PSC PROFESSIONAL SERVICES COUNCIL

STATEMENT OF

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EXECUTIVE VICE PRESIDENT, POLICY AND OPERATIONS
PROFESSIONAL SERVICES COUNCIL

BEFORE THE SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, ORGANIZATION, AND PROCUREMENT
OF THE
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
U.S. HOUSE OF REPRESENTATIVES

"H.R. 5712"

APRIL 15, 2008

Mr. Chairman, Ranking Member Bilbray, members of the subcommittee, thank you for the invitation to testify at today's hearing. I am Colleen Preston, Executive Vice President for Policy and Operations for the Professional Services Council (PSC).

PSC is the national trade association of the government professional and technical services industry. This year, PSC and the Contract Services Association of America (CSA) merged to create a single, unified voice representing the full range and diversity of the government services sector. Solely focused on preserving, improving, and expanding the federal government market for its members, PSC's more than 330 member companies represent small, medium, and large businesses that provide federal agencies with services of all kinds, including information technology, engineering, logistics, facilities management, operations and maintenance, consulting, international development, scientific, social, and environmental services, and more. Together, the association's members employ hundreds of thousands of Americans in all 50 states.

We support the efforts of this Committee, the Department of Justice's National Procurement Fraud Initiative, the various agencies and Office of Federal Procurement Policy to ensure the government is protected against fraudulent behavior by contractors, whether in the United States or abroad, whether commercial suppliers or government-only contractors.

We all share the goal of reducing unethical behavior. The question is how to best do that.

H.R. 5712 would require contractors to submit a written notification to the agency Inspector General whenever they have reasonable grounds to believe that an employee, agent, or subcontractor has committed a violation of federal criminal law or received a substantial overpayment. It then makes a contractor subject to debarment or suspension for failure to report. These rules would apply to commercial item purchases and overseas contracts with a value in excess of $5 million, as well as to all subcontracts, irrespective of value.

Often, what sounds like a simple and sensible proposal, when applied in the context of the realities of the contracting process, can end up having significant unintended consequences, and costs far beyond its benefits. We believe that is the case with H.R. 5712, and we oppose it in its present form.

Before going further, I would like to point out that the government is currently protected against fraudulent behavior by any number of criminal statutes, including the False Claims Act, by contract penalties it may impose, and by the Suspension and Debarment process. These protections apply whether the contractor is providing a commercial item, or whether the contract is performed domestically or overseas.

Our objections to the proposed legislation are based on the following key factors:

First, there is no reason to believe that a mandatory reporting program will actually result in reduced fraud or additional opportunities for redress by the government. Indeed, history suggests strongly that voluntary programs, properly structured and supported, are far more effective tools.

Second, we believe that voluntary disclosure programs are actually proving far more effective than the Department of Justice (DOJ) claims. In fact, the data show that while the specific DoD Voluntary Disclosure program DoJ referenced may have experienced a downturn, other equally important voluntary disclosure programs have demonstrated quite the opposite trend. Additionally, there are substantial improvements that could be made to the current voluntary disclosure program that we believe would strengthen the program without requiring that every error become the subject of a criminal investigation.

Third, the exemption from reporting for work performed outside of the United States was not added at the last second, as some suggest, and in no way changes a company's obligation to adhere to U.S. anti-fraud laws and regulations. Instead, it is consistent with longstanding U.S. policy and practice in this area which recognizes the difficulties and practical limitations inherent in trying to impose U.S. procedural requirements on firms constituted under the laws and regulations of other nations. This proposed legislation could make it impossible for the U.S. government to contract with entities in nations around the world where our policy is rightly to foster local economic growth by relying on local contractors. It would place similar challenges on the backs of prime contractors operating on behalf of the U.S. government overseas and who are required by contract to subcontract with substantial numbers of host nation companies.

Fourth, even the Department of Justice, in its comments on the proposed Federal Acquisition Regulation that this legislation seeks to codify, acknowledged that the proposed threshold for mandatory reporting – "reasonable grounds to believe" -- was too vague and would open the door to a potential landslide of unnecessary reports which have little or no relationship to actual fraud.

