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## **New Rules Mandate Increased Contractor Focus on Ethics and Compliance**

The Government recently issued the following two new rules impacting contractors' duty to follow ethical procurement practices and to detect fraud within their organizations:

- **FAR Case 2006-007** – “Contractor Code of Ethics & Business Conduct.”  
(Final Rule effective December 24, 2007)
- **FAR Case 2007-006** – “Contractor Compliance Program and Integrity Reporting.”  
(Proposed Rule; comment period closed January 14, 2008; Final rule not yet issued)

The two new rules constitute the Government's response to increased reports of procurement fraud associated with Iraq War and Katrina contracts and also to the perceived failure of contractors to utilize agency voluntary disclosure programs.

### **Contractor Code of Ethics and Business Conduct**

The Final Rule adds Subpart 3.10 to Part 3 of the Federal Acquisition Regulation (“FAR”) and is currently in effect. The new Part is divided into mandatory and non-mandatory requirements. FAR Section 3.1002 sets forth non-mandatory recommendations for all contractors to follow. It states that all contractors should have a written code of business ethics and conduct, an employee business ethics and compliance training program, and an internal controls system that:

1. Is suitable to the size of the company and extent of its involvement in Government contracting;
2. Facilitates timely disclosure of improper conduct in connection with Government contracts; and
3. Ensures corrective measures are promptly instituted and carried out.

Section 3.1003 – 3.1004 incorporate mandatory requirements that apply to contractors receiving contracts or subcontracts that were awarded after December 24, 2007, are expected to exceed \$5,000,000; and that have a performance period of 120 days or more. (Contracts for the acquisition of commercial items under FAR Part 12 and contracts that will be performed entirely outside of the United States are exempted.) The mandatory requirements are applied to contractors via two new clauses that must be added to applicable contracts.

FAR Clause 52.203-13 “Contractor Code of Business Ethics and Conduct” requires contractors:

- To have a written code of business ethics and conduct that is promoted by the company and to provide a copy of the code to each employee engaged in performance of the contract. (Must be completed within 30 days of contract award).
- To establish an ongoing business ethics and conduct awareness program and an internal controls system that facilitates the timely discovery of improper conduct in connection with Government contracts and ensures that corrective measures are promptly instituted and carried out. (Must be completed within 90 days of contract award. Does not apply to small businesses).

The internal control system should provide for:

- Internal reviews of company business practices, procedures, and policies and compliance with the company’s code of business ethics and conduct and other special government contracting requirements.
- A reporting mechanism, such as a hotline, by which employees may report suspected instances of improper conduct and instructions that encourage employees to make such reports.
- Internal and external audits.
- Disciplinary action for improper conduct.

FAR Clause 52.203-14 “Display of Hotline Posters” requires contractors:

- To prominently display all agency fraud hotline posters identified by the contracting officer in common work areas within business segments performing work under a covered contract and at contract work sites.
- To display an electronic version of the fraud hotline posters identified by the CO on any internal company websites only if the company already maintains a website as a method of providing information to its employees.

If the contractor has implemented a business ethics and conduct awareness program that already includes a hotline poster then the contractor does not need to also display the agency hotline poster (other than any required DHS posters).

Both clauses, 52.203-13 and 52.203-14, require prime contractors to flow down the requirements of each clause to subcontractors that meet the applicability standards of Section 3.1004.

## **Contractor Compliance Program and Integrity Reporting**

The Proposed Rule would expand upon the requirements of FAR 3.10 in three significant ways:

1. Mandatory Duty to Disclose – The Proposed Rule would require contractors meeting the applicability requirements, that is contractors that received a contract expected to exceed \$5 million and 120 days, to notify the agency Office of the Inspector General in writing, with a copy to the Contracting Officer, 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 in connection with the award or performance of a contract or any subcontract. The rule would also add a requirement that the internal control systems of contractors – except for small businesses – provide for timely reporting of suspected violations.
2. Suspension & Debarment – The Proposed Rule would amend FAR Part 9 to add causes for suspension and/or debarment for all contractors that commit “a knowing failure to timely disclose (a) an overpayment on a Government contract; or (b) a violation of Federal criminal law in connection with the award or performance of any Government contract or subcontract.”
3. Mandatory Duty to Cooperate – For contractors meeting the applicability requirements, that is contractors that received a contract expected to exceed \$5 million and 120 days, the new rule would “require full cooperation with any Government agencies responsible for audit, investigation, or corrective actions.” Small businesses would once again be excepted from this provision.

### **Related Provisions in FY 2008 Defense Authorization Act**

Section 848 of the FY 2008 Defense Authorization Act (“Report on Contractor Ethics Programs”) requires the U.S. Comptroller General to submit to the Committees on Armed Services of the Senate and the House of Representatives a report on the internal ethics programs of major defense contractors. Major defense contractors are defined as any company that was awarded contracts by the Department of Defense during FY06 in amounts totaling more than \$500,000,000. The Comptroller General is instructed by the Act to look at contractors’ ethics programs, internal reporting mechanisms, employee training and awareness programs, internal audit programs, self reporting requirements, disciplinary structure, and management oversight of the ethics program. The Act requires each major contractor to allow the Comptroller General access to information that falls into the scope of the required review.

### **Conclusion**

The new rules indicate a clear effort on behalf of the Government to root out fraud, waste, and abuse at government contractors. The nature of the new rules and the recommendations indicate that the Government is becoming increasingly impatient with the perceived lack of effort exhibited by contractors towards meeting their ethics and integrity obligations. We advise contractors to take a fresh look at their code of business ethics and conduct, their compliance program, and their internal controls to ensure they are prepared to meet this new heightened level of scrutiny.