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FAR Ethics & Compliance Requirements: A Checklist for Success

In 2010, federal contractors paid out more than \$4 billion in fines and settlements related to misconduct. One growing – and costly – way contractors find themselves targeted is being investigated for violating federal ethics regulations.

If an agency Inspector General asked to review your company's compliance program today, would you be prepared?

CFMs can be instrumental in developing a practical system to ensure their companies meet federal ethics and compliance requirements. This article will:

- provide a checklist of key considerations on how to develop and implement a federal ethics and compliance program;
- explore real-life, practical ways that contractors demonstrate compliance with requirements;
- highlight recent enforcement trends and common violations; and
- discuss best practices once a violation is alleged.

Filling the Information Gap

The Federal Acquisition Regulation (FAR) mandates that a federal construction contractor with a contract that exceeds \$5 million and a performance period of 120 days or longer must develop and implement:

- a clear and effective written code of business ethics and conduct;
- an ongoing employee business ethics compliance training program to educate contract personnel about ethical requirements and the company's code; and
- an internal control system that promotes timely discovery and prompt correction of impropriety.

How does a contractor meet these obligations? And, how does the government verify compliance? We recommend that a contractor can reasonably anticipate and answer both of these questions by crafting an ethics program and internal control system that pays particular attention to the Defense Contract Audit Agency (DCAA) Contract Audit Manual (CAM).

Sample Questions & Answers

FAR 52.203-13 – Contractor Code of Business Ethics and Conduct and DCAA CAM 5-306 – Integrity and Ethical Values require contractors to demonstrate compliance with 33 affirmative requirements. We recommend that a contractor be prepared to show the government that it is in compliance with each of these requirements.

An effective compliance program requires more than an explanation of these requirements – it requires action and benchmarking. The identification and documentation of specific compliance actions helps a contractor create a program that can be quantified and implemented with a reasonable amount of effort and cost.

To ensure that a contractor addresses each of the 33 requirements, we recommend a question and answer checklist approach. Following are some specific requirements and our sample suggestions on how a contractor might meet them.

How does the contractor know that all employees have received and understand the message that integrity and ethical values cannot be compromised?

- Management conducts random audits with employees after the initial ethics training.
- The company has designated an internal, high-level Corporate Compliance Officer (CCO), such as the CFO or head of HR, who reports directly to the CEO. The company's general counsel or outside federal contracts counsel meets with the CCO quarterly to discuss ethics compliance.

How does the contractor continually demonstrate a commitment to high ethical standards?

- Management highlights examples of ethical conduct in the company newsletter.
- The company has joined an industry ethics group and key management representatives attend annual industry ethics training.



Sample Ethics & Compliance Program Internal Controls

	YES	NO
<p>1 Has the management of the company conveyed the message that integrity and ethical values cannot be compromised? <i>DCAA CAM 5-306(a)</i></p>	<input type="checkbox"/>	<input type="checkbox"/>
<p>2 Has the management of the company confirmed that employees have received and understand the message that integrity and ethical values cannot be compromised? <i>DCAA CAM 5-306(a)</i></p>	<input type="checkbox"/>	<input type="checkbox"/>
<p>3 Does the management of the company continually demonstrate through words and actions a commitment to high ethical standards? <i>DCAA CAM 5-306(a)</i></p>	<input type="checkbox"/>	<input type="checkbox"/>
<p>4 Does the management of the company ensure that the company conducts business with the highest degree of integrity and honesty? <i>DCAA CAM 5-306(b)</i></p>	<input type="checkbox"/>	<input type="checkbox"/>
<p>5 Has a written code of business ethics and conduct been prepared? <i>DCAA CAM 5-306(b); FAR 52.203-13(b)(1)(i)</i></p>	<input type="checkbox"/>	<input type="checkbox"/>
<p>Has a copy of the code of business ethics and conduct been made available to each employee engaged in the performance of a "Covered Contract" according to FAR 3.1004(a)? <i>DCAA CAM 5-306.1; FAR 52.203-13(b)(1)(ii)</i></p>	<input type="checkbox"/>	<input type="checkbox"/>
<p>Is the code periodically acknowledged by each employee engaged in performance of a "Covered Contract" also according to FAR 3.1004(a)? <i>DCAA CAM 5-306.1</i></p>	<input type="checkbox"/>	<input type="checkbox"/>

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How is the code of business ethics and conduct provided to employees?

- The code is distributed electronically at the annual ethics training. New hires receive the code at orientation.
- The code is always available on the company intranet.

How does the company demonstrate that it provides a monitoring and auditing process to detect criminal conduct?

- The company's monitoring and auditing policy and audit results are maintained by the CCO and are made available to the government upon reasonable request.

What procedures are in place to ensure corrective measures are promptly instituted and carried out?

- From the time a report is made to the hotline, the company has a seven-step investigation process with a specific time frame, reporting protocols, and mandatory compliance actions.

What procedures are in place to disclose in writing to the agency Office of the Inspector General (OIG) and the Contracting Officer any credible evidence that a principal, employee, agent, or subcontractor has committed a violation of federal criminal law involving fraud, conflicts of interest, gratuity violations, or the civil False Claims Act?