Fifth, as the Department of Justice has also acknowledged, it is both unnecessary and inappropriate to impose this type of mandatory disclosure requirement on contracts for the procurement of commercial items, since doing so violates the very reasons commercial procurement procedures exist. Again, because commercial companies, like any other company, are subject to all of the government's anti-fraud statutes and regulations, the mandatory PROCESS requirements imposed by the rule are unnecessary.

Sixth, the proposed legislation would place prime contractors in an untenable position. The vagaries of the mandatory reporting threshold places them at great risk since it also requires them to have a degree of insight and knowledge about the business *processes and practices of subcontractors at all levels---even those with whom the prime contractor has no privity of contract.*

We believe the better approach would be to mandate that DOJ enter into discussions with contractors to ascertain why the DoD Voluntary Disclosure program may not be operating

as effectively as DOJ would like, and to require an assessment of the totality of voluntary disclosures made by government contractors before making further changes. We support the continued emphasis on education and training rather than penalties to foster that internal self-governance in companies that will encourage employees and others to seek guidance before taking action. And, we strongly encourage companies to voluntarily report to the appropriate government official when errors are made. We will be happy to work with the committee and the Department of Justice to assist in developing processes that will further the goal of enhancing ethical contractor behavior.

Mandatory Reporting Rather than Voluntary Disclosure Is Not a Better Means to Encourage Ethical Contractor Behavior

We are concerned that the requirement in H.R. 5712 that calls for a contractor to report to the agency IG whenever the contractor has "reasonable grounds" to believe an employee, agent or subcontractor committed a violation of federal criminal law or has received a significant overpayment, is a step in the wrong direction, because it would not encourage contractors to disclose overpayments and potentially fraudulent conduct, or ensure that their employees, agents and subcontractors act ethically in the first place.

This mandatory reporting requirement is similar to a Department of Justice (DOJ) proposal now out for public comment as a proposed change to the Federal Acquisition Regulations. DOJ proposed this new reporting requirement because, despite the number of government contractors who have established corporate compliance programs, they assert that "few have actually responded to the invitation of the Department of Defense (DOD) that they report or voluntarily disclose suspected instances of fraud."[1]
While DOJ perceived there has been a lack of sufficient numbers of voluntary disclosure, by defense contractors in particular, they looked only at the number of disclosures pursuant to one specific program. They did nothing to ascertain whether contractors were instead using less formal disclosure mechanisms or reporting under other voluntary disclosure programs (which have had an increase in participation), or whether there had been a reduction in reporting because many companies had instituted effective compliance programs that were in fact reducing fraudulent behavior. They did no analysis to determine why contractors weren't using the formal DoD Voluntary Disclosure program before recommending that the only way to encourage disclosure is to make it mandatory.

As stated in the January 12, 2008 comments on the proposed regulations provided by the Council of Defense and Space Industry Associations (CODSIA)[2] of which PSC is a member, making disclosure mandatory rather than voluntary is a major departure from the long-standing and proven federal policies that encourage voluntary disclosures. Since 1986, DoD's Voluntary Disclosure Program—which DoJ helped sponsor and has continuously supported—has recognized that the *voluntary* participation of defense

[1] Department of Justice Letter to the Administrator of the Office of Federal Procurement Policy, OMB, May 23, 2007.

[2] CODSIA Case No. 01-08, Comments on FAR Case 2006-007.

contractors is essential to achieving greater disclosure of wrongdoing. *Voluntary* disclosure rewards contractors that adopt effective internal controls, shoulder the burden of timely investigating evidence of fraud, and voluntarily cooperate with investigative authorities toward efficient resolution of issues that may or may not constitute violations of federal criminal law. The program has preserved attorney-client and work product privileges and given federal authorities an effective way to recognize, and indeed reward contractors that act responsibly.

