Government Contracts and Relationships:

Building a Values-Based Program that Reduces Risk and Effectively Engages the Government Customer

Eric R. Feldman, President
Core Integrity Group, LLC

Cherie Raven, Director
Ethics and Business Conduct
BAE Systems

Agenda

- About your speakers
- Foundational overview of government contracting compliance
- Ethics risks & challenges unique to the government contracting environment
- Risk mitigation
- Discussion
About Your Speakers

- Eric Feldman
  - Retired from CIA in April 2011 with 32 years of federal service
  - Government Accountability Office
  - Department of Defense
  - CIA/National Reconnaissance Office IG
  - Senior Advisor for Procurement Integrity

- Cherie Raven
  - Ethics Resource Center
  - ITT Corporation
  - BAE Systems

Why Worry About Ethics Now?

"Exactly how badly do we want to reach our projections?"
Foundational Overview of Government Contracting Compliance

Procurement

- Federal Acquisition Register (FAR) & DFAR
  - Seven minimum standards: Contractor Code of Business Ethics and Conduct Clause
  - Mandatory Disclosure Rule
- Truth in Negotiations Act (TINA)
- Procurement Integrity
- Organizational Conflicts of Interest (OCI)
- Influencing government actions
- Selling commercial items

Foundational Overview of Government Contracting Compliance

Contract performance

- Cost allowability
- Cost accounting
- Time charging
- Progress payments
- Product substitution
- Suspension and Debarment
Contractor Code of Business Ethics and Conduct Clause (FAR 52.203-13)

- Government contractors must now establish standards and procedures to
  - Facilitate timely discovery of improper conduct in connection with government contracts
  - Ensure that corrective measures are promptly instituted and carried out should a problem exist
- Seven minimum standards that the contractor’s internal control system must meet
  - Effectively shifts risk from the government to the contractor

Seven Minimum Standards Shift Risk to Contractors

1. Assign responsibility at a sufficiently high level and with adequate resources to assure effectiveness of the business ethics awareness and compliance program and internal control system

2. Reasonable efforts not to include an individual as a principal who has engaged in conduct in conflict with the company’s code of business ethics and conduct

3. Periodic reviews of company business practices, procedures, policies and internal controls for compliance with the contractor’s code of business ethics and conduct

4. An internal reporting mechanism, such as a hotline, which allows for anonymity or confidentiality, by which employees may report suspected instances of improper conduct.
Seven Minimum Standards Shift Risk to Contractors

5. Disciplinary action for improper conduct or for failing to take reasonable steps to prevent or detect improper conduct

6. Timely disclosure in writing to the Office of Inspector General and the Contracting Officer whenever the company has credible evidence that a principal, employee, agent or subcontractor has violated Federal law involving fraud, conflict of interest, bribery, gratuities or the False Claims Act

7. Full cooperation with any government agencies responsible for audits, investigations or corrective actions

New Federal Agency Responsibilities (and Contractor Risks)

- FAR Subpart 9.104-1 now directs that a contractor’s record of integrity and business ethics be a required element for the government to determine that a prospective contractor is a “responsible party.”

- Ethics and Compliance becoming a distinguishing factor in source selection, particularly in an increasingly competitive budget environment

- New FAR provisions specifically identify suspension and debarment as the remedy for a contractor’s “failure to timely disclose” fraud or other illegal activities under the mandatory reporting provisions.
All federal contractors are required by law to disclose to inspectors general credible evidence of a violation of federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations, or a violation of the civil False Claims Act, where such evidence arises in connection with a federal contract.
Truth in Negotiations Act (TINA)

- Applies to contracts/subcontracts/modifications >$500,000
- Requires contractors to submit "cost or pricing data"
  - Defined as all facts that prudent buyers and sellers would reasonably expect to affect price negotiations significantly
- Allows the contracting officer (CO) to ascertain the reasonableness of the offered prices
- Contractors must certify that the data are **accurate, current, and complete**
- Violations result in the contract price being reduced accordingly
- Exempts a contract of any dollar amount where:
  - the price agreed upon is based on adequate price competition
  - the price is set by law or regulation
  - the agency is acquiring a "commercial item"

