



**Audit Report No. 2007-02
SPECIAL REQUEST
OFFICE OF MINORITY BUSINESS ENTERPRISE
MBE COMPLIANCE
April 5, 2005-January 20, 2006**

**Prepared by
CITY AUDITOR
Richmond, Virginia**

August 22, 2006
Submitted to
The Honorable Members of City Council

Executive Summary

August 22, 2006

Rita Henderson,
Director, Office of Minority Business Enterprise

The City Auditor's Office has completed a special request from your Department to investigate a contractor's compliance with the Minority Business Enterprise participation requirement. It was alleged that:

- The contractor inflated his minority business enterprise (MBE)/ emerging small business (ESB) participation goals in order to obtain City contracts and subsequently reduced or eliminated the pledged goals upon award of the contracts.

- One of the participating MBE subcontractors was utilized as a pass-through, in which a commercially useful function was not provided, to satisfy the MBE requirement.

In addition to your Department's request, our Office also received a hotline call regarding MBE misrepresentation.¹ The caller alleged that an MBE firm received kickbacks for allowing a prime contractor to use its name to satisfy MBE requirements. The objective of this analysis was to verify the allegations. The accompanying report includes the detailed results of our analysis. The following is a summary of the findings and recommendations:

Conclusions:

- ❖ The prime contractor represented during the bid response that the MBE contractor would perform the roofing work and that they would receive 26.5% of the total contract price. However, the MBE contractor was used for only brokering procurement of materials and/or services for a 5% commission. This appears to be a misrepresentation and violates the spirit of the MBE Ordinance.

- ❖ The City's current contract language is vague and does not include a mechanism to properly address contractors' non-compliance with the contract terms. Including financial penalties in the contract for non-compliance will enhance the City's ability to enforce the contract terms.

¹ Based upon the provided information, auditors were unable to substantiate the allegation.

Recommendation:

Implement the following best practices:

- ❖ Require prime contractors to outline the outreach efforts that were utilized to solicit MBE businesses and obtain supporting documentation (i.e. written solicitations, bids, etc.)
- ❖ Require prime contractors to utilize certified MBE businesses to satisfy participation requirements
- ❖ Make contract awards contingent upon finalized agreements being in place with MBE subcontractors. Obtain copies of agreements prior to finalizing contract awards
- ❖ Bind the contractors to submitted participation commitments (including use of identified MBE businesses)
- ❖ Require the contractors to submit a written request and obtain approval prior to making any changes to pledged participation commitments
- ❖ Require the prime contractor to submit copies of each invoice submitted by MBE businesses for completed work in addition to monthly cost breakdowns
- ❖ Continue to conduct site visits
- ❖ Include financial penalties for non-compliance with MBE provisions included in contract with the prime contractor

We would like to thank your staff for their cooperation and assistance during this analysis.

Umesh V. Dalal, CPA, CIA, CA
City Auditor

C: City Council
William Harrell, Chief Administrative Officer
Daisy Weaver, Council Chief of Staff
Harry Black, Chief Financial Officer and Finance Director

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Background:

Pursuant to Article VII of the City Code, "it is the City's official goal to increase the dollar value of all contracts awarded to Minority Business Enterprise (MBE) and Emerging Small Business (ESB) contractors and subcontractors to the highest level that is reasonably achievable for any particular field of contracting."

To achieve this goal, good faith efforts² are required of all parties who contract with the City.

For construction projects, up to 30% of the total prequalification score can be earned for MBE participation

In accordance with the City's initiative, inclusion of minority contractors' participation could benefit prime contractors significantly to obtain City contracts. For example, on construction projects, bidders could earn up to 30% of the total prequalification score for his/her good faith efforts. Therefore, it would be inappropriate if a prime contractor includes MBE participation when bidding for the project and fails to award a legitimate contract to MBE firms.

According to statistics maintained by the Office of Minority Business Enterprise (OMBE), during Fiscal Year (FY) 05 the OMBE monitored 137 contracts with values of \$200,000 or more.

