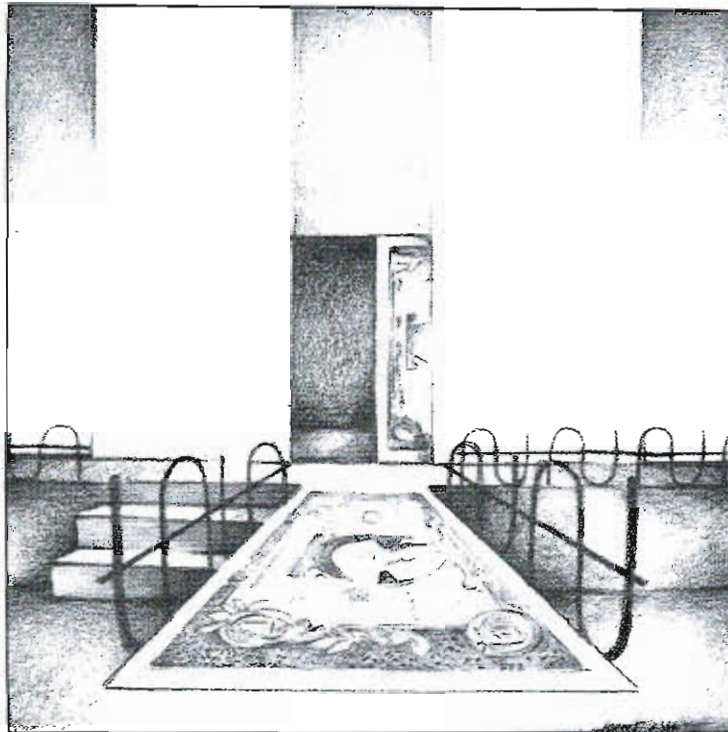


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**A Company Contract Compliance Program:  
Why You Need One and How to Implement It**

Richard D. Lieberman  
Sullivan & Worcester

**Investing in Infrastructure:  
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Civil Engineering Research Foundation

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J. Muller International

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# A Company Contract Compliance Program

Why you need one and how to Implement it

**E**very company that performs contracts or sub-contracts for the federal government needs to ask itself whether it has an effective program to detect and prevent any violation of laws or regulations in its operations. The recent "criminalization" of the procurement process means that any company, whether it has five employees, 100 employees, or 1,000 employees, may run a substantial risk of criminal prosecution and possible debarment from government contracting as a result of the way it bids and performs on government contracts. An effective contract compliance program is relatively inexpensive to implement, but can pay important dividends by helping avoid problems before they arise. For contractors, it is important to know how to set up a compliance program that includes all of the elements that are essential in today's contracting environment.

by  
Richard D. Lieberman

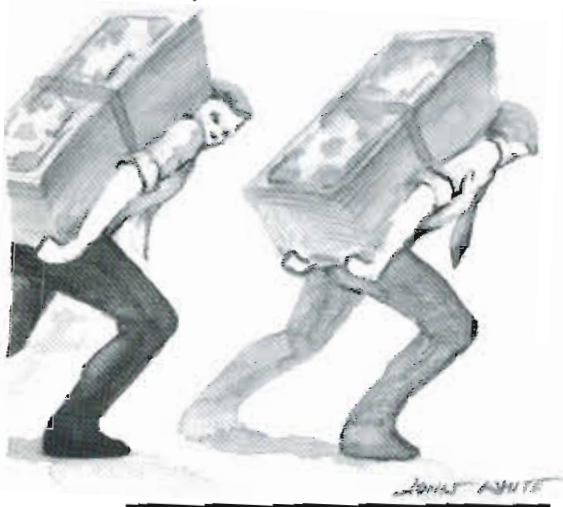


## WHY COMPLIANCE?

During the past 10 years, the entire government procurement process has been "criminalized." From bidding and award through claims and terminations, what once was treated as only a contractual dispute is now likely to be investigated and prosecuted as a violation of one of the many criminal laws that apply to all government contracts. Even where a dispute does not become the basis for a criminal investigation, the government will routinely stress literal compliance in such important areas as the disclosure of contract pricing information, quality control, testing and contract representations and certifications. This emphasis on both criminal investigation and contract compliance gives government contractors a powerful incentive to ensure that their compliance and internal control systems are in-place and operating effectively.

