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Two days with the FBI

In cooperation with SCCE, the FBI provided compliance professionals with a rare look inside its program and the Bureau's operations

See page 14



24

Understanding
the proposed
EU data protection
regulation

Robert Bond

30

Buyers on
the take

Peter J. Crosa

34

It's time to change
the SEC's culture

Marlowe Doman

40

Ethical
decision-making
models: Decisions,
decisions

Roz Bliss

by Eric R. Feldman

Building transparency, accountability, and ethics in government contracting

- » The Federal Acquisition Regulations (FAR) require contractors to self-report credible evidence of violations of federal criminal law and significant overpayments.
- » The federal government now requires more robust corporate ethics and business conduct programs as a component of “present responsibility” determinations when considering suspension and debarment actions.
- » A record number of suspensions and debarments of unethical contractors were made in 2011.
- » Agency suspension and debarment officials have placed greater emphasis on deficiencies in corporate ethical culture than on specific FAR violations during recent suspension and debarment actions.
- » Contractors can decrease their risk by taking proactive steps designed to improve both the corporate ethical culture and the effectiveness of the business ethics and compliance program.

Much has been written about the 2008 amendments to the Federal Acquisition Regulations (FAR), which require federal contractors to report “credible evidence of a violation of federal criminal law or the False Claims Act” to the respective federal agency Inspector General and the agency contracting officer. Before the FAR Mandatory Disclosure Rule was approved, industry comments predicted that the proposed change would result in mass SWAT teams of federal agents descending on government contractors, and that agency suspension and debarment officials would routinely disqualify contractors for “failure to timely disclose” even the smallest of infractions. Fortunately, neither of these things has happened.

What also hasn’t happened, however, is the kind of increased transparency and collaborative working relationships between contractors and federal agencies envisioned by the authors of the rule (including myself) who were serving

on the National Procurement Fraud Task Force at the Department of Justice (DOJ). To date, the vast majority of disclosures have been limited to the Department of Defense (rather than the civilian agencies), and those disclosures have been focused on smaller cost mischarging and false claims cases, rather than the large kickbacks, gratuities, product substitution, and Procurement Integrity Act violations that federal law enforcement believes are running rampant in federal contracting.

When any type of disclosure is made, a contractor runs the risk that contracting officers, Defense Contract Audit Agency staff, or suspension and debarment officials will immediately ask some very fundamental questions about the ethical environment of the company that may have allowed the violation to occur. A company’s compliance with FAR 52.203-13 requirements for a contractor Code of Business Ethics and Conduct and a related ethics program might be called into question, leading suspension and debarment officials to question the company’s “present



Feldman

responsibility” and possibly to suspend or debar them or their officers from future federal contracts, even before an investigation of the facts is completed.

Further, FAR 9.104-1 requirements (i.e., that *prospective* contractors be “responsible” parties) can also be invoked if it is determined that a contractor does not have “a satisfactory record of integrity and business ethics” —potentially disqualifying the contractor from future work. All of these risks are greater when a prime contractor or a whistleblower makes the disclosure regarding the subcontractor, thus calling into question the subcontractor’s transparency, ethics, and integrity.

Transparency is the goal

The Mandatory Disclosure Rule was originally modeled after a National Reconnaissance Office (NRO) contract provision developed by that agency’s Office of Inspector General (OIG) in mid-2004. The NRO is an agency of the Intelligence Community that conducts the research and development, acquisition, launch, and operations of the nation’s spy satellite network. The NRO provision was intended to address the growing number of procurement fraud cases coming to the Inspector General’s (IG’s) attention from sources other than the contractor’s own systems of control and disclosure.

I was the IG during this time and the presumption was, if contractors were required to report credible evidence of fraud to the OIG, with serious penalties for failing to report in a timely manner, the IG and the contractor would work more collaboratively in both conducting the investigation and in preventing future incidents from occurring. NRO management became convinced of the value of this approach, and the mandatory reporting provision was inserted into all NRO contracts in August, 2004.

The NRO OIG’s experience with the contract provision from 2004 through 2007 demonstrated the effectiveness of this approach

in creating a more transparent, collaborative environment between a government agency and its substantial—and mission critical—contractor base. As the number of disclosures increased, the NRO OIG created additional opportunities for sharing the best practices in procurement fraud prevention and detection between the government and contractors, and among contractors themselves. For example, the annual Business Ethics Conference hosted by the OIG was attended by a large portion of the contractor base. The conference provided an opportunity to share data and fraud trends, reporting issues, as well as fraud prevention and investigative techniques. Conference participation increased steadily, with up to 90% of invited contractors sending staff.