²Procurement Services defines good faith minority participation efforts as "the sum total of efforts by a particular business to provide equitable participation of minority employees and subcontractors. For past efforts, this sum total shall be comprised of the record of minority participation over the past five (5) years either through employment, retention, and promotion; or through subcontracting or joint ventures in the private sector; or through a combination thereof. For future efforts, it shall be comprised of such efforts which are proposed to allow equitable participation of minority employees and subcontractors."

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These contracts
totaled \$46
million of which
minority
contractors may
have received
approximately \$5
million.

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Introduction:

The City Auditor's office received a request from the Office of Minority Business Enterprise (OMBE) to investigate a contractor's compliance with the Minority Business Enterprise (MBE) participation requirements.

Allegations:

Prime contractor did not comply with MBE pledged goals

The OMBE alleged that:

- The contractor inflated his MBE/ESB participation goals in order to obtain City contracts and subsequently reduced or eliminated the pledged goals to obtain award of the contracts.
- One of the participating MBE subcontractors was utilized as a pass-through entity, which did not provide a commercially useful function to satisfy the MBE requirement.

MBE contractor was utilized as a pass-through entity

In addition to their request, the City Auditor's Office also received a fraud, abuse and waste hotline call regarding MBE misrepresentation. The caller alleged that a MBE firm received kickbacks for allowing a prime contractor to use its name to satisfy MBE requirements.³

³ Based upon the provided information, auditors were unable to substantiate the allegation.

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Contract

The Leigh Street Armory and the St. John's Church Cemetery Wall Restoration were awarded to the Prime Contractor for \$765,518 and \$1,122,098, respectively

The prime contractor was pre-qualified and was subsequently awarded the Leigh Street Armory and the St. John's Church Cemetery Wall Restoration contracts during calendar year 2005. MBE/ESB participation was required for both projects. During the contract bidding phase, the prime contractor pledged to subcontract a percentage of each contract to specific MBE/ESB businesses. However, upon award of the contracts, the prime contractor attempted to renegotiate the subcontract amounts; thus, reducing its pledged participation commitments. The contracts awarded totaled \$765,518 and \$1,122,098.10, respectively.

Methodology:

Auditors reviewed the prime contracts, subcontracts, conducted interviews and reviewed provided documentation to:

- Determine the scope of services and MBE participation requirements;
- Calculate the participation percentages; and
- Ascertain if the prime contractor adhered to the pledged goals.

In addition to the above steps, we also consulted the City Attorney's Office in legal issues related to the contracts.

Conformity with Auditing Standards

This evaluation was not a comprehensive audit conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States. However, during this project, auditors reviewed supporting documents and conducted other appropriate tests that were consistent with the requirements of these standards.

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Results:

Leigh Street

Armory Project:

\$202,850 MBE contract to furnish roofing supplies/materials and to install roofing package

MBE contractor served as a pass-through entity and received a 5% (\$6,664) commission on ordered goods

What was required?

The Leigh Street Armory contract for \$765,518 required at least a 20% MBE/ESB participation commitment. In order to satisfy the MBE participation requirement, the prime contractor pledged to subcontract 26.5% of the contract to a MBE contractor. According to the contract between the prime and MBE subcontractor, the MBE subcontractor was responsible for furnishing roofing supplies/materials and installing a roofing package for \$202,850.

What happened?

The MBE subcontractor indicated that their company was only responsible for acquiring the roofing materials and was paid a 5% commission on the ordered goods. The MBE subcontractor is a roofing company, not a supplier. The roofing materials were acquired from a local building materials supplier open to the public. The prime contractor could have purchased roofing material directly from the supplier without the assistance of the MBE contractor. It appears that the prime contractor used the MBE contractor participation in order to obtain the contract and, subsequently, did not use the MBE contractor for the work. The MBE contractor received only \$6,664.07 instead of an opportunity to make a profit on \$202,850 worth of work. Furthermore, the installation of the roofing package was completed by a non-MBE subcontractor.