By all objective measures, the formal DoD Voluntary Disclosure Program has served the public interest well and yielded substantial monetary recoveries for the government. There are also any number of other voluntary disclosure programs that are highly successful and touted by the DoJ for their success, for example:

- Under the DoJ's Antitrust Corporate Leniency Policy, the number of voluntary disclosures has increased dramatically, making the policy "the Division's most effective generator of international cartel cases and ... the Department's most successful leniency program;[3]
- The number of voluntary disclosures to the State Department Directorate of Defense Trade Controls, which enforces the export control rules increased from 216 in 1999 to 394 in 2004, according to the GAO;[4] and,

- There was a spike in voluntary disclosures of violations of the Foreign Corrupt Practices Act after DoJ adopted a policy of rewarding contractor disclosure and cooperation.

Clearly, if structured correctly, voluntary disclosure programs work!

In addition to the fact that there may be fewer formal DoD Program voluntary disclosures because so many companies have implemented successful integrity programs, we believe there have been many more informal voluntary disclosures – primarily direct to contracting officials, where they are appropriately being resolved as contract matters and the contractor is given the opportunity to take corrective action to ensure the conduct does not occur again. These disclosures most often involve routine billing or other administrative errors that are best resolved at the contract level rather than being immediately elevated to a criminal investigation, as would be the case under the proposed regulation and statute.

CODSIA and PSC also believe that the formal DoD Voluntary Disclosure program is not utilized to a greater degree because of a number of factors that inhibit disclosures. For example, the average time to close a DoD Voluntary Disclosure case is almost 3 years, and there are inadequate protections afforded relative to the use of disclosure reports in other

[3] See e.g., "An Overview of Recent Developments in the Antitrust Division's Criminal Enforcement Program," presented by Scott D. Hammond (January 10, 2005) (available at http://www.usdoj.gov/atr/public/speeches/207226.pdf).

[4] See Defense Trade: Arms Export Control System in the Post-9/11 Environment (GAO 05-234; February 16, 2005) at 64, available at: http://www.gao.gov/new.items/d05234.pdf .

civil or criminal actions. If these existing weaknesses were addressed, we believe contractors would be more likely to utilize the formal, DoD voluntary program.

There are already powerful incentives to voluntarily disclose fraudulent conduct without additional legislative punishments. First, the U.S. Sentencing Guidelines provide for dramatically reduced penalties for convicted organizations that voluntarily report and cooperate with government investigations. Second, disclosure to the government minimizes exposure to a *qui tam* suit and treble damages under the civil False Claims Act – once the government knows of the facts upon which the alleged fraud is based, no one outside of the government can bring suit. Finally, current regulations provide that, in considering debarment of a company, the debarring official must consider mitigating factors, including whether the contractor timely disclosed the conduct in question, fully investigated such conduct, and disclosed the results of that investigation to the government.

The best way to encourage ethical contractor behavior is to retain a voluntary disclosure process. In the 1980's, the President's Blue Ribbon Commission on Defense Management ("Packard Commission") composed of leaders in industry and commerce, concluded that additional federal rules and regulations that had been adopted in an attempt to foster appropriate government contract behavior had actually resulted in a decrease in individual and corporate ethical responsibility. Rather than striving for responsible decision-making and ethical behavior, companies were focused on complying with the rules and regulations. The Commission concluded that: "The process by which a contractor recognizes and distinguishes responsibility for compliance from a mere façade of compliance is self-governance." It is this culture that ensures that when a problem occurs, "the organization will respond promptly and responsibly to pin down the root cause and take appropriate corrective and disciplinary action."[5]

There are numerous practical problems associated with a mandatory reporting requirement.

"Reasonable Grounds" and Employees Being Trained in the Law

Instituting a mandatory reporting requirement, with the threat of debarment or suspension for not reporting soon enough, will force companies to report precipitously – before they have had an opportunity to do a complete and thorough investigation into whether or not an allegation has any merit. In other words, the proposed legislation creates an extremely vague threshold which will either require the reporting of every individual error even before the company has real insight to determine whether a criminal violation may really have occurred or require that company management literally become legal experts, since they will be charged with interpreting such vague language. Even the Dept. of Justice, in its January 14, 2008 letter to the General Services Administration (GSA), acknowledged that their proposed threshold was too vague and open-ended and thus recommended a modest tightening of the definition. We believe DoJ's proposed modification leaves far too

[5] Letter from the Defense Industry Initiative on Business Ethics and Conduct on FAR Case 2007-008; Contractor Compliance and Integrity Reporting, January 14, 2008.

much uncertainty and far too little flexibility for the company to conduct a reasonable internal investigation, but it is at least an acknowledgment of the dangers of "the reasonable grounds" standard for reporting.

