

**Contract Line Item Budgeting**

Georgia Tech Procurement Assistance Center

June 5, 2013




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**OUR MISSION**



- EI2 aims to increase the competitiveness of enterprises in Georgia through application of science, technology and innovation. Details at <http://innovate.gatech.edu>.
- GTPAC assists Georgia companies with all aspects of government contracting – federal, state and local. Details at <http://www.gtpac.org>.
- *Special Note:* Georgia Tech and UGA collaborate through the Georgia Entrepreneur & Small Business Program to better deliver services. Details at <http://onega.gamep.org>.




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**HOW TO BECOME A GTPAC CLIENT**

- Attend either our “Introduction to Government Contracting” class or our “Fundamentals of Working with the Government” briefing.
- Request a Client Application.
- Agree to respond to requests for quarterly reports.
- You’ll receive:
  - Electronic bid matches as often as daily.
  - Heads-up on important events and developments.
  - One-on-one counseling and advice.
- *All at no cost!*




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## OUR GUEST INSTRUCTOR

**Kevin Grimes** is a Compliance Consultant with CFO Leasing, Inc. He has over 10 years of accounting experience and specializes in DCAA compliance and accounting system implementations and migrations. Over the last year, CFO Leasing has successfully supported clients in over \$500M (\$.5Billion) in contracts with the DOE, NASA, Department of Army, Department of Navy, NSA, Department of Veterans' Affairs, USDA, and other federal agencies across the country. CFO Leasing has been featured nationally in Black Enterprise Magazine and locally in the Atlanta Business Chronicle and the Atlanta Tribune.

Mr. Grimes has studied over 300 hours of DCAA Auditor training provided by the Defense Contract Audit Institute (DCAI). Mr. Grimes is a QuickBooks Certified Pro Advisor and holds multiple Microsoft Certifications.

A veteran of the elite United States Navy Nuclear Submarine Force, Kevin earned a Master's Degree in Accounting and graduated Magna Cum Laude from Florida Metropolitan University. He has also pursued doctoral studies in the field of business leadership.

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I. Speaker Bio

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## BUDGETING OVERVIEW

"The Importance of Budgeting"  
In the Eyes of Banks, Investors, and Government Agencies



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II. Budget Overview

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## WHY SHOULD I BUDGET?

**REASONS WHY**

- **Banks** require it to secure major commercial & business loans (Business Plan)
- **Angel investors** require them prior to injecting start-up capital (Business Plan)
- **Venture Capitalists** require them prior to approving funds (SGP/Projections)
- **Investors** require them prior to purchasing stock (Projections)
- **Governments** require them prior to awarding contracts (Audits/Proposals)
- **Board of Directors** require them in the annual charter/bylaws (AOP/Budget)

**THOSE AREN'T BUDGETS**

- **Business Plan** – Has "at least" 3 years of financial projections based on facts
- **Strategic Guide Plan (SGP)** – Corporate objectives for 3-5 years
- **Annual Operating Plan (AOP)** – Corporate objectives for the next year
- **Projections** – Forecast of the company's resources vs. needs for the next year
- **Proposal** – Estimation of cost, which the buyer uses as a subset of their budget

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## ZERO-BASED BUDGETING

**THE CHARACTERISTICS & BENEFITS OF ZERO-BASED BUDGETING**

- #1 Non-traditional
- #2 Does not assume an automatic increase “Over Last Year’s Number”
- #3 Increases staff motivation by providing responsibility in decision-making
- #4 Drives managers to find cost effective ways to improve operations
- #5 Identifies and eliminates wasteful and obsolete operations
- #6 Provides a more accurate estimation of the “Break-Even Number”
- #7 Increases communication within the organization

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## BUDGET DEFINITIONS?

