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# The New Federal Government Contractor Compliance Requirements

## Presentation for NCMA - Potomac Chapter



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## About the Speaker

**Kristen Ittig** is a partner in Arnold & Porter's Government Contracts group. Her practice encompasses all aspects of federal procurement law, including litigation, compliance, claims and contract administration issues. Ms. Ittig advises clients on a variety of acquisition-related issues, including managing organizational conflicts of interest and maintaining compliance with the Buy American Act and the Trade Agreements Act. She provides advice regarding small business matters, including maintenance of small business status, formation and administration of teaming and strategic alliances, and strategies for acquisition structures. In addition to her bid protest practice, Ms. Ittig litigates Freedom of Information Act (FOIA) and reverse-FOIA matters relating to the release of sensitive contractor information, and has substantial experience in handling security clearance litigation matters. She also assists companies in audits, investigations, and suspension/debarment proceedings. Ms. Ittig is currently the co-chair of the American Bar Association Public Contract Law Section's Legislative Coordinating Committee.

## Rulemaking Process

- November 14, 2007 – First Proposed Rule
  - May 18, 2008 – Second Proposed Rule
    - November 12, 2008 – Final Rule

### Basic Elements

1. Internal Controls -- to detect and prevent improper conduct, should have a business ethics and awareness codes, compliance programs and internal control systems
2. Timely Disclosure -- contractual requirement -- mandatory disclosure of violations of federal law
3. Penalties -- New grounds for suspension/debarment

# Summary of the “New” Requirements

Type Of Requirements	Clauses/Coverage	Scope of Requirements
"Should have" requirements (non-mandatory)	<b>FAR 3.1002</b> • Applies to all federal contractors	• Code of conduct • Compliance program • Internal control systems (suitable to size, facilitate discovery and disclosure)
Contract based mandatory compliance and disclosure requirements	<b>FAR 52.203-13 (Code of Ethics/Conduct)</b> • To be included in all solicitations and contracts expected to exceed \$5M and 120 days and issued after the effective date (12/12/08)  <b>FAR 52.203-14 (Hotline Posters)</b> • To be included in all contracts over \$5M, other than for commercial items or to be performed entirely outside US	• Code of conduct to all employees on the contract • Mandatory disclosure • Compliance program (unless small or commercial item) to include training • Internal control system (unless small or commercial item) including procedures to uncover improper conduct, high level responsibility, employment screening, internal audits, reporting mechanism, discipline, disclosure requirements, cooperation with investigations and audits • Flow down to subcontractors which exceed \$5M and 120 days  • Display of agency hotline poster as identified
Contractor qualification requirements (responsibility, suspension, debarment, past performance, etc.)	<b>FAR 9.104-1, 9.406-2, 9.407-2, 42.1501</b> • Applies to all federal contractors	• New cause of debarment for knowing failure by principal to timely disclose (based on credible evidence) certain criminal violations, false claims, or significant overpayments related to a contract • Consideration of record of ethics as part of responsibility • Consideration of record of integrity and ethics, etc. under past performance • Consideration of contractor compliance efforts as mitigation

## **FAR 52.203-13(b), Contractor Code of Business Ethics and Conduct**

### **Code of Business Ethics and Conduct**

Within 30 days of award, contractor shall have

- Written Code of business ethics and conduct
- Make the Code available to each employee who works on the contract

In addition, a contractor shall

- Exercise due diligence to prevent and deter criminal conduct
- Promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law

## **FAR 52.203-13(c), Business Ethics Awareness and Compliance Program and Internal Control System**

Except for small business and commercial item contracts, within 90 days of award, contractor shall establish

1. An ongoing business ethics awareness and compliance program
  - Communicate periodically and practically company standards and procedures and other aspects of the company's business ethics awareness and compliance program and internal control system
  - Conducting effective training for principals and employees
  - Disseminating information appropriate to roles and responsibilities
2. An internal control system
  - Establish standards and procedures to facilitate timely discovery of improper conduct
  - Ensure corrective measures are promptly instituted and carried out

