



Richmond City Council

The Voice of the People.

Richmond, Virginia

OFFICE OF THE CITY AUDITOR

REPORT # 2013-01

AUDIT

Of the

Office of Minority Business Development

August 2012

OFFICIAL GOVERNMENT REPORT

Richmond City Council

OFFICE OF THE CITY AUDITOR

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*Committed to increasing government efficiency, effectiveness,
and accountability on behalf of the Citizens of Richmond.*

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Umesh Dalal, CPA, CIA, CIG
Richmond City Auditor

Richmond City Council

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Office of the City Auditor

Executive Summary

August 30, 2012

The Honorable Members of the Richmond City Council
The Honorable Mayor Dwight C. Jones

Subject: Office of Minority Business Development

The City Auditor's Office has completed a performance audit of the Office of Minority Business Development (OMBD). The auditors conducted this performance audit in accordance with Generally Accepted Government Auditing Standards.

Background

OMBD was established in 1993 to evaluate minority inclusion on City contracts and to create programs that supported and strengthened minority participation on City contracts, where possible. *Prior to 1989, the City had a 30% quota of contracts set-aside for racial discrimination remedial purposes. In the 1989 case, the J. A. Croson v. City of Richmond, the Supreme Court ruled that:*

- *The City's plan was not justified by compelling governmental interest.*
- *Record revealed no prior discrimination by the City in awarding contracts.*
- *The 30% set-aside was not narrowly tailored to accomplish a remedial purpose.*

In response to this development, in 1993, the City's 30% quota was replaced by a goal of awarding up to 30% of the evaluation points to minority contractors. In 2003, the City broadened the program and included the Emerging Small Business (ESB) program and extended the program to all contracts.

Findings:

The effectiveness of the City's MBE/ESB programs needs improvement.

Currently, OMBD is not able to ensure compliance with the MBE/ESB participation goals. This practice does not treat contractors that honestly disclose their intentions not to use minority participation or those who honor their pledges fairly. Repeat offenders failing to comply with pledged participation continue to get City business.

The *J. A. Croson v. City of Richmond* case limits the remedies the City may use to meet the objectives of the MBE/ESB programs. The City needs to make changes in the program that would meet the legal tests and be beneficial to the minority and emerging small businesses.

In *Ensley Branch NAACP v. Seibels*, 31 F.3d 1548 (11th Cir. 1994), the Eleventh Circuit U.S. Court of Appeals also held that the impact of the relief on the rights of innocent third parties should be taken into account when evaluating whether a race- or ethnicity-conscious affirmative action program is narrowly tailored. Currently, restrictions on the ESB program do not put this program on equal footing with the MBE program. The ESB participation compared to MBE program is significantly low.

The City Auditor's Office conducted limited research and obtained information from the City's OMBD that identified the possibility of overhauling the current program after conducting a "disparity study." The Tenth Circuit, in its 2003 decision, considered disparity studies as a tool available for governments to establish an affirmative action program that can endure legal scrutiny.

The City Auditor's Office was informed that these studies could cost a substantial amount of money. Therefore, like any other government decisions, careful consideration must be given to the cost-benefit of conducting the study by thoroughly researching similar studies elsewhere. However, this is the only option identified in the City Auditor's research to make meaningful changes that can withstand legal challenges.

Improvement in the amount of business to MBE/ESB

The service provided by the City has made some progress in encouraging minority businesses participation. OMBD has been successful in improving the amount of City business given to minorities. However, small a number of minority subcontractors are

receiving a large amount of business. The auditors observed that 14 or 1% of the total registered minority firms obtained 49% of about \$16 million of the business gained by MBE and ESB. Although, there has been a steady increase in spending with minority subcontractors since FY2008, the number of subcontractors has not increased proportionately.

Scoring of MBE/ESB participation needs improvement

The rationale for the scoring methodology is not clear as it includes duplication of scoring for the past and present good faith efforts. Audit testing revealed that points for past good faith efforts, for contractors with prior City contracts, are not being assigned in accordance with the pre-defined scale.

