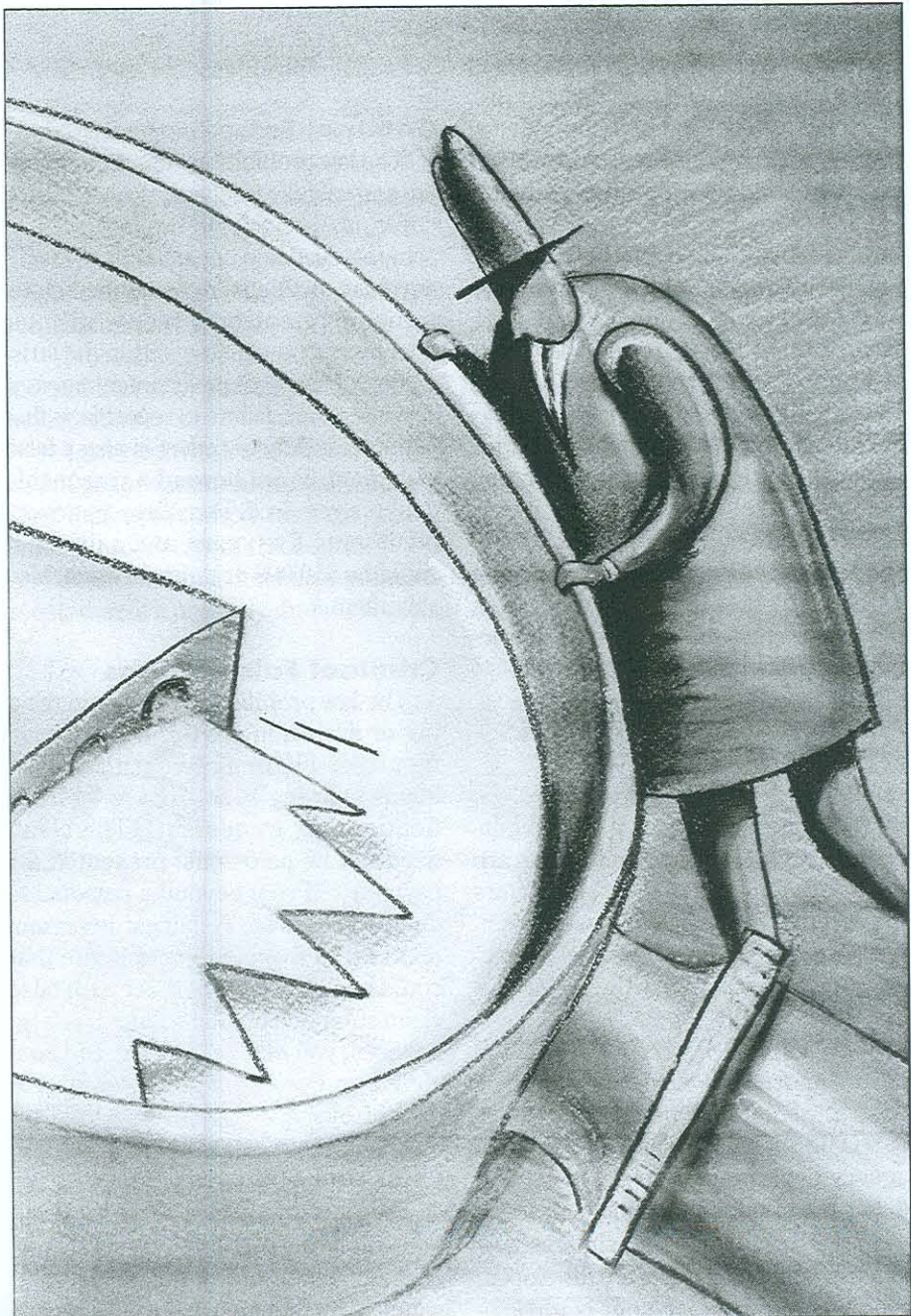


Compliance Programs— **THEY'RE WORTH IT!**

BY RICHARD D. LIEBERMAN

Prosecutors use several major federal statutes against contractors that try to defraud the government in the award or execution of their contracts. A diligently implemented company compliance program can help prevent or detect fraud, save the company millions of dollars, and keep individuals out of jail. The time to set up a program is before you experience problems.