The change during the past decade has been dramatic. In 1981, there were 15 statutory Inspectors General ("IG") in the federal government, each charged with detecting and preventing fraud, waste and abuse in government contracts and programs. At that time, the key personnel within the IG offices tended to work separately – the auditors audited and the investigators investigated. Coordination was a sought-after goal, not a reality. In addition, the Governmental Auditing Standards promulgated by the Comptroller General of the United States, which guided all

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## POTENTIAL PITFALLS

Inspectors General and prosecutors use a wide variety of laws in their pursuit of government contractors. Among the favorites are laws against:

- 1 **Criminal false statements** - prohibiting anyone from knowingly and willfully falsifying, concealing or covering up a material fact by any trick, scheme or device, or making or using any false, fictitious or fraudulent statement, representation, false writing or document, in any matter within the jurisdiction of any U.S. Government agency. Penalties: imprisonment up to five years and a fine up to \$10,000 for each false statement.
- 2 **Criminal false claims** - prohibiting anyone from making or presenting to the U.S. government any claim against the United States, knowing such claim to be false, fictitious or fraudulent. Proof beyond a reasonable doubt is required. Penalties: imprisonment up to five years and a fine up to \$10,000 for each false claim.
- 3 **Civil false claims** - prohibiting anyone from knowingly presenting to the U.S. Government a false or fraudulent claim for payment. Proof by a preponderance of the evidence is required – a lesser standard than the proof beyond a reasonable doubt needed to prove a criminal false claim. Penalties: For each false claim, a fine of between \$5,000 and \$10,000 plus three times the amount of loss sustained by the Government. Civil false claim actions often follow a criminal false statement or false claims conviction, and thereby substantially increase the penalties.
- 4 **Mail and wire fraud** - prohibiting anyone from using the mail or the wires, radio or TV to execute a scheme or artifice to defraud, or to obtain money or property by means of false or fraudulent pretenses. Penalties: Imprisonment up to five years and a fine of up to \$1,000 for each fraudulent use of the mail or wires.
- 5 **Conspiracy** - prohibiting two or more persons from conspiring either to commit any offense against the United States or to defraud the United States in any manner, where one person takes at least one overt act in furtherance of the conspiracy. Penalties: Imprisonment up to five years and a fine of up to \$10,000.

Investigators and prosecutors often charge violations of several different laws for any given scheme perpetrated by a government contractor. For example, if two persons conspire to submit a false progress payment, and the voucher for the payment is sent through the mails, the government could charge mail fraud, a criminal false statement or a false claim, and conspiracy. Once there is a criminal conviction, the government could seek substantial damages by charging a civil false claim.

*Richard D. Lieberman*

# THE CRIMINALIZATION OF THE PROCUREMENT PROCESS

The dramatic success of the Inspectors General during the past decade in criminal prosecutions, investigative recoveries and exclusion, debarment and suspension from federal contracting is shown on the table below:

## Successful Prosecutions

	1981	1985	1990
Defense	4	717	1,509
Education	28	159	205
Health and Human Services	106	1,005	1,310
All Agencies	<b>1,059</b>	<b>3,950</b>	<b>5,465</b>
Investigative Recoveries - All Agencies	\$36 mil	\$228 mil	\$754 mil
Debarment, suspensions & exclusions from gov't contracting - All Agencies	502 (1982)	1,446	3,228

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governmental auditors, did not require that auditors report instances of suspected fraud to the criminal investigators within their own offices. In 1981, all of the IGs had only about 5,131 personnel, annually accounted for only 1,059 criminal convictions, and caused fewer than 500 individuals and contractors to be suspended or debarred from government contracting.

During the past decade, Congress extended the IG concept to 60 government departments and agencies, the auditors and investigators learned how to work together to detect and investigate fraud, and the standards for auditors *required* that suspected fraud or illegal acts be reported promptly to investigative authorities. As a result, the IGs in the federal government now have over 34,000 auditors, investiga-

tors and inspectors, all of whom are charged with ferreting out fraud, and all of whom now generally work in harmony. This substantial force of oversight personnel includes more than 5,500 contract auditors in the Defense Contract Audit Agency ("DCAA"), an organization devoted exclusively to auditing government contractors. DCAA performs contract audits for all agencies in the Department of Defense, and for 46 other departments and agencies. (A better name for DCAA is *Government Contract Audit Agency*). DCAA's manual is replete with instructions on the need for contractor compliance, and explicit in its direction that any fraud suspected by the auditors must be reported promptly to an appropriate investigative unit. During the past five years, DCAA was a frequent source of referrals that eventually turned into criminal prosecutions.

