

PCI Financial Forum Series

Preventing, Investigating, and Reporting Accounting Issues

Agenda

- **Mandatory Disclosure Rule**
 - Internal Control Requirements
 - Disclosable Conduct
- **Statute of Limitations Considerations**
- **Investigating Potential Accounting Issues**
 - Initiating and Conducting the Investigation
 - Engaging the Legal Department and/or Outside Counsel
 - Privilege issues
- **Making a Disclosure**
- **Post-Disclosure Considerations and Best Practices**

Mandatory Disclosure Rule

- For contracts >\$5.5M and performance >120 days
 - Contractors must disclose credible evidence of any of the following (FAR Subpart 3.10 and § 52.203-13)
 - Violation of federal criminal law involving fraud, conflicts of interest, bribery or gratuities (Title 18)
 - Violation of the civil False Claims Act (FCA)
 - Internal control system to detect improper conduct is required
 - Suitable to the size of the company and extent of its involvement in Government contracting;
 - Facilitate timely discovery and disclosure of improper conduct; and
 - Ensure corrective measures are promptly instituted and carried out
- For all contracts/contractors
 - Failure to timely disclose credible evidence of either the above violations OR “significant overpayments” is a cause for suspension or debarment (FAR §§ 9.406-2 and 9.407-2)

Mandatory Disclosure Rule - Internal Control Requirements

- Contractor Code of Business Ethics and Conduct
- Ethics Training
- Periodic reviews of company business practices, procedures, policies, and internal controls
- Standards and procedures for discovering fraud
- Internal reporting (e.g., hotline)
- Assignment of responsibility at a sufficiently high level
- Timely disclosure

Disclosable Conduct - Examples

- Overbilling/double billing
- Timekeeping issues
- Improper billing of indirect costs as direct
- CAS violations
- Unallowable costs
- Improper retention of overpayments— “Reverse” False Claim
- Inaccurate cost estimates
- Wage Issues

Determining Credible Evidence

- The Mandatory Disclosure Rule does not define “credible evidence”
 - “[M]ay lie somewhere between reasonable grounds to believe . . . and a preponderance of the evidence” (FAR Councils)
 - Unrelated DFARS provision defines “credible information” as “information that, considering its source and the surrounding circumstances, supports a reasonable belief that an event has occurred or will occur” (DFARS § 252.246-7003, Notification of Potential Safety Issues)
 - It is a flexible standard—the government prefers it this way
 - Awaiting interpretation guidance from a court or board

Determining Credible Evidence Requires an Investigation

- The Mandatory Disclosure Rule requires contractors to investigate potential issues to determine if credible evidence exists
 - Contractor can “take some time for preliminary examination of the evidence to determine its credibility before deciding to disclose to the government” (FAR Councils)
 - “Until the contractor has determined the evidence to be credible, there can be no ‘knowing’ failure to timely disclose” (FAR Councils)
 - Look-back requirement: 3 years after “final payment”

The Yates Memorandum

- September 2015 memorandum states government will focus on individual criminal and civil liability
 - Government investigators must focus on individuals
 - Cooperative corporations must disclose facts about individual liability
- Important implications
 - Increased risk for corporate executives
 - New challenge for investigators
 - Individual counsel
 - Puts individuals on guard
 - All or nothing approach to cooperation
 - Attorney-client privilege

Recent Case Law Developments – Wage Issues

- New laws, regulations and Executive Orders create wage compliance challenges
 - Fair Labor Standards Act, Davis-Bacon Act, Service Contract Act
 - EO 13658, Establishing a Minimum Wage for Contractors
 - Paid Sick Leave
- Increased focus from DOL and other government agencies on wage issues has generated internal investigations
 - SCA, DBA, Walsh Healy, etc
 - Wage underpayments can form the basis of FCA liability and require disclosure
 - *United States ex rel. Wall v. Circle C Construction, LLC*
 - DBA underpayment rendered claims false
 - Government pursued exorbitant damages, but lost
 - Quantifying and remedying wage issues can be complicated and costly