OMBD needs to enhance internal controls

- OMBD's current policies and procedures do not address certain issues. Without the enhancements referenced in the report, staff expectations may be unclear and job performance may be inconsistent. In addition, policies and procedures ensure continuity of operations during employee turnover.
- OMBD's process does not request sufficient information to verify eligibility of the firms applying for MBE/ESB registration. This situation may allow a non-MBE or non-ESB firm to be registered with OMBD.
- Audit testing revealed that adequate controls and procedures were not in place to ensure that the non-certified, registered MBEs pursued and obtained certification as required. The auditors found that, in a sample of 100 registered MBEs, 50% of the firms were not actively certified. This means that OMBD has 50% of registered participants in the audit sample for whom there is no assurance that they qualify as the specified minority group.
- OMBD uses the monthly reports submitted by the prime contractor and verifies payments received by minority subcontractors through inquiries. This process is not working as intended as information is not received consistently from prime contractors, and the subcontractors are not as responsive in validating the information as required. According to OMBD staff, they cannot compel the prime contractors and MBE/ESB subcontractors to provide the required documentation.

The City Auditor's Office appreciates the cooperation of the Office of Minority Business' staff.
Please contact me for questions and comments on this report.

Sincerely,

Umesh Dalal

Umesh Dalal, CPA, CIA, CIG
City Auditor

cc: Mr. Byron C. Marshall, CAO
The Richmond City Audit Committee
Vicki Rivers, OMBD Director

#	<i>COMPREHENSIVE LIST OF RECOMMENDATIONS</i>	<i>PAGE</i>
1	Revise the procedures and document monitoring of scoring to ensure the scoring points are appropriately assigned.	21
2	Require additional documentation that demonstrates MBEs'/ESBs' eligibility for the respective programs.	21
3	Ensure that minority contractors are certified within pre-established time frames by following up on pending certification procedures.	21
4	Maintain the MBEs certification expiration dates to ensure that their certification has not expired when considering them for contracts.	22
5	In order to capture accurate information about minority business support, ensure reporting of minority subcontractors payments.	22
6	Address the Access database limitations by working with DIT, using the RAPIDS Solution or by replacing the system.	24
7	Enhance the existing policies and procedures manual to address the entire process from goal- setting to closing out of the contracts.	25
8	Train staff once the policy is enhanced.	25
9	Conduct a comprehensive legal analysis to evaluate the current program and make appropriate changes based on the results of the legal analysis to better enable the City to enforce contractual provisions related to MBE/ESB participation.	29
10	Conduct a cost-benefit analysis to determine the appropriateness of conducting a disparity study. If found beneficial, conduct a disparity study.	29

Introduction and Background

Introduction

The City Auditor's Office has completed a performance audit of the Office of Minority Business Development (OMBD). This audit covers the 18-month period ending December 31, 2011. The objectives of this audit were to:

- Determine the existence and effectiveness of operations;
- Evaluate the effectiveness of procedures to deter fraud, waste, and abuse;
- Evaluate compliance with applicable laws, regulations, City Code and policies and procedures; and
- Evaluate the efficiency and effectiveness of internal controls.

The auditors conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those Standards require that the auditors plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions based on the audit objectives. The auditors believe that the evidence obtained provides a reasonable basis for their findings and conclusions based on the audit objectives.

Methodology

To complete this audit, the auditors performed the following procedures:

- Interviewed relevant OMBD employees and performed a walkthrough of the information system used to gain an understanding of the process and any system limitations;
- Reviewed pertinent records, policies and regulations;

- Performed various audit tests and performed a trend analysis of payments received by minority firms;
- Benchmarked with ten localities to determine industry best practices and training classes offered by the localities, of which three responded;
- Surveyed both the prime contractors and the 1,337 minority subcontractors to determine the effectiveness of the current MBE program and develop an opinion of possible areas of improvement, of which 16 prime contractors and 115 minority subcontractors responded;
- Analyzed data from the OMBD database and traced it to supporting documentation to conclude on completeness and accuracy of information; and
- Conducted a ride-along with a Minority Business Development Analyst during onsite monitoring.

***Management
Responsibility***

The management of the City of Richmond is responsible for ensuring resources are managed properly and used in compliance with laws and regulations, City programs are achieving their objectives, and services are being provided efficiently, economically and effectively.

Background

OMBD was established in 1993 to evaluate minority inclusion on City contracts and to create programs that supported and strengthened minority participation on City contracts, where possible.

According to the OMBD Director, The Department is facing several challenges. In order to improve minority participation, OMBD must depend on prime contractors to employ MBE/ESB subcontractors.

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OMBD does not have control over the prime contractors except for taking enforcement actions. However, the enforcement is unlikely as the MBE/ESB participation is just a goal and does not obligate the prime contractors to comply with their stated goals. In addition, the outcome of the 1989 case against the City limits the OMBD’s ability to accomplish their objectives which will be discussed later in the report.

