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GC Newsletter



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We again invite you to visit our website where you can access previous issues of this bi-monthly GCNewsletter, copies of the periodic GCAAlert, our express notification of significant happenings in the government contracting arena of an immediate nature, and White Papers and presentations on various subjects of interest.

Visit www.GaffeyCPA.com

If you have any questions or comments relative to our website or the articles included in this issue of the Government Contracting Newsletter please contact us.

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Berry Amendment : If You Are a Service Provider the Berry Amendment May Apply to You //

Manufacturers and system integrators doing business with the Department of Defense take note. On June 22, 2006 I attended a meeting in Washington, D.C. to discuss the requirements of the Berry Amendment codified at 10 U.S.C.A. § 2533a. The amendment requires that funds appropriated or otherwise available to the Department of Defense may not be used for the procurement of an item not grown, reprocessed, reused, or produced in the United States or a qualifying country. The Berry Amendment should not be confused with the requirement of the Buy America Act or the Trade Agreement Act. Compliance with one of these does not ensure compliance with the others.

The Amendment covers a wide range of items including: food, clothing, tents, tarpaulins, or covers, specialty metals, and hand or measuring tools. We will be discussing specialty metals that include: steel; metal alloys consisting of nickel, iron-nickel, and cobalt base alloys, titanium and titanium alloys, and zirconium and zirconium based alloys.

Qualifying countries include: Austria (purchase-by-purchase determination), Australia, Belgium, Canada, Denmark, Egypt, Germany, France, Finland (purchase-by-purchase determination), Greece, Israel, Italy, Luxemburg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, and the United Kingdom of Great Britain and Northern Ireland. Items manufactured in a qualifying country are exempt from the requirements of the Amendment if the metals contained in them have been melted in the qualifying country or manufactured in a qualifying country without regard to the melt source.

If the procurement is for aircraft, missile and space systems, ships, tank-automotive, weapons, and ammunition the requirements of the Amendment flow down to subcontractors at each tier.

It applies to any drop of specialty metal. There are no de minimus exceptions. Any nut, bolt, screw or piece of wire qualifies as non-compliance. There is no exemption for commercial items.

Non-compliances can be remedied contractually by

withholding from reimbursement the cost of the item including all allocated indirect costs. Non-compliances can also be remedied under the Civil False Clams Act with penalties of between \$5,000 and \$11,000 per false claim, three times the damages sustained by the government, and the cost of any civil action brought to recover the penalties or damages.

Criminal liability can be assessed under the Criminal False Claims Act and the False Statements Act with penalties that can include imprisonment and substantial fines. Suspension and debarment are also an administrative remedy.

The “punch line” is that the requirements of this amendment can apply to not only manufacturers of product but to systems integrators that provide non-compliant items. It is getting more and more attention due to a decreasing or non-existent specialty metal melt from domestic mills, GAO compliance scrutiny and DoD’s focus on compliance.

We suggest that you contact your legal counsel knowledgeable in the requirements of the Berry Amendment to ensure your compliance.

State & Local Contracts –Understanding Surety Bond Requirements //

In order to succeed in any given business environment, contractors must be uniquely aware of the peculiarities of a given market. The State & Local Government marketplace is no exception to this rule. Within the State & Local Government marketplace, contractors are likely to encounter a contractual requirement that they do not often face in the private marketplace: a surety requirement.

Unlike customers within the private marketplace, many states and local governments are required by local codes/ordinances to require bid and performance guarantees in the form of surety bonds. In order to best understand how to meet these various surety requirements, contractors should become well versed in the language of surety bonding and fully understand why bonds are required and how sureties underwrite surety bonds.

A surety bond is a three party agreement between:

1. Obligee
2. Principal
3. Surety.

In exchange for a fee and a 'hold-harmless'/indemnity agreement from the Principal to the Surety, the Surety agrees that, in the event of a default on the part of the Principal, the Surety is required to perform the terms of the contract between the Principal and Obligee. Each party to this three party agreement has unique roles, rights, and responsibilities.

Obligee – The Obligee is the entity protected by the Surety bond against loss. The surety bond 'runs to' the Obligee and the Obligee has the ability to set the language of the surety bond.

Principal – The Principal is the entity obligated, with the Surety, to the Obligee. The Principal pays the fee for the bond and, via the indemnity agreement, holds the Surety harmless for its failure to perform the terms of the contract.

Surety – The Surety is the entity obligated, with the Principal, to the Obligee. Generally*, the Surety is an unsecured creditor relying only upon the 'promise to be made whole' contained in the indemnity agreement. (*Surety does have a security interest in receivables

and equipment on bonded jobs.)

The most common surety requirements faced by contractors operating within the State & Local Government Marketplace are bid, performance, and payment bond requirements.