CDA Statute of Limitations Considerations

- CDA requires that the government must assert any claim within six years of the date it accrues
 - *Boeing Co.*, ASBCA No. 58660, 15-1 BCA ¶ 35,828
 - Board held that the SOL did not begin to run until Boeing identified the impact (positive or negative) of cost accounting change
 - *Kellogg Brown & Root Svs., Inc.*, ASBCA No. 58175 15-1 BCA ¶ 35988
 - Board held that government's claim did not accrue until years later because the government "did not know that KBR had failed to comply with" certain contract requirements until DCAA received a consultant report specifically raising the issue of KBR's compliance
 - *Combat Support Assocs.*, ASBCA No. 58945, 14-1 BCA ¶ 35,782
 - Board held no claim accrued until contractor submitted detailed supporting data giving the government reason to know of its claims
 - *The Ryan Co.*, ASBCA NO. 58137, 15-1 BCA ¶ 35,998
 - Board declined to convert motions to dismiss into motions for summary judgment because the "should have known" test "has a reasonableness component based upon what facts were reasonably knowable to the claimant," and those facts were not in the record.

Initial Steps: Identifying Potential Issues

- Common issues: Timekeeping; Accounting errors/practices; Billing errors, Cost Accounting Standards (CAS) noncompliance; unallowable cost issues
- Identification:
 - Hotline or employee allegation
 - Government notice or investigation
 - Periodic internal audits by compliance personnel examining past problem areas
- Initial evaluation: Immediate action or formal investigation?
 - Deciding whether to terminate employee immediately
 - Consider temporarily holding costs from being billed

Designation and Attorney Involvement

- Designate individual to lead the investigation
 - Provides updates to compliance/management/in-house counsel
- Engage in-house legal department early
 - Necessary to maintain attorney-client privilege (discussed later)
- Assess whether it is necessary to engage outside counsel
 - Any basis to question independence of Legal Department?
 - Potential cost/penalty impact
 - Seriousness or pervasiveness of issue
 - Complexity of issues: Is subject matter expertise required?
 - History of related issues
- Issue legal hold/do not destroy memorandum as soon as practicable

Key Consideration: A/C Privilege

- *Upjohn* memo (*Upjohn Co. v. United States*)
 - Direction from management to the Legal Department to conduct an internal investigation
 - Provides evidence of attorney-client relationship
 - Memorializes management's request for legal advice
- Legal counsel must supervise entire process
- *Upjohn* admonitions during employee interviews
 - Attorney represents company and not the individual
 - Attorney is gathering information for purposes of providing legal advice
 - Privilege belongs to the company, only company can waive
- Mark documents and reports with privilege/work product legends
- Consider internal policy regarding whether/when to disclose internal investigation reports

Privilege Issues: Recent Decisions

- *United States v. ISS Marine*, 2012 WL 5873682 (D.D.C. Nov. 2012)
 - IG sought internal audit report
 - Not A/C privileged: not related to legal advice; minimal attorney involvement
 - Not attorney work product: purpose not clearly in anticipation of litigation and minimal attorney involvement
- *In re Kellogg Brown & Root, Inc.*, 756 F.3d 754 (D.C. Cir. 2014)
 - Initial District Court decision threatened to upend corporate privilege
 - Overturned on appeal
 - District Court on remand held that contractor had impliedly waived privilege by raising investigation documents in deposition, motion
 - D.C. Circuit granted contractor's mandamus petition on August 11, 2015
 - U.S. Supreme Court declined to hear relator's appeal in January 2016

Privilege Issues (cont.)