The Director further stated that, besides legal challenges, OMBD personnel feel that substantial work needs to be done in regaining the MBE/ESB firms’ trust. After receiving information about proposed projects, the MBE/ESB firms do not attend pre-bid conferences. Also, the size and capacity of the MBE/ESB firms within the City may prevent them from taking on larger projects offered by the City.

OMBD has grown from an office of two staff members to its current staffing level of seven. Before becoming a stand-alone department, OMBD reported to various agencies’ directors as follows:

<i>Year</i>	<i>Reporting Agency</i>	<i>Staffing Level</i>
1993-2000	Department of General Services	2
2000-2005	Department of Economic Development	4
2005-2006	Department of Procurement Services	4
2007-2010	Stand-alone agency	5
2011	Stand-alone agency	6
2012	Stand-alone agency	7

OMBD now offers an array of services including but not limited to:

- Providing technical assistance for walk-in vendors and scheduled one-on-one conferences to identify solutions for challenges posed to starting and operating businesses;

- Developing training to address current issues and help business owners manage effectively;
- Establishing MBE/ESB participation goals for City contracts; and
- Monitoring minority participation compliance.

Program Training

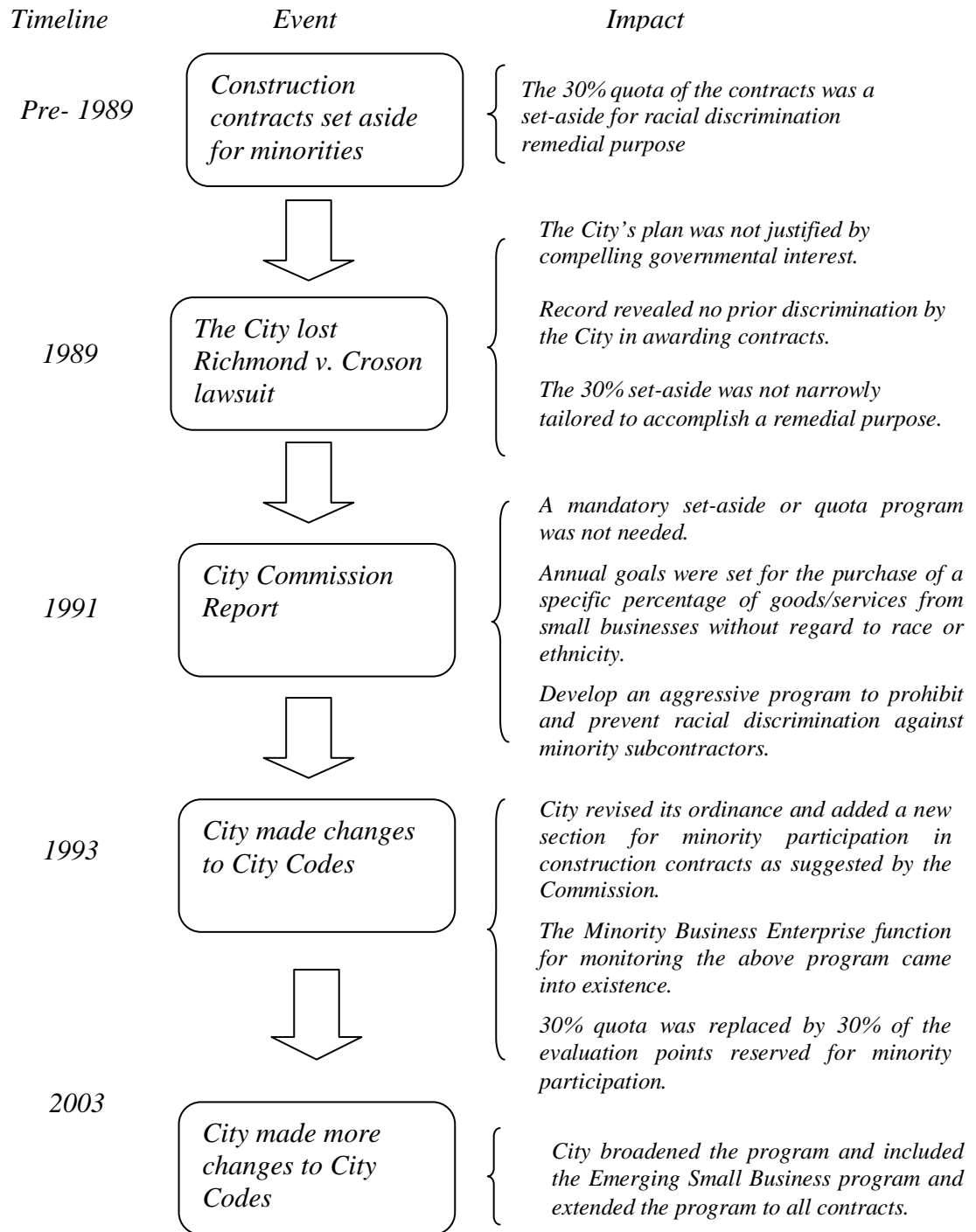
During the audit period, OMBD hosted 19 training sessions with an average attendance of six participants per training session. The training sessions covered such topics, as noted below, which are comparable to the training offered by other localities:

- How to start a business
- Developing a business plan
- Preparing for a business loan
- Marketing your business using social media
- Understanding Procurement Solicitations
- Project specific workshops

In addition to the above training sessions, six workshops for the schools' construction projects were hosted between January 2011 and August 2011. Based on the data obtained from OMBD, the average attendance was approximately 104 participants.

History

The history of the function is presented in the following diagram which includes timeline, event, and impact:



Observations and Recommendations

To evaluate this program, the following questions need to be answered:

- Why does the Program exist?
- Who are the beneficiaries?
- Is the Program effective in delivering the results?
- What is the solution for delivering services effectively?

This report attempts to answer these questions.

Why does the program exist?

“The mission of OMBD is to facilitate, produce, and advance opportunities for minority business enterprises (MBE), emerging small businesses (ESB), and disadvantaged business enterprises (DBE) to successfully participate in the full array of contracting opportunities available in the City of Richmond.”

The terms are defined as follows:

OMBD’s mission is to assist MBE, ESB, and DBE

MBE: Owned and operated by 51% minority (defined ethnic group) ownership

ESB: Small firms located in a Richmond Enterprise Zone with annual gross receipts of \$500,000 or less for construction and \$250,000 or less for non-construction businesses. See detailed definition on page 15.

DBE: For profit small business concern in which at least 51% is owned by one or more socially and economically disadvantaged individuals.

For the purposes of this report, MBE, ESB, and DBE businesses are referred to as minority businesses.

Who are the beneficiaries?

According to OMBD personnel and the mission of the Department, the goal is to:

- Improve MBE, ESB, and DBE business participation.
- Assist subcontractors to become prime contractors and prime contractors to become developers.
- Increase the amount spent on contracts awarded to minority businesses.

According to the OMBD website, the Office strives to increase:

- “The number and capacity of local MBE and DBE companies
- MBE and DBE company availability in certain under-utilized business categories (e.g. architecture)
- The number of public and private sector contracts won by MBE and DBE companies
- The number of effective strategic alliances, both in the MBE and DBE community and beyond
- MBE and DBE companies’ access to capital
- MBE and DBE company integration of information technology.”

Minority participation has increased recently

All contracts with values greater than \$50,000 are assessed by OMBD to establish MBE/ESB participation goals. Goals are established based upon the current availability and capacity of the MBE/ESB businesses for the scope of work. Goals are waived for projects when participation cannot be obtained due to lack of available MBE/ESB firms. To assist the City in achieving its goal, prime contractors are encouraged to utilize MBE and ESB firms through subcontracting.

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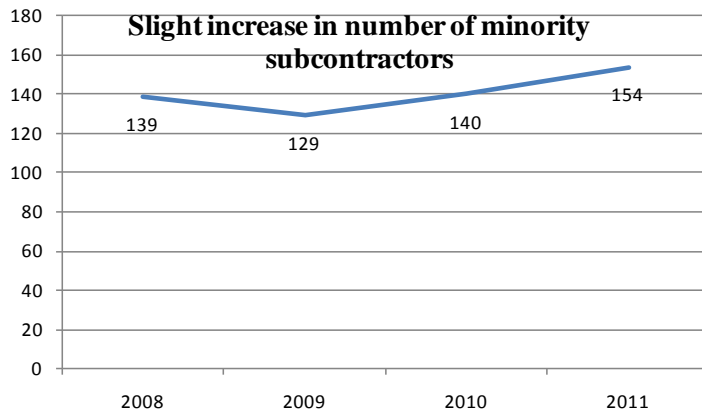
As demonstrated below, the City’s MBE/ESB program has increased:

	FY2008	FY2009	FY2010	FY2011
MBE/ESB Payments (Prime Contractors)	\$6,339,357	\$4,494,377	\$ 4,647,733	\$ 6,548,921
MBE/ESB Payments (Subcontractors)	\$8,018,140	\$9,506,387	\$11,763,834	\$ 15,772,775
Total Minority	\$14,357,497	\$14,000,764	\$ 16,411,567	\$ 22,321,696
Total Expenditures	\$225,559,963	\$251,366,000	\$232,611,845	\$240,595,100
MBE/ESB Spending % of total contract expenditures	6%	6%	7%	9%

Source: OMBD Annual 2011 Report (total expenditure figures obtained from Procurement Services)

There has been a steady increase in spending with minority subcontractors since FY2008, the number of subcontractors receiving payments has not increased proportionately.

