Taking a Dynamic Approach to Compliance Risk Assessments for U.S. Government Contractors

SCCE
Compliance & Ethics Institute

September 16, 2019

All opinions are those of the presenter, and are neither sponsored nor endorsed by General Atomics Aeronautical Systems, Inc., or any clients of Apogee Consulting, Inc.

1

Risk Assessments

- A Risk Assessment is a process through which compliance risks are:
  1. Identified
  2. Evaluated to determine whether controls are in place
  3. Prioritized for levels of risk exposure
  4. Managed via a mitigation plan (management's responsibility)
  5. Reported upwards when mitigation plans fail (i.e., risks materialize)

2

Risk Assessments

- Too many companies (not just USG contractors) believe the following statements to be true:
  - Risk Identification “should not take longer than a few days”
  - Risk Assessment is primarily based on existence/effectiveness of mitigating controls
  - Risk Prioritization is based on a simplistic “snapshot” analysis of likelihood and impact using a 1 to 5 scale or a high/medium/low scale

3

Risk Assessments

- Conclusion:
- The standard Risk Assessment approach may work for some companies; but it is not effective for U.S. government contractors
- USG contractors work in a highly dynamic environment where compliance risks must be **frequently evaluated**, because they are **frequently changing**
- Annual “snapshots” will create gaps in compliance planning

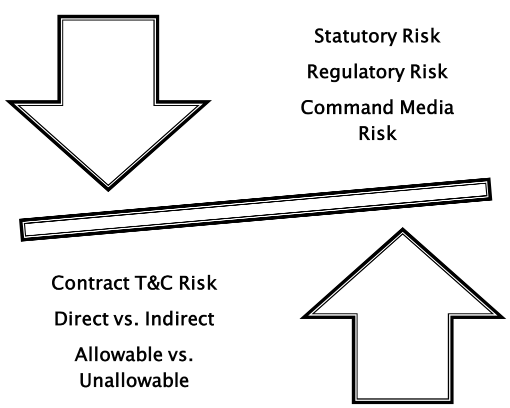
4

More General Assertions

- *Risk identification is lacking*
  - It is perfunctory
  - It is often disconnected from operations, where people who make day-to-day compliance decisions are located
  - Rarely are program risk registers reviewed (to the extent they exist)
- *Risk management too often assumes a stable or static environment*
  - Risk probabilities change over time; they have inflection points
  - Program risk registers aren't updated
  - Risks change as the company changes and grows through winning new contracts

5

Risk Identification/Assessment is a balance



- **Inputs must be received from Operations**
- **Inputs must be frequently evaluated for changes**

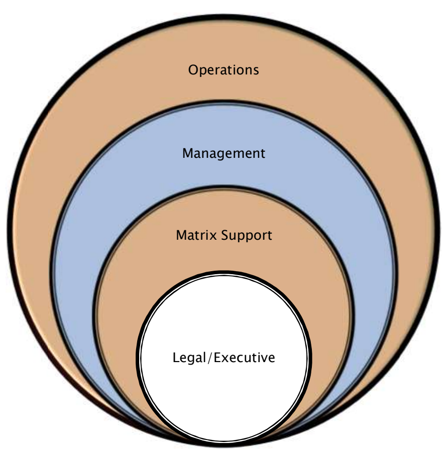
6

What a Future State Might Look Like for a USG Contractor

- Risk identification sessions are frequent
- Risk assessments are also frequent, taking into account:
  - Introduction of new risks
  - Feedback from risk-related events
  - Changes to program and/or company status
- Risk mitigation plans are developed and used to "burn down" risks
  - Mitigation plans are activated
    - At the beginning of the program
    - At inflection points

7

Risk Assessment requires cross-functional input



Risk Mitigation requires cross-functional buy-in

(

8

Examples of Evolving Risks

- An 8(a) business “graduates” from the 8(a) program and must now compete for new awards without the previous safe harbor
- A small business successfully performs an SBIR Phase 1 contract and then is awarded a Phase 2 contract
- A subcontractor becomes a prime contractor
- A successful small business grows and is now a large business
- A company submits its first proposal valued in excess of $2 million
- A company wins its first cost-reimbursable contract or subcontract
- A company wins its first T&M contract or subcontract
- A company is awarded an ID/IQ contract where each delivery order will be separately funded and may be any contract type