- Lessons Learned: Attorneys must be involved in all aspects of the investigation to maintain the privilege: witness interviews, Upjohn warnings, drafting of report, etc.
- Avoid “consultation lite” scenario: do not exclude counsel from internal investigation, but retain them in watered down capacity to consult
- Beware of inadvertent waivers
 - *United States ex rel. Frascella v. Oracle Corp.*, No. 07-cv-529 (E.D. Va. Mar. 30, 2011)
 - Contractor provided internal compliance report in response to IG subpoena
 - A/C privilege waived
 - Subject matter waiver: all related communications and documents
 - Ensure that markings are removed from documents provided to the government
 - Review all documents produced
 - Carefully consider whether to produce attorney communications
 - Carefully consider how to handle Yates Memo

Conducting the Investigation

- Many tools in investigator's toolbox
 - Statistical sampling of higher-risk transactions
 - Close working relationship with compliance/accounting personnel
 - Interviewing employees
 - One-on-one, in-person interviews are more likely to elicit candid responses and eliminates "group-think"; greater credibility
 - Compliance personnel or in-house counsel may participate
 - Separate participant should take detailed notes – later conversion to interview memoranda
 - Outside subject matter experts (e.g., accounting consultants)
 - BUT conclusions are ultimately the company's
- Document the results
 - Investigation report with conclusion regarding credible evidence
 - Consider separate, internal report that remains privileged

Making a Disclosure

- Mandatory Disclosure Rule requires “timely” disclosure
 - Determining whether credible evidence exists can be time consuming
 - Valuing potential accounting issues can take months
- If investigation confirms credible evidence before the investigation is complete, consider a preliminary disclosure
 - Explain that credible evidence exists
 - Describe investigation status
 - Provide a date for a final disclosure/follow-up report
- Early engagement with agency Suspension & Debarment Official (SDO) may be advisable depending on circumstances
 - Keeping SDO apprised of allegations indicates responsibility
 - Administrative agreements where necessary

The Disclosure

- Name and location of company or affected division
- Affected contract(s)
- Date when company learned of the issue
- How the company learned of the issue
- Steps taken by the company to investigate the issue
- Credible factual evidence
- Cost impact, if any
- Corrective action taken or under consideration
- Point of contact for government questions

Conducting the Investigation: Valuation of Potential Impact

- Consider engaging forensic accountants with expertise in valuing government contracts accounting issues
- Calculate rough order of magnitude (ROM)
 - Sampling and extrapolation
 - CAS net aggregate increased costs (FAR § 52.230-6)
 - Amount by which increased costs exceed decreased costs
 - Affected contracts
- Cost impact may require reconciliation of accounting records to source documents
- Determine whether more precise valuation is appropriate (GDM/CIS)

Valuation of Potential Impact (cont.)

- Evaluate potential interest issues
 - Truth in Negotiations Act (TINA)
 - Defective pricing issues
 - FAR § 52.215-11(d): downward pricing adjustments must be repaid with interest, compounded daily
 - CAS
 - Noncompliant/changed practices
 - FAR § 30.605(g): increased net aggregate costs must be repaid with interest
 - Others potential bases for interest
 - FAR § 52.232-17: interest accrues following government's written demand for payment of amounts payable to government
 - Time value of money based on early government payment

Post-Disclosure Considerations

- Process may unfold quickly
 - Have documentation assembled in anticipation of Government requests/subpoena/CID
 - Know: (1) what the company has, (2) what is privileged, and (3) what is not privileged
- Investigator will likely refer to DCAA for audit
- DCAA poised to demand access to employees
 - DCAA convinced it already has authority to interview employees
- Consult counsel to maintain cooperative atmosphere while resisting Government strong-arming
 - Strive to provide workable solutions

Best Practices: Investigation and Disclosure

- Establish policies and procedures for handling reported wrongdoing and making disclosures
- Internal investigation should be steps ahead of government investigation
 - No surprises
 - No scrambling for data and documentation in response to subpoena or CID
- Set up a separate charge number for potentially unallowable investigation-related time
- Maintain consistent willingness to engage and follow up
 - Quick and candid responses to inquiries are helpful

Best Practices (cont.)

- Distribute litigation hold and “do not destroy” notices to key employees
 - Required when litigation is “reasonably anticipated”
 - Work with IT: backup/archive data
 - Training and periodic follow-up required: not enough to simply notify employees

Questions?



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Thank you

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