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St. John's

Church Cemetery

Wall Restoration

Project:

**Prime contractor
pledged 10%
MBE
participation**

What was required?

The St. John's Church Cemetery Wall Restoration project required at least a 20% MBE/ESB participation rate. In response to the Invitation for Bid (IFB) for this project, the prime contractor pledged a 10% or \$60,000 MBE/ESB commitment goal. To satisfy its commitment goal, the prime contractor indicated that specific MBE subcontractors would be utilized for this project.

What happened?

According to the MBE contractor, his company bid on and won over \$60,000 worth of work for this contract. However, the prime contractor submitted a written contract for only a portion of the original agreed upon work for a total of \$17,000, which his company refused.

**Prime contractor
attempted to
reduce the MBE
contract from
\$60,000 to
\$17,000.**

The prime contractor finally managed to enter into an agreement with another MBE contractor resulting in 11% minority participation of the contracted work. Although, the prime contractor finally complied with the bid terms, the potential existed to substantially reduce the required MBE participation.

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***Recourse
Available to the
City***

Pursuant to a legal opinion obtained from the City Attorney's Office, the City at best *may* be able to debar the prime contractor from participating in future contracts for its actions. However, even debarment is not a guaranteed remedy since the prime contractor could appeal this decision. Even if the City successfully debars the prime contractor, debarment alone is an insufficient remedy to enforce the contractor's compliance. A company may be able to circumvent this remedy and continue to do business with the City under a different name and management unless extensive research is performed to identify the discrepancy.

**Enforcement of
the contract
terms related to
MBE can be
enhanced by
including
financial
penalties for
non-compliance**

The current language incorporated into the City Code and procurement documentation regarding MBE misrepresentation and non-compliance may not be stringent enough to enforce contractor compliance. Furthermore, according to the City Attorney's Office, the language in the standard contract is vague and not properly defined. Also, specific actions which would result in misrepresentation or non-compliance are not spelled out. Under the circumstances, the City would find it difficult to assess penalties or other remedies against contractors for MBE/ESB misrepresentation or non-compliance.

Best Practices:

In order to determine how other government entities are monitoring and enforcing MBE/ESB program goals and expectations, limited research was conducted via the internet. Auditors reviewed the monitoring and enforcement procedures employed in Indiana, Maryland and New York. In general, the procedures employed by these states are similar to the ones utilized by the City. However, they employ more in depth documentation requirements and enforcement

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procedures. This report includes a recommendation to adopt these best practices into the City's current practices.

Conclusion:

It appears that the prime contractor misrepresented its MBE/ESB participation for the Leigh Street Armory project and did not use MBE contractor to perform work. Instead, the prime contractor merely paid 5% commission to an MBE contractor to purchase material for the project. This action increased contract costs and may not be consistent with the spirit of the City ordinance related to MBE participation.

The procedures to monitor MBE compliance can be improved and the contract language needs to be strengthened

Currently, OMBE confirms with the MBE subcontractor it received the payments for the agreed upon work. However, documentation such as subcontractor's invoices, material delivery documents, labor records, etc. are not reviewed. The OMBE indicated that its representatives conduct site visits to verify work done by the MBE subcontractors. However, during our review, the evidence of site visits was not apparent. In addition, if the site visits were conducted on the Leigh Street Armory Project, the OMBE did not identify noncompliance with the contract.

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MBE program goals are met and to effectively enforce contractors' compliance with program expectations, the procedures used to monitor compliance as well as the current language incorporated into the City Code and procurement documentation need to be strengthened. A collaborative effort may be required by the Office of Minority Business Enterprise, Procurement Services, City Attorney's Office, and other applicable departments, to develop and implement necessary changes.

In order to ensure that the City's

Recommendation

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Implement the following best practices:

- ❖ Require prime contractors to outline the outreach efforts that were utilized to solicit MBE businesses and obtain supporting documentation (i.e. written solicitations, bids, etc.).