For example, Sally and John, who work on an assembly line at a defense contractor have a nasty falling out over the weekend and Sally breaks up with John, who had accused her of seeing other men. John is particularly upset, and while chatting with his boss in the break room the following week tells him that he saw Sally having lunch with a person he believes is their government contracting officer and that Sally picked up the check. It would appear that Sally may have violated the federal Procurement Integrity law. The boss doesn't know that John is a jilted suitor and has no reason to suspect John's version of the event. The question is, should the boss first call Sally in and ask her version of the events? Should he report the alleged incident through the company's internal ethics hotline, to his supervisor, or to the company's legal office? Or must the boss immediately report this incident to the agency Inspector General, or to the government contracting officer's supervisor? Do we want to require that everyone in a company have sufficient criminal law training to know if an activity might be criminal? Is the statement of a single witness "reasonable grounds" to believe that a violation of federal criminal law occurred? Does it make a difference in determining whether "reasonable grounds" exist to know that John was just jilted by Sally?

We don't know, and virtually every previous attempt to institute similar mandatory reporting requirements in regulation has raised the same questions about the vagueness of the standard that would trigger the requirement to report. Again, it is these practical implications of implementing what sounds like a good idea that cause us grave concern.

Overpayments

It becomes even trickier when you are talking about reporting "significant overpayments." Accounting under any large contract is incredibly complex. It's not as if you looked at your bank statement and all of sudden saw a deposit of $10,000 from the Social Security Administration and you weren't eligible to receive Social Security. In most cases numerous people are involved in billing and receipt. Billing systems are also highly automated. Despite that, mistakes can and will be made by both the government and contractors.

The Federal Acquisition Regulations (FAR) already require that, when an overpayment occurs, the contractor inform the contracting officer and that provisions for repayment be made, contrary to the Department of Justice's statements.[6]

Reporting to the Inspector General Rather than the Contracting Officer Only

If every incident were reported to the agency IG rather than to the contracting officer as a first step, the IG would be inundated with allegations that in many cases have no merit, or are not related to criminal wrongdoing, but rather a mistake or error on an employee's part. Many of these situations could easily be resolved if the company were able to do an internal investigation without the fear that some government official might after the fact conclude, because of the statute's vague language, that they should have reported the

[6] See, 66 FR 65353, December 18, 2001 and 68 F.R. 56667, October 1, 2003.

incident sooner. In addition, particularly in the payment area, it is critical that the contractor's system be reviewed to attempt to ensure that similar mistakes are not made in the future. Moreover, it would be travesty if every billing error were turned into a criminal investigation.

In it's recently released *2007 National Business Ethics Survey*, the Ethics Resource Center found that an overwhelming 90% of employees preferred to discuss possible issues with people they had a pre-existing relationship with – primarily supervisors, higher management, and other responsible persons, such as ethics officers. Perhaps even more important is that employees seek guidance at an early stage before misconduct occurs. It is in everyone's best interest for the contractor to have an effective ethics program, with the ability to do a thorough investigation internally before it makes a report to the government.

If an employee thinks that their company could lose the contract they're working on, or be debarred or suspended and not have any government contract if they report a violation, or that they themselves will be investigated by an Inspector General - they are going to be <u>less</u> likely to disclose, <u>not more</u>. The better course of action in many cases is to be able to resolve disputes in an administrative fashion – to take appropriate action against an offending employee, make monetary restitution to the government, <u>and work to ensure that the behavior will be prevented in the future</u>. That is the key – not punishment! But once a matter is reported to the IG as a potential criminal fraud matter, under the Contract Disputes Act the contracting officer is no longer authorized to settle the matter – only DOJ is. As a result, even the most routine disclosures, made to the IG out of an abundance of caution and fear of violating the reporting requirement and being debarred or suspended, will take years to resolve.

