

DCAA Audit Guidance on FAR Provisions Regarding Contractor Code of Business Ethics and Conduct

On July 23, 2009, DCAA issued revised audit guidance which sets out procedures for reviewing contractor compliance with FAR 52.203-13, Contractor Code of Business Ethics, and FAR 52.203-14, Display of Hotline Posters. See Memorandum for Regional Directors, et al., [Audit Guidance on Federal Acquisition Regulation \(FAR\) Revisions Related to Contractor Code of Business Ethics and Conduct.](#)

The new guidance indicates that contractor business ethics and compliance systems will be subject to heightened oversight by DCAA, including requests for access to records relating to the operation of those systems.

Background

FAR 52.203-13, which was revised pursuant to a November 2008 final rule, requires contractors to have a written Code of Business Ethics and Conduct and to provide training regarding the contractor's business ethics awareness and compliance program and internal controls system. It also requires, and sets minimum standards for, contractor internal control systems which are to include, among other elements, systems and procedures to facilitate discovery of improper conduct in connection with Government contracts, and periodic reviews of business practices for compliance with the contractor's standards of business ethics and conduct. In addition, the FAR clause requires contractors to have an internal reporting mechanism such as a hotline, to take disciplinary action for improper conduct, and to fully cooperate in government audits, investigations or corrective actions. As revised, FAR 52.203-13 also commits contractors to make "timely" written disclosure to the IG of the contracting agency whenever the contractor has "credible evidence" of violations of certain criminal laws or of the civil False Claims Act in connection with the award, performance or closeout of prime contracts and subcontracts under those prime contracts. Finally, the November 2008 final rule makes a knowing failure to disclose certain criminal offenses and violations of the civil False Claims Act a cause for suspension or debarment.

FAR 52.203-14 requires contractors to display agency or DHS hotline posters, and to display them electronically if the contractor has a website. The agency or DHS posters generally do not need to be displayed if the contractor's business ethics and conduct program includes an internal reporting mechanism.

The New Audit Guidance

The new audit guidance is reflected in revisions to the sections of the DCAA Audit Manual (DCAM) (§ 5-306, Integrity and Ethical Values) and to DCAA's related audit program regarding audits of contractor internal controls.

Codes of Business Ethics and Conduct

The FAR does not prescribe the contents of a contractor Code of Business Ethics and Conduct. However, DCAM 5-306.1 provides that a Code "should generally address ethical business practices and expected

standards of ethical and moral behavior,” and goes on to state that a Code “should cover dealings with customers, suppliers, employees, and other parties.” It essentially provides that an adequate code should address “conflicts

of interest, illegal or other improper payments, anticompetitive guidelines, and insider trading,” as well as “Government contracting requirements for procurement integrity, classified information, and recruiting and employing current or former Government personnel.” *Id.* Based on the new guidance, contractors should also ensure that they provide for employee acknowledgement of the Code, and that the Code instructs employees on what to do if they encounter “improper behavior” and addresses consequences of non-compliance with the Code. In addition, auditors are instructed to obtain training materials and documents confirming that training has been provided to appropriate individuals. DCAM § 5-306.2. (Note that the FAR clause provides for training of a contractor’s principals and employees and, “as appropriate,” its subcontractors and agents.)

Business Ethics Compliance Program and Internal Controls

FAR 52.203-13(c)(2) directs that a contractor internal control system shall include standards and procedures to discover improper conduct and to promptly take corrective action. The audit guidance focuses on the minimum standards in FAR 52.203-13(c)(2)(ii) for a contractor’s internal control system.

