

**Published in Construction Accounting, and Taxation**  
**January/February 2009**

## **NEW FAR RULE ON COMPLIANCE PROGRAMS AND ETHICS**

*CHRISTOPHER A. MYERS, ESQ. AND ALLISON V. FEIERABEND, ESQ.*

*CHRISTOPHER A. MYERS is co-chair of Holland & Knight's Compliance Services Team and a member of the firm's White Collar Defense Team. He is a former federal prosecutor and has experience in a broad range of complex matters affecting heavily regulated industries, including health care, government contracts, financial institutions, real estate, securities and other companies. He has represented clients with respect to matters involving civil and criminal fraud investigations, corporate governance, anti-money laundering, design and implementation of compliance programs, and administrative litigation. In addition to his practice, Mr. Myers has been a faculty member at a wide variety of continuing legal education and law school programs relating to enforcement and compliance issues, investigations, records retention programs, e-discovery issues and risk assessments. Mr. Myers is a certified Anti-Money Laundering Specialist and a Certified Compliance & Ethics Professional. ALLISON V. FEIERABEND, ESQ., an associate at the same firm, practices in the areas of government contracts and business litigation. Ms. Feierabend's government contracts experience includes bid protests, compliance programs, contract disputes, contractor claims, and counseling clients on diverse government contracts issues.*

### **The new rule mandates comprehensive internal controls and mandatory disclosure of violations and overpayments.**

Many construction companies perform both commercial and federal contracts as prime contractors and subcontractors. Contractors performing any work for the federal government should be aware of the new Federal Acquisition Requisition (FAR) provisions and clauses that require government contractors to establish and implement compliance programs and make mandatory disclosures of certain violations of criminal law, violations of the civil False Claims Act, and significant overpayments. Contractors performing work for the federal government must make these disclosures or face potential suspension and debarment.

### **Final rule issues**

On November 12, 2008, the FAR Council issued a final rule that further amends the FAR to amplify existing compliance program provisions (Subpart 3.10) and clauses (52.203-13 and 52.203-14). The rule also adds requirements that contractors and subcontractors disclose certain violations of criminal law, violations of the civil False Claims Act, and significant overpayments.<sup>1</sup> The new rule took effect on December 12, 2008.

This new rule builds upon earlier compliance program requirements established in a December 2007 amendment of the FAR. That rule requires construction companies receiving awards of government contracts and subcontracts expected to exceed \$5 million and with a performance period of 120 days or more to:

- Have a code of business ethics and conduct within 30 days of award;
- Implement a formal “awareness” or training program on the code within 90 days of award;
- Develop internal controls to support the code, also within 90 days of award; and
- Display a hotline poster.

The FAR Council has clarified that the \$5 million trigger includes the anticipated dollar value of the contract, including options. <sup>2</sup>

## Changes to the December 2007 rule

The December 2007 rule did not impose specific requirements for training programs or internal control systems. In response, the Department of Justice (DOJ) proposed amending the rule to provide more specific guidance on the compliance program requirements. The DOJ compliance program proposal was based on the United States Sentencing Commission's *Guidelines Manual* § 8B2.1 which provides guidance on “effective” compliance and ethics programs.

The new rule includes clarifications and revisions to the December 2007 rule. First, the new rule eliminates the previous exclusion of compliance program requirements for commercial item contracts and contracts that will be performed entirely outside the U.S. <sup>3</sup> This change has widespread implications. For example, Federal Supply Schedule contractors and construction companies performing work for the federal government in Iraq and Afghanistan will have to meet these requirements as well as the requirements specified in the new rule.

Also, the new rule must be flowed down to subcontractors, so, under certain circumstances, vendors will also be required to comply with this rule. Prime contractors will need to verify whether or not the subcontractor has a compliance program in place for covered contracts before placing orders. Prime contractors are not expected to review or approve a subcontractor's ethics code or internal controls system—just verify the existence of a program. <sup>4</sup>

The new rule clarifies that contractors have flexibility in the method of communicating the code of conduct. They are required to “make a copy of the code available to each employee engaged in performance of the contract.” <sup>5</sup> This will permit construction companies to refer employees to websites and use other means of information technology rather than distributing paper copies.

## New requirements

The new rule requires contractors to establish a business ethics awareness and compliance program and internal control system, which include:

- Having a written code of business ethics and conduct;
- Making the code available to all employees involved in performance of the contract;
- Exercising “due diligence” to prevent and detect improper conduct;
- Promoting an organizational culture that encourages ethical conduct and a commitment to compliance with the law.