**Understanding Cost Drivers & Cost Behaviors**

- **Fixed Cost** – Does not change unless something drastic happens
  - Monthly Mortgage/Lease/Rent Payment
  - Monthly Installment Loan Repayment
  - Salaries
- **Variable Cost** – Changes based on volume (Usually have a tolerance range)
  - 10% Commission – (Sales Driven)
  - Hourly Labor
  - Material Costs – (Sales Driven)
  - Credit Card Charges, Marketing, SEO/Pay Per Click, Travel

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## BUDGET DEFINITIONS?

**Understanding Revenue Drivers & Revenue Behaviors**

- **Recurring Revenue** – Does not change unless something drastic happens
  - Retainers/Annual Subscribers
  - Maintenance Agreements
  - License
  - Most valuable type for lending/acquisition/investment
- **New Business** – Based on a pipeline using real data
  - Most financial analysts will discount new business by as much as 60%
  - A pipeline formula should be used based on sales milestones using historical data:
    - End user/buy has expressed interest and has an adequate budget = 0%
    - Performed a product demo = 10%
    - Client requests a written quote = 25%
    - Client requests a contract/invoice = 75%
    - Purchase Order = Closed Sale 100%

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## BUDGETING PROCESS

“Creating the Budget”

In the Eyes of Banks, Investors, and Government Agencies



III. Budget Process 

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## BUDGETING (FY) REVENUE

- **Use existing contracts and “booked” business as a baseline**
  - Contracts with option years
  - Clients under warranty/maintenance agreements
  - Signed contracts/purchase orders with start dates in the new fiscal year
  - Existing work that will overflow and be performed in the new fiscal year
- **Include project sales based on historical averages or proven trends**
  - FedBizOpps Full & Open ratio = (1-to-10) = 10.0%
  - FedBizOpps SBA Set-Aside ratio = (1-to-8) = 12.5%
  - GSA Schedule ratio = (1-to-5) = 20%
  - SBA Set-Asides (Designations) = (1-to-4) = 25%
  - CDC / NIH ratio = (1-to-2) = 50%

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## SAMPLE FEDERAL PIPELINE

CFO LEASING - SALES PIPELINE				
Prospect	Amount	Stage	Factor	Pipeline
STEM001	\$ 3,045,875.00	CDC	50.0%	\$ 1,522,937.50
HPHTIP	\$ 2,970,875.00	NIH	50.0%	\$ 1,485,437.50
HAITI	\$ 2,895,875.00	NIH	50.0%	\$ 1,447,937.50
VACCINES	\$ 789,457.00	CDC	50.0%	\$ 394,728.50
USACE	\$ 975,000.00	FBO - Open	10.0%	\$ 97,500.00
US Army	\$ 900,000.00	FBO - Open	10.0%	\$ 90,000.00
DOE	\$ 825,000.00	FBO - Open	10.0%	\$ 82,500.00
DOD	\$ 750,000.00	FBO - Open	10.0%	\$ 75,000.00
USACE	\$ 1,675,000.00	FBO - Set Aside	12.5%	\$ 209,375.00
US Army	\$ 1,600,000.00	FBO - Set Aside	12.5%	\$ 200,000.00
US Navy	\$ 500,000.00	FBO - Set Aside	12.5%	\$ 62,500.00
US Army	\$ 555,000.00	FBO - Set Aside	12.5%	\$ 69,375.00
USACE	\$ 250,000.00	GSA	20.0%	\$ 50,000.00
DOE	\$ 305,000.00	GSA	20.0%	\$ 61,000.00
US DOT	\$ 360,000.00	Designations	25.0%	\$ 90,000.00
US DOT	\$ 415,000.00	Designations	25.0%	\$ 103,750.00
USACE	\$ 470,000.00	Designations	25.0%	\$ 158,750.00
	<b>\$ 19,282,082.00</b>		<b>32.16%</b>	<b>\$ 6,200,791.00</b>

III. Budget Process 

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### SAMPLE COMMERCIAL PIPELINE

