Analysis&Perspective

Sarbanes-Oxley Act

Audits

The Particular Perils of the Sarbanes–Oxley Act for Government Contractors

W. STANFIELD JOHNSON

FREDERICK W. CLAYBROOK JR.

In August, the president signed into law the Sarbanes-Oxley Act of 2002.[1] Enacted with much fanfare, the act addresses securities and public accounting issues raised by current financial reporting scandals of publicly held companies—most notably the Enron/Arthur Andersen debacle. The act's stated purpose is to improve corporate governance, public auditing, and Securities and Exchange Commission oversight so that the investing public will be adequately protected. Much attention has been given to these protections and their implications for corporate America.

Little analysis has been directed, however, to the particular impacts of Sarbanes-Oxley on those public companies that contract with the United States. These companies are already subject to risks, requirements, certifications, disclosures, oversight, and sanctions peculiar to government contracting. For government contractors, Sarbanes-Oxley puts these already existing challenges in a new crucible.

This perhaps unintended consequence of a securities-related law comes about principally because its corporate governance provisions will more directly implicate the corporate executive suite in government contract risks, controls, and failures, in a way not previously generally practiced and that may subject senior corporate officers to severe sanctions. In other words, to the extent the act requires increased levels of governance and elevates that governance to the highest echelons of the company, the stakes of government contracting problems will escalate. The resulting corporate process will, in turn, open new opportunities for government audit and investigation or whistleblower allegations. Indeed, the new law requires disclosures to independent auditors that may in turn become available to those adverse to the company and its shareholders.

Some of the perils for government contractors arise from the precise terms of Sarbanes-Oxley, others from its imprecision. Certain terms are undefined—terms such as "fairly presents," "fraud," and "internal controls"—leaving the danger that they will be interpreted beyond the context of financial reporting.

Sarbanes-Oxley also may put an intimidating overlay on the extensive recordkeeping obligations with which government contractors must already contend. The statute's document destruction felony—obviously responding to the Enron/Andersen obstruction—is so broadly worded as to apply potentially to all aspects of contract "administration." This will require government contractors to review document retention and destruction policies and related internal controls, responsibility for which the statute appears to put in the hands of top corporate executives.

For these principal reasons, Sarbanes-Oxley imposes unique burdens on, and poses unique risks to, government contractors. This analysis of these special challenges is organized by traditional issues familiar to all government contractors:

(1) contract risks (overruns, performance problems, and government claims);

(2) internal controls;

(3) fraud (disclosure, allegations, audits, and investigations);

(4) document policies;

(5) crimes and punishment; and

(6) suspension and debarment implications.

Doing business with the government has always involved significant risks. Now, those risks for publicly held contractors will take on additional refractions through the prism of Sarbanes-Oxley.

A. Contract Risks

Section 302, titled "Corporate Responsibility for Financial Reports," requires that both the CEO and the CFO certify in annual and quarterly reports that the report "does not contain any untrue statement of a material fact" or "omit to state a material fact" and that "the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations

[1] Act of July 30, 2002, Pub. L. No. 107-204, 116 Stat. 745.

W. Stanfield Johnson and Frederick W. Claybrook Jr. are partners in the Washington, D.C. office of Crowell & Moring LLP, specializing in government contracts litigation and counseling. *They wish to thank Irving Yoskowitz and Richard Bednar, senior counsel, and Brian Elmer and Terry Albertson, partners in Crowell & Moring, for their helpful comments and observations.*

of the issuer as of, and for, the periods presented in the report . . . .''[2]

Section 906 requires the CEO and the CFO to accompany the periodic report containing financial statements with a statement certifying that the report complies with the Section 302 requirements and that the report ''fairly presents, in all material respects, the financial condition and results of operations of the issuer.''[3] A knowing false statement or certificate is a felony, not only because of existing 18 U.S.C. § 1001, but because Section 906 adds the following to the Criminal Code at Section 1350(c):

> (c) Criminal penalties.—Whoever—
>
> (1) certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than $1,000,000 or imprisoned not more than 10 years, or both; or
>
> (2) willfully certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than $5,000,000, or imprisoned not more than 20 years, or both.[4]

To the extent the Sarbanes-Oxley Act requires increased levels of governance and elevates that governance to the highest echelons of the company, the stakes of government contracting problems will escalate. The resulting corporate process will, in turn, open new opportunities for government audit and investigation or whistleblower allegations.