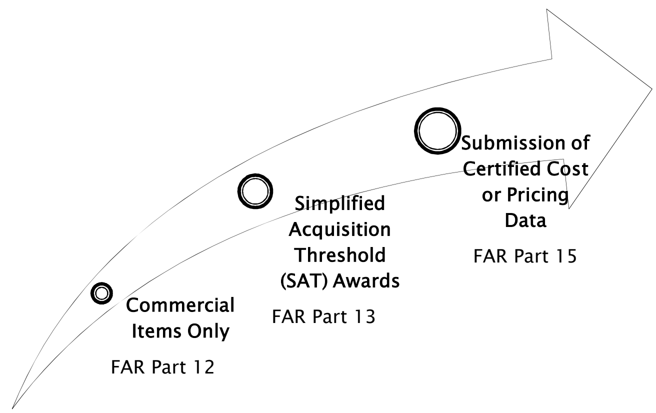
9

Examples of Evolving Risks

- A company wins its first CAS-covered contract
- A company is now subject to Full CAS coverage
- A company is now required to submit its first CASB Disclosure Statement
- A GSA contractor decides to compete for DOD contracts
- A DOD contractor decides to compete for GSA contracts

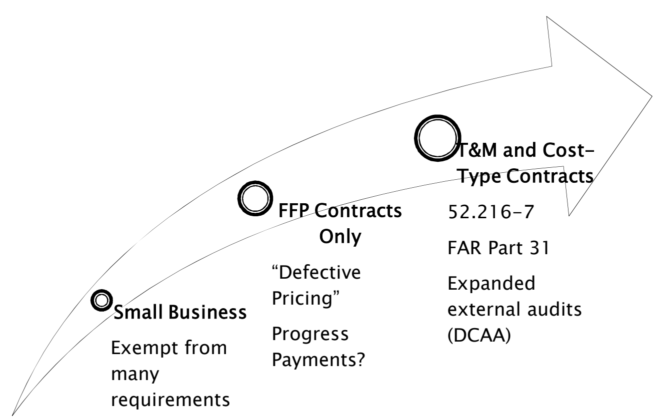
10

Risks Evolve as the Company Wins New Contracts



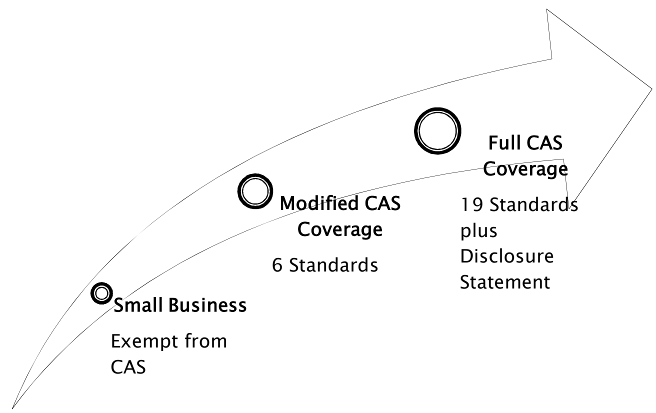
11

Risks Evolve as the Company Wins New Contracts



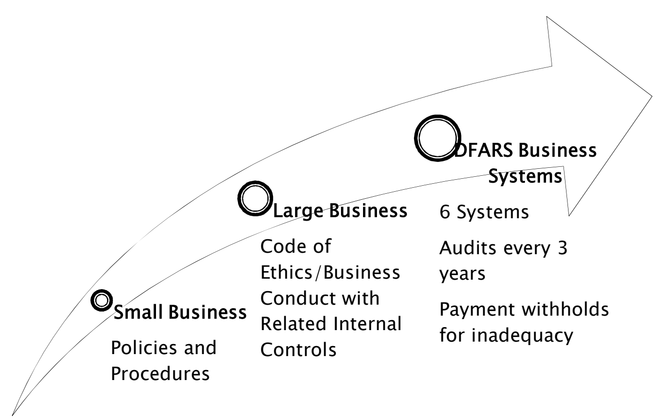
12

Risks Evolve as the Company Wins New Contracts



13

Risks Evolve as the Company Wins New Contracts



14

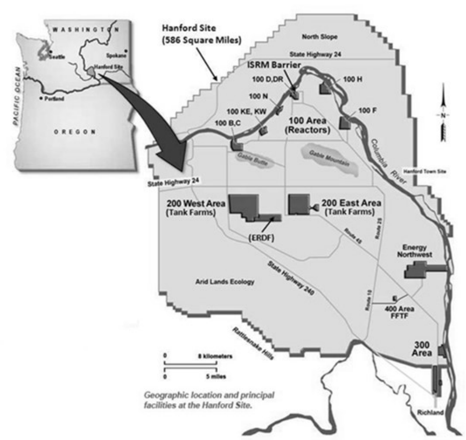
What Can Go Wrong?