CFO LEASING - SALES PIPELINE				
Prospect	Amount	Stage	Factor	Pipeline
Akron	\$ 345,875.00	Lead	0%	\$ -
Savannah	\$ 270,875.00	Lead	0%	\$ -
Macon	\$ 195,875.00	Lead	0%	\$ -
Detroit	\$ 120,875.00	Lead	0%	\$ -
Zenith	\$ 500,000.00	Demo	10%	\$ 50,000.00
Pluto	\$ 425,000.00	Demo	10%	\$ 42,500.00
Space	\$ 350,000.00	Demo	10%	\$ 35,000.00
Channel	\$ 275,000.00	Demo	10%	\$ 27,500.00
Coordinate	\$ 200,000.00	Demo	10%	\$ 20,000.00
Honor	\$ 125,000.00	Demo	10%	\$ 12,500.00
Clyde	\$ 50,000.00	Demo	10%	\$ 5,000.00
Romeo	\$ 105,000.00	Demo	10%	\$ 10,500.00
Alpha	\$ 250,000.00	Quote	25%	\$ 62,500.00
Beta	\$ 305,000.00	Quote	25%	\$ 76,250.00
Charlie	\$ 360,000.00	Contract	75%	\$ 270,000.00
Delta	\$ 415,000.00	Contract	75%	\$ 311,250.00
Echo	\$ 470,000.00	Contract	75%	\$ 366,250.00
<b>Total</b>	<b>\$ 4,763,500.00</b>		<b>27.07%</b>	<b>\$ 1,289,250.00</b>

III. Budget Process

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### BUDGETING (FY) COSTS

- > Use the Chart of Accounts as a Guide
  - > Cost Drivers are already there: Expense & Cost of Goods Sold/Cost of Sales
  - > Walk down each account line by line
  - > Determine how each item is incurred
  - > Assign a real dollar value \$\$ or a real percentage %
  
- > Ask Managers if they are anticipating any changes from last year
  - > Change in legislation - (COBRA, Healthcare, Restrictions/Tariffs)
  - > Change in industry standards – (Must have Level II cert instead of Level I)
  - > Change in strategy – (New location/New Product/Discontinuation)
  - > Change in economic factors – (Recession, foreign currency factors)
  - > Change in strategic partners – (Major Suppliers/Distributors)

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### SAMPLE COST WORKSHEET

G/L Account	Account Name	Cost Methodology	Basis
50001	Direct Salaries	\$2,000,000.00	Fixed
50002	Hourly Labor	13% of revenue	Historical Cost
50003	Construction Materials	20% of revenue	Historical Cost
50004	License Fees	\$1,000,000.00	Fixed
50005	Tools	5% of revenue	Historical Cost
50006	Insurance	1% of revenue	Contracted Amount
<b>Total</b>			

G/L Account	Account Name	Cost Methodology	Basis
60001	G&A Labor Salary & Wages	\$500,000.00	CFO Budget/FIXED
60002	Amortization/Depreciation	\$40,000.00	Asset Plan
60003	Automobile Expense	\$10,000.00	CFO Budget
60004	Bank Service Charges	\$6,000.00	CFO Budget
60005	Business Development	\$275,000.00	Sales Manager Budget
60006	Business/Tax/License/Permits	\$15,000.00	CFO Budget
60007	Computer Expense	\$250,000.00	IT Manager Budget
60008	Dues & Subscriptions	\$1,200.00	CFO Budget
60009	Education & Training	\$4,000.00	CFO Budget
60010	Employee Benefits	\$62,000.00	HR Manager Budget
60011	Office Supplies	\$150,000.00	CFO Budget
60012	Postage/Freight/Shipping	\$15,000.00	CFO Budget
60013	Professional Services Legal	\$1,275,000.00	CFO Budget
60014	Rent	\$400,000.00	Operations Budget/FIXED
60015	Repairs & Maintenance	\$50,000.00	Operations Budget
60016	Travel	\$10,000.00	CFO Budget
60017	Utilities	\$60,000.00	Operations Budget/Variable
<b>Total</b>		<b>\$3,323,200.00</b>	

