

NEW FRAUD DISCLOSURE RULE – A TRAP FOR SMALL BUSINESSES?

Last week, the Federal Government issued a new rule that requires both prime contractors and subcontractors (at any tier) to report to the Government whenever a contractor has evidence of fraud connected with a Government contract. Any contractor that fails to make “timely disclosure” of contracting fraud to the Government risks debarment. Even small businesses -- which are exempt from the requirement to establish a code of ethics and develop an internal controls program -- must disclose evidence of fraud or risk debarment.

Details on the procedures and the penalties are set forth in the Federal Register, and will appear in various sections of the Federal Acquisition Regulation (FAR). Debarment may occur for knowing failure to make timely disclosure to the appropriate agency Inspector General (IG) and Contracting Officer (CO) whenever a “principal” of the company has “credible evidence” of fraud relating to the award, performance or closeout of a Government contract or subcontract at any tier.

Because “principal” is defined to include not only officers and directors, but also supervisors of business units, such as plant managers, contractors need to revise their code of ethics and internal controls systems to include procedures for (a) conducting an internal investigation whenever certain violations of criminal law or the Civil False Claims Act, or significant overpayments, become apparent, and (b) disclosing to the relevant IG and CO whenever the investigation results in credible evidence of fraud.

We recommend that small businesses, like large contractors, establish and maintain a written code of business ethics and conduct and an effective “awareness program and internal control system” to ensure compliance. Such programs are becoming not only the *de facto* minimum standard for determinations of responsibility and favorable past performance ratings but also a “safe harbor” in the event of government audits or investigations.

The new rule, which becomes effective next month, requires COs to insert the new FAR clauses in all contracts exceeding \$5 million and 120 days in duration. The rule does not apply to contracts for commercial items. Although small businesses (as defined by the size standard applicable to the contractor’s industry) remain formally exempt from the requirements for an ethics code and internal controls system, they are, along with large contractors, subject to the new fraud disclosure provisions. Moreover, although the rule will be included in new contract actions only, the disclosure requirement applies to all fraud relating to an ongoing contract, even fraud that occurred before the effective date of the rule.

The contents of this Alert are for informational purposes only, and do not constitute legal advice. If you have any questions about the Alert or would like additional information, please contact Ira Hoffman, Chair of the Shulman Rogers Government Contracts Practice Group (tel: 301-231-0948; email: ihoffman@srgpe.com), or the Shulman Rogers attorney with whom you regularly work.

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