Bid Bond – A surety bond given by a bidder on a contract; it guarantees that the bidder, should they be selected, will enter into the contract and furnish the prescribed performance bond. The bid bond is usually a small percentage of the overall contract.

Performance Bond – A surety bond which guarantees faithful performance of the terms of a written contract. Performance Bond amounts can vary from 100% of contract price to a smaller percentage of the contract price. (Performance bonds frequently incorporate Labor and Material and Maintenance liability.)

Payment/Labor and Material Bond – A surety bond given by a contractor to guarantee payment for the labor and material used in the work which he is obligated to perform under the contract.

As mentioned above, Obligees within the State & Local market are frequently required by law to require surety bonds from contractors bidding on public work. From the Obligee's standpoint, the benefits of requiring surety bonds are numerous. For example, through the requirement of a bid bond, the Obligee ensures that only qualified bidders will bid the job and, if a low bidder 'walks away' from their bid and does not enter into a contract with the Obligee, the Obligee recovers the bid penalty that will cover the costs of rebidding the job. The second benefit enjoyed by the Obligee through the surety requirements is that of prequalification. By requiring bid and performance bonds, the Obligee 'pushes off' to the Surety industry, the necessary prequalification work that must be undertaken to ensure that a given contractor has the capacity to perform the given task. In this example, the surety requirements are like 'hurdles' put in place by the Obligee; only those contractors able to clear the 'hurdles' are deemed capable to work for the Obligee. Lastly, and perhaps most importantly, through requiring a Performance Bond, the Obligee protects the public from the downside risk of contractor failure. Should a bonded contractor fail to perform the terms of the

bonded contract, the Surety is required to perform on behalf of the defaulted Principal. Therefore, the public funds are protected and the project is guaranteed to be completed as contracted.

When underwriting a given contractor, the Surety will examine the contractor's character, capacity, and capital. (This is commonly referred to as the three C's of surety underwriting.)

Character – Does the contractor have a good reputation as an upstanding business?

Capacity – Does the contractor have the capacity to perform the contract? Have they done this work before? Have they successfully handled a job of similar size?

Capital – Should the contractor default, is there sufficient capital (\$\$\$) within the company to make the surety whole for the costs they will incur to remedy the contractor's default.

Insurance policies are underwritten with the expectation that losses will occur and the premium charged for the policy contains a provision for expected losses. Unlike insurance underwriting, the surety underwrites to a zero loss ratio. If the surety underwriter cannot become satisfied with the contractor's character, capacity or capital, he/she will simply decline to offer surety credit.

In order to establish a bond line with a surety market, contractors should work with an experienced surety agent that will assist them in demonstrating to the surety markets that the contractor has the aforementioned 3 C's required to gain the surety's approval. Basic underwriting information required includes several years of CPA prepared financial statements, background materials on the contractor, as well as scope of work/rfp's for the bonded job(s) in question.

The contractors that view their surety as an important member of their 'team' will enjoy more success and bond approvals than those that treat the surety as an outsider or a 'necessary evil' within the State & Local Government marketplace. Not only will the surety be more responsive to their needs and requests, however, the contractor can and should use a strong surety

relationship as a competitive advantage over their competitors that may not be as readily 'bondable'.

This article has been provided by Tim Hutton (thutton@ah&t.com), Director of Surety, for AH&T. AH&T Insurance is an insurance brokerage, risk management, employee benefits, surety bond and 401(k) professional services organization dedicated to providing innovative solutions globally for businesses and individuals. AH&T is one of the largest independent insurance brokerage firms in the nation and a partner of the RiskProNet and TechAssure global broker networks. AH&T Insurance is a charter member of the Northern Virginia Technology Council (NVTC) and in 1998 was selected to design and manage insurance programs for NVTC member programs. These specially designed programs, RiskNet and BeneNet are offered exclusively to NVTC Members. For more information about AH&T, visit www.atins.com or call (800) 648-4807.

PROBLEMS WITH THE DRAFT GSA ALLIANT RFP!//



A review of the new GSA DRAFT Alliant RFP discloses that it includes language that would limit prime contractors using sub-contractors to billing customers the rates the sub-contractors charge them. This is the same issue that is in the yet to be released final rule on payments under time and material and labor-hour contracts (Federal Register: September 26, 2005, Volume 70, Number 185, Page 56314). We will keep you informed!

NONCOMPETE AGREEMENTS-DO'S AND DON'TS//

Noncompete agreements are utilized to protect employers from losing valuable trade secrets and employees. While noncompete agreements can be an effective way to protect your business's trade secrets, it must be kept in mind that the legal system places a high value on a person's right to earn a living. California statutes invalidate noncompete agreements except in very limited circumstances and in Virginia a Supreme Court decision has made enforcement of noncompete agreements even more difficult (*Omniplex World Services Corp. v. U.S. Investigation Services*, 270 Va. 246, 618 S.E. 2d 340 – 2005)

So what are some tips on crafting enforceable noncompete agreements?