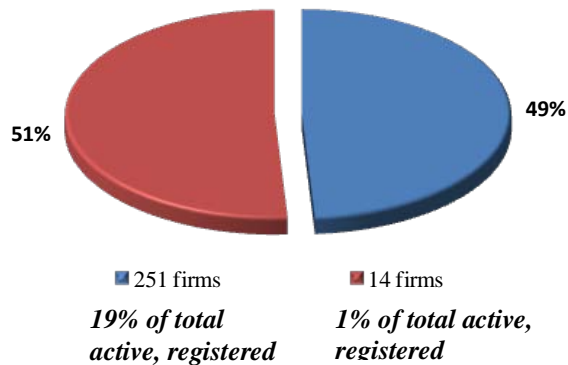
Number of minority subcontractors receiving payments has increased



During the period from FY 2008 through FY 2011, the payments to minority subcontractors increased by 97% and the number of subcontractors receiving payments increased by 11%.

In addition, it was noted that between FY2008 and FY2011, minority subcontractor payments totaling approximately \$53 million were recorded for 265 MBE/ESB firms.

Small number of minority firms are getting large amount of business



Only 1% of registered MBE/ESBs are getting 49% of business

Is the program effective?

OMBD has a positive impact on MBE participation

Lack of Ability to Enforce

Note: The pie-chart is based on updated information as of the date of observation

The above information indicates that OMBD has made a positive change in minority participation, but there is room for improvement.

The following factors impact the effectiveness of the program:

Currently, prime contractors are required to propose MBE/ESB participation depending upon the established goals in order to earn the City’s business. The pledged MBE/ESB participation is incorporated into the contract and becomes a contract term.

According to the City Attorney’s Office, the pledged MBE/ESB participation is only a goal and these pledges cannot be enforced as the City does not have a set-aside program. However, the City Codes include the following recourses:

Although, MBE participation is a goal, the City Code has provisions for enforcement

§74-49 and §74-50 of the City Code regarding the prequalification based on the use of MBE/ESB states; “*the proposed efforts must be set in writing and be legally binding on the prospective bidder.*” Also, language to this effect is incorporated into the 2012 procurement solicitation documents.

Code §74-301 states, “*Any contractor, bidder or offeror, or any principal thereof or person associated therewith, found to have engaged in substantial and intentional misrepresentation concerning either good faith minority business enterprise and emerging small business participation efforts or minority ownership status shall be debarred from any city contracting for a period of two years.*”

Code §74-304 states, “*No contract shall be renewed unless the contractor has first reported to the chief administrative officer or a designee thereof on the good faith minority business enterprise and emerging small business participation efforts which have been made during the contract period.*”

According to the City Attorney’s Office, the remedies offered by the City Code are limited in value

According to the City Attorney’s Office, while the above language may appear to offer remedies, they are limited in value and difficult to enforce. Also, the City’s debarment procedures are cumbersome and make it difficult to carry through.

RFQ and RFP Scoring

Based upon discussion with the OMBD staff, the prime contractor’s good faith and past good faith efforts are taken into account during the scoring of the Request for Proposals (RFPs) and Request for Qualifications (RFQs). These processes are described below:

- **RFQ** – two phase solicitation process whereby potential bidders or offerors are required to submit documentation to demonstrate

their ability to manage, their financial soundness, and their past experience with similar projects to successfully complete the plans and specifications of the solicited work.

- **RFP** – a solicitation process used when the scope of work/specifications cannot be completely defined by the City; the goods and services can be provided in several different ways; and qualifications, experience or the quality of the goods and services to be delivered are significant factors of consideration, in addition to price.

The rationale for the scoring methodology is not clear as it includes duplication of past and present good faith efforts

Minority participation is included as one of the evaluation criteria for request for qualifications (RFQs) and request for proposals (RFPs). Unless other weights are stated, minority participation represents 30% (30 points out of 100) of the total evaluation score. Minority participation is scored by OMBD based on the three areas identified below:

<i>Description</i>	<i>Maximum Points</i>
Past good faith effort History of the prime contractor to adhere to the minority goal during the past contracts	5
Good faith effort Providing minority subcontractor participation during qualification or proposal process	5
Pledged participation <ul style="list-style-type: none"> • Past good faith – up to 10 points • Proposed participation – up to 10 points % of minority participation pledged by the prime contractor	20

The above scoring indicates duplication between past and present good faith efforts and pledged participations. The rationale for the scoring methodology is not clear.