## FAR 52.203-13(c), Contractor Code of Business Ethics and Conduct (cont.)

### Required elements of the internal control system

- Ensure effectiveness by **assigning responsibility at a sufficiently high level** and **providing adequate resources**
- Conduct due diligence to ensure that no individual appointed as a **principal** engaged in conduct in conflict with company's code of business ethics and conduct
- Conduct **periodic reviews** of business practices, procedures, policies and internal controls to ensure compliance with the code and government contracting requirements
  - **Monitoring and auditing** to detect criminal conduct
  - **Periodic evaluation** of effectiveness of ethics and compliance program and internal control system
  - **Periodic assessment** of risk of criminal conduct, and implementation of steps to modify the ethics and compliance program and internal control system to reduce this risk
- **Internal reporting mechanism** (hotline), allowing for anonymity or confidentiality
  - Report suspected instances of improper conduct
  - Instructions that encourage employees to make such reports
- **Disciplinary action** for improper conduct and for failing to take reasonable steps to prevent or detect improper conduct
- **Timely disclosure** to OIG and CO when contractor has credible evidence of violation of criminal law or civil FCA
- **Full cooperation** with government enforcement agencies

## Is Our Compliance Program OK?

### **Standards for an Effective Compliance Program – Federal Sentencing Guidelines**

- Organizational culture and “tone at the top”
- Standards of conduct and internal controls
- Oversight and operational responsibilities of board and management
- Due diligence on background of “substantial authority personnel”
- Communication and training
- Periodic evaluation of program effectiveness, including auditing and monitoring
- Incentives to promote proper conduct and disciplinary measures for violations
- Take reasonable steps to respond to detected problems and prevent further misconduct
- Periodic risk assessments



## Is Our Compliance Program OK?

### Other Sources:

- Justice Department “Principles of Federal Prosecution of Business Organizations” (<http://www.justice.gov/opa/documents/corp-charging-guidelines.pdf>)
- SEC “Seaboard Report” ([http://www.sec.gov/litigation/investreport/34-44969.htm#P16\\_499](http://www.sec.gov/litigation/investreport/34-44969.htm#P16_499) )
- Sarbanes-Oxley ([http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107\\_cong\\_public\\_laws&docid=f:publ204.107](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107_cong_public_laws&docid=f:publ204.107) )
- HHS OIG Guidelines (<http://oig.hhs.gov/fraud/complianceguidance.asp> )

## Is Our Compliance Program OK?

### Assessing Effectiveness of Internal Controls -- COSO Guidelines for Internal Controls

- **“Internal Control”**: “a process designed to provide reasonable assurance regarding the achievement of objectives in the areas of reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.”
- 5 key internal control components
  - Control environment
  - Risk assessment
  - Control activities
  - Information and communications
  - Monitoring
- Sarbanes-Oxley Section 404 Assessment of Effectiveness of Internal Controls (activity-level controls)
  - Documented v. undocumented
  - Automated v. manual
  - Preventive v. detective
  - Foundational, operational or monitoring

# Is Our Compliance Program OK?

## Conducting a Government Contracts Risk Assessment

- What are your key risk areas?
  - Where have you been the subject of government audits, investigations or enforcement actions? Private suits?
  - What are the high risk areas based on current government enforcement initiatives?
  - In what areas are your competitors subject to suits?
  - What are the emerging areas of concern? (recently filed law suits; press reports; comments by enforcement officials; Congressional hearings; etc.)
- Assessment tools
  - Audits
  - Benchmarking/best practices
  - Surveys
  - Focus groups
  - Post-training test of content knowledge