Whereas the principal certification was previously done by the public auditor, under the new statute it becomes an expanded, personal matter for the top executives. Investors are now to be protected by these enhanced representations about the business by both the CEO and the CFO, not just by the outside auditor applying generally accepted accounting principles (GAAP). These particular certifications are limited by ''such officer's knowledge,'' but that caveat nonetheless and necessarily means that the executives must have a process that informs them and allows them to evaluate whether the statements are true and ''fairly present'' the company's financial conditions.[5]

For government contractors, this evaluation is not just a question of financial accounting. It involves evaluation of the status of contracts that can be at once dynamic, complex, risky, unstable, long-term, significant, and adversarial. In the ''real world,'' contract performance, contract rights, government contract accounting, and customer relations must be measured.

While there are similar risks in some sectors of the commercial world, they are experienced to a greater degree by government contractors. Government contractors are also more susceptible than companies in a typical commercial context to being affected by material risks because the government has more decision-making institutions, processes, and officials capable of taking uncoordinated positions that may destabilize a contract or have a significant adverse effect. To illustrate, here are some familiar government contracting situations that, under Sarbanes-Oxley, may be the subject of the CEO and CFO certification if they are ''material'':

(1) Cost Overruns. A major, fixed-price contract is overrunning by millions of dollars, with an increasing loss projected, unless recovery is made on claims for equitable adjustment. Under Financial Accounting Standards Board Statement of Position 81-1, contractors have been able to book expected revenues, even though not yet received, when they have claims and it is ''probable that the claim will result in additional contract revenue and . . . the amount can be reliably estimated.''[6] While the act does not expressly eliminate this standard, it will require additional scrutiny by companies of the realistic potential for recovery of amounts in addition to the contract price.

Is ''more probable than not'' a sufficient basis for a fair presentation? Undoubtedly, some individuals with hindsight will be on the alert to assert, when a changes claim does not materialize in the amount originally anticipated as reflected in past financial statements, that the company made a misleading statement as to its revenues under the contract. Such potential exposure may affect the financial statement or, subsequently, a company's willingness to settle changes claims with the government at a number that does not at least cover the cost of performance (SOP 81-1 limits the write-up to the actual costs incurred, not including profit[7]). It also highlights the need for companies—and the CEO and CFO—to keep a record of exactly what was known and considered when certifying an SEC report, especially when the company has ''booked'' revenues it expects to receive later on the basis of filed or to-be-filed claims.

(2) Performance Problems. A multibillion dollar, fixed-price contract is delayed in performance; plus, there are problems in meeting specifications. The contractor is at least technically in default. Because of the program's importance to the government, termination is unlikely, but a cure notice is quite possible. How are the CEO and the CFO to evaluate and then certify with respect to this risk? What will be thought of their optimistic certification that turns sour, when the government terminates

[2] *Id.* §§ 302(a)(2), (3).
[3] *Id.* § 906, to be codified at 18 U.S.C. § 1350(b).
[4] *Id.*, to be codified at 18 U.S.C. § 1350(c).
[5] Some issuers are required by Section 409 to ''disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer . . ., which may include trend and qualitative information . . . .'' *Id.* § 409, to be codified at 15 U.S.C. § 78m(1). This implies that top executives must be informed in real time.
[6] FASB SOP 81-1, ¶ .65.
[7] *Id.*

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for default, cuts off this revenue stream, and demands millions, perhaps even billions, of dollars back?

This circumstance will require a meaningful process which informs the executives and builds an effective defense to ''false certification'' allegations made in hindsight. Optimism of division or program management may not suffice; technical and legal opinions may be required. Even if—indeed, particularly if—an optimistic evaluation is adopted by the executives, material facts that cast doubt on that assessment (such as the government denying responsibility for inadequate specifications) may have to be disclosed in the public report. The independent auditor, energized by Sarbanes-Oxley, will have to be advised. Such advice may not be privileged—indeed, to be permitted to issue audit reports by the newly established Public Company Accounting Oversight Board, a public auditor must consent to cooperate and comply with any request by the board for testimony or documentation.[8] The process set in motion by the new statute may thus cause disclosure to competitors, the public, and Congress of awkward facts that neither the company nor its customer wants aired.