Pursuant to City Code §74-50 and §74-71:

- Prospective bidder receiving less than 50 percent of the possible minority participation points shall neither be prequalified nor awarded a contract unless the Chief Administrative Officer (CAO) waives the requirement using a narrowly defined authority by the City Code.
- Prequalification may be denied for contractors that fail to make or propose to make good faith minority participation efforts.

*OMBD does not
always follow its
predefined scores in
some categories*

The OMBD scoring system is based upon a series of questions for which points are assigned. The questions are segmented based upon whether or not the contractor has worked on previous City contracts. This means that the questions used to evaluate contractors who have worked on previous City contracts are different than the ones used to evaluate contractors who have never worked on City contracts.

The system is designed to be objective in nature as each question has a pre-defined score for each response option. For example, the past good faith effort, for contractors with prior City contracts, is calculated based upon the difference between proposed minority participation and actual participation on prior contracts. A defined scale is in place which dictates the assigned point value for the calculated difference.

However, audit testing revealed that points for past good faith efforts, for contractors with prior City contracts, are not being assigned in accordance with the pre-defined scale. Higher scores, in excess of what the scale allows, are being awarded to contractors that have not achieved their pledged minority participation for prior contracts.

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Auditors found that OMBD staff awards the minimal participation points (15) required to prequalify to bid on contracts as long as the prime contractors are pledging any minority participation. Contractors are disqualified only when they refuse to pledge any minority participation.

Contractors who fail to pledge minority participation are disqualified unless waived by the CAO

Given this practice, prime contractors, who have failed to perform good faith and past good faith efforts were allowed to compete for and, in some cases, ultimately receive City contracts.

The auditors found the following discrepancies which have significant impact on the effectiveness of this program:

Repeat offenders failing to comply with pledged participation continue to get City business

Pledging MBE/ESB/DBE goal and not adhering to it

The following is a selected number of prime contractors that continually pledge minority participation, fail to demonstrate present or past good faith efforts and still have ability to get City contracts:

<i>Vendor</i>	<i>No. of Contracts</i>	<i>No. of Contracts failed to demonstrate good faith efforts</i>	<i>\$ Amt Contracts procured with vendor</i>	<i>Proposed MBE Goal</i>	<i>Actual MBE Participation</i>
<i>A</i>	<i>6</i>	<i>5</i>	<i>\$10.7 Million</i>	<i>25%</i>	<i>5%</i>
<i>B</i>	<i>6</i>	<i>5</i>	<i>\$7.5 Million</i>	<i>26%</i>	<i>11%</i>
<i>C</i>	<i>10</i>	<i>7</i>	<i>\$10 Million</i>	<i>16%</i>	<i>10%</i>
<i>D</i>	<i>10</i>	<i>8</i>	<i>\$6.7 Million</i>	<i>20%</i>	<i>10%</i>
<i>E</i>	<i>8</i>	<i>6</i>	<i>\$5.3 Million</i>	<i>18%</i>	<i>6%</i>

Note 1: the table includes all the contracts that included MBE goals, awarded to the selected prime contractors

Note 2: The above table includes contracts awarded outside of audit period to capture past good faith efforts.

Collectively, these vendors pledged \$8.4 million in subcontracting to minorities. However, they actually paid \$3.3 million or only 39% of amount pledged to the minority subcontractors.

Currently, the City is reluctant to enforce the provisions of the City Code due to perceived legal liabilities

Currently, the City is reluctant to enforce the provisions of the City Code due to perceived legal liabilities surrounding the Croson case. As a result, several prime contractors may be taking undue advantage of the City's reluctance. This reluctance prevents OMBD from fully achieving the City's goal for increasing minority participation on City contracts.

This practice is not in compliance with City policies and procedures. In addition, it does not treat contractors that honestly disclose their intention not to use minority participation or those who honor their pledges fairly. Apparently, contractors are able to pledge minority participation without the intention of fully complying with their pledges. Auditors found that two bidders on a contract were disqualified due to failing to pledge minority participation. In this case, the winning contractor who had a history of not meeting its MBE goals, failed to put forth good faith efforts to meet the pledged minority participation. This practice has the potential of exposing the City to liabilities.