Under the new rule, contractors must also timely disclose 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. <sup>6</sup> The disclosure requirement is triggered whenever a contractor has “credible evidence” of a violation. Contractors and subcontractors must submit written disclosures to the agency Office of the Inspector General

with a copy to the contracting officer on the contract at issue. Note that under the new suspension and debarment provisions, contractors and subcontractors must make these disclosures on *all existing contracts and subcontracts (including completed contracts and subcontracts within 3 years after final payment)*, regardless of whether the clause is included in the contract and regardless of the contract value or duration. <sup>7</sup>

Contractors must also “fully cooperate” in government audits, investigations, or corrective actions relating to contract fraud and corruption. Thus, contractors and subcontractors are required to fully cooperate with the government in matters which must be disclosed. The FAR Council indicates that this does not apply in the context of routine contract administration such as a DCAA audit. <sup>8</sup>

Construction companies can expect to see the new clauses requiring compliance programs and disclosures in contracts and subcontracts solicited and entered into starting on December 12, 2008.

The rule also provides that a contractor or subcontractor may be suspended or debarred for “knowing” failure by one of its “principals” to disclose a violation or to disclose significant overpayment(s) on the contract, other than overpayments resulting from contract financing payments: “Principal means an officer, director, owner, partner, or a person having primary management or supervisory responsibilities within a business entity (e.g., general manager; plant manager; head of a subsidiary, division, or business segment and similar positions).” <sup>9</sup> This applies to all contracts and subcontracts, regardless of whether the clause is included in the contract and regardless of the contract value or duration. <sup>10</sup>

As most government contractors know, suspension and debarment can last for years and cost a company millions of dollars of business in the federal marketplace. Many companies are relying on their federal contracts to help sustain the company if its commercial construction projects are slowing due to the current economic crisis. This makes it imperative that construction companies performing government contracts begin implementing policies and procedures to meet these requirements now.

**Business ethics and compliance program with internal controls system.** The business ethics and compliance program requires:

- Reasonable steps to communicate the contractor's standards and procedures and other aspects of the ethics and compliance program through effective training programs and other dissemination of information appropriate to an individual's roles and responsibilities;
- Training requirements apply to the contractor's principals, employees, and, when appropriate, its agents and subcontractors;
- Establishing a detailed internal controls system within 90 days after contract award;
- The internal control system must establish procedures to “facilitate timely discovery of improper conduct in connection with government contracts.” This includes at a minimum:
  - Assigning responsibility for oversight of the program at a sufficiently high level and providing adequate resources to ensure the effectiveness of the program;
  - Making reasonable efforts to exclude individuals as principals who have engaged in conduct that violates the contractor's code, i.e., don't employ violators as managers or supervisors;
  - Conducting periodic reviews of company practices, policies, procedures and internal controls for compliance with the code and the requirements of government contracting. This includes:
- Monitoring and auditing to detect improper conduct;

- Periodic evaluation of the effectiveness of the program and internal control system;
- Periodic assessment of the risks of improper conduct and implementation of appropriate steps to address the risks identified;
- Establishing an internal reporting system that provides for anonymous or confidential reporting (when desired) of suspected improper conduct (e.g., hotline);
- Imposing a consistent system of disciplinary action for engaging in or failing to take reasonable steps to detect and prevent improper conduct, as well as incentives to encourage compliance behavior; and
- Making timely disclosure of violations of federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations or the civil False Claims Act (described further below).

Note that the training and internal control systems are not required on contracts with small businesses or for commercial items, as defined in FAR 2.101.

Contractors with effective compliance programs know that it takes time to develop and implement new policies and procedures. Companies with existing programs have a head start on meeting these requirements and may only need to perform a gap analysis to determine where their existing policies fall short and then revise their program accordingly. These companies will likely receive, and keep, contracts with the government.

However, companies that do not have compliance programs in place will need more than 90 days to accomplish all of these requirements, and these companies risk being terminated if they do not comply with these requirements within the specified time limits. Either way, any construction company doing business with the federal government should start examining the risks for the company and getting their compliance program up to speed.