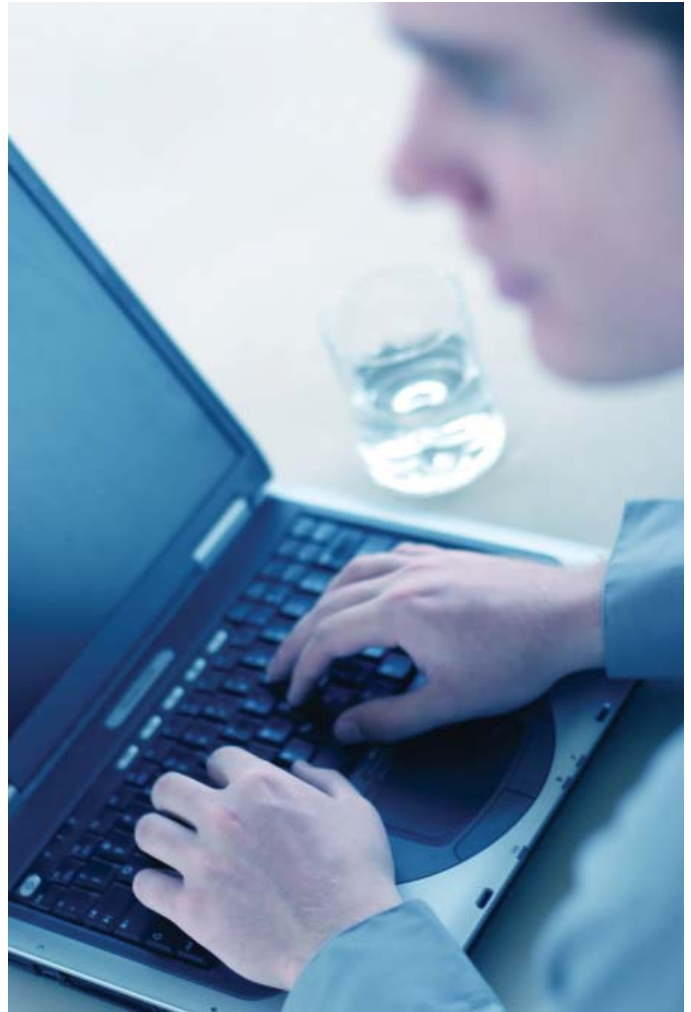
Have a good business reason – Noncompete agreements should not be established simply to punish an employee for leaving the company. They need to be designed to protect trade secrets or a customer base. You need to assess whether the employee is so valuable and whether you have or will have spent so much time and money on training that losing him or her will damage your business or whether they have access to important information you do not want revealed to a competitor.

One size does not fit all – Do not use a form noncompete agreement. Carefully draft your agreement to protect the legitimate business interests as applied to each individual employee. If you are selective about the employees asked to sign noncompete agreements you are likely to have greater success in enforcing it.

Provide a benefit to the employee – What does the employee get out of signing your noncompete agreement? An offer of a job? A raise or bonus? It cannot be viewed as only a penalty on the employee!

Be reasonable – To be reasonable the noncompete agreement can not last to long (six months to two years are generally considered reasonable), can not cover to wide a geographic area, and cannot prohibit an employee from engaging in too many types of businesses that may or may not appear to infringe on your business area.

If you are presently drafting a noncompete agreement or are having issues with enforcing the ones you have we suggest that you contact legal counsel.



GOOGLE U.S. GOVERNMENT SEARCH //

Google U.S. Government Search offers a single location for searching across U.S. government information, and for keeping up to date on government news. You can choose to search for content located on either U.S. federal, state and local government websites or the entire Web – from the same search box. The Google U.S. Government Search index includes U.S. federal, state and local sites with domains such as .gov, .mil as well as select government sites with .com, .us, and .edu domains (eg. .usps.com, .ca.us and ndu.edu).

Give it a try at: www.google.com/ig/usgov.

OMB- PERFORMANCE-BASED CONTRACTING IS THE GOVERNMENT GAMING THE SYSTEM //

The Office of Management and Budget established a quota for the use of performance-based contracting of 40 percent. Recent data gathered by the Service Acquisition Reform Act Advisory Committee was presented on Thursday, June 29, 2006. Eighty high-value contracts or task orders from 10 agencies were randomly selected from those transactions identified in the Federal Procurement Data System as performance-based.

Their findings indicated that the various agencies included in the findings either did not understand performance-based contracting or were “gaming the system”. The Committee received only 48 valid responses and found that 38 percent correctly applied performance-based contracting methodologies, 23 percent included some aspects of the methodology but showed serious flaws in application, and approximately 40 percent were completely without performance based characteristics. Of the 40 percent of transactions that showed no performance-based characteristics there was an admission that they were mislabeled, agencies declined to provide any information or the Committee was asked if another contract could be substituted.