## Conducting a Government Contracts Risk Assessment (cont.)

### ■ Risk areas

- Procurement integrity/bribery and gratuities
- Agents; contingent fees
- Revolving door restrictions
- Byrd Amendment; lobbying restrictions
- Cost, pricing and accounting
  - Defective pricing
  - Compliance with cost principles; CAS
  - Cost mischarging
- Progress/milestone payments
- Estimates to complete (ETCs)
- Content requirements
  - BAA/TAA/Berry Amendment/ Specialty metals
  - New material/inventory control
  - Product substitution
- Employee qualifications
- Time charging
- Performance issues
  - Potential termination for default; show cause; cure notices
  - Past performance problems
- Compliance with specifications, quality, inspection and testing requirements
- Organizational conflicts of interest

## Conducting a Government Contracts Risk Assessment (cont.)

- Document Review
  - Contracts and subcontracts
  - Contract files
    - Audit reports
    - Correspondence with CO, COTR and DCAA
    - Cost and schedule reviews (estimate-to-complete reviews)
    - Contract changes and REAs
  - Proposal files
    - Cost, price, discount, sales information
    - Support for reps and certs
  - Policies and procedures
- Interview key personnel
- Evaluate internal controls in identified risk areas

## Conducting a Government Contracts Risk Assessment (cont.)

- Basic information—
  - Prime or subcontract
  - Customer agencies
  - Types of contracts
  - Subject matter
  - Contract pricing
    - Certified cost or pricing data
    - Commercial pricing
  - Set-asides
  - Other preferred status (industrial base producer)
  - Outstanding bids and proposals
  - Pending investigations, claims, litigation

## What to do to Comply with the New Rules -- Large Companies with an Existing Compliance Program

- If you already have a **code of conduct, business ethics and compliance program, and internal controls**:
  - Map government business
  - Identify government contracts legal risks
  - Assess applicability current FAR business ethics and compliance program, internal controls, and disclosure requirements (Subpart 3.10 and 9.4 and 52.203-13 and 52.203-14)
  - Conduct a compliance review against FAR business ethics and compliance program and internal controls requirements (Subpart 3.10 and 9.4 and 52.203-13 and 52.203-14) based on FSG standards and industry best practices
  - Conduct a deeper dive review into policies, procedures and operational practices in identified risk areas
  - Revise and modify, as necessary, code, business ethics and compliance program and internal controls to facilitate compliance with FAR requirements and develop a strategy to address shortcomings
  - Develop and implement a periodic schedule for program reviews, audits and training (including employees, “principals,” board, agents, subcontractors)
  - Train “principal” level personnel on mandatory disclosure requirement and establish necessary reporting and disclosure procedures
  - Ensure employment screening practices are operating as intended
  - Amend form subcontracts as necessary

## What to do to Comply with the New Rules -- Large and Mid-Size Companies without an Existing Compliance Program

- If you are a mid-sized or large federal contractor without a code of conduct, business ethics and compliance program, and internal controls:
  - Develop a **corporate business ethics and compliance program** and an **internal controls system** that satisfy FAR requirements
    - Use Federal Sentencing Guidelines as a baseline
    - Incorporate other applicable agency rules, guidelines, policies
    - Invest program resources/budget reflecting company size and business (one size does not fit all)
    - At all costs, avoid creating a “paper program”
  - Assign a high-level employee to oversee the program
  - Identify and prioritize legal risks specific to the company’s government business
  - Develop and implement an ethics and compliance awareness and training program tailored to government business and applicable legal requirements
  - Develop targeted training based on job function
  - Train “principal” level personnel on mandatory disclosure requirements and establish necessary reporting and disclosure procedures



## **What to do to Comply with the New Rules -- Large and Mid-Size Companies without an Existing Compliance Program**

- Develop and implement employment screening practices for hiring and promotion
- Develop and implement a “hotline/helpline” or similar anonymous or confidential reporting system
- Develop an ongoing monitoring system and plan for periodic reviews and audits
- Ensure “tone at the top”
  - Unequivocal upper management support for the program
  - Incentives and rewards
  - Commitment to enforce policies, including disciplinary actions and remedial measures
- Use technology
  - Post code of conduct, delivery ethics/compliance messages, web reporting system/hotline/helpline, document delivery of code of conduct, deliver training
- Amend form subcontracts as necessary