Failure to mandatory report basis for debarment or suspension

The government already has the right to suspend or debar a contractor to avoid having to contract with an unscrupulous contractor. Suspension and debarment is not designed and should not be used as an additional penalty for behavior that is already the subject of criminal or civil penalties. Voluntary reporting of the offending behavior is already an element to be considered in mitigation by the debarment or suspension authority when determining whether debarment or suspension is appropriate. Making failure to report a basis for debarment or suspension on its own is effectively forcing a contractor to incriminate itself in order to avoid being banned from what may be its only market. In addition, the practical issues arise again – what if an employee - even a manager or supervisor commits fraud? They are likely to do everything in their power to conceal the crime from anyone else in the company. Will that failure to report on themselves give rise to a debarment or suspension of a company, effecting potentially thousands of innocent co-workers?

<u>Exclusions from Coverage for Commercial Items and Overseas Contracts</u>

The exclusion for application of the proposed regulations to contracts performed entirely outside the United States and when the contract is for the acquisition of a commercial item

is identical to the scope of coverage in the FAR Contractor Code of Business Ethics and Conduct final rule published on November 23, 2007, and the previous Defense Federal Acquisition Regulation on which it was based. That regulation has been in existence since 1988 with the exclusion for overseas contracts. The exemption for Commercial Items resulted from the directive in the Federal Acquisition Streamlining Act to minimize the number of government-unique requirements imposed on commercial suppliers so that the government would have access to commercial technology and innovations in the commercial sector.

Exclusion for Contracts Performed Entirely Outside the United States

We have made it a policy in Iraq, Africa, the Middle East, and virtually anywhere in the world that we provide assistance, to utilize local companies to the maximum extent possible - whether as prime contractors or subcontractors to U.S. companies. The exclusion for contracts performed entirely outside the United States is based on the fact that while all contractors, anywhere in the world are subject to U.S. criminal fraud prosecution for their activities on U.S. contracts, it is unreasonable and impractical to expect foreign firms to be able to comply with the unique procedural requirements the U.S. government imposes on its government contractors. A local cement provider in Kuwait, or a family-run plumbing contractor in Iraq, cannot be expected to be aware of and to effectively institute an ethics or reporting program that would comply with U.S. standards. Of course, those firms are entirely liable for adherence to U.S. anti-fraud laws of all kinds, but the companies are constituted under their own country's laws and standards. How can we expect these companies to understand American rules of jurisprudence such as "a reasonable grounds to believe" when we can't define them sufficiently ourselves?

Similarly, the flow-down requirements of the proposed legislation are also problematic. Simply put, it is even more unreasonable and impractical to expect prime contractors to know the details of the internal business operations and practices of all of the subcontractors involved on a project, particularly those at lower tiers with which the prime contractor has little or no relationship. It is equally unreasonable to hold prime contractors responsible for reporting potential violations based on a standard that is so vague, whether the subcontractors are performing in the United States or abroad.

Exclusion for Commercial Items

The general exclusion of commercial items from regulations that dictate specific internal company policies and procedures is a result of the directive in the Federal Acquisition Streamlining Act to minimize the number of government-unique requirements imposed on commercial suppliers so that the government would have access to commercial technology and innovations in the commercial sector. The issue is not whether laws precluding fraud and requirements to return overpayments apply to contractors providing commercial products – they do. Rather, the issue is whether companies from whom the government buys, just like any commercial purchaser, should be forced to accept government-unique contract terms and conditions. Even DOJ, in its January 14, 2008 letter providing comments on FAR Case 2007-006, supported the exclusion of the mandatory business ethics, compliance and reporting clause for commercial items contracts.

The government must have access to the best technology and services offered in the commercial marketplace. Numerous policies over the years have instituted a requirement to use commercial products before paying to develop government-unique products or services. While there are certain government-unique clauses included in commercial contracts, including the current regulatory requirement to report to the contracting officer if the contractor believes a violation of law has occurred, it is unrealistic to assume that companies that sell all over the world are willing to accept the risk of a "black mark" such as might occur under H.R. 5712 to protect what is typically a tiny share of their market. Remember also that there are already significant incentives to report fraud or other criminal behavior.

