. The Federal Acquisition Regulation Council

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REGULATORY UPDATES

issued an interim rule, effective June 24, 2014, limiting allowable contractor compensation to \$487,000 annually. This was significantly lower than the \$952,308 allowable as recently as fiscal year 2012 under FAR 31-205-6(p). As a result, contractors may find themselves with contracts subject to both the new and old compensation limitations.

To help simplify the burden associated with this rule change, DOD has issued guidance for contractors to use a “blended rate.” The blended rate approach would be approved by the Contract Officer and calculated and documented in such a way to substantiate the final actual blended rate. Contractors would begin to implement the new rate for interim billing. The final overhead submission will be audited to ensure only the total allowable compensation is billed to the Government.

Additional implementation guidance will be forthcoming from the Defense Contract Management Agency (DCMA) in consultation with the Defense Contract Audit Agency (DCAA). See <http://www.acq.osd.mil/dpap/policy/policyvault/USA006248-14-DPAP.pdf> for the full memo.

GAO Report on DCAA Requests for Internal Audit Reports

On Nov. 12, 2014, the U.S. Government Accountability Office (GAO) issued a report to Congress, “Additional Guidance Needed Regarding DCAA’s Use of Companies’ Internal Audit Reports.” The Defense Contract Audit Agency (DCAA) revised its guidance in the Contract Audit Manual to address the documentation requirements mandated by section 832 of the National Defense Authorization Act (NDAA) for Fiscal Year 2013. The revisions include provisions for DCAA auditors to document (1) that access to company internal audit reports is necessary to an ongoing DCAA audit, (2) the request sent to the company and (3) the company’s response.

The GAO report finds that based on review of selected cases, implementing the changes has been inconsistent across the agency. “None of the eight requests for company internal audit reports GAO selected in a random, nongeneralizable sample contained all documentation required by the NDAA

Bid Protest Statistics for Fiscal Years 2010-2014

	FY 2014	FY 2013	FY 2012	FY 2011	FY 2010
Cases Filed	2,561 (up 5%2)	2,429 (down 2%)	2,475 (up 5%)	2,353 (up 2%)	2,299 (up 16%)
Cases Closed	2,458	2,538	2,495	2,292	2,226
Merit (Sustain + Deny) Decisions	556	509	570	417	441
Number of Sustains	72	87	106	67	82
Sustain Rate	13%	17%	18.6%	16%	19%
Effectiveness Rate	43%	43%	42%	42%	42%
ADR (cases used)	96	145	106	140	159
ADR Success Rate	83%	86%	80%	82%	80%
Hearings	4.70% (42 cases)	3.36% (31 cases)	6.17% (56 cases)	8% (46 cases)	10% (61 cases)

provisions and DCAA’s guidance. All eight records contained documentation of DCAA’s request to the company, but none contained a full statement of the requested report’s connection to DCAA’s work and two did not cite any connection.”

GAO recommends that DCAA clarify its guidance and establish and monitor internal controls to help ensure that requests for company internal audits are fully documented in accordance with the act, and that the guidance defines authorized use. DCAA concurred with GAO’s recommendations. For the full GAO report, please refer to <http://gao.gov/assets/670/666866.pdf>

GAO Bid Protest Annual Report to Congress for FY14

On Nov. 18, 2014, the GAO issued its Bid Protest Annual Report to Congress for FY 2014. This included data regarding overall protest filings for the fiscal year, notices of any agencies that did not fully implement GAO’s recommendations with respect to a bid protest and a summary of the most prevalent grounds for sustaining protests during the fiscal year. Additionally, this year’s report included information regarding the impact of the October 2013 Federal Government shutdown. In October 2013, the U.S. government shut down for 16 days. At the time of the shutdown, there were 280

active bid protest cases. These cases received a deadline extension up to the maximum about of 16 days. The GAO was able to resolve all but five cases in less than the maximum timeframe.

The report reveals that during FY 2014, GAO received 2,561 cases: 2,445 protests, 50 cost claims and 66 requests for reconsideration. GAO closed 2,458 cases during the fiscal year: 2,351 protests, 49 cost claims and 58 requests for reconsideration. In addition, of the 2,458 cases closed, 292 were attributable to GAO’s bid protest jurisdiction over task orders. See below for a chart comparing the bid protest data for fiscal years 2010 through 2014.