- Acquisition target makes material misrepresentations in a proposal *on the day the acquisition closed*, leading to allegations of violations of the False Statements Act; costs the acquiring entity $14.8M to settle
- An "8(a) woman-owned and operated general construction company" continued to bid on, and receive, 8(a) contracts after graduation via use of an alleged front company; cost the company owners $3.6M to settle
- Small business allegedly received *both* SBIR and STTR funds for the same effort and directed employees to mischarge labor; costs owners $2.75M to settle alleged FCA violations
- Small business affiliated with a large business claims to qualify for small business status to receive SBIR awards; costs the large business $12.2M to settle alleged FCA violations

15

A Case Study in Operational Non-Compliance

- *The Hanford Site* – Decommissioned Nuclear Production Site
  - Contractors include: CH2M Hill and Washington River Production Solutions



16

Problems at the Hanford Site

- The CH2M Story
  - Managed Hanford Tank Farm remediation contract 1999 – 2008
  - Eight employees pleaded guilty to felony charges related to "timecard fraud"
  - Carl Schroeder was one of the eight employees
  - Schroeder filed a *qui tam* suit under the False Claims Act
    - "… although the time card fraud scheme and conspiracy was contrary to CH2M Hill's written procedures, submitting false time cards for unearned pay was an accepted practice … Schroeder … admitted to participating in and profiting from the time card fraud scheme and conspiracy. … the time card fraud conspirators also engaged in patterns designed to avoid detection by law enforcement. [Allegedly] certain CH2M Hill supervisory personnel, despite being aware of the time card fraud conspiracy in general and Mr. Schroeder's participation in particular, did not reprimand or admonish Mr. Schroeder in any way until the discovery of the conspiracy by law enforcement was brought to their attention."

17

Timecard Fraud at the Hanford Site

- The CH2M Story (Cont'd.)
  - USG intervened but moved to have Schroeder dismissed from the case
  - $19.1million settlement, March 2013
    - "CH2M Hill has agreed to pay $18.5 million to settle civil and criminal allegations of defrauding taxpayers through widespread timecard fraud at the Hanford nuclear reservation."
    - "CH2M Hill also will pay $500,000 toward a timekeeping system to better monitor timecards for workers on its current Hanford contract. … It will hire a corporate monitor at a cost of up to $80,000 to develop policies, procedures and employee training, the settlement agreement said. In addition, CH2M Hill will continue to cooperate in the Department of Justice's ongoing fraud investigation."

18

Timecard Fraud Continues …

- Washington River Production Solutions
  - Contract awarded Oct. 2008
    - "WRPS was advised by law enforcement of specific concerns about systemic timecard fraud being committed by the previous contractor at the Tank Farms, many of whose employees and procedures were retained by WRPS."
  - *Yet WRPS did not change timekeeping procedures until July 2013 – nearly five years after contract award*
    - "… the government alleged that WRPS knowingly charged DOE for overtime for busy work or for work that was not actually performed and premium emergency call-in pay that was not authorized by the [contract]"
  - $5.3 million settlement, Jan. 2017

19

Timecard Fraud Part of the Culture?

- Washington River Production Solutions (Cont'd.)
  - "The government also alleged that WRPS charged the government for auditing work that was not performed. *WRPS allegedly installed as the head of the contractually required Internal Audit Department for the first three years of the Tank Farms contract its own general counsel, who allegedly had no auditing experience and failed to provide any meaningful oversight of the Audit Department. The government alleged that this knowing violation of an important safeguard in the contract enabled the extensive timecard fraud.*"

20

What Does It All Mean?

- Statutory and regulatory issues often start at the lower tiers of an organization
  - It is there where day-to-day business decisions are made that can result in allegations of noncompliance that can be expensive to resolve
- Thus:
- Risk Identification/Assessment needs to address risk at the lower levels
- Each new contract award can create risk
- As the company grows it is subject to new risks and new compliance expectations

21

Thought Exercise

- You are an employee at a medium-sized USG contractor providing services to various agencies, including components of the Dept. of Defense
- You have employees located at various sites, including CONUS and OCONUS military bases
- Historically, you have been a subcontractor but you are eager to become a prime contractor and manage your own subcontractors
- You have a Code of Ethics/Conduct but not a robust compliance function; there is no internal audit function
- You have a strong accounting function that can calculate rates, but not a robust audit liaison function

22

Thought Exercise

- You have recently competed for, and been awarded, a $500 million ceiling ID/IQ contract where you must prepare task order proposals to win work
- You are now subject to Full CAS coverage
- Awarded task orders may be FFP, T&M, cost-plus, or a hybrid
- You have 2 subcontractors who will work with you on the task orders you will win

23

Thought Exercise

- What are some key risks?
- How can they be assessed?
- How can they be mitigated?

- You need to increase your focus on compliance and internal controls, but your President is reluctant to authorized the necessary budget.
- What is your sales pitch?

24