**Mandatory disclosures.** All construction contractors and subcontractors are required to disclose to the agency Office of Inspector General (OIG) violations of federal criminal law involving fraud, conflict of interest, bribery, or gratuities or violations of the civil False Claims Act.<sup>11</sup>

Disclosure must be made when a contractor or subcontractor has *credible evidence* that a principal, employee, agent, or subcontractor has committed a violation in connection with the award, performance, or closeout of a contract or subcontract thereunder. Contractors and subcontractors are required to report violations relating to *any* ongoing contract, even one that occurred prior to the effective date of the new rule, regardless of whether or not the clause is in the particular contract and whether or not an internal control system is in place.<sup>12</sup> The disclosure requirement for an individual contract or subcontract continues until at least three years after final payment on the contract.<sup>13</sup>

A contractor must make “timely” disclosure. However, there is no set time period for what constitutes “timely” reporting. Time for an investigation by the contractor is permitted. The FAR Council states that the term “credible evidence” implies that a contractor will undertake a “preliminary examination of the evidence to determine its credibility before deciding to disclose to the Government.”<sup>14</sup> Timeliness is generally measured from the date of determination of credible evidence. This raises issues for contractors or subcontractors who already have credible evidence of prior violations. Failure to timely disclose is grounds for suspension and debarment.

Disclosure should be made in writing to the agency Office of the Inspector General (“OIG”) with a copy to the contracting officer.<sup>15</sup> Violations of federal criminal law involving fraud, conflict of interest, bribery, or gratuities prohibited in Title 18 of the United States Code and violations of the civil False Claims Act must be disclosed.<sup>16</sup>

"Knowing" failure to disclose means actual knowledge of the violation on the part of one or more of the contractor's or subcontractor's principals, as defined in FAR 2.101. In other words, contractors must make written disclosures when a principal of the company has knowledge of a violation. Under the definition of "principal," this could include compliance officers or directors of internal audits, as well as other positions of responsibility.<sup>17</sup> "Until the contractor has determined the evidence to be credible, there can be no 'knowing failure to timely disclose.'" <sup>18</sup> This has immense implications for construction contractors. A contractor or subcontractor with principals who know of credible evidence that a principal, employee, agent, or subcontractor has committed a covered violation in connection with a Government contract or *subcontract* must make timely disclosure to the OIG and contracting officer. This includes situations where the violation occurred prior to the effective date of this rule. Construction companies are well advised to establish a system to capture the knowledge that could trigger this requirement and a system for reporting violations as required under the rule. Construction companies that fail to make these disclosures may find themselves suspended or debarred as described below.

**Full cooperation.** The new rule requires contractors and subcontractors to fully cooperate with the government in the government's efforts to audit, investigate, or take corrective action relating to violations which must be disclosed. According to a newly added definition, "full cooperation" means "disclosure to the government of information sufficient for law enforcement to identify the nature and extent of the offense and the individuals responsible for the conduct. It includes providing timely and complete response to government auditors' and investigators' requests for documents and access to employees with information."<sup>19</sup>

Full cooperation does not require disclosure of information covered by the attorney client-matter privilege or work product doctrine. However, contractors are advised that facts are not protected and must be disclosed. Nor does cooperation require any officer, director, owner, or employee to waive his or her Fifth Amendment rights.<sup>20</sup> Contractors may conduct a thorough internal investigation and defend proceedings or disputes relating to potential or disclosed violations and still "fully cooperate."<sup>21</sup>

**Suspension and debarment.** The rule also provides that a contractor or subcontractor may be suspended or debarred for "knowing" failure by a principal to make the mandatory disclosures identified above, as well as failing to disclose significant overpayment(s) on the contract (other than overpayments resulting from contract financing payments as defined in FAR 32.001). This applies to all existing contracts and subcontracts (and those within three years after final payment), regardless of whether the clause is included in the contract and regardless of the contract value or duration.<sup>22</sup> The suspension/debarment risk continues until three years after final payment on any government contract awarded to the contractor. The FAR Councils rejected the argument that this new requirement is improperly retroactive. They noted that criminal violations and violations of the civil False Claims Act are already illegal and that the only change is the requirement to disclose the illegal behavior. However, this new ground for suspension or debarment also includes the failure to report "significant overpayments," which the rule does not define. The FAR Council indicated that this may not be based on monetary value alone, and what constitutes a "significant overpayment" will be determined by the suspension and debarment official.<sup>23</sup> (Contractors are already obligated to report and return overpayments under the payments clauses.<sup>24</sup>)

**Other relevant information.** In conjunction with the new rule, the government has provided guidance about protecting confidential information, flowing down compliance and disclosure requirements to subcontractors, and including integrity and ethics in performance evaluations.