While a significant number of protests filed with GAO are resolved by agencies taking corrective action, some are not. If protests are not resolved, agencies must “defend the protest on the merits.” Of those, approximately 13 percent are sustained by GAO. The most prevalent reasons for sustainment by GAO during the fiscal year were:

- (1) failure to follow the evaluation criteria;
- (2) flawed selection decision;
- (3) unreasonable technical evaluation; and
- (4) unequal treatment.

Perspective in Government Contracting



The number of private equity platform investments in the government contracting space declined steadily over the last three years, with many generalist firms that were once drawn to the reliability of the industry being deterred by

budget volatility and sequestration fears. Exits have been delayed as private equity firms that invested in the industry five or six years ago have waited patiently for conditions to improve.

Despite these slower years, interest in the sector is rebounding. Fiscal 2014, in particular, has been more active for government contracting deals in light of increased spending certainty and sequestration caps that were raised in 2014 and 2015. Moreover, with midterm elections complete, government spending restrictions may lift and contractors may see favorable changes to the defense budget. The federal fiscal deficit – at \$483 billion – is lower than many predicted, which may trigger new spending bills. As global conflicts continue and evolve, lawmakers are facing pressure to increase spending on military and defense – areas that were hit hard by cuts in recent years. Moreover, industry sources expect spending on health services to rise over the coming fiscal years in response to global health crises and bioterrorism threats.

Meanwhile, with multiples on the rise and the market shifting to favor sellers, there are early signs that exits may be picking up. Combined with excessive dry powder, cash on corporate balance sheets and debt markets that are ready to invest, deal volumes are expected to continue their ascent.

The sector is also ripe for consolidation, especially in the services space as many similarly focused firms vie for a shrinking pool of federal dollars. Engility's recently announced acquisition of rival TASC for \$1.1 billion, for example, was one of the biggest deals in the federal contracting market this year, and could "herald a wave of consolidations among professional services companies," according to The Washington Post. This follows several other PE-backed corporates that completed add-on acquisitions in the services space including PAE's acquisition of CSC's applied technology division in 2013 and Vencore's acquisition of QinetiQ North America in 2014.

With a potential increase in federal spending, private equity investors may experience a new era of opportunity in the government contracting industry.

PEerspective in Government Contracting is a feature examining the role of private equity in the government contracting industry.

QUESTIONS TO ASK WHEN FILING VIRGINIA BPOL TAX RETURNS

With Virginia's business, professional and occupational license (BPOL) tax returns due March 1, 2015, government contractors need to be aware of common issues that may arise when filing, such as:

- 1 Are we required to file in localities where we merely have employees onsite at government facilities?;
- 2 Are we in the proper classification(s) for BPOL purposes (determines applicable rate)?;
- 3 How do we source gross receipts for BPOL purposes?;
- 4 How do we calculate the out-of-state gross receipts deduction (2014 ruling may impact the calculation)?;
- 5 What documentation is needed to support the out-of-state gross receipts deduction?;
- 6 How do we determine gross receipts if our accounting data is on an accrual basis, but we file our tax returns on a cash basis?;
- 7 Are we entitled to any exemptions such as an exemption for software developed in the locality?; and
- 8 What do we do if our gross receipts figures change after our BPOL filing?

As localities become more stringent in auditing BPOL filings, it's critical for contractors to resolve the issues identified above. In some cases, the resolution of an issue may lead to refunds.

For more information, please contact Jeff Saltzberg, senior manager, State and Local Tax Services (jsaltzberg@bdo.com, 301-634-4942) or Jeremy Migliara, senior director, State and Local Tax Services (jmigliara@bdo.com, 703-770-0596).

MARK YOUR CALENDAR...

FEBRUARY 2015

February 3

NASA Small Business Industry Day

INFINITY Science Center
Pearlington, Miss.

February 17-20

2015 ASM Biodefense and Emerging Diseases Research Meeting

Washington Marriott Wardman Park
Washington, D.C.

February 17-21

West Government Contracts Year-in-Review Conference

Washington Omni Shoreham Hotel
Washington, D.C.

MARCH 2015

March 11

15th Annual Alliance Mid-Atlantic Small Business Procurement Fair

Chase Center on the Riverfront
Wilmington, Del.

March 11-14

2015 Section of Public Contract 21st Annual Federal Procurement Institute and Midyear Council Meeting*

Loews Annapolis Hotel
Annapolis, Md.

March 19

Veteran Woman Owned Small Business

Women's Memorial at Arlington National Cemetery
Arlington, Va.

* Indicates that BDO is sponsoring and/or speaking at this event.

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