***MBE/ESB
Qualification***

Pursuant to the OMBD policies and procedures manual, all firms participating in the City of Richmond's Minority Business Enterprise and Emerging Small Business Program must be qualified minority or emerging small businesses. Qualifications of MBE and ESB are described as follows:

<i>Category</i>	<i>Qualification</i>
MBE	<ul style="list-style-type: none"> • At least 51% owned and operated by minority • Citizens of the U.S who are African-American, Hispanic-American, Asian-American and American Indian
ESB	<ul style="list-style-type: none"> • Fewer than ten full-time permanent employees • Annual gross receipts of \$500,000 or less –construction business • Annual gross receipts \$250,000 or less –non-construction business • Cannot be a subsidiary of another business or cannot be part of a group of businesses owned and controlled by the same individuals • Principal place of business entity must be within the City of Richmond Enterprise Zone boundaries • Possession of a City business license • Must be a personal property, real estate and business taxpayer in the City of Richmond, as applicable

Registration requirements for ESB are more restrictive compared to MBE

Richmond’s process does not verify qualification of MBE/ESB

Insufficient information is requested to properly verify the qualification of minority firms

The City requires MBEs to register with the City and ESBs to complete the OMBD certification process. Auditors identified that OMBD’s processes do not ensure that only eligible businesses are

registered/certified. Sufficient information is not being requested and maintained to validate MBE/ESB firms' qualifications.

The information requested during registration does not always allow for verification of MBE/ESB eligibility

Both MBE registration and ESB certification applications require the following information:

- Business license,
- Owner and essential personnel resumes,
- Owner professional license, and
- Overview of past work projects.

However, this documentation is not sufficient to establish eligibility of MBE and ESB as depicted below:

<i>Category</i>	<i>Qualifications Required</i>	<i>Does OMBD verify qualifications?</i>
MBE	• % ownership and operation	N
	• Ethnicity	N
ESB	• # of employees	N
	• Gross receipts	N
	• Controlling interest	N
	• Business license	Y
	• Taxpayer	Y

The Virginia Department of Minority Business Enterprise requires the following documentation for certification and registration in its Small, Women and Minority (SWAM) program:

- Copy of government photo I.D.
- Schedules from tax returns (e.g. Schedule C – Sole Proprietorship)
- Federal 941 Quarterly Payroll tax form

- Signed Business Federal Income Tax Return

Documentation such as the above may be necessary for OMBD to determine and demonstrate that registered/certified vendors are in compliance with eligibility requirements. The absence of necessary information for verification of eligibility does not provide assurance that the firms included in the City's MBE/ESB list are eligible to participate in the program.

OMBD's process to verify minority status needs improvement

OMBD policies require that all registered MBEs seek certification through one of the following certifying agencies:

- Small Business Administration (SBA);
- Virginia Department of Minority Business Enterprise (DMBE);
or
- Virginia Department of Transportation Disadvantage Business Enterprise (DBE) through DMBE

MBEs must seek certification from one of the three certifying agencies

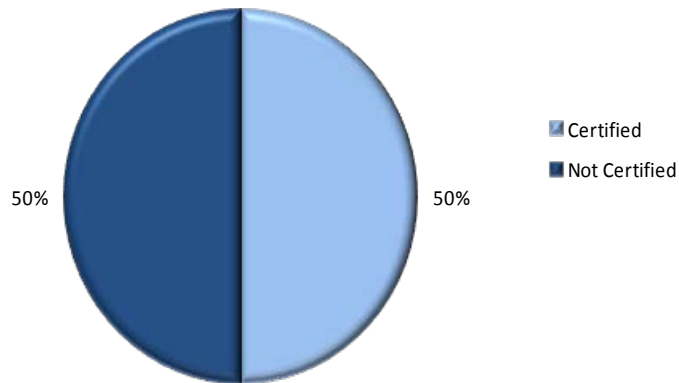
Time frame for getting certification by subcontractors is not defined

OMBD policies and procedures further dictate that if the subcontractor is not registered and/or certified at the time the contract is executed, the prime contractor would be given a specified time to get the subcontractor registered and certified or jeopardize receiving credit towards any MBE/EBS goals. However, the timeframe is not defined in OMBD policies and procedures.

Audit testing revealed that there were limited controls and procedures to ensure that the non-certified, registered MBEs pursued and obtained certification as required. The auditors found that, in a sample of 100 registered MBEs, 50% of the firms were not actively certified.

Half of selected registered MBEs in audit sample were not certified

Half of the selected registered MBEs were not certified as required



Nine of the fifty minority subcontractors firms that were not certified, received payments totaling about \$953,000 during the audit period.

