

M&A BUY SIDE SERIES: THE POST-CLOSING PHASE

In this third insight in our three-part Merger and Acquisition (M&A) Buy-Side series for government contractors (GC), we move to the final and often longest phase in the deal journey: "post-closing." As discussed in our [previous insight in this series](#), the process of creating an integration strategy should have already begun so you have a roadmap to follow on day one of operating as a combined company. In the "post-closing" phase, it's time to expand our view beyond the first day of operation and put processes in place that will endure and create long-term success. In this insight, we'll look at three key areas to address before the deal is signed.



1. TAKE A MEASURED APPROACH TO INTEGRATING SYSTEMS

If you have acquired a GC to bolster growth, capturing new sales opportunities is a top priority in the first few months of operation. However, it's also prudent for leaders to take this time to contemplate when to integrate systems and procedures to prevent unnecessary disruption to stakeholders. For example, given the rigors of federal government reporting, GCs must ensure that operating systems continue to produce required contract data post-close. Care should be taken to fully analyze post-close reporting structure requirements and related business

processes, and then to identify and select an appropriate solution and implement it at the appropriate time.

Steps for a successful system migration:

- Create a plan that details the timeline and parties responsible for the migration. The plan should also outline the resources—people, time and funds—appropriate for the size of your organization that will be dedicated to integrating systems and procedures. This is a critical first step to creating efficiencies.
- Assess how work gets done based on existing processes, approvals and systems from both the buying and selling entity. Leveraging best practices from each entity will ultimately help leaders streamline operations and reduce costs.
- Realign the P&L to match the new organization, plan for updates to IT systems and redesign both management and operational processes.
- Assess legacy performance measures from both entities and update targets—both for the transition period and the future state/post-implementation.
- Maintain a review cadence that engages senior management throughout the implementation to ensure that the integration is completed on-time, on-budget and with the expected synergies.



2. RALLY YOUR MOST POWERFUL ASSET: YOUR PEOPLE

One of the greatest challenges in a merger or acquisition is that both leaders and employees resist change and it's common for morale to dip during the process. Therefore, alignment at the leadership level is one of the greatest indicators of a successful merger. Bringing the right team together to create the details and allowing for debate and consensus before the next level of details are decided will build commitment and have a positive impact on all levels of the organization. Creating an effective leadership team to lead the merged entity on day one should have been addressed in earlier M&A phases.

In the post-closing phase then, it's important to create a plan for other functional role changes. This includes a communications plan that will clearly outline roles and expectations of employees in this newly merged firm. However, valued employees should not feel dictated to. Throughout the M&A process communicating the 'why' early and often is a key factor in employees' acceptance of the future state. Assessing the various stakeholder groups and tailoring the benefits based on what's in it for them will support adoption. Engaging all levels and giving them a voice or role to play in the newly merged organization will reduce resistance to change.

Steps to smooth employees' transition to a newly merged firm include:

- Conduct a baseline assessment before the integration to accurately assess morale and adoption at a post-implementation milestone, such as six months.
- Adequate resourcing is critical, and often overlooked or downplayed during the merging of two organizations. It's important to account for what part of your valued employee's 'day job' is replaced with their 'transition role' and set them up for success as they navigate shifting priorities.
- Another area that is often overlooked is attrition—planned and unplanned—during the transition period. It is important to have dedicated HR professionals update recruitment programs, training programs and compensation strategies, as well as to provide support on succession planning and leadership development.
- Employee benefits, employment changes and payroll often need to be in place within three days of operation. Proper planning ensures that your employees will not miss a payroll period or feel as though they are without the needed benefits during the transition.

Using an existing structure or mirroring one from another organization can be an appealing shortcut. However, studies show that to reap the benefits you must design a structure that represents the combined strategy, culture and capabilities of the new company.



3. ESTABLISH FINANCIAL REPORTING PROCESSES TO ENSURE A SMOOTH TRANSITION

While the above steps and strategies provide guidance on integrating acquirees regardless of industry, GCs should be aware of particular financial reporting requirements dictated by their main customer—the government—that they must comply with on day one as a consolidated company. Cost synergies provide the controllable element of the acquisition and should be addressed as soon as possible. While stakeholders expect some disruption due to the integration of companies, it's important to establish new processes as soon as possible so everybody is clear on how the newly merged company will operate.

In particular, business combinations can put a strain on the finance and accounting (F&A) teams of both the buyer and the seller. It is important to assess what resources the F&A team may need to bring in or use to supplement the existing team to ensure that the entity is able to keep up with deadlines for financial and tax reporting.

Here are some of the most important financial processes that GCs must address in the short-term:

Policies and procedures:

It is important to assess any duplicative and/or conflicting accounting procedures related to government business systems (e.g. estimating, MMAS and purchasing). Management should ensure proper consideration is given to harmonizing or developing new policies and documenting compliant processes across the new organization. Any major changes to a business system should be disclosed to the government and the organization should be prepared for the increased likelihood of a system audit.

Indirect rate restructures:

It is important for companies, both pre- and post- transaction, to determine and implement the optimal structure that yields compliant and competitive rates in the marketplace. Indirect rates should be analyzed to determine the best structure to maximize cost recovery and profit. The goal is to find the right balance of complexity in an integrated rate structure that allows the new organization to be compliant, competitive and easily integrate any future acquisition targets.

Home office development:

Business combinations can result in changes to, or requirements to create, compliant processes to allocate home office expenses to segments covered by Cost Accounting Standards (CAS). There may also be a requirement to create or amend the home office or intermediate level home office designation in the CAS disclosure statements. It is important to analyze these cost

allocation structures to ensure compliance, and to address any potential cost accounting changes that may result from the new business combination.

Disclosures:

To mitigate risk associated with defective pricing and the requirements of the Truthful Cost and Pricing Act, be prepared to provide segments with proper disclosures for use on the first day of operations as a combined company. These disclosures should include any expected changes in the organization that are known, as well as any full financial impacts that may not be known that would affect direct or indirect costs associated with any outstanding pricing negotiations (e.g. changes in supply chains, workforce changes and cost allocation changes). Unknown financial impacts to organizational changes may result in the government negotiating reopener clauses in new contracts.

External restructure:

Costs associated with extraordinary plans to combine and/or eliminate operations or headcount are recoverable under USG contracts if certain regulatory criteria are met. It is important to ensure these criteria are understood by management prior to execution of any plans to capture the data necessary to support your claim to the government. Not involving the proper resources during the planning phase of these activities may result in a lost opportunity to recover a considerable amount of pertinent costs.

CAS disclosure statements and associated cost impacts:

Changes in organization structure and the formation of new segments, business units or intermediary home offices may result in the requirement to create new disclosure statements and/or modify existing disclosure statements. Any changes to disclosed cost accounting practices that are under consideration should be evaluated to determine if a cost impact proposal would be required prior to the implementation of the new practice. Cost impacts which are unfavorable to the government may lead to unilateral adjustments to contract prices and may affect profitability.

In conclusion, migrating disparate systems and supporting employee morale during an acquisition is challenging for companies in any industry. For GCs, there is an added layer of complexity due to the requirements from the government about financial reporting processes as a newly-merged organization. At BDO, we encourage GC acquirers to address the accounting for the business combination as soon as possible. This may involve engaging a CPA firm to assist and advise on accounting requirements, and may also require a formal valuation prepared by a valuation specialist to address the value of the assets acquired, liabilities assumed, earn outs and roll over equity, among other considerations. It is important to begin this process as soon as possible to ensure a timeline is established to meet the company's deadlines for financial statements and tax returns.





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