About a year ago, a system manufacturer whose sales off the General Services Administration (GSA) schedules are among the top 10 asked me to develop a government contracts compliance program for the company. When I visited their headquarters and met with the senior officers, I told the company it was the first time I had ever been asked to establish a compliance program by a contractor that was not then under indictment, under active investigation, being tried for criminal or civil fraud, or suspended or debarred (or about to be).

My remarks were only partly facetious. Waiting until your company is in trouble is too late. Most contractors, especially those that sell commercial items through the schedules or other vehicles such as indefinite delivery, indefinite quantity (IDIQ) contracts, are unaware of the substantial benefits they can receive from a well-planned and well-executed compliance program. Aside from helping to prevent problems altogether, such as criminal or civil fraud, a compliance program that has been diligently established can reduce criminal fines by as much as 95 percent. To obtain all of the benefits, a compliance program must be established with the help of counsel, include all nine essential elements recognized by the pertinent regulations, and be implemented properly.

POTENTIAL LEGAL PITFALLS FOR CONTRACTORS

When there is suspicion of wrongdoing, most government contractors are investigated by one of the 60 inspectors general (IG) in the federal government. If enough evidence of criminal wrongdoing can be established, the IG will normally refer the case to a United States attorney for prosecution of either criminal or civil fraud. Even if the evidence is not sufficient for criminal or civil prosecution, the IG may refer the facts to an agency debarment official and seek to debar the offending company for three years (or more), or seek an interim suspension while more facts are developed. Suspension or debarment is govern-

mentwide and prevents the government from awarding any new contracts to the contractor or exercising any options on its existing contracts.

Although there are numerous criminal and civil fraud laws on the books, IGs and prosecutors primarily use six basic statutes to enforce the laws relating to government contractors:

- Criminal false statements
- Criminal false claims
- Civil false claims
- Mail fraud
- Wire fraud
- Conspiracy

Criminal False Statements

The law prohibits 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. The intentional failure to report facts that you have a duty to report is also a false statement. Proof beyond a reasonable doubt is required. Penalties: imprisonment up to five years, and a fine that could be \$10,000 or more for each false statement.

Criminal False Claims

The law prohibits 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. (The claim need not be paid—just presented for payment). Proof beyond a reasonable doubt is required. Penalties: imprisonment up to five years, and a fine that could be \$10,000 or more for *each* false claim submitted. If you submit five false invoices, you can be indicted and convicted on five counts of submitting a false claim.

Civil False Claims

The law prohibits anyone from knowingly presenting to the U.S. government a false or fraudulent claim for payment, including using a false record

to get a fraudulent claim paid or approved; conspiring to defraud the government by getting a false claim paid; delivering less property than appears on a receipt; and using a false record or statement to conceal, avoid, or decrease an obligation to pay money to the United States. 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 claims actions often follow a criminal false statement or false claims conviction, and the courts have ruled that this does not violate double jeopardy or double punishment protections in the Constitution. The Civil False Claims Act invites private parties, called “relators,” to bring a “qui tam” or private attorney general action in court against a company that violates the act. These whistle blowers are protected, and they are entitled to receive between 15 and 30 percent of the government’s recovery. The amount depends on whether the government decides to intervene in the case and the extent to which the relator contributes to the case. The government has recovered more than \$2 billion from qui tam actions since 1996, and relators have received about \$300 million in all, with at least 15 receiving more than \$1 million each.

Mail Fraud and Wire Fraud

Each is a separate offense, but the elements are similar. The law prohibits anyone from using the mail or the wires, radio, or television 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 that could be \$1,000 or more for each fraudulent use of the mail or the wires.

Conspiracy

The law prohibits two or more persons from conspiring either to commit any offense against the United States (such as submitting false claims or

statements or mail or wire fraud) 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 seek and prosecutors often bring indictments for violations of several different laws for a given scheme perpetrated by a government contractor. For example, if two persons conspire to submit one false progress payment, use the telephone to discuss their scheme, and send the progress payment request through the mail, the government could charge wire fraud, mail fraud, a criminal false statement or a false claim, and conspiracy. Once there is a criminal conviction, the government could then seek substantial monetary damages by bringing a case for a civil false claim based on the exact same facts.