The NRO documented its experiences in the *Journal of Public Inquiry*, a publication for federal Inspectors General.¹ When the National Procurement Fraud Task Force was established circa 2006, several of the agency IG’s, who had become familiar with the NRO’s mandatory disclosure experience, raised this idea for possible government-wide application. Department of Defense representatives acknowledged that the voluntary disclosure program, which initially produced dozens of significant disclosures after its implementation in 1986, had waxed and waned, with few disclosures coming in during the 2006/2007 timeframe. With substantial increases in procurement fraud (particularly in the war zones) and increasing public outrage, it appeared the time for a mandatory disclosure requirement had come.

Federal agencies seek a corporate ethical culture

The proposed FAR rule on mandatory disclosure was initially drafted based on the NRO experience, but requirements for more robust corporate business ethics and conduct programs, and specifications regarding both source selection and present responsibility

standards, were wisely added by a variety of experienced IG's, agency suspension and debarment officials, and DOJ representatives. The final FAR package was forwarded in the form of a memorandum from Alice Fisher, then Assistant Inspector General for the Criminal Division at DOJ, to the Office of Federal Procurement Policy (OFPP) at the Office of Management and Budget. After several modifications (including an initial exclusion for overseas contracts inserted at the White House level but subsequently eliminated by the 2008 Defense Supplemental Appropriations Bill), the rule was sent out for industry comment and ultimately adopted.

The government seeks ethical behavior that flows from a corporate culture of providing employees with appropriate tools (e.g., training, reporting mechanisms, and corporate communications) and encouraging staff to do the right thing in dealing with government customers.

Although some confusion and disagreement still exist over terms like "credible evidence," "timely disclosure," subcontractor "flow down," and "full cooperation" with government officials, one thing has become abundantly clear: Through disclosure and improved contractor self-governance, the government is looking for more than just compliance. The government seeks ethical behavior that flows from a corporate culture of providing employees with appropriate tools (e.g., training, reporting mechanisms, and corporate

communications) and encouraging staff to do the right thing in dealing with government customers.

Since the creation of the Defense Industry Initiative in 1986, the nation's largest federal contractors have invested considerable resources in developing comprehensive business ethics and compliance programs. Notable programs include strong leadership commitment and "tone at the top," anonymous reporting hotlines, comprehensive codes of conduct, and tailored ethics training.

Many of these programs started strictly as compliance activities under the company's Legal department, aimed at ensuring adherence to the increasingly complex federal regulations that govern the contracting process. Over time, however, most evolved into comprehensive, values-based programs that recognize legal standards, but aim for even higher ethical standards of business conduct.

Increased attention to values-based ethics is due, in part, to statements contained in the Organizational Sentencing Guidelines, particularly the November 2010 amendments that give credit to companies which develop and maintain an "ethical culture." As a result, agency contracting officials, Inspectors General, and agency suspension and debarment officers are focusing greater attention on mandatory disclosure as one element of transparency that can demonstrate the presence—or absence—of a corporate ethical culture.

Suspension and debarment actions

The Obama Administration, under pressure from Congress to weed out government contractors for ethics violations and poor performance, proposed to suspend or debar almost as many contractors in 2011 as the Bush Administration did during its entire second term.² Federal agencies are under scrutiny after a series of Congressional

hearings and reports from agency IGs and the Government Accountability Office accused procurement officials of failing to keep unethical contractors out of the \$500 billion a year federal market. According to the General Services Administration, the proposed debarments (more than 1,000 during 2011) are the most since 1997, the earliest year comparable data is available.

As Kathleen Miller reported in *Bloomberg News*, Moira Mack, a spokesperson for the Office of Management and Budget, said, “For too long, the government failed to use suspension and debarment, even in the face of egregious conduct by contractors. That’s why this administration has been pushing for tougher oversight of contractors, and we’ve seen results.” The Project on Government Oversight, a federal contracting watchdog, agreed stating, “We are starting to see the pendulum swing to more contractor accountability, but government needs to do a lot more to ensure it only works with responsible contractors and thereby protects the public.”