## WHEN COMPLIANCE FAILS

By 1990, the IGs were responsible for 5,465 convictions and 3,228 suspensions and debarments – a nearly five-fold increase in convictions and six-fold increase in debarments and suspensions during the past decade. The convictions included false statements on claims, invoices, test results and certifications provided to the government, bid rigging and collusion, conspiracy to defraud the government, mail and wire fraud, theft and conversion of government property, bribery, and conspiracy. Although the news media have focused on the prosecution of the large government contractors, the statistics for the Department of Defense alone reveal that more than *six times* as many small and medium size companies were indicted and convicted in 1991 for contractual violations as large companies.

The improper conduct of government contractors included such matters as the "padding" of invoices and requests for payments from the government, the falsification of test results (inflating a test score or not testing at all), the mismarking of employee time cards and "kicking back" money to a buyer in order to get a subcontract. Convictions are frequently based on the failure of a company to disclose information to the government that it is required by law to disclose.

Often, IG investigations led to criminal prosecution and conviction, including fines and possible jail sentences, and eventual debarment from receiving government contracts. Even if an employee perpetrated the crime without the knowledge of management, the company was generally held responsible and the penalties were often applied to the company as well.

Two other factors in the government contracting equation have made the situation even more difficult for contractors. The first was the proliferation of procurement laws and regulations that occurred during the past decade. In 1988 alone, the Congress passed eight statutes embodying roughly 60 separate provisions affected the procurement process. Between

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## Contract Compliance

1984 and 1990, the government's procurement regulatory scheme, known as the "Federal Acquisition Regulation," grew by 43 percent in actual page count – increasing from 3,416 pages to 4,900 pages in the Federal Register. Every time there is a significant change in statute or regulation, government contractors have a bigger compliance job on their hands.

The other significant factor in the government procurement equation is the new Sentencing Guidelines for Organizations, which affect all crimes occurring after November 1, 1991. The new Guidelines were designed to provide a powerful incentive for organizations to maintain effective company compliance programs. Organizations sentenced for crimes under the new Guidelines will face criminal fines that are likely to be *four times higher than the pre-Guidelines fines*. (Companies and corporations cannot be jailed, so the criminal punishment is normally a fine).

The emphasis in the new Guidelines on compliance programs is so significant that a company can reduce its fine by as much as *95 percent*, if it has an effective compliance program similar to the one described in this article. An effective company contract compliance program is the modern equivalent of the old adage "an ounce of prevention is worth a pound of cure" and can pay dividends by preventing improper actions, or by helping to minimize the adverse consequences even if those actions are not detected in time.

### UNDERLYING OBJECTIVES OF A COMPANY COMPLIANCE PROGRAM

Before implementing a compliance program, a company should understand the objectives which generally underlie such a program. These normally include the following:

- To promote employee compliance with all laws, regulations, standards of conduct and company policies.
- To provide an effective early warning system for management of possible trouble areas, and to insulate the company and its top manage-

ment from liability, if possible, in the event some type of violation occurs.

- To create tangible evidence of a company's anti-fraud, pro-compliance commitment through internal control systems and procedures. (This will be helpful in demonstrating to the Government that the company has implemented an effective compliance program, and that the company is eligible for the reduction in fines set forth in the Sentencing Guidelines for Organizations.)
- To permit the company to detect and correct areas of noncompliance.
- To reduce the likelihood of the company being suspended or debarred. (The Federal Acquisition Regulation, like the Sentencing Guidelines, encourages companies to implement compliance programs, and specifically requires that government officials consider such programs when deciding whether or not to debar a government contractor from receiving new contracts.)
- To improve operational management by implementing the various internal control mechanisms that a compliance program provides.

An effective compliance program should be able to meet all of these underlying objectives.

### THE NINE ESSENTIAL ELEMENTS OF AN EFFECTIVE COMPANY COMPLIANCE PROGRAM

A compliance program, which is usually implemented with the assistance of an attorney, begins with a "baseline review" of the business, evaluating its operations and potentially vulnerable areas. A good baseline review includes interviews of key employee personnel and considers the size of the organization, the nature of its business, its previous history of problems or noncompliance, its management structure and its specialized areas of government contracting. The baseline review also examines the education and training levels of company employees, their compensation (e.g., fixed salaries, profit-sharing, commissions, etc.), and the company account-

ing systems and various internal controls already in existence.

When the baseline review is completed, the company should have a clear understanding of potential problem areas – places where the company might be vulnerable to noncompliance or fraudulent activities – and where the emphasis in the compliance program should be placed.