- The Corporate Compliance Officer, with the assistance of outside federal contracts counsel, investigates each allegation of potentially improper conduct and prepares a recommendation. The recommendation shall include a decision regarding disclosure that is in accordance with all applicable legal requirements.

Don't Overcomplicate Compliance

A successful compliance program is a practical program. It should be tailored to a contractor's business practices and accessible to all employees. If employees do not follow the company's code of ethics because it's unclear or too complicated, then a contractor is in no better position than if it had no code.

Contractors are often tempted to develop a code to address every possible violation an employee may commit. The result is a needlessly complicated code and training program that leads to employees missing the goal, which is to learn how to identify and report unethical and criminal conduct.

The FAR requires contractors to disclose to the agency OIG and Contracting Officer violations of federal criminal law "involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code; or a violation of the *Civil False Claims Act*." (FAR 52.203-13(b)(3)(i)(A and B))

Contractors should focus the training on these concepts – and how a trainee might encounter and react to them – instead of addressing the universe of possible noncriminal and unintended violations of complicated labor or environmental statutes.

Don't Create a "Paper Program"

A needlessly complicated program often results in what prosecutors call a "paper program." It is insufficient for a contractor to develop a paper program that addresses the FAR requirements on paper but fails to implement the program effectively – or sometimes at all.

The demise of Enron offers a cautionary ethics tale. Despite widespread fraud within the company, Enron developed and published a 64-page code of ethics, which was distributed to each employee. During the trial of Enron CEO Ken Lay, prosecutors submitted evidence of his copy of the code, which was still in its original shrink-wrapped packaging.

Enron's failure to act upon its program likely hurt the company more than never creating a code at all. The significant time and resources spent creating a perfect code that never left the shelf likely created more trouble in the end.

Because the government does not usually scrutinize an ethics program until there is a violation, contractors must be proactive. At the time of contract award, Contracting Officers will simply confirm the existence of a code and compliance program. However, if a contractor subsequently finds itself in trouble ethically and the Contracting Officer, agency Inspector General, or a federal prosecutor determines the compliance program is merely a paper program, then the contractor's conduct will be treated harshly.

Not So Fast, Small Businesses

Although federally-classified small businesses are exempt from the requirements for a formal ethics training program and internal control system, small contractors should still develop a code of ethics and promote employee compliance. A small business is only exempt from the formal ethics training program and internal control system requirements for as long as it stays out of trouble.

Moreover, FAR 3.1002 provides that *all* businesses should have a written code of business ethics and conduct and training program. As such, if a small contractor is in trouble ethically while performing on a federal contract, then the responsible agency can require that it comply with the training program and internal control system requirements.

Because a small contractor could be held responsible for implementing a training program and internal control system, it should, at a minimum, implement policies to enforce its code of business ethics and conduct. These measures may help to later demonstrate its commitment to ethical conduct and avoid fines, penalties, or suspension if a violation occurs.

Most Common Type of Violation

The most common intentional violation that we have seen arises with respect to compliance with the *Davis-Bacon Act*. We have been involved in several investigations in which a lower-tiered subcontractor's employee alleges, through the contractor's hotline or the responsible agency's hotline, a misclassification of its trade, overstatement of hours, and related violations. We have also seen fraudulent testing certifications, fraudulent change orders, and a variety of routine HR allegations, which, upon investigation, are not reportable for various reasons.

What to Do if a Violation Is Alleged

Contractors must be prepared to act quickly if a violation is alleged. Once a contractor learns of an allegation, it should engage in an initial investigation to determine if the allegations have merit.

To ensure attorney-client privilege, the investigation should be conducted by outside federal contracts counsel, as federal prosecutors routinely take the position that an inside attorney's communication with other employees are not privileged. Once the investigation is complete, the contractor should take quick and decisive action to comply with any legal requirements if a violation is found.

Failing to act quickly may result in additional involvement by government officials. Generally, in our experience, a Contracting Officer and an agency Inspector General are satisfied with a contractor's swift and decisive efforts to remedy a violation.

However, where we have seen a violation brought to the attention of a federal prosecutor, the prosecuting official is not as likely to drop an investigation because of a contractor's quick remedial action. When informed of a possible violation, prosecutors are more likely to probe further into a contractor's compliance program. As such, to the extent a contractor can quickly remedy a violation and demonstrate to a Contracting Officer or agency Inspector General that its compliance program is effective, the contractor is likely to resolve the issue faster, at a lower cost, and with less involvement from government officials.



Conclusion

It pays to proactively implement a clear, practical code of ethics and training program. Failure to take these requirements seriously or react quickly to alleged violations can result in years of government investigations, litigation, and a loss of future business opportunities.

Good intentions or mere discussion about ethics is not enough. A federal contractor must be able to show, through documented actions, how it meets the numerous ethics and compliance requirements.

A checklist approach clarifies and conveys a contractor's ethics commitment, both internally and externally. And, employees will understand what it means to be an ethical contractor and learn how they can help the company meet this ongoing objective. ■

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