Procurement Integrity Act

Four basic provisions:

1. A ban on disclosing procurement information
2. A ban on obtaining procurement information
3. A requirement for procurement officers to report employment contacts by or with a competing contractor
4. A 1-year ban for certain personnel on accepting compensation from the contractor
Organizational Conflicts of Interest

A conflict that arises because of activities or relationships with other persons [companies/Government organizations] that:

- Renders a person / company unable or potentially unable to render impartial assistance or advice to the Government
- Impairs or may impair the person / company’s objectivity in performing the contract work
- Creates an unfair competitive advantage (Ref. FAR 9.501)
- Examples: SETA Contracts/Hardware

DCAA “Recharged”

- July 2008 GAO report: DCAA failed to comply with government auditing standards
  - Too lenient on contractors
  - Insufficient independence from contractors
  - Production-oriented culture
- Flurry of DCAA Actions
  - Controls no longer deficient “in part” (Pass/Fail)
  - Questioned Costs not required to report significant deficiency in controls
  - Fraud or irregularities can now be reported directly to cognizant investigators without Branch review
  - Contracting Officers can be reported directly to the IG if they fail to act on DCAA recommendations or give contractor “excessive profit”
DCAA “Recharged”

- Audits of the contractor code of business ethics and conduct
  - Auditors must perform procedures to address the requirements of the new compliance regulations during audits of a contractor’s control environment and accounting system controls. The audit program requires that the DCAA obtain and review copies of the contractor’s internal/external audit reports performed as part of the internal control system.

Risks & Challenges Unique to the Government Contracting Environment

- Hiring rules
  - Affirmative Action Plans (AAPs)
  - Hiring Former Government Employees (Revolving Door)

- Ethics rules
  - Gifts & hospitality rules
  - Personal Conflicts of Interest (COI)

- Security
  - National Industrial Security Program Operating Manual (NISPOM)
  - Additional standards beyond DOD
  - IT security and social media use
Risks & Challenges Unique to the Government Contracting Environment

International Business
› Export (ITAR, EAR)
› Anti-boycott provisions

Suspension and Debarment
› Designed to protect the taxpayer
› Not supposed to be punitive

FCPA/UK Bribery Act
› Defense and Aerospace Industries targeted by FBI/DOJ

Gifts & Hospitality

› Generally not provided or accepted
› Limited exceptions:
  ◦ Promotional items of less than nominal value
  ◦ Refreshments during meetings
    · Coffee, soda, juice, water
    · $20 / $50 rule (boxed lunches often run closer to $10)
    · Light hors d’oeuvres for evening events (should not amount to a meal)
  ◦ Provide a basket for government employees to cover their own costs
  ◦ Prior relationships, i.e., spouse or long-time friend employed by customer
Personal Conflicts of Interest

- Conflicts are complicated! When in doubt, ask
  - Simple disclosure resolves many conflicts
- A few areas to consider
  - Outside employment
    - Employees generally cannot hold second jobs with customers, competitors or subcontractors, suppliers, vendors, etc.
  - Family interests
  - External investments or directorships

Personal Relationships at Work

- Personal Relationships include:
  - Familial relationships
  - Relationships between partners
    - Marriage, civil partnerships, cohabitating, etc.
  - Other relationships of an intimate nature
- At Work includes:
  - Two employees
  - Employee and contractor or supplier
  - Employee and customer
  - Employee and competitor
### Personal Relationships at Work

<table>
<thead>
<tr>
<th>Personal relationships at work must be disclosed when:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Two employees</td>
<td>One employee has influence over the other’s career (job assignments, compensation, etc.)</td>
</tr>
<tr>
<td>Employee and contractor or supplier</td>
<td>Employee has influence over the contractor or supplier (purchasing decisions, etc.)</td>
</tr>
<tr>
<td>Employee and competitor</td>
<td>Both individuals are working on bids or projects in direct competition with the other Employee has access to competitive information which could aid the other</td>
</tr>
<tr>
<td>Employee and customer</td>
<td>Employee has a working relationship with the customer</td>
</tr>
<tr>
<td>Employee and recruitment candidate</td>
<td>Employee is involved in or has any influence over the recruitment process and/or decision</td>
</tr>
<tr>
<td>Other</td>
<td>May present an actual or perceived conflict of interest</td>
</tr>
</tbody>
</table>