First, DCAM § 5-306.3(a)(1) provides that DCAA will look at whether the contractor has assigned management responsibility for its business ethics awareness and compliance program and internal control system at a “sufficiently high level” in the company, as required by FAR 52.203-13(c)(2)(ii)(A). However, § 5-306.3(a)(1) goes on to state that “[t]he manager responsible for the ethics program should report to a high level official such as the vice president or CFO.” *Id.*

Second, according to DCAM § 5-306.3(a)(2), DCAA will also examine the procedures used by contractors “to ensure that individuals that previously engaged in conduct that conflicts with the contractor’s code of conduct are not appointed as a principal of the company (e.g., officer, director, partner),” and suggests, by way of an example, that those procedures should include background checks. Third, auditors will also examine whether the contractor has undertaken periodic evaluations of the effectiveness of its business ethics and awareness compliance program and internal control system. Contractors should expect those evaluations to be the subject of requests for access to records, as § 5-306.3(a)(3) directs auditors to “review the results of these evaluations and determine the impact on any audits.” (Moreover, in recent letters to major contractors relating to audits of internal controls, DCAA indicated that it expected the contractors to disclose to DCAA and the ACO, *inter alia*, any findings arising out of such contractor reviews that “significantly impact government contracts,” and do so within 5-10 days of identification. It also requested a list of violations of the Code for the past 12 months. Neither of these is required by FAR 52.203-13.)

Fourth, the new guidance also provides for assessments of whether contractors have taken “[d]isciplinary action for improper conduct, or failing to take reasonable steps to detect improper

conduct.” DCAM § 5.306-3(a)(4). It also directs auditors to request documentation regarding any disciplinary action taken by the contractor and implies that auditors should inquire further into cases where disciplinary action was not taken. In short, contractor personnel actions are likely to be subject to DCAA scrutiny. Moreover, failure to take disciplinary action for improper conduct where appropriate is a basis for citing the contractor for an internal control deficiency.

Fifth, DCAA audits will now also include review of internal reporting mechanisms, including instructions to employees relating to use of those mechanisms. See id. § 5.306-3(a)(5). (In its recent letters to major contractors, DCAA requested a list of non-compliances reported in the past 12 months.)

Sixth, the new guidance also addresses the provisions of FAR 52.203-13 regarding contractor disclosures to the IG. Auditors are directed to “ensure that the contractor’s policies and procedures include a reasonable definition of credible evidence and a reasonable timeframe for disclosure once credible evidence is obtained.” DCAM § 5-306.3(a)(6). They are also instructed to “verify that the contractor did not delay disclosing the violation once it was determined that credible evidence exists,” id., and to review any disclosures and assess whether the contractor has taken appropriate corrective action. Further, the DCAM also now provides that a failures to comply with the timely disclosure provisions of FAR 52.203-13, should reported as an internal control deficiency and that a copy of any audit report finding such deficiencies is to be provided to the DCAA Justice Liaison Auditor.

Finally, DCAA internal controls audits will also assess whether the contractor has fully cooperated with Government audits, investigations, or corrective actions, and failure to do so can result in a citation for a deficiency in the contractor’s control environment. See id. § 5.306-3(a) (7). (In its letter to contractors, DCAA asked for a “company-wide list of any current open investigations” in connection with verification of contractor cooperation under FAR 52.203-13(c)(2)(ii)(G).)

Summary

As the discussion above indicates, the new Guidance will result in increased requests for access to records. In that regard, in December 2008, DCAA issued a memorandum that ‘clarified’ its audit guidance relating to access to contractor records which indicated that DCAA expects quicker access to contractor records and is more likely to treat delays providing records as a denial of access. See Memorandum for Regional Directors, et al., Audit Guidance on Denial of Access To Records Due to Contractor Delays, Dec. 19, 2008. In addition, as noted above, the July 2009 revisions to the DCAM specifically provide for reporting certain failures to comply with FAR 52.203-13 as internal control deficiencies. Such a finding could result in an audit opinion that the contractor’s system is “inadequate” and that, in turn, could result in the suspension of a percentage of progress payments or reimbursement of costs. See Memorandum for Regional Directors, et al., Audit Guidance on Significant Deficiencies/Material Weaknesses and Audit Opinions on Internal Control Systems (Dec. 19, 2008) (identifying contractor ethics and integrity programs as an example of an internal control objective which, if not “accomplished,” should be reported as a significant deficiency/material weakness); see also DFARS 242.7502.