



New Mandatory Disclosure and Ethical Requirements for Government Contractors and their Subcontractors: Spill the Beans or Else!

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U.S. Government contractors are now required to report to the Government potential criminal violations, False Claims Act violations, and overpayments received. This is known as mandatory self-reporting. According to a recent final rule revising the Federal Acquisition Regulation (“FAR”), if you are a Government contractor or subcontractor, you may now be required to report to the pertinent inspector general and contracting officer if you have credible evidence of certain criminal violations in connection with your Government contract, False Claims Act violations, or if you have been overpaid.

This new mandatory reporting requirement, among other new changes relating to ethics compliance, is a sign of increased concern over reports of fraudulent, unethical and criminal conduct by Government contractors and subcontractors. It is part of a renewed emphasis on regulation and the criminalization of Government contract disputes. The federal Government spends billions of dollars each year on goods and services. But surprisingly, despite the importance of contractor ethics, only recently has the U.S. Government instituted a Government-wide requirement for contractors to have a written code of ethics.

On June 30, 2008, however, Congress passed the Close the Contractor Fraud Loophole Act (Pub. L. 110-252, Title VI, Chapter 1). That law requires the FAR to include “provisions that require timely notification by Federal contractors of violations of Federal criminal law or overpayments in connection with the award or performance of covered contracts or subcontracts, including those performed outside the United States and those for commercial items.” A covered contract was defined as “any contract in an amount greater than \$5,000,000 and more than 120 days in duration.”

On November 12, 2008, the FAR Council implemented this mandatory reporting requirement, among other new ethics requirements, in a final rule as part of the much-anticipated revisions to the FAR relating to Government contractor business ethics and compliance. See 73 Fed. Reg. 67091 (November 12, 2008). A portion of the recent final rule elaborates and expands the business ethics and compliance revisions to the FAR made on December 24, 2007; and parts of the rule, like the mandatory reporting requirement, create entirely new obligations. These new rules will go into effect on December 12, 2008.

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The Previous Business Ethics Requirements

Previously, in December 2007, the FAR Council issued rules that required non-commercial contractors and subcontractors receiving awards for contracts in excess of \$5 million that have performance periods of 120 days or more to comply with new Government-wide business ethics requirements. The initial rules included, among other things:

- (1) a written code of business ethics and conduct;
- (2) an ongoing business ethics and ethics awareness program;
- (3) an internal control system to timely discover and correct improper conduct; and
- (4) the posting of agency OIG fraud hotline posters in the workplace.

These requirements can be found in the current FAR contract provisions 52.203-13 Contractor Code of Business Ethics and Conduct (DEC 2007) and 52.203-14 Display of Hotline Poster(s) (DEC 2007). These requirements did not apply to contracts or subcontracts performed entirely overseas. Moreover, small businesses were exempt from implementing an ongoing business ethics and business conduct awareness program or an internal control system.

The Requirements of the Final Rule

The new final rule issued by the FAR Council expands on the previous revisions to the FAR and adds several new requirements. In particular, FAR 52.203-13 Contractor Code of Business Ethics and Conduct has been revised to include new mandatory self-reporting requirements. It also has expanded its requirements with regard to a contractor's business ethics plan, ongoing business ethics awareness and compliance program, and internal controls system. The major new or expanded requirements include:

