

Is your firm financially shovel-ready?

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Getting public-sector work isn't the only thing companies need to do. They need to consider overhead rate too.

Much of the talk about the \$787 billion American Recovery and Reinvestment Act of 2009 (ARRA), even before it was approved, was about the idea that projects under the so-called economic stimulus package needed to be shovel-ready. That term, a new one for many in the AEC industry, essentially meant there was a short window to get the work started after it was found to qualify for the federal money.

Still, even if your firm is working on a project that's on the fast track, there's more to consider than just the speed with which the project can be done, according to a recent article in the company newsletter *DGC Connection* entitled, "Is your firm financially shovel-ready?" by audit manager Anne Baldwin of accounting firm **DiCicco, Gulman & Company LLP** (Woburn, MA), and James Lemay, a principal in the firm's audit department.

"When you're working with the government, you know you'll get paid, and it's profit, even if the profit isn't at the level you're used to," Lemay says. "Still, I'm not sure a lot of firms understand the headaches that can come with it. A lot of them think it's like working with a developer or a college or university. The money has never been big enough in the past for a lot of these firms to get involved in this type of work, but it's a great opportunity for them right now because of the stimulus package."

In many instances, a firm will not even be allowed to bid on a government contract unless it has been pre-qualified by a government agency, Lemay says. Usually, this means a firm must submit an overhead rate that is in accordance with the Federal Acquisition Regulations (FAR). Most government contracts are governed by FAR, which require that engineers, architects, and most other hourly service providers be reimbursed at their allowable overhead rates and labor amounts plus a predetermined profit percentage.

Firms must determine their allowable overhead rates before bidding on projects, Lemay says. In many ways, it's like developing a budget, he says. Some firms have developed budgets that eventually led to them doing nothing more than covering their direct expenses and missing out on the profit of a job well done, Lemay says.

"Some clients don't like delving into the numbers to find little bits of information, but you have to do it the right way or you'll find yourself in some trouble later," he says. "These government agencies all have their own method of how things are reported, how things are recorded, and how you get paid. It can create a large headache, especially when it ends up being the project manager who has to try to manage the budget every step of the way."

Lemay suggests setting up a system that minimizes the amount of involvement the project manager has in tracking direct and indirect costs and advises firms to be ready for an audit, which is required on all major projects funded by the government.

"Even if you quote your overhead rate at what you think it will be, when you get reimbursed, you're only going to get back what the actual amount is," Lemay says. "The key is to address it before you quote a job and track and monitor the expenses as they come up. You need to see it while it's happening rather than after the project's over."

Minimize indirect costs

To minimize overhead rates, some AEC firms will require that all direct costs— such as copies, mileage, phone charges, computers, etc.— be billed to their clients and not be included in the overhead cost pool. The other factor that helps with overhead rates is utilization, meaning all staffers must be largely chargeable to clients.

Rob Phillips, executive vice president and chief operating officer at Sam Schwartz Engineering (SSE) (New York, NY), an 80-person traffic and transportation engineering firm, says preparation and communication are important to bidding on government work.

“The time it takes to become eligible to work for state and municipal clients can be lengthy,” he says. “The good news is once you figure out the particular roadmap, you are all set. SSE a year ago was about 70% private and 30% public in terms of gross revenue. We have successfully made the transition to about 80% public and 20% private in 2009. Fortunately, in our more established offices the groundwork was already in place for the pre-qualifications and the overhead calculation required to meet FAR. In our newer and recently acquired offices that primarily focused on private clients, we have been working hard to complete all the paperwork and supply the required documentation.

“Being ready is the first important step. Secondly, we must be in touch with the firms that are in the know. Who is going to be receiving the shovel-ready projects and how will SSE be involved? This involves advanced intelligence on what projects are coming and figuring out which, if any, do we need to team with. For firms that do not have the connections or experience working in the public sector, it will be a challenging task to complete all paperwork and develop teaming relationships in a short period of time,” Phillips says.

Do the math

For a private-sector job, according to the DiCicco, Gulman article, if a firm has a break-even multiple of 2.80 (1.0 for direct labor and 1.80 for associated indirect labor, fringe benefits, and other overhead expenses), then the billing multiple needs to be 3.5 in order to return a 20% profit on the project.

Many factors, including the geographic region in which the project is being done, the type of work, the scope of work, and the technical expertise required, can determine the overhead rates firms should target, Lemay says. The typical multiplier range is 1.20 to 1.90, he says, but each firm needs to figure out on its own what number to use.

J. Kevin Hebblethwaite, president of EDI, Ltd. (Atlanta, GA), a 21-person technology consulting and design firm, has a client list that includes architects, program managers, developers, hospitals, corporations, academic institutions, and government agencies throughout the U.S., Canada, and Middle East.

“We’re developing opportunities in health care IT, a \$36 billion portion of ARRA,” he says. “We’ve been very successful in this market already, and now in 2009, our hospital clients face more technology challenges than ever before. We’re also paying close attention to cash flow, keeping our (days sales outstanding) down and updating forecasts more often.”

Lemay encourages firms to do their homework and see if government work is right for them. Engineers, he says, can leverage their work through stimulus money because all building projects need their expertise in some way. Architects, he says, also have an opportunity to be part of it, especially those that are certified through the **U.S. Green Building Council (USGBC)** (Washington, DC) Leadership in Energy and Environmental Design (LEED) initiative.

“That’s a big plus, with Washington so focused on green design right now, for the architect and the firm,” Lemay says.— D. CRAIG MACCORMACK (cmaccormack@zweigwhite.com)