Agencies can propose contractors for debarment for poor performance, as well as a variety of ethical issues, including overbilling, falsely claiming entitlement to special treatment under minority or small business programs, or violating any of the many FAR requirements that govern the bidding, negotiation, execution, and management of government contracts. Because of the FAR Mandatory Disclosure Rule, an increasing number of such ethical issues are being reported by the contractors themselves, their prime contractors, or subcontractors. From the contractors’ vantage point, the political push for greater accountability through the use of suspensions and debarments, combined with the Mandatory Disclosure Rule, make them vulnerable both for reporting and failing to report. They view themselves to be “between a rock and a hard place.”

An interesting phenomenon is emerging: It is not uncommon for a prime contractor (in order to proactively protect itself) to “drop a dime” on a subcontractor or supplier for even a minor FAR violation by disclosing it to the agency IG and contracting officer. The IG or contracting officer sends the disclosure to the agency’s suspension and debarment official (SDO). This is standard procedure within the Department of Defense. The SDO asks the subcontractor what it knew, when, and why it did not disclose the infraction. If a determination is made that there is a deficiency in the subcontractor’s ethical culture, the SDO issues a debarment notice, based on a lack of “present responsibility” as defined in the FAR ethics and integrity provisions. This is not a contrived scenario; it has happened multiple times in the past year.

How should a contractor respond?

The scenario described above puts the federal contractor or subcontractor in the awkward position of either indicating that its controls and compliance mechanisms were so weak that its corporate leadership did not know about the alleged violation, or that it knew but failed to disclose. Either explanation can be devastating for the contractor and its future business with the government, because each indicates the contractor has a weak ethical culture and needs to significantly strengthen its corporate ethics and compliance programs in order to demonstrate “present responsibility.”

What is a contractor to do? If the company has followed the practices neatly described in the 2010 amendments to the Organizational Sentencing Guidelines, it has likely chartered “periodic independent assessments of the effectiveness of its ethics and compliance activities” already. These assessments can be used to demonstrate that the company has indeed established a credible, effective ethics program that promotes an ethical culture.

The problem violation can then be characterized as an anomaly, a one-time failure by a bad actor who circumvented company controls and was outside the norms of company culture.

But what if such an independent assessment had not been previously conducted, and the company's ethics and compliance activities have not been values-based, comprehensive, or effective? In recent cases, the government has been willing to set aside debarment determinations in favor of several company actions, including:

- ▶ A complete internal investigation that identifies the facts surrounding the alleged violation, the causal factors that led to the problem, and recommendations for improvements to processes and controls;
- ▶ A comprehensive external, independent assessment of the company's ethical culture by a values-based ethics expert, including evaluation of the company's ethics and compliance program, and specific recommendations for improvement;
- ▶ A company action plan that outlines proposed steps for implementing each of the recommendations contained in the independent assessment; and
- ▶ A period of independent monitoring (typically 2-5 years) to evaluate company progress in implementing the actions promised in its plan, and to report on improvements to the corporate ethics and compliance posture.

The independent monitor as corporate mentor

An independent monitor is often thought of as a corporate "cop" brought in as the result of a Deferred or Non-prosecution Agreement with the DOJ. A monitor is tasked with reporting on whether the corporate behavior that got the company into trouble has either ceased or is continuing to occur. In some cases, the monitor has been a retired senior military

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officer, political appointee, a law firm, or a large accounting firm that includes monitoring among several lines of business services it provides to its clients. The monitoring approach is often limited to looking over the shoulder of the subject company to report any obvious, continuing violations in the specific area that got the company in trouble in the first place.

In the new paradigm of transparency and ethical culture as an essential element of government contracting, this traditional, reactive approach to monitoring is outdated. SDOs, U.S. Attorney's Offices, government regulators, and others who scrutinize the behavior of government contractors and regulated entities are focusing greater attention on less punitive, more effective ways of rehabilitating companies so they can continue to be government contractors, regulated professionals, productive employers, and responsible mission partners. It is not just that these government entities face unmanageable caseloads (which they do), or that they are suffering from woefully inadequate resources to accomplish their mission (which they are). Many individuals who have worked in this area believe that repeated, multiple government investigations of contractor misconduct are simply not the most effective way of making sure that

contractors are ethical. Establishing standards for corporate self-governance and creating an ethical culture through comprehensive ethics and compliance programs, and holding contractors accountable for maintaining these standards, is a more logical way to reduce risk and improve accountability to the taxpayer.