(3) Government Claims. Increasingly, government contractors face government claims that come in many forms—for example, cost disallowances, accounting disputes, defective pricing adjustments, and false claims assertions, and fraud allegations (which present particular challenges under Sarbanes-Oxley discussed below). These claims can often be material in amount. For some time, government contractors have had to evaluate these risks and make appropriate reserves for such government claims, but Sarbanes-Oxley, through the personalized CEO and CFO certifications, changes both the stakes and the stakeholders. If the assessment of risks and reserves turns out to be wrong, will second-guessing of the certificate be successfully defended by reference to some GAAP rule? Or will the focus turn to whether the CEO and CFO gave adequate personal attention to the particular matter?

These illustrations support the general proposition that standard government contract risks will now be subjected to more intense scrutiny. Corporate responsibilities with respect to them likely will not be satisfied by a simple disclosure (whether obscure or precise), because the certificate also goes to whether the financial statements ''fairly present'' the financial condition. Assessments likely will be somewhat less optimistic, given the new corporate-level responsibilities and the continuing interface with more intrusive, more cautious auditors.[9] In any event, such assessments will need to be well supported and documented.[10] That justification must be carefully reviewed so that executives will be able to defend their certifications based on the knowledge available to them at the time when later challenged by disgruntled investors relying on the reality of a risk gone bad.

And, whether these corporate determinations are well-founded or not, it will be difficult to keep the assessments and the facts on which they are based private and out of the hands of adversaries. Disclosures of contract problems—whether overruns, performance problems, or accounting issues—may bear upon competitive evaluations of past performance.[11] In this way, compliance with the Sarbanes-Oxley disclosure requirements may impair a contractor's effort to obtain future contracts.

For government contractors, this evaluation is not just a question of financial accounting. It involves evaluation of the status of contracts that can be at once dynamic, complex, risky, unstable, long-term, significant, and adversarial.

B. Internal Controls

(1) Scope. Under Section 302(a)(4), the CEOs and CFOs are, by statute and their own certifications, ''responsible for establishing and maintaining internal controls.''[12] In fulfilling this responsibility, they must certify that they ''have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities . . . .''[13] This particular certification puts the executives on a hook from which it will be hard to escape. While the substantive truthfulness and ''fairly presents'' certificates of Sections 302(a)(2) and (3) are caveated by ''such officer's knowledge,'' lack of knowledge may indicate a failure to have complied with the Section 302(a)(4) certification requiring design and oversight of adequate internal controls.

With the strong emphasis on ''internal controls,'' it is surprising and unfortunate that the term is not defined in the act, leaving it for future development on a case-by-case basis (unless the Board or SEC defines it by regulation, as the SEC has recently proposed[14]). ''Internal controls,'' as used in Sarbanes-Oxley, would appear to include all financial procedures within the company designed to ensure that information that may have a material effect on the company's financial condition is made known to the most senior executives. Under this reading, for example, a government contract program's estimates to complete and financial performance data would be covered.

It is unclear whether ''internal controls,'' as used in Sarbanes-Oxley, is limited to such financial controls, although that inference can easily be drawn from the requirement that the CEO and CFO disclose to the internal auditors and the audit committee of the company's board internal control deficiencies ''which could ad-

[8] Sarbanes-Oxley Act § 102(b)(3).

[9] *See, e.g.*, Phyllis Plitch, *Auditor Letters Now Worrisome For Executives*, Wall St. J., Oct. 17, 2002, at B9.

[10] These same concerns could be implicated, for example, if a company allegedly understates the health of its financial position by ''under-booking'' or ''over-reserving.''

[11] Past performance is, in general, required to be evaluated in all competitive, negotiated acquisitions over $100,000 in value. FAR § 15.304(c)(3).

[12] Sarbanes-Oxley Act § 302(a)(4)(A).

[13] *Id.* (B).

[14] 67 Fed. Reg. 66,207, 66,218-22 (Oct. 30, 2002); *see also* Exchange Act Rules 13a-14, 15d-14 (Aug. 29, 2002) (implementing the Sarbanes-Oxley Act).

versely affect the issuer's ability to record, process, summarize, and report financial data.''[15] The SEC's proposed rule defining ''internal controls'' notes varying possible definitions and appears to limit ''internal controls'' to financial reporting.[16] However, confusion remains whether, in practice, the limitation would be meaningful.