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## TEST FOR PROFITABILITY

➤ **Revenue Projections**

- Use the revenue projections to determine the variable costs that scale with revenue

➤ **Calculate**

- Add all production costs to determine gross margin (dollars & percent)

<b>Projected Revenue</b>		<b>\$12,000,000.00</b>		
G/L Account	Account Name	Cost Methodology	Basis	Cost Methodology
50001	Direct Salaries	\$2,000,000.00	Fixed	
50002	Hourly Labor	\$1,440,000.00	Historical Cost	12% of revenue
50003	Construction Materials	\$2,400,000.00	Historical Cost	20% of revenue
50004	License Fees	\$1,000,000.00	Fixed	
50005	Tools	\$600,000.00	Historical Cost	5% of revenue
50006	Insurance	\$120,000.00	Contracted Amount	1% of revenue
<b>Production Costs</b>		<b>\$7,560,000.00</b>		
<b>Gross Margin</b>		<b>\$4,440,000.00</b>		
<b>Gross Margin</b>		<b>37.00%</b>		

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## TEST FOR PROFITABILITY

➤ **Subtract corporate costs from gross margin to determine profitability**

<b>Total Revenue</b>	<b>\$12,000,000.00</b>
<b>Gross Margin</b>	<b>\$4,440,000.00</b>
<b>Corporate Costs</b>	<b>\$3,323,200.00</b>
<b>Net Income \$</b>	<b>\$1,116,800.00</b>
<b>Net Income %</b>	<b>9.31%</b>

G/L Account	Account Name	Cost Methodology	Basis
60001	G&A Labor Salary & Wages	\$500,000.00	CFO Budget/FIXED
60002	Amortization/Depreciation	\$40,000.00	Asset Plan
60003	Automobile Expense	\$10,000.00	CFO Budget
60004	Bank Service Charges	\$6,000.00	CFO Budget
60005	Business Development	\$275,000.00	Sales Manager Budget
60006	Business Tax/Licenses/Permits	\$15,000.00	CFO Budget
60007	Computer Expense	\$250,000.00	IT Manager Budget
60008	Dues & Subscriptions	\$2,200.00	CFO Budget
60009	Education & Training	\$4,000.00	CFO Budget
60010	Employee Benefits	\$62,000.00	HR Manager Budget
60011	Office Supplies	\$150,000.00	CFO Budget
60012	Postage/Freight/Shipping	\$15,000.00	CFO Budget
60013	Professional Services/Legal	\$1,275,000.00	CFO Budget
60014	Rent	\$600,000.00	Operations Budget/FIXED
60015	Repairs & Maintenance	\$50,000.00	Operations Budget
60016	Travel	\$10,000.00	CFO Budget
60017	Utilities	\$80,000.00	Operations Budget/Variable

III. Budget Process

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## SCENARIOS

➤ **Budget is Perfect**

- It never happens
- If it does, nominate your CFO as "CFO of the Year"
- If the year ends and the budget is not met, Fire your CFO!! ☹

➤ **Indicates the company is not profitable (or not profitable enough)**

- Review data for accuracy
- Look at cutting costs (but not the CFO)
- Do not recommend cutting marketing costs, because that will reduce sales
- Explore innovation, creative sales ideas
- Look for suitable substitutes, outsourcing, strategic partners

➤ **Budget is unrealistically high (30% net income or higher)**

- Review data for accuracy and cost realism
- Make sure all cost elements were included
- Stakeholders are skeptical of "too high net income"
- Consider investing in research & development
- High net income/profit does occur in emerging markets

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## PRICING OVERVIEW

“The Importance of Budgeting”  
The Impact on Pricing



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IV. Pricing

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## BUDGETING (FY) PRICING

- **Indirect Rate Calculations**
  - Calculations for proposals and all other pricing estimates must be done using budgeted rates:

(Aug 2010) PSP 730.5.1.A/2010-032 - MEMORANDUM FOR DCAA DIRECTORS  
SUBJECT: Audit Alert Related to Budgetary Data Supporting Forward Pricing Rates

- “Contractors must indicate how they computed and applied their indirect rates while also showing trends and budgetary data with explanations to support the reasonableness of the rates per the requirements of FAR Part 15”.