The Committee identified three common problems: (1) the agencies ability to define appropriate performance standards and metrics to assess contractor performance; (2) failure to link those metrics to desired contract outcomes; and (3) confusion in assuring and monitoring quality.

DATA DUMP //

The interest rate to be used in the calculation of the cost of facilities capital under CAS 414 and CAS 417 for the period July 1, 2006 through December 31, 2006, is 5.75% (5.75 per centum) per annum. This rate was published in the Federal Register, Volume 71, Number 126, Pages 37638-37639 on Friday, June 30, 2006. The previous rate applicable to the period January 1, 2006 through June 30, 2006 was 5.125%

FAR CORNER //

Far Corner – FAR Case 2004-14, Buy-Back of Assets

The depreciation cost principle was revised to address the allowability of depreciation costs of reacquired assets involved in a sale and leaseback arrangement. The wording at FAR 31.205-11 (3)(i) now reads: In the event the contractor reacquires property involved in a sale and leaseback arrangement, allowable depreciation of reacquired property shall be based on the net book value of the asset as of the date the contractor originally became a lessee of the property in the sale and leaseback arrangement –

- (A) Adjusted for any allowable gain or loss determined in accordance with 31.205-16(b); and
- (B) Less any amount of depreciation expense included in the calculation of the amount that would have been allowed had the contractor retained title under FAR 31.205-11(h)(1) and 31.205-36(b)(2).

This final rule becomes effective July 28, 2006.

FAR Corner – FAR Case 2004-35, Submission of Cost or Pricing Data on Noncommercial Modifications of Commercial Items

FAR 15.403-1, Prohibition on obtaining cost or pricing data, has been revised to address the need for cost or pricing data associated with noncommercial modifications of commercial items. It reads as follows:

(c)(3)(ii)(A) For acquisitions funded by any agency other than DoD, NASA, or the Coast Guard, such modifications of a commercial item are exempt from the requirement for submission of cost or pricing data.

(B) For acquisitions funded by DoD, NASA, or the Coast Guard, such modifications of a commercial item are exempt from the requirement for submission of cost or pricing data provided the total price of all such modifications under a particular contract does not exceed the greater of \$500,000 or 5 percent of the total price of the contract.

(C) For acquisitions funded by DoD, NASA, or the Coast Guard such modifications of a commercial item are not exempt from the requirement for submission of cost or pricing data on the basis of the exemption provided for a FAR 15.403-1(c)(3) if the total price of all such modifications under a particular contract action exceeds the greater of \$500,000 or 5 percent of the total price of the contract.

This final rule is effective July 28, 2006.

GAFFEY & ASSOCIATES PARTICIPATE IN THE G-CON SYMPOSIUM //

The Government Contracting Services Group participated in the June 10, 2006 Small Business Contracting Symposium presented by the NCMA Tysons Corner Chapter, Provident Bank and the Northern Virginia GovCon Council. Some 250-300 people attended the event held at the Hilton McLean across the parking lot from our offices. Speakers included Congressman Donald Manzullo, Chairman of the U.S. House Committee on Small Business, Joseph Kampf, President & CEO of the Anteon International Corporation, and Hector Barreto, Administrator of the Small Business Administration. There were some 61 exhibitors from business, the government and academia.



David Talley and Sam Davidson in front of our booth at the G-CON Symposium

UPCOMING EVENTS //

The Second Quarterly Small Business Forum

Presented by The Coalition for Government Procurement and Patton Boggs, LLC on Tuesday, July 18, 2006, the Forum will focus on: (1) teaming agreements, subcontracting plans, and joint ventures; (2) the transition from a small business to a medium-sized business; (3) audit avoidance, preparation and response; and (4) contract tracking.

It is being held from 8:30AM – 12:00PM at the Patton Boggs offices, 2550 M Street, NW, Washington, D.C. To register for this must attend event contact atucker@thecgp.org at the Coalition. You may also attend via teleconference.

CAREERS AT GAFFEY & ASSOCIATES, PLC //



The Regulated Industries Group of Gaffey & Associates is looking for individuals interested in becoming a part of our exciting and rapidly expanding public accounting and professional services firm. A college degree is required. Experience in accounting for a regulated industry, financial services or government contract accounting is desired. CPA and/or DCAA experience a plus but not required. Contact Sam Davidson at samuel.davidson@gaffeycpa.com or David Talley at david.talley@gaffeycpa.com.

Thought for the Day

“ In any moment of decision the best thing you can do is the right thing, the next best thing is the wrong thing, and the worst thing you can do is nothing. - Theodore Roosevelt ”

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