### Social Media / IT Acceptable Use

- Government contractor IT networks are particular targets of hackers
- Contractors track and monitor network IT usage
- Do not discuss products or services on the internet without approval
- Employees are prohibited from posting:
  - Anything misleading, untrue, disrespectful or unprofessional
  - Confidential, proprietary or non-public information
  - Personally identifiable information about an individuals
Risk Mitigation

- Demonstrable Controls
  - DCAA will be looking
- Time Charging Systems/Audits
- Extraordinary caution/legal reviews of federal employee hiring
  - "Safe Harbor" Memos
- Upper-level Scrutiny of Proposals
  - Plausible deniability of competitor information or government budget data won’t work

- OCI firewalls, or even divestiture
- Periodic, independent assessments
  - Internal Controls
  - Ethics and Compliance Programs
- Suspension and Debarment
  - Alternative Resolutions
  - Administrative Settlements
  - Corporate Integrity Agreements
  - Independent Compliance Monitoring
Risk Mitigation: Key Government Assessment Areas

- Ethical Leadership: Tone at the Top
- Creation of an Ethical Culture
- Internal Control Program
- Corporate Code of Ethics
- Ethics Training
- Ethical Behavior Rewards and Sanctions
- Anonymous Reporting Process
- Internal Investigations Capability
- Mandatory Disclosures to the Office of Inspector General

Best Practices: What the Government is Looking For

- Ethics and Compliance Officer
  - Independence
  - Authority
  - Both values-based and compliance focused
- Leadership Commitment and Tone at the Top
  - Visible
  - Constant
  - Participatory
- Code of Conduct
  - Useable, not shelfware
  - Company and employee responsibilities
  - Employee acknowledgement/affirmative duty to report
  - Focused on unique vulnerabilities
Best Practices: What the Government is Looking For

- Training
  - New hires
  - Live and CBT
  - Scenario-based
  - Cascading
  - Tests of comprehension
- Anonymous Reporting
  - Hotline: Phone and e-mail
  - Trend analysis/feedback
  - Expert contractors abound
- Subcontractor Flowdown
  - Terms of reference
  - Validation
  - Extension of Resources

Ethics Under The Legal Department?

RUN THIS BY THE LEGAL DEPARTMENT, BUT RUN SUPER FAST SO THE ETHICS DEPARTMENT DOESN'T SEE IT.
Risks of Program Placement

Necessary skill sets and perspectives of a GC / CECO are different

<table>
<thead>
<tr>
<th>General Counsel</th>
<th>Chief Ethics &amp; Compliance Officer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Settle issues involving unethical behavior internally to decrease risk to the organization</td>
<td>Broad dissemination of ethics issues crucial to teaching, prevention, communication of leadership resolve</td>
</tr>
</tbody>
</table>

Recent case studies reveal government perspective: Tenet, Pfizer, Wellcare

The Ethical Culture Imperative

IF YOU SEE ANYONE VIOLATING THE NEW CORPORATE CODE OF ETHICS, REPORT IT IMMEDIATELY.

I'D LIKE TO REPORT OUR SENIOR MANAGEMENT FOR TELLING US TO SHIP PRODUCTS THAT WE KNOW ARE DEFECTIVE.

YES, I WILL TAKE CARE OF THAT.

OOOH! OOH! LYING!!! I REPORT YOU!!!
Is the Government Walking the Talk?

BAILOUT HEARINGS

MR. DOGBERT, DID YOU FLY HERE IN A CORPORATE JET?

YES, THE SAME JET THAT TOOK YOU ON A FACT-FINDING TRIP TO ARUBA. YOU WOOL-COATED GLOB OF FAT.

BRING IT ON! I CAN DO THIS ALL DAY.

