TECHNOLOGY Outlook

Watkins, Meegan, Drury & Company, L.L.C.

Clear Vision, Powerful Results

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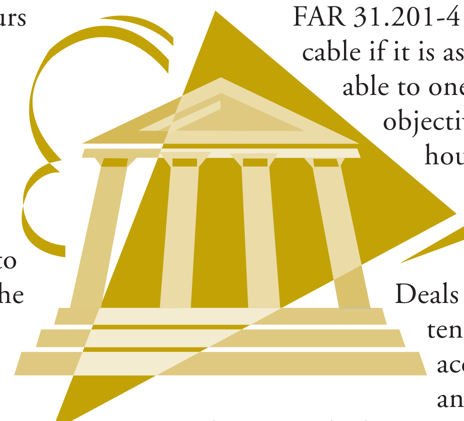
Labor Accounting for Government Contractors

Kristen Eitzel

Many government contractors have found themselves in a "discussion" with DCAA auditors regarding uncompensated overtime at one point or another. Uncompensated overtime is the unpaid hours worked over the standard 40 hours for exempt employees. DCAA is concerned about how these hours are recorded.



Total time accounting requires all hours worked to be recorded and prorates the salaried cost of the individual across all charges. This is the standard amongst defense contractors for recording time as well as the most accepted method by DCAA. Without a total time accounting policy, it is up to the employee's discretion how hours will be charged to the government. This flexibility leaves the door wide open for the possibility of unfairly increased profit margins, distorted pool bases, and irritable DCAA auditors.

Total time accounting is the standard amongst government contractors for a reason. The DCAA audit manual, or DCAM, cites in section 6-410.3.d, "If it is determined that government contracts are being overcharged by a material amount due to an inequitable allocation of costs because the contractor does not record all time worked, the contractor should be cited as being in noncompliance with FAR 31.201-4 and CAS 418." Government contractors have also run into trouble with CAS 401 on this issue. While there are no regulations that specifically identify total time accounting as required, DCAA uses the regs to support its position on total time accounting as follows:

FAR 31.201-4 – "A cost is allocable if it is assignable or chargeable to one or more cost objectives." – i.e. all hours worked should be applied to final cost objectives.

CAS 401– Deals with the consistency between accounting and bids and proposals. If all hours worked are recorded on your general ledger, they should be included in the build-up of your cost proposals.

CAS 418 – Relates to the proper allocation bases for direct and indirect costs; DCAA cites this to support its view that the exclusion of uncompensated overtime hours will distort the pool base.

The two most widely used methods for recording uncompensated overtime are the effective hourly rate method and the payroll variance method. The effective hourly rate (or auto adjust) method takes the hours an employee works over 40 in a week and prorates their hourly rate down accordingly. The payroll variance (or overhead credit) method takes

*(See **LABOR ACCOUNTING**, p. 5)*

TECHNOLOGY *Outlook*

The Watkins, Meegan, Drury & Company, L.L.C. Technology Outlook welcomes feedback and suggestions for articles to assist government contractors and other professionals in meeting their organization objectives. If you wish to submit an idea, request use of any information in this issue, or be added to our mailing list, please contact Christine Williamson at (703) 761-4848 or e-mail at Christine.Williamson@WatkinsMeegan.com.

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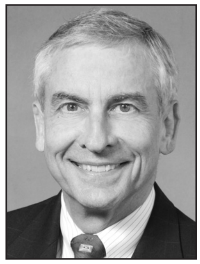
Valuations for Small Closely-Held Businesses: Part I – Factors to Consider



Michael E. Meegan

The valuation of a small closely-held business is a complicated calculation because there are numerous qualitative and quantitative factors that affect the value of a company. Qualitative factors to consider are the quality of the current employees, location of the business, the industry's legislative environment, competition, and the stability and longevity of the company. Quantitative factors include the company's historical and projected financial statements, industry statistics, and other financial information that is relevant to the company.

The approach used will depend upon the seller's intentions. If the seller wishes to pass on the business to a family member, the valuation is for tax purposes and must be based on fair market value. The owner wishing to sell to a third party will want to maximize the sale price. Because market conditions can change rapidly, a valuation may not be relevant if not used within a certain time period.

Business valuations may be completed for a variety of reasons. Many are conducted for estate planning or, on the opposite side, post-death estate taxes. The valuation is particularly important in the cases of estate or gift taxes. The IRS requires valuations of closely-held corporations to be at fair market value, instead of book value. Fair market value is defined as "the price at which property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts." If the IRS finds that the sale of a company has been undervalued, this could create a tax liability for those involved in the transaction. Businesses may use a valuation to obtain financing from a bank, or to determine the amount of insurance necessary for its key owners/executives to carry. Oftentimes a valuation is completed in divorce situations because there is a requirement to value certain interests. In most cases, it is used when any interest in a company is going to be sold.