A broader interpretation may well be attempted and intended, however, including in the concept of ''internal controls'' *any* company procedures, including those for non-financial data and for government contract administrative procedures designed to protect the government. For example, are quality control systems and hotlines included in the ''internal controls'' for which the CEO and CFO must certify, even though they generally may not have anything to do with the reporting of material facts for financial reporting purposes? If they are, then the CEO and CFO must certify to an evaluation of their effectiveness as well.[17] This raises the specter of the CEO and the CFO having to be presented a full review of any major program at least once each quarter.[18]

Thus, whether or not by design, the Sarbanes-Oxley certificate thrusts the top officers of publicly held government contractors into more intensive oversight than is currently the norm at many companies. Maintaining such internal controls has frequently been the ''objective'' of lower level officials, in separate divisions, subject to supervision. The new, personalized CEO and CFO responsibilities will likely present a serious institutional challenge for many publicly held government contractors. Effective institutions and processes, focused on government contract risks and compliance as well as financial accounting, may have to be designed to support the top officers in fulfilling their new statutory responsibilities.

(2) Deficiencies Reporting. The problems for the CEO and the CFO do not stop there. Under the act, they are also required to report significant deficiencies in ''internal controls,'' that come to their attention and to certify as follows:

> the signing officers have disclosed to the issuer's auditors and the audit committee of the board of directors . . .
>
> (A) all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize, and report financial data and have identified to the issuer's auditors any material weaknesses in internal controls . . . .[19]

The scope of this requirement obviously depends on how restrictively or expansively ''internal controls'' is defined. Consider whether, after product substitution or testing failures are discovered, program quality control will, in hindsight, be deemed an ''internal control'' which the CEO and the CFO must now report as a ''significant deficiency'' to the outside auditors and audit committee of the board of directors. And disclosures made to them will undoubtedly also attract the attention of the government's auditors, investigators, technical representatives, and contracting officials.

C. Fraud

Since the passage in 1978 of the Inspector General Act, which signaled the start of the ''War Against Procurement Fraud,'' contractors have had to struggle with the financial reporting implications of allegations of contract fraud.[20] With the watering down of civil fraud in terms of knowledge (scienter) and burden of proof, relaxation of statutes of limitation, liberalization of whistleblower (qui tam) litigation, and increases in punitive damages, allegations under the civil False Claims Act have become an increasing problem in this regard. The materiality of such fraud issues may depend on tests other than simply the monetary amount involved. Many companies have relied on generalized disclosures that they, like other government contractors, are subject to these kinds of allegations, which may result in suspension or debarment.

For a number of reasons, Sarbanes-Oxley appears to require more disclosure than a generalized caveat of this type, and certainly a more detailed corporate inquiry than such a caveat would suggest. Claims of fraud, whether by or in the name of the government, are particularly troublesome because of the shadow they cast on a company's reputation and its potential for future business. At what point do such claims become material facts not to be omitted from the certified report? What reserves are required for huge potential punitive damages in order to ''fairly present'' the company's financial condition? Sections 302(a)(2) and (3), quoted above, require a determination of what the material facts are and what their impact is on fair presentation of the company's financial condition.

Furthermore, Section 302(a)(5)(B) requires a certification by both the CEO and the CFO that deals expressly with ''fraud'':

> the signing officers have disclosed to the issuer's auditors and the audit committee of the board of directors . . .
>
> (B) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls.[21]

The scope of the requirement for disclosure of ''any fraud'' is unclear. When read in context, this may only cover any ''internal controls'' fraud, *i.e.*, any fraud related to individuals in their performance of internal control functions. Of course, the breadth of this more restrictive reading of the certificate's coverage would in

[15] Sarbanes-Oxley Act § 302(5)(A).

[16] 67 Fed. Reg. at 66,218-22. The proposed rule would adopt American Institute of Certified Public Accountants Auditing Standard 319, which deals with ''internal control.'' While Auditing Standard 319 says internal control relates to ''effectiveness and efficiency of operations,'' that term appears to be defined to relate only to accounting procedures of the company. However, a component of ''internal control'' under the standard is ''risk assessment,'' which is further defined as an entity's ''identification, analysis, and management of risks relevant to the preparation of financial statements,'' which would make ''internal control'' susceptible to a broader reading, as material risks would appear to be within the ambit of financial reporting.