- *Mandatory self-reporting.* The most significant new requirement under the final rule is the mandatory self-reporting requirements. Contractors must now timely disclose to their agency inspector general and contracting officer when the contractor has credible evidence of a violation of federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations or a violation of the False Claims Act in connection with the award, performance, or close-out of a Government contract or subcontract. This requirement continues to apply to contracts expected to exceed \$5 million and at least 120 days in duration.
- *New grounds for debarment.* According to changes to FAR 9.406-2 and 9.407-2, Government contractors may now risk suspension or even debarment for the knowing failure of a principal to timely disclose to the Government credible evidence of a violation of certain federal criminal laws, a violation of the False Claims Act, or any significant overpayments on a contract not resulting from contract financing in connection with the award, performance, or close-out of the contract or subcontract thereunder. This mandatory disclosure obligation continues for three years after final payment is made on a contract. Such a failure is a ground for suspension or debarment regardless of whether the new FAR 52.203-13 applies.
- *Exception from business code of ethics requirement for commercial-item contracts and contracts performed overseas eliminated.* Contractors with commercial-item Government contracts and subcontracts or who hold contracts performed entirely overseas must now have a written code of business ethics and conduct, exercise due diligence in preventing and detecting criminal conduct, and abide by the new mandatory disclosure requirements pursuant to FAR 52.203-13 (b) Contractor Code of Business Ethics and Conduct. This requirement continues to apply to contracts expected to exceed \$5 million and at least 120 days in duration.

- *Ethics training and on-going business ethics awareness and compliance program.* Contractors, other than those classified as small business or commercial-item contractors, must have an ongoing business ethics awareness and compliance program that will: (1) take reasonable steps to periodically communicate the contractor's ethics standards and procedures and other aspects of its business awareness and compliance program and internal control system; (2) provide ethics training to its principals, employees, and, where appropriate, its agents and subcontractors. This requirement continues to apply to contracts expected to exceed \$5 million and at least 120 days in duration.
- *Expanded internal control system.* Contractors, other than those classified as small business and commercial-item contractors, must also have an internal control system that establishes standards and procedures to facilitate timely discovery of improper conduct regarding Government contracts. It must also ensure that corrective actions are instituted and carried out. Contractors with contracts expected to exceed \$5 million and at least 120 days in duration should ensure their internal control system, at minimum, will:
 - assign responsibility at sufficiently high levels and provide adequate resources to ensure effectiveness of the ethics programs;
 - take reasonable efforts to not include individuals as principals, whom due diligence would have exposed as having engaged in conduct in conflict with the contractor's code of ethics;
 - periodically review the contractor's business practices, procedures, policies, and internal controls for compliance with the contractor's code of business ethics and conduct;
 - provide for an internal reporting mechanism that allows for anonymity and confidentiality;
 - provide disciplinary action for improper conduct and for the failure to take reasonable steps to prevent or detect improper conduct;

- provide for timely disclosure upon credible evidence of certain criminal violations; and
- provide for full cooperation with any Government agency responsible for audits, investigations, or corrective actions. Full cooperation, among other things, means disclosing sufficient information to the Government for law enforcement to identify the nature and extent of the offense and the individuals responsible.

When will the new rules go into effect?

The new FAR contract provisions must be included in solicitations and resultant contracts after the December 12, 2008 effective date of the new final rule. For contracts containing the new FAR 52.203-13, contractors and subcontractors will have up to 30 days from the date of award to implement their new or revised code of business ethics and conduct. And contractors and subcontractors, other than small businesses or commercial-item contractors or subcontractors, will have up to 90 days from the date of award to implement their new or revised ongoing awareness program and internal control system.

Contractors should be wary because the new grounds for suspension and debarment are effective December 12, 2008 and apply to all Government contracts even if the newly revised contract provisions are not applicable. Therefore, contractors have a continuing obligation to report certain violations for existing contracts, even if they occurred prior to the effective date of the rule.

In the meantime, Government contractors and subcontractors who currently have a written business code of ethics, a code of ethics awareness plan, and/or an internal control system should review their existing policies and procedures to ensure they meet the expanded requirements of the final rule. Moreover, previously exempted commercial-item contractors

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and/or contractors who perform contracts overseas should be aware that there are new ethics requirements they must comply with in contracts awarded after December 12, 2008. Finally, given the new obligation to report on employees who commit certain criminal acts, Government contractors and subcontractors who employ unionized workers should review their collective bargaining agreements to ensure they comply with employee's rights, including union representation during investigatory interviews.

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