

For the past three years, on and off, we have been supporting a small business located in the Pacific Northwest. We were first contacted by internal counsel, who relayed some concerns. That counsel was employed by a large aircraft manufacturer, headquartered in the Northeast. It turned out that the small business was actually a subsidiary of the large aircraft manufacturer.

That small business had been doing business the same way for many years. About half its business was commercial and the other half was government; but the government work was 100% competitively awarded FFP subcontracts so differences between the government and commercial work were minimal. Even when that small subsidiary performed a FFP “subcontract” directly for its Northeastern headquarters, not much was different in terms of how the work was priced, or accounted for, or billed.

Now, you might be concerned (as we were) that perhaps treating inter-organizational work as FFP wasn’t strictly in accordance with the requirements of the FAR cost principle at 31.205-26(e), but we were told not to worry about that issue, because Northeastern headquarters had directed its buyers to treat all inter-company work as being a subcontract and, moreover, that all subcontracts were to be FFP type. The direction was that *all* suppliers were to be treated as being arms-length subcontractors, even if some weren’t really so arms-length. That was the direction, and it was faithfully followed by the buyers in the Northeast with respect to this particular “subcontract” with a small business in the Pacific Northwest, even though that small business was in reality a subsidiary.

Accordingly, the small PNW business had received a FFP subcontract from Northeastern HQ for a piece of an aircraft that was still in development.

You probably know how we feel about that situation. We’ve [written](#) about it before. We wrote “... the subcontract type has to be appropriate. If every subcontract is FFP, that’s not necessarily a good thing, especially in a development environment. You can usually tell if the contract type was appropriate by looking at post-award change order activity.”

Our point of view on choosing the correct subcontract type is informed by our experience. Consistent with what our experience tells us would be the case, the Northeast “prime contractor” made a number of changes along the way, and so the small business “subcontractor” generated quite a few change order notifications and asked for its firm, fixed-price to be increased to compensate it for the changed work. The “prime contractor” was reluctant to admit its changes were causing cost impacts and the parties essentially were at a stalemate regarding the appropriate value of the equitable adjustments to be made.

Meanwhile, the large Northeast aircraft manufacturer was acquired by an even larger defense contractor (one of the “five families” at the top of the defense contracting pecking order). That mega defense contractor had its own policies with respect to “subcontracting” between affiliated entities—policies that were more aligned with the requirements of 31.205-26(e)—and consequently that FFP “subcontract” needed to be treated as a cost-plus-no-fee inter-organizational transfer. In essence, the FFP “subcontract” needed to be reformed, and priced based on actual costs incurred to date plus an estimate of allowable direct and indirect costs to be incurred.

The challenge, of course, was that this small business didn’t have an “adequate” accounting system, and thus both its actual costs incurred as well as its estimates of future direct and indirect costs to be incurred were suspect.

That’s where Apogee Consulting, Inc. came in.

We entered into a nearly three year-long attempt to enhance the small business’ accounting system to adequacy, so that it could price, account for, and bill, its actual, allowable, costs to what had been its “prime contractor” but what was now a sister division within the mega defense contractor’s empire. To be clear, our role was advisory and the heavy lifting was done by some of the people who worked at the small business. These individuals had long careers within government contracting. A couple had been long-term employees of a DOE O&M/M&O contractor. One was a CPA with years of government accounting experience. Another was an attorney trained at the GW School of Law in government contracts. They were knowledgeable and experienced but, as is so often the case, they didn’t have the bandwidth to do their jobs plus write policies and procedures and instructions, plus review spreadsheets and job aids, plus reconcile transactions to ensure the cost allocations were accurate. That’s what we did. We would visit for a few days, review the work that had been done, make suggestions on additional work to be done, review policies and procedures, make suggested revisions and, in general, try to push the project along. Then we would come back a few months later and do the same thing.

In addition, we strategized with program management, contracts, and financial management on how to convince the former “prime contractor” that (a) the small business’s costs were accurate and compliant, and (b) what the budget should be (going forward) for the cost-type inter-organizational work that was being performed. You might be surprised (as we were) to learn that the “prime” buyers were resistant to changing the subcontract type, or to admitting that the price they had budgeted in their Estimates-at-Completion—which was the firm,

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Written by Nick Sanders  
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fixed-price they had initially awarded before the myriad changes—was in need of an increase.

The buyers at the “prime” were so reluctant to change the way it had always been done that they called in DCAA to audit their own sister division, to make sure that small business “subcontractor” wasn’t somehow trying to overbill them.

*Really.* They called in DCAA on their own people. That’s how far out-of-touch with reality they were.

But by this point, that small business was ready to go and DCAA had no findings. (To be clear: our contribution to that outcome was small; the audit support was executed by the people at the local business. Dealing with auditors was something they could do and they did it well.)

At this point, after three years of effort, the small business in the Pacific Northwest was ready to price, and account for, and bill, its actual, allowable, costs to its sister division located in the Northeast.

*Mission accomplished!*

And then that small business located in the Pacific Northwest was sold to a venture capital firm.

Everything that we had done needed to be undone. That cost-plus-no-fee inter-organizational transfer budget needed to be recast as an FFP subcontract—albeit at a higher price than was originally awarded. That task took some negotiating, for sure. As one person close to the action wrote me, “As much work as it was to turn [the subcontracts] into Cost Type, it was an even bigger mess to untangle back to FFP.” We were not part of those efforts, and we empathize with those who were.

It might seem as if our efforts had been wasted, that three years of work had been trashed. And perhaps that’s true. But such is the life of a consultant.

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Often, our best efforts go unappreciated, or unrewarded. In my first true consulting gig (in 1999) we billed the client \$500,000 and for that price delivered 18 solid recommendations for improvement (so as to avoid further very expensive False Claims Act-related litigation). That client implemented *just one* of the 18 recommendations, and ignored the rest. In a later project, we billed one of the Top 5 mega defense contractors north of \$500,000 to develop an innovative supplier risk management solution that delighted the program manager who had hired us, but which was immediately killed by Sector HQ because that's where risk management was functionally located—and they didn't appreciate the competition. In yet another gig, I reconciled the ins-and-outs of cost allocations for a multi-billion-dollar aircraft manufacturer with multiple business segments. I identified \$90 million in differences (errors) that impacted the company's indirect cost rate calculations—only to be told it was a “rounding error” that should be ignored. In so many engagements, the consultant's efforts do not result in the intended outcomes, often for reasons that the consultant cannot control.

*So it goes.* We do our best and sometimes our best isn't good enough, or isn't politically correct, or is overtaken by changing circumstances. You try to keep a positive attitude and make sure the checks are cashed. What else can you do?

And what about my clients, whom I came to call my friends, at that small business located in the PNW? They are all being laid-off by the new management, who views them as being non-value-added backoffice lackeys. Perhaps they are, in fact, now redundant in the company's new environment (which is really the old environment) of 50% commercial/50% government FFP subcontracts. It probably does make financial sense to let them go, despite their decades of experience. That experience just won't be as valuable to the stand-alone entity as it was to the mega defense corporation that acquired the large aircraft manufacturer that had a small subsidiary located in the Pacific Northwest.

Thus, while we at Apogee Consulting, Inc. get to go home and work on new projects for other clients, those former employees now have to search for new jobs. To assist them: ***if you are reading this and want to hire some really good, experienced, financial management or contracts people who are based in the PNW, please email us!***

In the meantime: to Annette, to Chuck, to Nestor—it was a pleasure to work with you, and we here at Apogee Consulting, Inc., wish you only the best.