- **Method for verifying the reasonableness for pricing**
  - Auditors will review your financial statements (primarily the Income Statement/Profit & Loss Statement) to identify trends and previous/current year ratios
  - Auditors will use your existing data and calculate indirect rates using your existing cost pools structure (and everyone is required to have cost pools)

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## DIRECT VS INDIRECT COSTS

**Direct Costs** are the items/services/labor that are required to physically build the car. (Doors, assembly workers, windshields, tires, engine, frame, etc.)

**Indirect Costs** are items that “influence and support” the completion of the car, but are needed for every model or for the corporation. These items are “normally” present, even in the absence of a “SPECIFIC” contract. (Electricity, quality assurance inspector, plant supervisor)

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## GEOGRAPHY & INDIRECT RATES



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## COMMON ELEMENTS

**Indirect Costs – (North America)**

- Fringe – (Canada)
  - Accrued Leave (Vacation/Sick/Holiday)
  - Health & Welfare (Medical Insurance)
  - Payroll Taxes
- Overhead – (United States)
  - Facilities Costs
  - Project/Contract Management Salaries
  - Utilities
- General & Administrative Costs/G&A – (Mexico)
  - General Business Expenses
  - Corporate Salaries
  - Corporate Insurance

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## UNDERSTANDING THE FORMULAS

The Three Tier formula is for companies that have overhead broken out into a separate cost pool:

➢ (Three-Tier)  
 ➢  $(((\text{Direct Labor} + \text{Fringe}) + \text{Overhead}) + \text{G\&A}) = \text{Base Rate}$

The Two Tier formula is for companies that have overhead and G&A in one cost pool, where overhead is NOT broken out into a separate cost pool:

➢ (Two-Tier)  
 ➢  $(\text{Direct Labor} + \text{Fringe}) + \text{G\&A} = \text{Base Rate}$

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### STEPS IN THE PROCESS

#### LABOR BASES & FRINGE

STEP 1: Separate all labor costs & determine percentages

Total Labor = \$1,000,000

➤ Direct Labor	\$670,000	67%
➤ Overhead Labor	\$50,000	5%
➤ G&A Labor	\$280,000	28%

STEP 2: Allocate fringe costs across all labor pools

Total Fringe = \$200,000, which equals 20% (200,000/\$1,000,000)

➤ Direct Fringe	67%	\$134,000
➤ Overhead Fringe	5%	\$10,000
➤ G&A Fringe	28%	\$56,000

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### STEPS IN THE PROCESS

#### LOADING OVERHEAD AND G&A

STEP 3: Load overhead costs to direct costs only. Overhead is not applied to G&A because overhead supports projects **ONLY**

Total Overhead = \$75,000, which equals 7.5% (\$75,000/\$1,000,000)

➤ Direct Labor	\$670,000
➤ Direct Fringe	\$134,000
➤ Direct Materials, etc.	\$196,000
➤ TOTAL DIRECT	\$1,000,000

STEP 4: Calculate the G&A rate

Total G&A = \$322,500, which equals 30% (\$322,500/\$1,075,000)

➤ Total Costs	\$1,075,000
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### ESTABLISHING THE RATES

#### INDIRECT RATES (USING THIS EXAMPLE)

➤ Fringe	20.0%
➤ Overhead	7.5%
➤ G&A	30.0%

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**QUESTIONS & ANSWERS**

# Questions?

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## DCAA Compliance



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