

Federal Regulations Now Require A Comprehensive Compliance Program For All Government Contractors

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On Nov. 23, 2007, the federal government announced additions to the Federal Acquisition Regulations (“FAR”) that require virtually all prime and subcontractors with government contracts to institute comprehensive ethics and compliance programs. In another important development, on Nov. 14, 2007, the government announced more proposed FAR ethics and compliance regulations that would expand the final regulations that were just adopted.

These initiatives are elements of the federal government’s ongoing commitment to root out fraud, waste and abuse in contracting on federally funded projects. This commitment is reflected in the Department of Justice’s creation of its “National Procurement Fraud Task Force” in Oct. 2006 and in recent court decisions that have placed construction contractors in the spotlight for violations of the false claims and anti-kickback laws.

The New Final FAR Regulations

Effective Dec. 24, 2007, the new FAR Subpart 3.10, “Contractor Code of Ethics and Business Conduct,” imposes the following requirements on all government contractors (prime and subcontractors), regardless of the contracting agency, who receive a contract award in excess of \$5 million with a performance period of at least 120 days:

- Within 30 days after contract award, contractors must have a written code of ethics and business conduct, a copy of which must be provided to “each employee engaged in the performance of the contract.”
- Within 90 days after contract award, contractors must have instituted an employee ethics and compliance training program and internal control systems.

- Time periods may be extended by the contracting officer.
- Contractors must display a hot line poster “in common work areas” within the business units performing the contract and on the company’s website if the company conveys information to employees via its website.
- The compliance program must:
 - Facilitate the timely discovery of improper conduct in connection with government contracts
 - Ensure corrective measures are promptly instituted and carried out
 - Promote compliance with the company’s code of business ethics and conduct
 - Set up an internal reporting mechanism, such as a hotline, by which employees may report suspected instances of improper conduct
 - Perform internal and/or external audits, as appropriate
 - Carry out disciplinary action for improper conduct

Exemptions

Contracts to be performed outside the United States and contracts for “commercial items” are exempt, along with contracts that do not meet the dollar or performance period thresholds.

Companies that qualify as small businesses are partially exempt; they are not required to have a formal training program and internal controls, but are still subject to the general requirement for a code of business conduct that must be distributed to all employees.

“Self-Reporting” Requirement

The final FAR regulations do not address the controversial self-reporting requirement that would have required contractors to report their own suspected violations of criminal laws and other contracting irregularities. Instead, the self-reporting requirement will be considered when the newly proposed amendments to the FAR regulations are considered, as discussed below.

Flow Down to Subcontractors

Prime contractors are required to “flow down” the requirements to their subcontractors and vendors that meet the threshold requirements and are not otherwise exempt. The contractor is not required to judge or monitor the ethics awareness program and internal control systems of the subcontractors—just check for existence.

Failure to Comply

The final rule does not specify the penalties for failing to comply with these FAR requirements. Instead, the FAR drafters stated, somewhat ominously, “The FAR already provides sufficient remedies for breach of contract requirements.”

The Newly Proposed FAR Regulations

On Nov. 14, 2007, additional FAR regulations were issued that would provide more specificity to the requirements of the compliance regulations that were just finalized and would address the self-disclosure requirement. The newly proposed FAR regulations would supplement, not replace, the recently finalized FAR regulations. Key highlights:

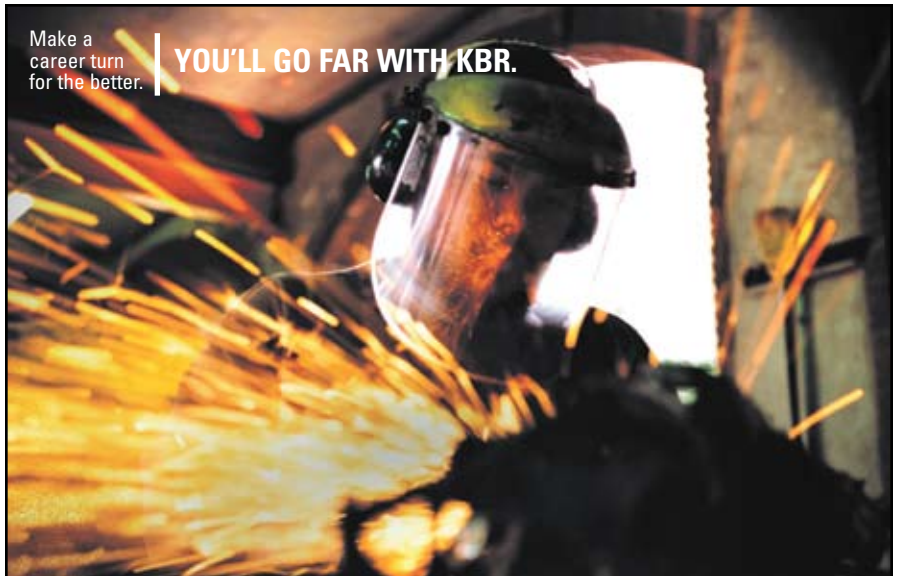
- Ethical violations will be considered in past performance evaluations of bidders, and may form the basis for suspension or debarment

- The contractor shall exercise due diligence to prevent and detect criminal conduct and otherwise promote an organizational culture that encourages ethical conduct
- Minimum standards for contractor's ethic awareness programs and internal control systems outlined
- Self Disclosure Requirement providing that contractor must issue a "timely report" in writing whenever the contractor has reasonable grounds to believe that a principal, employee, agent, or subcontractor of the contractor has committed a violation of federal criminal law

Bottom Line

Instituting and implementing an effective compliance program is now an integral and essential part of doing business with the federal government. The FAR regulations finalized effective Dec. 24, 2007, coupled with the proposed FAR regulations on Nov. 14, 2007, will mean that prime and subcontractors must have in place – within a short time after award of a contract over \$5 million and a performance period of at least 120 days – a comprehensive compliance program replete with a code of ethics and conduct, educational programs, compliance audits, anonymous reporting and other internal controls.

In addition, prime contractors will be required to ensure that any subcontractors meeting the dollar and performance period thresholds have the same type of compliance program. Yet to be determined is the perilous issue of self-disclosure, which would effectively conscript contractors into policing and prosecuting themselves. **CM**



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