## What to do to Comply with the New Rules -- Small Companies Without an Existing Compliance Program

- If you are a small contractor without a code of conduct, business ethics and compliance program and internal controls:
  - Assess feasibility of implementing best practices for mid-sized to large contractors, considering business size, volume of government business, resources and risk
  - Alternative proactive approach: map legal risks; develop, implement, distribute, and enforce a tailored code of conduct, train to code, implement controls, audit
  - Alternative reactive approach (not preferred given FAR policy, mandatory disclosure requirement, suspension/debarment risk): monitor new contract awards until such time as company receives a contract containing FAR 52.203-13 and FAR 52.203-14 and then implement practices above
  - Regardless of approach, familiarize “principals” with mandatory disclosure requirements
  - Use technology to the extent consistent with resources
  - Train employees on basic principles and rules of federal contracting
  - Amend form subcontracts as necessary

# Mandatory Disclosure Obligation

## Applicability

- The mandatory disclosure requirements apply to federal contracts with a performance period of 120 days or more and a value of more than \$5 million.
  - Includes Federal Supply Schedule (FSS) Contracts with an anticipated overall value of more than \$5 million.
  - This applies to all government contracts, including those for commercial items and those performed exclusively overseas.

# Mandatory Disclosure Obligation

## 52.203-13(c)(2)(ii)(F)

- Contractors must timely disclose, in writing, to the agency OIG, with a copy to the Contracting Officer (CO), whenever, in connection with the award, performance, or closeout of this any government contract or any subcontract thereunder, the Contractor has credible evidence that a principal, employee, agent, or subcontractor of the Contractor has committed:
  - (A) a violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code; or
  - (B) a violation of the civil FCA. FAR 52.203-13(b)(3)(i).
- “Credible evidence” standard replaced the “reasonable grounds to believe” standard in the second Proposed Rule.
  - According to the Councils, “[t]his term indicates a higher standard, implying that the contractor will have the opportunity to take some time for preliminary examination of the evidence to determine its credibility before deciding to disclose to the Government.” 73 Fed. Reg. 67073.
  - The Councils clarified that the new standard does not impose an obligation to undertake a complex investigation, but “only to take reasonable steps that the contractor considers sufficient to determine that the evidence is credible.”

## Mandatory Disclosure Obligation - Subcontractors

- The Rule mandates flow-down of the disclosure requirements contained in FAR 52.203-13 for subcontracts with a value in excess of \$5 million and a performance period of more than 120 days. FAR 52.203-13(d).
- Subcontractors report violations directly to the OIG rather than through the prime contractor.
- Under-disclosure Concern
  - As part of the rulemaking process, the Councils clarified that a prime contractor is subject to debarment only if it fails to disclose known violations by the subcontractor.
- Over-disclosure Concern
  - Is there liability for prime contractors who erroneously disclose violations that are not substantiated?
    - In the rulemaking process, the Councils stated that the “credible evidence” standard reduces the prime contractor’s liability by providing the prime contractor with the opportunity to determine the credibility of any alleged violations. 73 Fed. Reg. 67084.

# Internal Investigations & the Decision to Disclose

*Review: Except for small businesses and commercial item contracts, all contractors must have in place a mechanism to investigate suspected instances of wrongdoing. FAR 52.203-13(c)*

- If there is an Investigations, What Should the Goals of the Investigation Be?
  - **Find out what happened**
    - Determine whether there is a problem at all
    - Determine the nature and scope of any problem
    - Decide whether disclosure is required
    - Decide if remedial measures are needed to avoid recurrence

# Who Should Conduct the Investigation?

- In most cases, investigation should be conducted under the direction of lawyers:
  - Preserves the option of asserting company's attorney/client privilege
  - Investigations often involve complex legal issues
- Advantages of in-house counsel
  - More familiar with company and its culture
  - Known to management and employees
  - Less likely to disrupt operations
  - Cheaper
- Advantages of Outside Counsel
  - “Fresh look” at the facts
  - Employees may be more willing to share concerns about management
  - Greater credibility with the government
  - Facilitates assertion of privileges
    - Dual role of in-house counsel: business or legal advice?