OTHER POTENTIAL PITFALLS

As every government contractor knows, fraud is not the only area where there are potential traps for the unwary. Sales to the government are made in a highly regulated environment. The *Federal Acquisition Regulation (FAR)* alone, including the more than 35 agency supplements, occupies thousands of pages of regulations, not to mention the detailed and applicable rules of the Department of Labor (DOL), the Small Business Administration, and the Financial Accounting Standards Board. With this type of regulatory structure governing the formation and administration of government contracts, a company runs many risks, including:

- Failing to disclose all of the company's commercial sales practices and discounts when forming multiple award schedule (MAS) contracts
- Failing to implement the required price reductions associated with "most favored customer" pricing on MAS contracts
- Defectively pricing a contract proposal (i.e., submitting data to the government that is not current, accurate, and complete)

- Charging for unallowable items in invoices submitted to the government
 - Failing to pay minimum wages required by DOL wage determinations in government contracts
 - Permitting a small business to become affiliated inadvertently with a large business, which makes the former company no longer small for purposes of receiving set-aside contracts
 - Failing to comply with the Buy American Act or Trade Agreements Act clause in the contract
 - Not complying with the Procurement Integrity Act
 - Improperly completing the representations and certifications in a bid or proposal
 - Violating subcontracting requirements
 - Failing to perfect assignments under the Assignment of Claims Act
 - Failing to comply with equal opportunity and affirmative action requirements
 - Not fully disclosing cost accounting practices, or not consistently following them
 - Ignoring the rules on care and use of government furnished property
 - Failing to comply with the quality control provisions of the contract
- The thorough and consistent implementation of a properly drafted compli-

ance program can help prevent these types of problems or can serve as the "eyes and ears" to alert management to problems while they are still in their early stages and can be solved more easily.

HOW CAN A COMPLIANCE PROGRAM HELP?

As part of the sentencing reforms of the 1980s, which were designed to ensure that individuals actually served the time to which they were sentenced, Congress also changed the way organizations, including corporations and companies, were sentenced. (Remember: the legal system can put a person in jail but cannot jail an organization. Organizations can be fined, however.) Since 1991, all crimes committed by organizations are subject to the Sentencing Guidelines for Organizations, which generally provide for criminal fines that are likely to be four times higher than the preguidelines fines. These new guidelines were designed to provide a powerful incentive for organizations to maintain effective company compliance programs.

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

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effective compliance program similar to the one described in this article. An effective 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.

One sentencing example shows the significance of a compliance program. If a company defrauds the government out of \$1 million and is caught and found guilty, if it has never implemented any type of compliance program a court can impose fines of between \$1 million and \$2 million (plus order restitution, of course). However, if the very same company has in place an "effective program to prevent and detect violations of law" (i.e., a compliance program), fully cooperates in the investigation, and accepts responsibility for its criminal conduct, the court can only fine the company between \$5,000 and \$20,000. According to the Sentencing Guidelines, the reduction in the fine is required even if the compliance program *failed* to prevent or detect the particular criminal activity for which the company is being sentenced.

In short, a compliance program can not only prevent and detect violations of law, it can significantly reduce your company's fines even if it fails to do that.

HOW DOES A COMPANY IMPLEMENT A COMPLIANCE PROGRAM?

An effective compliance program begins with a "baseline review" of the business, including an evaluation of its operations and all of its potentially vulnerable areas. A good baseline review examines all pertinent company documentation, including investigative reports, audit reports, disciplinary reports, default terminations, and the like. It also includes interviews of key company personnel, considers the size of the organization, the nature of its business, its previous history of prob-

lems or noncompliance, its management structure, and its specialized areas of government contracting. The baseline review examines the education and training levels of company employees, their compensation (i.e., fixed salaries, profit sharing, commissions), and the company accounting systems and internal controls already in existence.

A good baseline review provides a clear understanding of the risk areas where the company might be vulnerable to noncompliance or fraudulent activities and where the emphasis on the compliance program should be placed. It gives the implementing official a clear road map that he or she can follow as the organizational compliance structure and documents are established.

