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The 2008 Elections: Changing Federal Procurement Environment

By Charles L. Bonuccelli, CPA

No matter which political party you support, the presidential elections of 2008 will bring about change. A new President will appoint a new administration with new policy goals and new objectives. Recent scandals and a lack of competition in many procurements means that Congress and the new administration will continue a closer scrutiny of current government programs. Mostly such scrutiny will be directed at the Department of Defense. Just how much and how deep will depend on who is elected. Major programs could be terminated, others reduced, some increased, other proposed programs shelved and new programs proposed. It will be a time of challenge and of opportunity.

This wave of change is inevitable for government contractors. No business wants to be caught unprepared. Prepared, a company may be able to ride out the “wave” or even prosper. Unprepared, the company may be swept away by events. It is time to start measuring the consequences of a new administration on your federal contracts. With a clear understanding of the possible changes that may occur with each of the candidates, planning will take on an important role in determining what actions to take, those to avoid and those to postpone.

Each company needs to develop a contingency plan to optimize its response to expected changes. Many executives think of a contingency plan in terms of catastrophic events. The “what if” type of planning that requires back up storage or offsite data retention because a terrorist attack, fires, floods or other major acts of nature. However, as used in this article, a contingency plan is for a known major event, the 2008 election that is just beyond the horizon. The choice will be between one of two major party candidates and the effect on procurement based on past experience, stated platform and major supporters. The consequences for electing either candidate will have a different impact on a specific government contractor. There are many questions that the company needs to be asking itself, such as:

- Will any contract be terminated?
- Is there a possibility of a partial termination?
- Will some programs grow?
- Will some programs be slowed down?
- Will some currently planned federal procurements be shelved?
- Are there going to be different opportunities?
- Do we need to adjust our plans for expansion?
- Do we need to plan for a significant reduction?
- How do we address reductions in force?
- Does the company need to change its skill set?
- Will the local economy be affected?
- Do I have my finances prepared to address my contingencies?
- Are there actions I can take to mitigate some of the risks?

There are a thousand more questions that could be asked. It is imperative that such questions be addressed before the election. The company's future may be in the balance. These questions need to be addressed as soon as the presidential candidates for the two major parties are known. Scrutiny should be placed on what the candidate may be planning. Closely looking at positions that they have publically espoused or formerly have taken will give you an idea of what may happen to your specific federal contracts. If the candidate does not have a clear record, then looking at US Senators who support the candidate would be a good indication of what may occur.

In over 30 years in federal contracting it is clear that this business has its ups and downs. The federal government is like a pendulum that swings its policy on many issues based on who is in charge. Contracting out, military programs, domestic spending all are affected by the election.

The one thing for certain is that not much is likely to stay the same. During the last several years with the fight against global terrorism, a rush to contract for urgency requirements led the federal government to use significantly less competition than a decade ago. Yes, there may have been some procurement abuses and yes a number of contractors may have made profits (not a dirty word). Now that things appear to be settling down in Iraq, it is likely that the sense of urgency will diminish and likely that some procurements will be scaled back. Worst case scenario planning should be performed when there is any concern whether a program would be cancelled under a different administration.

Examining your company's contracts and identifying the related program funding should be identified in the normal course of business. Monitoring the federal budgeting and congressional funding of the program is just as important. Look at the various candidates positions that would affect your federal contracts. In general terms the programs should be classified as:

- Likely cancelled or terminated
- Significant reduced funding (more than a 10% reduction)
- No major change
- Significant increase in funding

For most companies, the only two classifications that matter are the first two because they carry the highest negative risk. This is where the contingency plan begins. Once risky contracts are identified, you must determine how much it affects the company. The following is an example of what this type of analysis will disclose:

Program: Iraq Security Contracts

A FFP Federal contract \$100,000,000 awarded in January 2008. Candidate A has reported a complete discontinuation of contracting out such programs. Based on previous actions in supporting bills that would have discontinued the practice, the program would likely be cancelled by June 1, 2009.

Candidate B on the other hand has indicated that such contracting should continue. However, with the war stabilizing the company expects a slight reduction of 5% in the funding.

Likely Impact to Revenues: if candidate A is elected the contract will be terminated on June 1, total revenues will fall by \$20,000,000 per year.

If Candidate B is elected the contract will continue with a slight reduction in revenue that may be offset by increases commercial sales.

Likely Recoveries from Federal government termination:

Under the candidate A scenario, the company will have a reduction in force of 150 people with 1 month of severance pay that is estimated to be \$1,500,000. The company will submit an equitable adjustment for indirect cost rates increases for \$500,000. The expected termination settlement cost is estimated to be \$50,000. The total estimated recovery is \$2,050,000. The time of the recovery is expected to be as much as 1 year after termination.

Likely Impact to Revenues and Other Contracts:

Under a termination under Candidate A, 2009 revenue are expected to be reduced by \$11,666,666 profitability will be reduced by at least \$1.1 million for FY 2009. For future years, the decrease is \$20 million with a reduction in profitability of \$1.9 million

Under the Candidate B scenario revenues are reduced by \$1,000,000 and profitability by at least \$100,000 for FY 2009.

Recommended Actions After Election:

If candidate A is elected the company should prepare processes to capture all the cost of any termination to optimize the amount recovered. It needs to prepare HR for the likely termination and review policies and liabilities related to such a termination. In addition, the company needs to shift its emphasis on federal sales to commercial entities and foreign governments. It will also have to plan on ways to increase efficiencies of operations and reduce indirect costs.

However if candidate B is elected the company does not have to significantly change the way it operates. It should focus its efforts on expanding its government and commercial sales. Many of the current businesses practices would continue with more an emphasis on shifting the strategy and focusing on new business opportunities.

In this example, one candidate has a more profound impact on what the company needs to expect and prepare for. The consequences have a longer term impact to revenues and profitability than with the other candidate.

When conducting this type of analysis, the differences may not be so clear with respect to your programs and a significant amount of educated assumptions may need to be made. Even assuming the analysis of Candidate A was incorrect, the consequences to the company would be less severe, but the value of the recommended actions would still benefit the company. While no immediate actions are required for Candidate B, many of the same actions recommended under Candidate A would still be of value. It is the sense of urgency to take immediate action after the election of Candidate A that is important, and the ultimate difference in minimizing the negative impact in results that is a matter of timing. But if consequences are severe because a large portion of revenue may be terminated, as an example, the actions that need to be taken may lessen the hardship that the termination may cause. For example, the company may rethink renewing a lease, or may delay a move. Developing a transition plan and refocusing

existing talent into new products and services may be crucial. Identifying key staff to be retained in the coming months and motivating them to stay with the company is important. Any number of actions that may be taken from staffing to financing to marketing can be determined based on what is expected to occur.

This article only touches on the surface of the process that all conscientious firms should consider. By design, I have not demonstrated the positive impact of consequences that may also occur because the impact and actions are not as important to the survival of a company. Hopefully, your company is planning on being prepared to take appropriate action based on the anticipated consequences of a new President and administration. Not to anticipate and plan will increase the difficulties of operating in the changing federal procurement environment.