**Confidential information.** The government is obligated, to the extent permitted by law, to safeguard and treat information obtained pursuant to the disclosure requirement as confidential when the information has been marked "confidential" or "proprietary" by the

company.<sup>25</sup> It is important for contractors to properly mark information before disclosing it to the government.

**Subcontractor flow-downs.** The government requires prime contractors to flow-down the compliance clauses in all subcontracts expected to exceed \$5 million and with a performance period of 120 days or more. This includes commercial item contracts and contracts performed outside the U.S. Prime contractors must only verify the existence of the subcontractor's code, compliance program, and internal controls, and need not review the program for adequacy.<sup>26</sup> Subcontractors must also make the mandatory disclosures described above.

**Performance evaluations.** The new rule also amends section 42.1501 (contractor performance information) to include compliance with contract requirements, cooperation with the government, and the contractor's record of integrity and business ethics. Contractors can expect to see changes in performance evaluations based on the new rule.

## Conclusion

Many construction companies already have compliance and ethics programs that meet FAR requirements and the Sentencing Guidelines criteria. Others have designed programs to meet the requirements of the December 2007 final rule, but have not implemented full Sentencing Guidelines programs. We recommend that all contractors perform gap analyses/risk assessments to determine whether their programs meet the new requirements, and, if not, where they fall short. Some companies will need to begin a program from scratch. Federal contractors should be aware that the grace periods established by the FAR—30 days after contract award to implement codes of ethics and business conduct, and 90 days to implement training and internal control systems—are generally not sufficient to do a risk assessment, gap analysis, and establish and implement a program. We recommend that construction companies begin examining these issues now so that programs can be rolled out in a coherent and timely manner.

The other area that may cause construction companies difficulty and place them at risk is the requirement to report prior violations about which they have knowledge, even when the contract in question does not contain the new compliance provisions. government contractors must timely disclose violations which are known to the company's principals (as defined in the FAR) as of December 12, 2008. This means that contractors should immediately begin to determine whether the company's principals have credible evidence of any violations that must be disclosed and prepare to make those disclosures.

Lastly, contractors must stay attuned to whether states propose similar regulations in this area or simply adopt the FAR requirements. It will not be surprising to find states adopting similar requirements that will apply to all contracts and subcontracts performed for the individual state. If, in the future, individual states implement similar requirements for state law projects, construction companies with compliance programs already in place will likely only need to make minor adjustments to those programs to meet state requirements. But, for now, getting a compliance program and reporting system in place that meets the federal requirements is imperative.

<sup>1</sup>

<sup>2</sup> 73 Fed. Reg. 67064, FAR Case 2007-006, Contractor Business Ethics Compliance Program and Disclosure Requirements (Nov. 12, 2008).

<sup>3</sup>

<sup>3</sup> 73 Fed. Reg. 67085.

[4](#) 73 Fed. Reg. 67090.

[5](#) 73 Fed. Reg. 67084.

[6](#) 48 C.F.R. 52.203-13(b)(1)(ii).

[7](#) 31 U.S.C. 3729 et seq. (emphasis added).

[8](#) 73 Fed. Reg. 67073, 67085.

[9](#) 73 Fed. Reg. 67078.

[10](#) 73 Fed. Reg. at 67091.

[11](#) 73 Fed. Reg. 67085.

[12](#) 48 C.F.R. 52.203-13(b)(3).

[13](#) 73 Fed. Reg. 67074.

[14](#) 73 Fed. Reg. 67092.

[15](#) 73 Fed. Reg. 67073.

Contracts used by multiple agencies, such as the Federal Supply Schedule, require making disclosures to the OIG for the ordering agency *and* the OIG of the agency responsible for the basic contract.

[16](#)

[17](#) 31 U.S.C. 3729 et seq.

[18](#) See 73 Fed. Reg. 67079.

[19](#) 73 Fed. Reg. 67074.

[20](#) 48 C.F.R. 52.203-13(a).

[21](#) 48 C.F.R. 52.203-13(a)(2).

[22](#) 48 C.F.R. 52.203-13(a)(3).

[23](#) 73 Fed. Reg. 67085.

[24](#) 73 Fed. Reg. 67080.

[25](#) See, e.g., 48 C.F.R. 52.232-25, 52.232-26, 52.232-27, and 52.212-4(i)(5).

[26](#) 48 C.F.R. 52.203-13(b)(3)(ii).

73 Fed. Reg. 67084.

© 2009 Thomson Reuters/RIA. All rights reserved.

# 6040608\_v1