Ownership control plays a large role in valuation. There are three types of ownership interest values: controlling interest; marketable, non-controlling interest; and non-marketable, non-controlling interest. A marketable, non-controlling interest in a company is similar to equity in a publicly traded company. A non-marketable, non-controlling interest is similar to minority interest in a closely-held company. Generally, there is a premium attached to ownership control, while there is a discount attached to lack of control or marketability.

The IRS has established revenue rulings describing eight factors that should be considered when valuing a closely-held company. In the second article of this series, we will guide you through these eight factors.

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Terms: Deficiencies and Material Weaknesses, What Do They All Mean?

Phil Philips

A financial statement audit is designed to express an opinion on the financial statements, not on the entity's internal control. However, obtaining an understanding of controls remains a key part of every financial statement audit. As part of obtaining that understanding, auditors may identify control gaps or deficiencies. If these deficiencies are significant, the auditor is obligated to report them to company management.

Auditors have always been required to communicate control matters to management. Sometimes these matters were communicated in the form of a "management letter." Other times, auditors chose not to issue a formal letter but instead reported to management orally. Under the standards that recently became effective, these communications now must always be in writing.

Don't be surprised if your company has significant control deficiencies – auditors have never been required to report all control deficiencies they identify, only the significant ones. In the past, the reporting of significant deficiencies was relatively uncommon. That is not true under the new standards. Most likely this notification of control deficiencies does not mean that there has been a significant deterioration in control effectiveness since the last audit.

The new reporting of control deficiencies could be a result of one or more of the following developments:

- ***Changes to the Definition of "Significant"*** – Under previous standards, determining whether a control deficiency was "significant" was entirely a matter of professional judgment. In exercising that judgment, auditors often considered the specific circumstances of the entity – for example, its size or the complexity of its operations. The new standards define *significant deficiencies* as those that create "more than a remote likelihood that a misstatement of the financial statements that is more than inconsequential will not be prevented or detected." If the key thresholds of there being a remote likelihood of an error that is more than inconsequential seem low, they are.

  When these definitions became effective for public companies under the Sarbanes-Oxley Act, most auditors determined to establish thresholds for reporting that were much lower than what they had used in the past. As a result, it is likely that control deficiencies that were not considered "significant" in the past will now meet the definition, triggering written communication from the auditor.

- ***Reporting Deficiencies From Prior Audits*** - Under the old standards, the auditor was not required to report deficiencies that the audit committee (or its equivalent) already knew about. No such

*(See **TERMS**, p. 4)*

Accountants Recognized as "Super CPAS" by Virginia Business Magazine

We are pleased to announce that *Virginia Business Magazine* named ten accountants from our firm as "Super CPAs." For the sixth year, the magazine has compiled the list in cooperation with the Virginia Society of Certified Public Accountants. Ballots went to more than 6,600 members asking them to nominate and vote on the leading members of the accounting profession in Virginia. Accountants were divided into 12 different categories.

This year's winners from Watkins Meegan include:

1. Christine Williamson (Assurance Services)
2. David Gaver (Employee Benefits)
3. Hartwell (Phil) Philips, Jr. (Assurance Services)
4. John Eric Nelson (Corporate Taxation)
5. Justin Reid (Assurance Services)
6. Karen Louis (Government/ Non Profits)
7. Kristen Eitzel (Small Business Consulting)
8. Louise Peabody (Employee Benefits)
9. Michael Meegan (Corporate Taxation)
10. Rebecca McDonald (Young CPAs)

All ten are members of the firm's Northern Virginia office.

(TERMS, from p. 3)

exception exists under the current standards—your auditor is required to report all significant deficiencies that exist, even those that have existed for some time and that management knows exist.

- ***De Facto Significant Deficiencies*** - Previous standards allowed the auditor to use extensive judgment in determining whether to include an identified control deficiency in a letter to management. In contrast, the new standards list a dozen different conditions that are de facto significant deficiencies and therefore required to be reported. It is possible that these conditions existed at your organization for some time but were not reported because, in the auditor's judgment, they were not considered significant. Now, the auditor has no choice.

- ***Increased Emphasis on Internal Control*** - The audit of the financial statements does not require the auditor to identify all control deficiencies that may exist at an entity. New auditing standards require auditors to perform substantially more work to understand internal controls than was required in the past. As a result of this additional work, it is possible that the auditor will identify more control deficiencies. Conditions that existed in the past but that went unnoticed now may come to light.