[17] Sarbanes-Oxley Act §§ 302(a)(4)(C), (D).

[18] The SEC's proposed rule emphasizes the need for quarterly CEO and CFO certifications. 67 Fed. Reg. at 66,221.

[19] Sarbanes-Oxley Act § 302(a)(5).

[20] *See* Pub. L. No. 95-452, 92 Stat. 1101 (1978).

[21] Sarbanes-Oxley Act § 302 (a)(5)(B).

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turn depend on how expansively ''internal controls'' will eventually be interpreted. Or this certification may receive a broader reading and relate to any *type* of fraud, as long as it involves individuals significantly involved in ''internal controls,'' *i.e.*, whether or not the fraud itself has any relation to the individual's financial reporting duties.

The CEO and CFO, to be safe, should have a corporate governance process that brings to their attention all non-frivolous allegations of government contract fraud and, necessarily, a process for evaluation and support of their assessments.

Hopefully, the SEC or the board will clarify and limit this disclosure obligation, as the SEC proposes to do with the confusion about ''internal controls.'' However, at this point, it does seem safe to predict that this ''any fraud'' provision may be interpreted by some to cover government contract fraud, even of limited dimension. Moreover, it seems apparent that ''management *or other employees who have a significant role* in the issuer's internal controls'' (emphasis added) may reside far down in the company's ranks. If the CEO and CFO must certify that such fraud has been disclosed, it follows that they must take steps to identify it.[22] Thus, the CEO and CFO, to be safe, should have a corporate governance process that brings to their attention all non-frivolous allegations of government contract fraud and, necessarily, a process for evaluation and support of their assessments.

Not only does the statute potentially escalate ''any fraud, whether material or not,'' to the top ranks of the company, any such fraud must also be disclosed to the independent audit committee and to the independent auditors.[23] Whatever the further duty of disclosure by such independent persons, this disclosure of ''fraud'' to the auditors is not likely to be privileged. The board can demand its disclosure from the auditors.[24] Nor is it likely that disclosure of related details, made as auditors further scrutinize the ''fraud,'' will be privileged. Thus, Section 302(a)(5)(B) may prove troublesome for government contractors who would like to enjoy the privacy of their own deliberations regarding fraud allegations against them.

Requirements such as this, dealing with ''fraud,'' sound good and make sense if one assumes the result, that is, that fraud has actually occurred. The difficulty is that these disclosure decisions may have to be made before resolution, based only on suspicion, investigation, or allegations of fraud. Government contractors are used to, and practice, voluntary disclosure of fraud, but such disclosures are generally not made until the company, by an internal process, has made a considered judgment.

Section 302(a)(5)(B) is problematic because it may well impose on the CEOs and CFOs risk of a severe penalty for misjudging whether there was in fact ''fraud.'' A failure to disclose what is thought not to be, but turns out to be, ''fraud'' could be very damaging to the certifying executive. The question may well be asked, ''What did the CEO know, and when did he know it?'' Obviously, there better be a good answer.

As a consequence, companies may make disclosures to the audit committee and auditors of all alleged or suspected, but unresolved, government contract frauds. Such disclosures will entail their own process, perhaps requiring the executives, the audit committee, and the independent auditors to make their own assessments of conduct that could potentially be deemed fraudulent. Meanwhile, it may be anticipated that government contracting officials, auditors, and investigators will be interested in obtaining (non-privileged) Sarbanes-Oxley lists of identified ''fraud.'' In this way, the statute may have effects on the government contracting process beyond its presumed financial reporting focus.