Conclusion

Abandoning well-established principles of self-governance and voluntary disclosure in favor of mandatory disclosure as proposed by H.R. 5712 will result in less disclosure of potentially fraudulent activity and less opportunity for contractors to work with the government to improve their ethics practices and procedures. Mandatory disclosure raises numerous legal issues, including the protection from self-incrimination that companies are able to resolve in a voluntary disclosure environment. Contractors that would knowingly violate criminal laws are not going to be persuaded to stop because another law says they must now report when they do violate the law. Instead, mandatory disclosure and the additional provisions of H.R. 5712 add additional risk that contractors who are trying to behave in an ethical manner will get tripped up in and incur additional penalties, if not total banning from government contracts.

We agree that stopping unethical behavior is the right goal, the only question is, how best to do that. We believe the better approach would be to mandate that DOJ enter into discussions with contractors to ascertain why the DoD Voluntary Disclosure program may not be operating as effectively as DOJ would like, and to require an assessment of the totality of voluntary disclosures made by government contractors before making further changes. We support the continued emphasis on education and training rather than penalties to foster that internal self-governance in companies that will encourage employees and others to seek guidance before taking action. And, we strongly encourage companies to voluntarily report to the appropriate government official when errors are made. We will be happy to work with the committee and the Department of Justice to assist in developing processes that will further the goal of enhancing ethical contractor behavior.

On behalf of the Professional Services Council, I appreciate the opportunity to provide our comments on the important issues before the subcommittee and I look forward to any questions you may have. We also look forward to working with the subcommittee as you continue your deliberations on this legislation.

STATEMENT REQUIRED BY HOUSE RULES

In compliance with House Rules and the request of the Committee, in the current fiscal year or in the two previous fiscal years, neither I nor the Professional Services Council, a non-profit 501(c)(6) corporation, has received any federal grant, sub-grant, contract or subcontract from any federal agency.

BIOGRAPHY

Colleen A. Preston joined PSC as Executive Vice President for Policy & Operations during the association's merger with the Contract Services Association. Prior to accepting her position at CSA, Ms. Preston was a consultant focusing on the federal acquisition process and business process reengineering.

From 1993-1997, she held the newly created position of Deputy Under Secretary of Defense for Acquisition Reform, where she led a small team that provided the catalyst for reengineering and improving the Department of Defense acquisition process through internal process, regulatory and legislative (Federal Acquisition Streamlining Act and the Federal Acquisition Reform Act) changes.

For six months prior to becoming deputy undersecretary, Preston was the Special Assistant to the Secretary of Defense for Legal Matters, advising the Secretary of Defense on all legal issues coming before him and handling the legal, ethical and financial issues arising out of the appointment and Senate confirmation of the Department of Defense Presidential appointees.

Before her stint at DoD, she served for 10 years as the primary legal advisor on acquisition policy issues for the Committee on Armed Services, U.S. House of Representatives, beginning with her assignment with the Investigations Subcommittee and ending as General Counsel to the full committee. She was instrumental in the development of numerous acquisition improvement measures, such as the Competition in Contracting Act, the Small Business and Federal Competition Enhancement Act, acquisition provisions of the Goldwater-Nichols Act, and the Defense Acquisition Workforce Improvement Act.

She came to the committee staff after 4 years as an attorney/advisor in the Office of the General Counsel, Secretary of the Air Force, where in addition to providing legal guidance on acquisition issues, including bid protests, she acted as counsel to the Air Force Contract Adjustment, and Debarment and Suspension Boards.

Ms. Preston received both her Bachelor of Arts in Political Science and her Juris Doctor with Honors from the University of Florida, where she was a Law Review Student Works Editor. She received her Masters of Law, with emphasis on government contracting, from Georgetown University.

She is the recipient of numerous awards, including the National Contract Management Association (NCMA) Herbert Roback Award, the Department of Defense Distinguished Civilian Service Medal, the Defense Acquisition University Alumni Association David C. Acker Award, and a four-time recipient of the Federal Computer Week Federal 100 Award. She is a member of the Florida Bar and a Fellow, NCMA.