Management Response:

The Office of Minority Business Development proposes to have each contractor develop and submit a written description outlining how they propose to obtain their MBE participation. We agree with the auditor's recommendation that they can submit written solicitations, bids, copies of advertisements in newspapers and periodicals to show "Good Faith Efforts." Implementation date: **12/31/06**.

- ❖ Require prime contractors to utilize certified MBE businesses to satisfy participation requirements.

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Management Response:

All firms seeking registration with our office will be required to be certified with one of the certifying agencies; State Office of Minority Business Enterprise, Small Business Administration (8a) Program, or any other acceptable certifying entity. Firms in the process of getting certified can sign an affidavit with our office stating that they are the owners of the company and are in the process of becoming certified. Their registration with the city will be contingent upon their certification. Implementation date: **12/31/06**.

- ❖ Make contract awards contingent upon finalized agreements being in place with MBE subcontractors. Obtain copies of agreements prior to finalizing contract awards.

Management Response:

Currently, we are able to verify with MBE subcontractors that they will be working on a project with a Prime Contractor/Vendor through the MBE-2 Report. However, to strengthen this process, we propose to require the Prime Contractor/Vendor to have an *Intent to Award Letter* with the minority subcontractor before the City awards the contract to the Prime. Implementation date: **12/31/06**.

- ❖ Bind the contractors to submitted participation commitments (including use of identified MBE businesses).

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Management Response:

After awarding the contract, the Prime Contractor/Vendor must make written requests for changes relating to the MBE's contract amount, replacement of an MBE subcontractor, MBE participation commitment or any other changes that would directly impact the MBE participation on the project. Implementation date: **12/31/06.**

- ❖ Require the contractors to submit a written request and obtain approval prior to making any changes to pledged participation commitments.

Management Response:

After awarding the contract, the Prime Contractor/Vendor must make written requests for changes relating to the MBE's contract amount, replacement of an MBE subcontractor, MBE participation commitment

or any other changes that would directly impact the MBE participation on the project. Implementation date: **12/31/06.**

- ❖ Require the prime contractor to submit copies of each invoice submitted by MBE businesses for completed work in addition to monthly cost breakdowns.

Management Response:

Procedures will be developed to require the Prime Contractors/Vendors to submit the MBE-3 Report to verify payments to the MBE subcontractors. Invoices must accompany the MBE-3

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Report to substantiate those payments. Implementation date:
12/31/06.

- ❖ Continue to conduct site visits.

Management Response:

OMBD will continue to conduct random site visits with limited staff. The entire compliance review process is under review for possible overhaul to model that of the Virginia Department of Transportation's DBE compliance monitoring program. Implementation date:
12/31/06.

- ❖ Include financial penalties for non-compliance with MBE provisions included in the contracts with the prime contractors.

Management Response:

OMBD agrees with auditor's recommendation and our office will review all possible remedies in situations where the Prime Contractor/Vendor fails to meet its MBE commitment. There needs to be additional discussions among Procurement Services, the City Attorney's Office and other city agencies in order to identify, develop and implement repercussions for purposefully neglecting to meet MBE participation. Implementation date: **12/31/06.**



City Auditor Report Evaluation Form

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Your feedback helps us do a better job. If you would please take a few minutes to fill out the following information for us, it will help us assess and improve our work.

Please rate the following elements of this report by checking the appropriate box.

	Too Little	Just Right	Too Much
Details	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Length of Report	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Clarity of Writing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Potential Impact	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Suggestions for our report format: _____

Suggestions for future studies: _____

Other comments, ideas, thoughts: _____

Name (Optional): _____

Thanks for taking the time to help us.

Fax: 804.646.2230
Mail: City Auditor’s Office, 900 E. Broad Street, Room 806, Richmond, VA 23219
Call: Umesh V. Dalal, CPA, CIA, CA, City Auditor, 804.646.5640
Email: askcityauditor@ci.richmond.va.us
Hotline: 804.646.5697