



Government Contractor Acquisition: Having the knowledge to make the right deal

No one wants to close on an acquisition only to find out that they negotiated with incomplete information or—worse yet—made a mistake. Acquiring a government contractor can involve special risks that may impact the purchase price and terms of the transaction, but only if they are understood and considered in the negotiations.

Working under the pressure of limited exclusivity windows or auction down-select deadlines can easily lead to certain risks being overlooked. Having knowledge of the target government contracting risks helps provide clarity and level the negotiations playing field. In some instances, understanding these risks may enable the buyer to negotiate more advantageous terms; in others, it may support a decision to abandon the pursuit.

Thorough diligence of a government contractor target can identify and evaluate target-specific risks that unless known, may lead to excessive purchase prices and future difficulties in capturing and realizing value, and ultimately risk the successful integration of the target into existing operations. It also aids in negotiating essential terms required to move forward successfully, and—in some instances—avoiding unknowingly purchasing someone else's problems. While not every risk can be eliminated or quantified with precision, identifying and understanding risks can go a long way to establishing protections and mitigating their overall impact on the deal.

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Government contractor due diligence can provide answers to many important questions, including:

- Am I, as the buyer, adequately protected for prior-year contract cost audit risks?
- What happens to contracts that were awarded based upon the entity's small business status?
- Are there any unresolved contract requests for equitable adjustment or claims?
- Are there any open disputes or government investigations?
- Has there been a history of retroactive government cost disallowances or penalties?
- Has the entity claimed any compliance exemptions that it did not appear eligible for (e.g., Cost Accounting Standards) that may result in retroactive contract repricing and potential penalties?
- Is there a history of contract compliance or performance deficiencies?
- Does the contract compliance infrastructure appear adequate to support its post-close needs and, if not, what investments will be required?
- Are the target's contractor business systems approved?
- Is there a history of adverse government audit findings and corresponding financial risks?

Depending upon the answers to these and other questions, the purchase price may be impacted through balance sheet adjustment assumptions or the quality of earnings and cash flow analyses. Certain other risks and potential liabilities may be disposed of (e.g., retained by the seller) or used as items for negotiation. Without a knowledge and understanding of those risks, you're likely negotiating at a severe disadvantage to the seller.

Another important area for negotiations includes the custody and access to legacy contractor records that may be subject to government audit for six or more years into the future. While the buyer will generally assume the financial liability for future audit outcomes, seldom do all of the records or access rights to the records needed to support future audits transfer to the acquiring entity. Examples include legacy corporate home office expense data and third-party vendor data (e.g., benefit providers, travel agencies). Failure to provide records in response to auditor requests in a timely manner due to either lack of custody and/or access can result in substantial cost disallowances. Continued access to legacy records to support future audits is essential and should be addressed in pre-close negotiations.

Government Contractor Acquisition Due Diligence Services

Deloitte Risk and Financial Advisory's Government Contract Advisory Services group has the experience, insights, and tools to assist buyers in obtaining the critical knowledge to negotiate deals backed with the right information. Whether the target is a large, mid-sized, or small entity, we can help you identify the risks, request key documents, ask the critical management questions, evaluate the key risks, and provide strategic guidance. Our government contracting team brings deep experience in several industries including aerospace & defense (A&D), services, healthcare, technology, engineering & construction (E&C), and manufacturing. We have supported numerous government contractor target due diligence efforts and know how to work efficiently and effectively with acquiring entities and their external advisors.

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