I YIELD MY TIME TO THE HYPOCRITE FROM ANOTHER STATE.

Contact Information

Eric R. Feldman
Core Integrity Group, LLC
1732 Aviation Blvd. Suite 421
Redondo Beach, CA 90277
(540) 226-3070
eric@coreintegritygroup.com

Cherie Raven
BAE Systems
4075 Wilson Blvd. 9th floor
Arlington, VA 22203
(703) 896-0847
cheryl.raven@baesystems.com
State of Ethics Today: 
Reasons for Concern

“Lie, Cheat and Steal: High School Ethics Surveyed”*  
- 78% of high school students surveyed reported cheating.  
- 64% of students cheated on a test in the past year and 38% did so two or more times, up from 60% and 35% in a 2006 survey.  
- 60 years ago, only 20% of college students admitted to having cheated while in high school; today, only 22% report they did NOT cheat.  
- Serious implications for the workforce (both government and industry)
  - Ethical values can’t be assumed
  - Entry-level training requirements
  - Different approaches for Gen X and Gen Y

*Source: Josephson Institute 2008 Study
State of Ethics Today:
Reasons for Concern

“Did you *Cheat* to Get Into Graduate School?”*

YES!!

<table>
<thead>
<tr>
<th>Field</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liberal Arts</td>
<td>43%</td>
</tr>
<tr>
<td>Education</td>
<td>52%</td>
</tr>
<tr>
<td>Law/Medicine</td>
<td>63%</td>
</tr>
<tr>
<td><strong>Business</strong></td>
<td><strong>75%</strong></td>
</tr>
</tbody>
</table>

*Source: Rutgers University Survey of Students

State of Ethics Today:
Reasons for Concern

Graduate School Cheating

MBA: 56%
Engineering: 54%
Education: 48%
Law: 45%

*Source: Rutgers University Survey of Students
State of Ethics Today: Reasons for Concern

Why Do They Cheat?

› Students in the Rutgers Study rationalized their cheating:
  * Too many pressures.
  * Desire to please parents and professors.
  * Intense competition for jobs.
  * Everyone is doing it.
  * Disinterested in required classes.
  * Professors don’t care about students.

*Source: Rutgers University Survey of Students

It’s the “way of the world”; getting others to do my work is a skill I will need in business

State of Ethics Today: Reasons for Concern

Graduating MBAs

› 76% were willing to understate expenses that cut into their companies’ profits.

› Convicts in 11 minimum security prisons had higher scores on an ethical dilemma exam than MBAs.

*Source: Rutgers University Survey of Students
State of Ethics Today: Reasons for Concern

- Other Studies of Note:
  - U.S. News and World Report:
    - 80% of "high achieving high school students admitted to cheating; 51% did not believe cheating was "wrong"
    - 75% of college students admitted to cheating, and 90% didn’t believe cheaters would be caught
    - 85% of college students said cheating was necessary to get ahead
  - Center for Academic Integrity:
    - 44% of college faculty were aware of student cheating in their course, but never reported a student to campus authorities
    - Serious test cheating on campuses with honor codes is typically 1/3 to ½ lower than the level on campuses without honor codes

Why Worry About Ethics Now?

- Mistrust of “Corporate America” is at an all-time high; according to the 2009 Edelman Trust Barometer, public trust in U.S. business stands at 38%, down from 58%
- The Committee on Oversight and Government Reform identified 187 contracts valued at $1.1 trillion that have been plagued by waste, fraud, abuse, or mismanagement over the last six years.
- The Justice Department has made corporate fraud and misconduct a national priority.
- According to the Ethics Resource Center, misconduct in the workplace rises as much as 11% when financial or economic turmoil rocks an organization. Employees, supervisors and managers all feel extra pressure to meet goals—and may cut corners.
- PricewaterhouseCoopers Advisory Group reports that breakdowns in companies’ internal controls occur most often in (1) operations that are soon to be discontinued, and (2) units that are subject to severe cost cutting pressure.
- Deloitte Financial Advisory Services survey found that 63% of executives expect accounting fraud to increase during the next two years because of the recession.
Ethics and Compliance in Prosecution Decisions