## What Should Management's Role Be?

- Investigation should be independent of management control to ensure credibility
  - BUT it needs management's agreement and support
- Written agreement defining scope of engagement
  - Purpose is to provide legal advice to the company
- Management makes the ultimate decision on whether to make disclosure
  - BUT management may be within the scope of the investigation
    - Don't report to individuals who are potentially involved
    - Consider reporting to the Board of Directors or a Board committee



## How Should the Investigation be Conducted?

- Develop plan for investigation
  - Obtain “buy in” from various constituencies
- Preserve and collect documents
  - “Hard copies” of documents
  - “Soft copies” of documents
- Conduct interviews
  - Prepare standard set of opening comments
    - Who you are and what you’re doing
    - “Do I need a lawyer?”
  - Advisable to have two people participate
  - Prepare interview memoranda
    - Privilege issues
- Prepare assessment

## When Should the Results be Disclosed?

- Mandatory disclosure when “credible evidence” of
  - civil FCA violations,
  - certain crimes,
  - and “significant” overpayments. FAR 52.203-13, 9.407-2(a)(8).
- Intended to be a “sea change” from voluntary disclosure.
- Cannot conduct investigation to final conclusion.
  - Preamble to Rules: “[T]he contractor will have the opportunity to take some time for preliminary examination of the evidence to determine its credibility” before making disclosure.
  - Take reasonable steps that the contractor considers sufficient to determine that the evidence is credible.

# What are the Critical Issues in Deciding Whether to Disclose?

- Innocent mistake or civil fraud/crime?
  - Credible evidence of fraudulent intent?
  - Is an overpayment “significant” or not?
    - Preamble: The standard involves more than just dollar value and depends on the circumstances of the overpayment as well as the amount.
- Contents of disclosure?
  - Simple notice or full report?
  - “May be credible evidence” or “there is credible evidence”?
  - Supporting/underlying information and materials?
- Continuing the investigation and updating the disclosure?

## To Whom Must the Disclosure Be Made?

- Disclosure to the agency Inspector General, with a copy to the Contracting Officer. FAR 52.203-13
  - CO is not in a position to evaluate individual employees' potentially criminal behavior – better suited to IG
- For violations relating to multiple contracts, disclosure to the agency Inspector General and Contracting Officer responsible for the largest dollar value contract impacted by the violation.
- For violations relating to multi-agency contracts, disclosure to OIG of the ordering agency and OIG of the agency responsible for the basic contract.

## How Do I Make a Disclosure?

- If the Agency has a form, consider whether to use it
- Disclose facts
- Avoid characterizations and admissions
- Explain timing of disclosure
- Err on side of disclosure – there is no track record on what is “credible evidence” or on what is “timely” or on what makes an overpayment “significant”
- Demonstrate a culture of compliance
  - Proactive approach to problems
  - Non-retaliatory environment
  - Show the solution/why this will not happen again
- Demonstrate candor

# Full Cooperation

FAR 52.203-13(c)(2)(ii)(G):

A contractor's internal control system must provide for "full cooperation with any Government agencies responsible for audit, investigation, or corrective action."

"Full cooperation" means/includes:

- Disclosure to the Government of the information sufficient for law enforcement to identify
  - (1) the nature and extent of the offense, and
  - (2) the individuals responsible for the conduct.
- Providing timely and complete response to Government auditors' and investigators' request for documents and access to employees with information. FAR 52.203-13(a)(1).

Full cooperation does not require—

- A Contractor to waive its attorney-client privilege or the protections afforded by the attorney work product doctrine; or
- Any officer, director, owner, or employee of the Contractor, including a sole proprietor, to waive his or her attorney client privilege or Fifth Amendment rights . . . " FAR 52.203-13(a)(2).