In 2008, Acting Deputy Attorney General Craig S. Morford issued a memorandum to U.S. Attorneys outlining the best practice principles for using and choosing independent monitors. The memorandum was written in response to the frequent appointment of former senior government officials (including former Attorney General Ashcroft) to serve as monitors, leaving in doubt the independence and integrity of the monitoring process used in such agreements. The Morford memo reiterated the inherent value of independent monitoring, stating that “the corporation benefits from expertise in the area of corporate compliance from an independent third party. The corporation, its shareholders, employees, and the public at large benefit from reduced recidivism of corporate crime and the protection of the integrity of the marketplace.”³

Ideally, an independent corporate monitor is a person or entity who has in-depth knowledge and experience with regulatory schemes and oversees businesses that have been sanctioned for the violation of one or more regulations or laws. In some cases, the independent monitor is engaged proactively in response to investigations and the threat or *potential* for sanctions. The corporation pays for the monitor, and, in exchange for agreeing to ongoing oversight, typically avoids more severe sanctions (such as suspension, debarment, or prosecution). Describing the monitor’s role, Morford said that, once an agreement is reached on how to prevent future misconduct, “[a] monitor’s primary responsibility is to assess and monitor a

corporation’s compliance with the terms of the agreement specifically designed to address and reduce the risk of recurrence of the corporation’s misconduct, and not to further punitive goals.” More specifically, the memo indicates the monitor should “oversee a company’s commitment to overhaul deficient controls, procedures, and culture.”

In practical terms, the most effective independent monitor, consistent with the Morford view described above, would take any number of the following steps to “mentor” the company, resulting in a strengthening of the company’s ability to function as a responsible government contractor:

- ▶ Assess the company’s corporate ethical culture;
- ▶ Evaluate internal controls over corporate financial, purchasing, contracting, human resources, property management, or other key business processes;
- ▶ Assess key risks and vulnerabilities, particularly in the areas of fraud and due diligence over subcontractors and suppliers;
- ▶ Evaluate the adequacy of the company’s business ethics and conduct programs; and
- ▶ Make recommendations for improvement.

Convergence of the FAR and independent monitoring

Government agencies, regulators, contracting officers, and SDOs are looking for an important characteristic in government contractors: *transparency*. In many ways, the mandatory disclosure requirements and the ethics and business conduct provisions of the FAR provide tacit recognition that mistakes in government contracting will occur; that some employees might make bad, even unethical decisions; and that the difference between an ethical and an unethical company is often the manner in which the company deals with the problem *after* it occurs. In fact, SDOs are increasingly focusing on the state

of a company's "ethical culture" in making decisions on "present responsibility" —the main factor that drives whether to suspend or debar a contractor from doing business with the government. This is recognized in the FAR-mandated penalties for a company's "failure to timely disclose" credible evidence of violations or overpayments (i.e., suspension or debarment).

As of the writing of this piece, there had not yet been a case of the government suspending or debaring a company solely for violating the Mandatory Disclosure Rule. However, there have been several cases in which the government determined that the underlying violation, coupled with the failure to disclose in a transparent manner, signaled an unethical corporate culture that raised enough questions about the company's "present responsibility" that a proposed debarment was in order.

In an increasing number of cases, well-advised companies have avoided or reversed suspension/debarment decisions by offering to proactively hire an independent monitor to (1) conduct an independent assessment of the ethical culture of the company, (2) evaluate the strength of the corporate ethics

and compliance activities, (3) make specific recommendations to improve the ethics program and internal controls of the company, and (4) independently monitor (with reports to the government) the company's progress in implementing the monitor's recommendations.

The steps described above have not only been enough to avoid suspension, debarment, prosecution, and other punitive actions, but they have also created greater transparency in the government contracting process. Strengthening their ethical culture, establishing or enhancing the FAR-mandated business ethics and conduct programs, and educating staff about the broad applicability of mandatory reporting requirements have, in fact, helped companies become more responsible government contractors. In the final analysis, isn't that the end game we are all working toward? *

1. Larsen, Alan S. and Feldman, Eric R.: "Convincing Contractors to Report Their Own Procurement Fraud." *Journal of Public Inquiry*, Spring/Summer, 2006.
2. Miller, Kathleen: "US Agencies Want 1,000-plus Contractors Barred." *Bloomberg News*, December 28, 2011.
3. Morford Craig S: "Selection and Use of Monitors n Deferred Prosecution Agreements and Non-Prosecution Agreements with Corporations." U.S. Department of Justice, Office of the Deputy Attorney General, March 7, 2008.

Eric R. Feldman is President of Core Integrity Group LLC and Director of Corporate Compliance, Affiliated Monitors in Redondo Beach, California. He may be contacted at eric@coreintegritygroup.com.

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