- US Attorney’s Manual Section 9–28.000 requires federal prosecutors to consider nine charging factors in addition to general charging policies and resource allocation issues:
  - Compliance Related Factors:
    - Pervasiveness of the corporate wrongdoing
    - Existence and effectiveness of the corporation’s *pre-existing* compliance program
    - The corporation’s remedial actions

Organizational Sentencing Guidelines

- Benchmark for companies attempting to develop an effective ethics and compliance program
- Used by prosecutors in making charging decisions and trying to decide on an appropriate fine
- DOJ instructs prosecutors to look at the guidelines to determine what constitutes an effective compliance program for purposes of the three factors contained in the US Attorney’s Manual, and to decide whether to file criminal charges, decline prosecution, or enter into a deferred or non-prosecution agreement
Organizational Sentencing Guidelines

2004 Amendments: Seven Hallmarks of an Effective Ethics and Compliance Program
1. Compliance Standards and Procedures
2. Accountability and Oversight at the Top
3. Due Diligence in Selecting Ethics and Compliance Staff
4. Adequate Training and Communication
5. Robust Monitoring and Auditing
6. Effective Incentives and Discipline
7. Prompt and Reasonable Response to Criminal Conduct

“Promote an Organizational Culture that Encourages Ethical Conduct and a Commitment to Compliance”

Organizational Sentencing Guidelines

2010 Amendments
1. Reaffirmed the importance of Ethics and Compliance
2. Higher standards and effort required
3. Greater likelihood of credit
4. New Application Note 6, organization should:
   - Respond appropriately to criminal conduct (restitution, self-reporting, cooperation)
   - Act appropriately to prevent further similar criminal conduct (assess/modify C&E program, use of outside advisors recommended)
Organizational Sentencing Guidelines

- Organizations can now receive credit for an effective ethics and compliance program, even when the organization’s high level personnel are involved, if the following criteria are met:
  - The detection of the offense by the company’s ethics and compliance program occurred PRIOR to external discovery
  - The offense was promptly reported to the government
  - The operational ethics and compliance personnel were NOT involved in the offense
  - Those with operational responsibility for the ethics and compliance program have “direct reporting obligations” to the Board of Directors or its designated committee

Dodd–Frank Increases Corporate Risk

- Section 922 of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank Act):
  - Created awards of 10–30 percent of monetary sanctions for whistleblowers who report to the Securities and Exchange Commission (SEC) original information leading to securities law enforcement actions that recover more than $1 million
  - These rewards are expected to increase the number of allegations that organizations will be expected to investigate.
Dodd-Frank Increases Corporate Risk

- According to The Wall Street Journal, the SEC is getting at least one whistleblower bounty-seeker FCPA tip per day since the Dodd-Frank provisions went into effect.
- Dodd-Frank covers both public and private companies in ALL INDUSTRIES, not just the financial sector.
- SEC looking for securities laws violations, including insider trading, FCPA, and any type of accounting fraud.

An Incentive for Change

- The combination of the Dodd-Frank Act and the amendments to the Organizational Sentencing Guidelines create a strong incentive for change.
- Companies need to:
  - Drive performance of the internal whistleblower system as high as is feasible to encourage reports to be made internally.
  - Develop incentives for employee reporting.
  - Create an corporate culture that rewards, rather than retaliates against whistleblowers.
  - Alter, as necessary, the reporting lines for the head of the compliance and ethics program.
  - Formalize annual assessments of the compliance and ethics program (including its whistleblower system) with a report to the board or audit committee.
Values-Based Ethics and Ethical Culture

- What is Ethical Culture?
  - How things are “really done around here”.
- Ethics Resource Center (ERC) identifies the ethical culture of an organization as the primary determining factor on whether misconduct will take place
- ERC and other studies identify leadership commitment and tone at the top as the key driver of an organization's ethical culture