If you wish to speak to us regarding these changes that may affect your company audit, please contact Phil Philips at Phil.Philips@WatkinsMeegan.com.

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Members of the Virginia Office Chosen to Teach at *Deltek Insight* Conference Two Years Running

Deltek PARTNER

The inaugural *Deltek Insight* Conference was held in Las Vegas, NV in 2007. Members of the Virginia office were among those chosen from over 800 proposals to teach at the conference. Mike Meegan was voted in the top 25 most highly rated speakers from the event. The following classes were offered by the firm.

- *Leadership: What Stage Are You At?* Christine Williamson & Stan Sinclair
- *Stock Options: Expensing is here:* Phil Philips & Kristen Eitzel
- *Understanding CAS – Are You Knocking on the Door of Applicability?* Mike Meegan
- *Understanding Financial Statements of a Government Contractor:* Mike Meegan & Christine Williamson

Can't get enough of us? Come see us at *Deltek Insight* 2008 in Nashville, TN from May 19-22. Classes we have been chosen to teach are:

- *Cost Submissions Using GCS Premier*: Christine Williamson & Keith Romanowski
- *Re-engineer Your Indirect Rate Structure In-Line With Your Growing Business?* Karen Louis & Kristen Eitzel
- *Uncompensated Overtime – Employees and DCAA*: Kristen Eitzel & Stephanie Widzinski
- *Industry Trends Forum For Government Contractors:* Kristen Eitzel
- *10 Steps to Designing Effective Incentive Plans:* Kristen Eitzel

New Government Contractor Ethics and Conduct Federal Acquisition Regulation

- Effective December 24, 2007
- FAR 52.203-13 – Contractor Code of Business Ethics and Conduct
- FAR 52.203-14 – Display of Hotline Poster(s)
- Affects most $5 Million+ contracts with a POP of 120 days
- Ethics Awareness Program to be adopted
- Requires a written code of conduct to be developed and provided to each employee within 30 days of contract award

Watkins Meegan Named One of the 50 Best Places to Work

Watkins, Meegan, Drury & Company, L.L.C. was chosen as one of the top 50 Best Places to Work in the Greater Washington, DC Metropolitan Area by the *Washington Business Journal* for a second consecutive year. Watkins Meegan was ranked 9th out of the top 15 Large Companies with Local Headquarters category. In addition, we were the top ranked Accounting Firm in the Small, Medium, and Large sized categories (with local headquarters).

We continue to strive to keep the best talent for our culture, clients, and associates.

(LABOR ACCOUNTING, from p. 1)

the variance of hours from a 40-hour week and multiplies it by the standard hourly rate and charges the variance to an overhead "variance" account.

It seems that DCAA's hot topics surround uncompensated overtime, comp time, and officer compensation. In our next newsletter we will discuss the different types of comp time that are frequently utilized and how your company can be DCAA audit prepared with respect to your comp time policies. In addition, Watkins Meegan will be teaching classes and participating in a panel discussion on these topics in this year's *Deltek Insight* conference in Nashville.

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Accountants – *Down on the Farm*

For two years in a row members of the Virginia office have thrown down their calculators and picked up hammers!?! We participated in the Corporate Farm Olympics fundraising event at Frying Pan Park in Herndon, VA this past summer. Twelve corporate teams competed in various challenges and farm chores, which helped to preserve open spaces, strengthen park programs, and create an amphitheater in support of the Fairfax County Park Authority. The Virginia office fielded two teams in the event, which provided for great fun. We learned problem solving skills, farm techniques, and, most importantly, the realization that we should stick to accounting…

Participants from Watkins Meegan were: Back Row: Ju Lee; Middle Row (from l to r): Dave Gaver, Kristen Eitzel, Susan Longo, Vanita Kataria, and Wanda Zazzara. Front Row (from l to r): Katherine Crawford, Karen Louis, Justin Reid and Mike Meegan

New Entity Formed to Resell Deltek Products and Provide Consulting

WJ Technologies, L.L.C. (WiJiT) got its first year off the ground in 2007 as the premier Deltek reseller in the government contracting market. WiJiT brings to the table a complete package: software, implementation, business consulting, and hosting. Please contact Karen Louis at Karen.Louis@wjtechnologies.com to find out more about WiJiT products and services. Also, you can email us at info@wjtechnologies.com to receive email updates on our complimentary Lunch & Learn series. We look forward to talking with you regarding your Deltek needs.

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