NINE ESSENTIAL ELEMENTS OF AN EFFECTIVE COMPLIANCE PROGRAM

No fewer than six different groups during the past 15 years have agreed on what it takes to have an effective compliance program. These are the President's Blue Ribbon Commission on Defense Management (the Packard Commission of 1986), the Defense Industry Initiative on Business Ethics and Conduct, the FAR drafters (see FAR 9.406-1), the *Defense FAR Supplement* drafters (see DFARS 203.7001), the drafters of the Sentencing Guidelines for Organizations, and the Inspector General of the Department of Health and Human Services, which has recently published three different model compliance programs (for hospitals, clinical laboratories, and home health agencies). Here's what you should include in your program:

(1) A compliance official, ombudsman, or other official who is personally responsible for implementing the compliance program. Preferably this official will be divorced from the day-to-day operational aspects of the company, but he or she can have other duties in a smaller company. Successful management of the compliance program should be at least one element in

this employee's annual performance appraisal and bonus evaluation.

(2) An ethics code that sets forth, in clear and understandable terms, the company's commitment to honesty, integrity, and compliance with law and regulation. The code advises employees of the various areas in which they may encounter problems, and it should set forth or reference all of the other aspects of the company's compliance program so that employees know exactly what is expected of them. New employees should receive the code as part of their company orientation.

(3) Training and communication to employees, so they are all familiar with the ethics code, the company policies, and what is expected of them as members of the company team. Although it may seem mundane, this element is critical to a successful program.

(4) A hotline or similar confidential mechanism 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.

(5) Internal reviews of how well the program is operating (sometimes performed by certified public accountants or other consultants). These reviews should systematically cover all major areas of company operations including purchasing, quality control, estimating and bidding procedures, and the like. The reviews may be performed on a one- or two-year cycle, tailored to your company.

(6) Corrective actions by the company 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.

(7) 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.

(8) 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 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 that could be abused or that effective internal controls and proper supervisions be exercised over that particular employee.

(9) A willingness of the company to report wrongdoing to the government, cooperate with the government, and accept responsibility for its actions. The defense, veterans' affairs, and Health and Human Services IGs all have voluntary disclosure programs to which more than 100 companies have disclosed serious wrongdoing. Voluntary disclosure may decrease the likelihood that a contractor will be prosecuted. Generally the disclosing company will not be suspended or debarred until after the investigation is completed. Disclosure and cooperation with the government are carefully considered by prosecutors when assessing whether to bring charges against a company.

PRACTICAL SUGGESTIONS FOR IMPLEMENTING THE COMPLIANCE PROGRAM

A company should have a compliance official with primary responsibility for implementing the program, reporting to the president or chief executive officer and the board of directors (if there is one) on matters concerning the president. 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 compliance 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 operate a hotline mechanism that can be a live person, a mail drop, or a voice mail line that receives messages. However, all credible reports of possible wrongdoing must be investigated by the compliance official, reported to management if warranted, and corrected if required. Any internal company investigation must be thorough and should be conducted by an attorney or under the supervision of an attorney if there appears to be any potential criminal violation.

The company's code of ethics should be brief (10-25 pages) and should stress the need for integrity in key company business areas. Many companies can use similar ethics codes, tailoring them only 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, been given an opportunity to ask questions about, 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 a simple, informative way. Companies should use audiovisual training aids such as videotaped case studies or interactive training sessions to as to maintain employee interest and get the message across.

Finally, every contractor should have an appropriate records manage-

ment program whereby it retains records for the length of time specified by law or regulation, and then systematically destroys them (including paper, disks, hard drives). Records needed for any internal or governmental investigation should not be destroyed until the matter is concluded.

AN OUNCE OF PREVENTION

What formerly were mere contractual disputes in government contracting are now likely to result in a criminal investigation by an IG and may result in severe criminal or civil prosecution and debarment from government contracting. Every company that performs federal contracts, especially those that are providing commercial items and are less likely to be familiar with intricate federal regulations, should have a contract compliance program in place to prevent and detect violations of laws or regulations.

A company should establish a compliance program that begins with a baseline review and the appointment of a compliance official as well as the promulgation of an ethics code and the other essential elements outlined above. This will let employees know what is expected of them and will increase the likelihood that they will perform the way management expects, thereby reducing risk to management. It will not only help prevent fraud within the company, but it will also assist the company in coping with the myriad federal regulations encountered in government contracting. Finally, if all else fails and there is a criminal violation at the company, a good compliance program can reduce criminal fines substantially. ●

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