Ethics vs. Compliance

- Individuals and companies at the heart of economic and financial meltdown often obeyed the letter of the law, not the spirit
  - AIG/Lehman Bros/Goldman actions unethical, not necessarily illegal
  - Many companies choose not to go beyond the minimal code of ethics provisions of Sarbanes-Oxley
  - Ethics developments in industry have been largely rules-based
    - Less emphasis on values than on statutory requirements (law as the ceiling, rather than floor of corporate behavior)
    - Ethics and Compliance Officer titles often interchangeable; often managed by or through the Legal Department
    - Training focused on legal obligations versus ethical decision-making

*Government Contracting Officials and Prosecutors Looking for Values-Based Programs that Promote a Corporate Ethical Culture*
Building an Ethical Framework

Ten Important Considerations in Building an Ethical Culture

1. Relationship between ethics and performance
   ◦ Cost of preventing a scandal is exponentially lower than the costs of fixing ethical problems.
   ◦ Current data indicates that ethical companies are more competitive, profitable, and sustaining than unethical companies.

2. Ethics training
   ◦ The most successful ethics training moves from theory to practice, and from the conceptual to the real.
   ◦ Live case studies can help employees, leadership, and management solve relevant ethical dilemmas.

3. Recruiting and retaining great talent
   ◦ Fortune’s top 100 companies to work for contains a wide variety of companies with no obvious common denominator (salary, benefits, career opportunities, profession, location all vary).
   ◦ Common factor: trust between employer and employee.
   ◦ Ethical behavior can lay the groundwork for attracting and retaining the best talent.
Ten Important Considerations in Building an Ethical Culture

4. Ethics and Compliance risk assessment
   - Each company has its own ethical nightmare, but most face similar ethical exposures (theft, accounting irregularities, kickbacks and gratuities, etc.).
   - Companies should examine the potential hazards of perverse incentives (e.g., compensation based 100 percent on financial goals) and the various unintended consequences of policies, procedures, or expectations.

5. Being proactive in ethics, culture, and corporate citizenship
   - Leaders need to own and shape the culture as much as any other management initiative.
   - Characteristics of predictable ethical outcomes include management credibility, upward communication, perceived organizational support, and teamwork.
   - Well-tested diagnostic tools can help measure success in these areas.
Ten Important Considerations in Building an Ethical Culture

6. Tone at the Top
   - What leaders say – or don’t – affects the tone as much as their actions
   - Mistrust, cynicism, or indifference can erode loyalty to the organization and push ethical leaders out the door
   - Proactive, visible engagement of senior leadership and the Board is key

7. Mood in the Middle
   - Employees see “leadership” as their supervisor, their local management of their
   - 40% of employees leaving an organization voluntarily do so because of their supervisor

8. Buzz at the Bottom
   - Do employees buy your story? Do they trust management?
   - Have you given them reason to?
   - (Do you really even know?!)  

9. Who is responsible for paying attention to ethical culture in your organization?
   - Do they have the time and can they make it a priority?
   - Are they qualified? Do they have the knowledge, skills, resources and influence?
   - How is their value measured? How is their success measured?
Building an Ethical Framework

Ten Important Considerations in Building an Ethical Culture

10. Express lanes (or Roadblocks) to honest conversations
   ◦ Informal culture, and bureaucracy can easily trump formal ethics program mechanisms
   ◦ Need to have the mechanisms in place to assess the current state of play
   ◦ …. and the willingness to make changes, when necessary.

“In looking for people to hire, you look for three qualities: integrity, intelligence, and energy. And if you don’t have the first, the other two will kill you.”

-- Warren Buffet, CEO Berkshire Hathaway
A Hint, Perhaps?

“Apparently, neither Tenet nor Ms. Sulzbach saw any conflict in her wearing two hats as Tenet’s general counsel and chief compliance officer. As general counsel, Ms. Sulzbach zealously defended Tenet against claims of ethical and legal non-compliance….while as chief compliance officer, she supposedly ensured compliance by Tenet’s officers, directors and employees. It doesn’t take a pig farmer from Iowa to smell the stench of conflict in that arrangement.”

--Senator Chuck Grassley, Chair
Senate Finance Committee