D. Document Retention and Management

In reaction to the dramatic document shredding for which Arthur Andersen was convicted, the Sarbanes-Oxley Act, in Section 1102,[25] adds to the existing obstruction of justice provisions of Criminal Code Section 1512 by criminalizing ''tampering with a record'' or ''otherwise impeding an official proceeding.'' ''Corruptly'' obstructing or influencing an official proceeding, or attempting to do so, carries a fine and/or 20-year prison sentence.[26] The official proceeding ''need not be pending or about to be instituted at the time of the offense.''[27]

In addition, the Sarbanes-Oxley Act in Section 802 creates a new, related felony as a new Section 1519 of the Criminal Code. This new felony is not limited to an ''official proceeding,'' but sweeps in actions taken in ''contemplation of'' proceedings and ''proper administration of any matter'':

> Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or *proper administration of any matter within the jurisdiction of any department or agency* of the United States or any case filed under title 11, or in relation to *or contemplation of* any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.[28]

The italicized words suggest the possibility of a broad reading of this new crime—one that might apply to the ''administration'' of government contracts. Whether an investigation is actually ongoing or anticipated will often be made irrelevant, not just by the ''contemplation of'' language, but by the term ''administration.'' The statutory language may be interpreted in accordance

[22] This portion of the certification is not explicitly limited by the caveat ''based on such officer's knowledge,'' *id.*, although presumably it would be so interpreted, assuming a sufficient inquiry to support the certificate.

[23] *Id.*

[24] *Id.* § 102(b)(3).

[25] *Id.* § 1102, to be codified at 18 U.S.C. §§ 1512(c)(1), (2).

[26] *Id.*

[27] 18 U.S.C. § 1512(e)(1) (2000), to be recodified at *id.* (f)(1).

[28] Sarbanes-Oxley Act § 802(a), to be codified at 18 U.S.C. § 1519 (emphasis added).

with the section's title—"Destruction, alteration, or falsification of records in Federal investigations and bankruptcy"—but such a construction is far from clear and does not go as far as the literal text of new Section 1519.

A contractor's failure to preserve contract documents has in the past had potential non-criminal consequences, such as, for example, raising adverse presumptions in civil litigation. The failure to preserve documents is not an uncommon occurrence, given the long terms of many contracts and the frequently extended period before contracts are closed out formally. While the scienter language of new Criminal Code Section 1519 ("knowingly," "intent to influence") will protect contractors in most cases,[29] the burden of investigation and allegation when documents have been destroyed makes this new criminal issue of serious concern. As the Arthur Andersen experience has taught, wrongdoing by a relatively few individuals in an organization can stigmatize both the individuals and the organization, with serious business consequences.

New Section 1519 also criminalizes the alteration of documents if done to "influence." Read hyperliterally, this would implicate behavior routinely practiced on a government program. "Documents" are often "knowingly" "altered" with "intent to influence" contract "administration" without any corrupt purpose.[30] For example, a contractor might alter labor changing records to correct errors found by an internal audit. Conduct such as this, while literally covered by new Section 1519, surely was not intended to be criminalized and, presumably, the section will be interpreted to require wrongfulness of purpose as an element of the crime, even if it is not literally required by the statutory language. But it is troublesome that, in drafting new Criminal Code Section 1512(c), corrupt motive is specified to be an element of the crime[31] and, in new Section 1519, it is not.[32] To be on the cautious side, contemporaneous records and memoranda should be kept to document the purpose of specific alterations.

Obstruction of contract "administration," as defined in new Criminal Code Section 1519, may now be alleged as a serious felony. A 20-year sentence looming over everyday business activities in contract "administration" should be an attention-getter. Government contractors will need to revise their document preservation policies and train personnel in document management to minimize this new peril.

E. Increased Penalties for Old Crimes

Sarbanes-Oxley also contains a title known as the "White-Collar Crime Penalty Enhancement Act of 2002,"[33] which does exactly what is indicated. Sarbanes-Oxley not only creates new felonies, but also increases the penalties for existing ones. Section 902 makes the penalty for attempt or conspiracy the same as "those prescribed for the offense, the commission of which was the object of the attempt or conspiracy."[34]

Further, Section 903 increases all mail and wire fraud incarceration penalties from five to 20 years. Although individuals would probably be sufficiently deterred by five years in jail, this fourfold increase in the potential prison term is striking, to say the least. The special point for government contractors is that these crimes usually can attach not just to financial reporting or securities crimes, but to all the now-familiar crimes that have been the subject of investigations and prosecution of government contractors since 1978.