A compliance program should include nine basic elements:

1. An *ethics code* which sets forth the company's commitment to honesty and integrity, and advises employees of the various areas in which they may encounter problems. The code normally sets forth or references all of the other aspects of the company's compliance program, so that employees know exactly what is expected of them.
2. A *training program* which communicates the ethics code to all employees. The compliance program cannot succeed unless employees have read and can understand it.
3. A *compliance official* who is personally responsible for operating the compliance program, even if he/she has other duties. Successful management of the compliance program should be at least one element in the employee's annual performance appraisal and bonus evaluation.
4. Careful *discretion in the delegation of authority* to ensure that only reliable employees are given significant responsibilities for programs and contracts. The company's personnel system should scrutinize the background of all potential employees. If the company hires someone who has had some past problems, such as instances of dishonesty or disciplinary action taken against him or her, it is imperative that such a person not be delegated duties which could be abused, or that effective internal controls and proper supervision be exercised over that particular employee.
5. A *company hotline* or similar mecha-

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nism so that employees can anonymously report suspected wrongdoing without fear of reprisal. A good hotline serves as a pressure relief valve for employees, alerting management not only to allegations of fraud, but to general employee "gripes" as well.

6. *Internal reviews* of how well the program is operating (sometimes performed by CPA's or other consultants). These reviews should systematically cover all major areas of company operations, including purchasing, quality control, estimating and bidding procedures, etc. The reviews need not be made every year, but could be accomplished, for example, on a two-year cycle.
7. *A willingness to have the company report wrongdoing* to the government, an agreement to *cooperate with the government*, and an *acceptance of the company's responsibility* for its actions. The Department of Defense, for example, has a "Voluntary Disclosure" program to which over 100 companies have disclosed serious wrongdoing. Voluntary disclosure decreases the likelihood that a contractor will be prosecuted. Although more than \$135 million in damages have been recovered by the government through this program, only three contractors were prosecuted and convicted, and only one company was debarred from contracting. Disclosure and cooperation with the government are carefully considered by prosecutors when assessing whether to bring charges against the company.
8. *Effective discipline* when employees violate the ethics code. Generally, ethics codes mandate that disciplinary action be taken with appropriate compassion and understanding for employees. Because employee discipline serves both to deter and punish crimes and wrongdoing, accountability is an essential element of any effective compliance program.
9. *Corrective actions* by the company

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when problems are discovered. These include more than just disciplinary actions for employees and encompass changes in company policies, procedures and internal controls in order to correct systemic weaknesses.

### PRACTICAL TIPS

A company's code of ethics should be brief and should stress the need for integrity in key company business areas. Many companies are able to use similar ethics codes, differing only as required for the special nature of the company's business. Every employee should receive a personal copy of the ethics code, and be required to acknowledge in writing that he or she has read and understood the code.

Employee training is essential to communicate the ethics code. Every employee involved in the government contracting process should be trained when the code is put in place, and every new employee should be trained shortly after being hired. At least one session of refresher ethics training should be given to each employee annually. Training sessions should also be informal and cover likely problem areas in an informal way. Companies should use audio-visual training aids such as videotaped case studies, or interactive training sessions so as to maintain employee interest and get the message across.

A company should have a compliance official with primary responsibility for implementing the company compliance program. This may be a full time job, or more likely, an additional duty for the company's Personnel Director or Quality Assurance Director. The compliance official should conduct preliminary inquiries when there are problems, request counsel to conduct investigations and report on compliance activities to management. The company's General Counsel should not be assigned as the ethics official because it is not necessary to have an attorney serve in this capacity, and furthermore, the General Counsel may be needed to supervise or conduct investigations requested by the ethics official.

The compliance official should also

operate a hotline mechanism which can be a live person, a "mail drop" for problems, or a telephone line that simply receives recorded messages. However, all credible reports of possible wrongdoing should be investigated by the ethics official, reported to management, if appropriate, and corrected if warranted. Any internal company investigation must be thorough, and should be conducted by an attorney or with the help of an attorney (either in-house or outside the company) if there appears to be any criminal violation.

Finally, every contractor should have an appropriate records management program whereby it retains records for the length of time specified by law or regulation. Records needed for any internal or government investigation should not be destroyed until the matter is concluded.

### SUMMARY

With the recent "criminalization" of government procurement, what formerly was a mere contractual dispute is likely to result in a criminal investigation by one of the Inspectors General, and may result in civil or criminal prosecution and debarment from government contracting. Every company that performs federal government contracts should have some type of contract compliance program in place to prevent and detect any violation of laws or regulations.

A company can establish a compliance program that begins with an ethics code and includes the nine essential elements outlined above to let employees know what is expected of them and to increase the likelihood that they will do what is expected and that top management will discover potential violations of laws or regulations well before they become serious problems.

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Note: This article does not constitute legal advice as to any particular transaction.