## Do I Have to Disclose Privileged Material?

- Whose Privilege Is It and Which Privileges Apply?
- Nothing in the new rules requires a waiver of attorney-client privilege
  - Investigation to determine whether there is credible evidence may be conducted by counsel and can be protected
    - Underlying facts are not protected, but the investigation may be
    - Will the investigation report be disclosed anyway?
- Full cooperation requirement in Code of Ethics does not require waiver of privilege

## What Happens After the Disclosure?

- Upon receipt of disclosure of possible contractor violation of federal criminal law, as defined, then Contracting Officer must
  - Coordinate the matter with the OIG
  - Take action “in accordance with agency procedures”
- Post-disclosure contracting issues
  - Impact on status as responsible contractor
  - Impact of past performance evaluation
    - Must be able to demonstrate a satisfactory record of performance, including a record of integrity and business ethics
    - In making disclosure, contractor should consider adding narrative that demonstrates record of integrity and business ethics



## What Happens After the Disclosure?

- Who gets to see my Disclosure?
  - The Government, to the extent permitted by law and regulation, will safeguard and treat information obtained pursuant to the Contractor's disclosure as confidential where the information has been marked "confidential" or "proprietary" by the company
  - If requested under FOIA, Government will give prior notice to the Contractor of the request (and presumably a chance to argue for non-release)
  - Government can provide the information to "any department or agency within the Executive Branch" if it relates to matters within that entity's jurisdiction

## What Happens After the Disclosure?

- Debarment or Suspension
  - Upon preponderance of the evidence, knowing failure to timely disclose
    - Violation of federal criminal law
    - Violation of civil False Claims Act
    - Significant overpayment
  
- Suspension and debarment not intended to be punitive – supposed to protect government from non-responsible contractors, SO
  - Disclosure can still be a mitigating factor
  - In disclosing, contractor should explain why it is still a responsible contractor

# Suspension and Debarment

## **FAR 9-406-2(b)(1)(vi)/9-407-2(a)(8) – Causes for debarment/suspension**

- Knowing failure by a principal, until 3 years after final payment on any Government contract awarded to the contractor, to timely disclose to the Government, in connection with the award, performance, or closeout of the contract or a subcontract thereunder, credible evidence of—
  - Violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code;
  - Violation of the civil False Claims Act (31 U.S.C. 3729-3733); or
  - Significant overpayment(s) on the contract, other than overpayments resulting from contract financing payments as defined in 32.001
- New causes for suspension and debarment apply to all Government contracts, regardless of whether they include the newly revised version of FAR 52.203-13.
  - Unlike contracts subject to mandatory disclosure, no dollar value threshold applies.
  - Applies to overseas contracts, small business contracts, and commercial item contracts.
  - Applies to contracts that pre-date the Final Rule where contractors have credible evidence of a past violation related to a contract that was not closed out before December 12, 2005, even though the contractor is not subject to the new mandatory disclosure provisions, which are prospective only.

## Practical Impact of the “New” Compliance Rules

- DCAA has issued letter requests seeking detailed information about contractors’ “control environment”
  - Focus on efforts to comply with the new rules, and
    - The existence of written codes of conduct/evidence,
    - Self-governance activities,
    - Policies and procedures that address management intervention, and
    - Internal and external audit functions and efforts.
  - Concern – DCAA is seeking information beyond the mandatory disclosure provisions.

## Practical Impact of the “New” Compliance Rules

- Additional requests exceeded mandatory disclosure requirements by asking for
  - Disclosure of “findings that significantly impact government contracts,” not just where there is “credible evidence”
  - Such disclosures within 5-10 days of discovery, not just “timely” disclosure,
  - Disclosure to DCAA, not required under FAR,
  - A list of noncompliances reported to the contractor’s hotline within the past 12 months, and
  - A list of any current open investigations, not just where “credible evidence” is found.

## Questions?

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