F. Suspension and Debarment

Government allegations against corporations and/or their officers for violations of the securities-related provisions of the act will likely be a new focus of debarring officials. One would hope that such officials would defer to the SEC in such matters, but the reach of FAR Part 9.4, as written and sometimes enforced, extends beyond procurement-specific issues to any conduct indicating a lack of business integrity.[35]

Some debarring officials aggressively reach beyond procurement issues, if only to protect the government through continuing oversight of a contractor's "present responsibility."[36] The lesson of the Enron/Arthur Andersen debacle confirms the collateral impact of financial reporting issues on eligibility to contract with the United States. Although the indictment for document destruction precipitated Andersen's suspension, the General Services Administration's focus was on financial auditing issues as well. GSA suspended Enron and its officers based on allegations of financial reporting fraud.

Suspension creates difficult parallel proceedings problems even in less consequential circumstances. When a company and its officers are under investigation or subject to indictment or civil charge of Sarbanes-Oxley violations, the vise of parallel proceedings will be worse. The accused government contractor that wishes to defend in traditional, lawful, even "due process" ways—for example, government burden of proof, protection of attorney-client privilege, joint defense privileges—will also face a debarring official demanding that it make a complete disclosure in order to avoid suspension or restore its eligibility for contract awards. Further, suspension—based only on "adequate evidence"—shifts to the contractor the burden of proving either innocence or responsibility through admissions and correction of alleged wrongdoing.[37] This disparity of process has always been debilitating—in the context of allegations against the corporate officers, it may be potentially intractable.

It has often been the case in procurement-related suspension actions that the problem is shown to be isolated in a small part of a company or as involving only a few individuals who have already left, or will be forced to leave, the company. In such situations, the extent of corrective action required to lift the suspension or its

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[29] *Id.*

[30] New Criminal Code Section 1519 does not expressly require the action to be taken "corruptly." *Compare* new 18 U.S.C. § 1512(c) (action must be taken corruptly).

[31] Sarbanes-Oxley Act § 1102.

[32] *Id.* § 802.

[33] *Id.* tit. IX, § 901.

[34] *Id.* § 902, to be codified in 18 U.S.C. § 1349.

[35] *See, e.g.*, FAR §§ 9.402(a), 9.406-2, 9.407-2. These latter two sections also allow debarment and suspension for "falsification or destruction of records."

[36] A further impact of alleged failures to comply with Sarbanes-Oxley, or of disclosures required by compliance with the Act, is that a contracting officer could deem a contractor not responsible and therefore not eligible for a particular award. *See* FAR §§ 9.103, 9.104-1.

[37] *Id.* § 9.407-2(c).

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threat is fairly contained. But this approach may not be possible when, based on Sarbanes-Oxley certifications and responsibilities, assertions are made that the CEO and CFO have miscertified or should have identified the problem sooner.

The corporate leadership sets ''the culture'' (to use a debarring official's term) of the *entire* organization, and this concept is reinforced (even in some sense ''codified'') by Sarbanes-Oxley. Corrective action to satisfy the debarring official will not come easily with an alleged Section 302 or Section 906 violation, as it may require radical surgery at the top. It's one thing to terminate or demote lower-level personnel to keep the company's license to do business, but quite another to topple a CEO.

Another approach—frequently compelled by the severe impact of suspension and the practicalities of the process—has been to plead to an offense and bring the matter to an end on all fronts. Debarring officials sometimes say they cannot lift a suspension until there is ''closure'' on what happened, so that they can be sure that all the necessary corrective actions have been taken. Pleas may not come so easily in Sarbanes-Oxley cases involving top corporate officers, though this will depend on how conservative and discriminating the government is in pressing charges. In any event, in the context of charges under this new statute, the ''shoot-first, talk-later,'' burden-shifting nature of suspension will be even more onerous and difficult to deal with. The result could be a perverse, unintended impact on shareholder interests if, before SEC resolution or full adjudication, government contracting officials irreparably injure the company through suspension or debarment.

Conclusion

The Sarbanes-Oxley Act has been, and will continue to be, known as a law passed in reaction to corporate accounting scandals to protect investors under the securities laws. The House-Senate Conference Report described the act's goals in this way: ''to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, *and for other purposes*.''[38] Indeed, government contractors will need to understand and address *all* the purposes of the act, as well as its possible interpretations and unintended effects, as they continue to do business with the government.

[38] Conf. Rep. 107-610, 107th Cong., 2d Sess., at 69 (July 24, 2002) (emphasis added).