Based upon research conducted by the Virginia Department of Minority Business Enterprise (DMBE), the below reasons were cited for the firms not being actively certified.

Description	Total
No record in State database	24
Did not re-certify or complete process	9
Did not complete application process	10
Denied certification - firms located in states without reciprocity with VA	4
State could not conclude based upon information provided	2
Became certified in June 2012 after testing period	1
Total Non-Certified Businesses	50

OMBD does not have a formal procedure to verify if the applicant for registration actually belongs to a specified minority group

According to OMBD, the majority of its applications are walk-ins. The auditors were informed that OMBD staff visually assess the applicant and determine their eligibility as minority. However, applications may not always be delivered by the owner of a business. OMBD does not have a formal procedure to verify if the subcontractor applying for registration actually belongs to a specified minority group.

This means that OMBD has 50% of registered participants in the audit sample for whom there is no assurance that they qualify as the specified minority group. In this event, the perceived minority participation may be misleading. This situation also may have an impact on determining the effectiveness of the program.

Based upon information obtained from Procurement Services, it was noted that, in at least one case, a bidder protested a contract award on the basis that the prime contractor was utilizing a non-certified minority subcontractor and won.

Invalid federal IDs further limit OMBD's ability to verify eligible businesses

Some of the MBE/ESB subcontractors being paid had invalid federal identification

During audit testing, the auditors observed that some of the MBE/ESB subcontractors being paid had invalid federal identifications (e.g. 4444444444, 5555555555). According to OMBD staff, some minority subcontractors are reluctant to provide their federal identification numbers. As such generic identification numbers are used to record their payments. Without validating the identification numbers, OMBD does not have assurance that these are legitimate businesses.

***Prime contractors
were granted full
MBE participation
credit for non-
certified MBE
firms***

According to OMBD staff, prime contractors were granted full credit for minority participation for non-certified MBE firms during the audit scope. Potentially, this lack of compliance with policies could allow the prime contractors obtaining MBE/ESB participation credit for utilizing ineligible businesses.

Auditors also noted that OMBD does not maintain the expiration dates for the MBE's certifications. Without this information, OMBD does not know whether the registered subcontractors are currently certified or when they are due for renewal. Based upon the research conducted by the DMBE, it was determined that 10 of the reviewed minority firms were initially certified but did not apply for recertification and/or complete the re-certification process.

***Compliance
Monitoring***

OMBD monitors compliance to ensure the prime contractors and subcontractors adhere to policies and procedures governing the City's MBE/ESB program. During the life of a contract, they are expected to verify actual minority participation by tracking the prime contractor's payments to minority subcontractors.

***Prime contractors
and subcontractors
do not always
comply with the
reporting
requirements***

OMBD monitors contracts valued at \$50,000 or more for compliance with a minority participation goal. Monthly compliance letters are submitted to the prime contractors once the City has paid at least \$15,000 to the prime. OMBD submits a request to the prime firms to forward copies compliance reports and subcontractor invoices that relates to the reported payments. Also, verification letters are forwarded to the MBE/ESB subcontractors to validate the reported payments by the prime contractor.

Audit testing revealed that this process is not working as intended as information is not always received from the prime contractors, and the subcontractors are not as responsive in validating the information as required by policy.

During the course of audit test work, auditors identified minority subcontractor payments reported by the prime contractors totaling approximately \$642,000 (84%) of the audit sample of \$765,000 that were not supported by subcontractor invoices. Approximately \$430,000 of these expenditures was supported by subcontractors' validation letters. However, it is not clear whether the subcontractors received about \$213,000 included in the audit sample as validation letters also were not completed and returned by the minority subcontractors.

According to OMBD staff, they cannot compel the prime contractors and MBE/ESB subcontractors to provide the required documentation. As a result, OMBD could not have assurance that the program is effective to improve minority participation in the City's contracts.

Recommendations:

- 1. Revise the procedures and document monitoring of scoring to ensure the scoring points are appropriately assigned.***
- 2. Require additional documentation that demonstrates MBEs'/ESBs' eligibility for the respective programs.***
- 3. Ensure that minority contractors are certified within pre-established time frames by following up on pending certification procedures.***

- 4. Maintain the MBEs certification expiration dates to ensure that their certification has not expired when considering them for contracts.*
- 5. In order to capture accurate information about minority business support, ensure reporting of minority subcontractors payments.*

***Database
Limitations***

OMBD tracks compliance using an Access database which is updated in part by the Department of Procurement Services. This database was developed by the Department of Information Technology (DIT) staff several years ago.

The database did not capture several prime contracts that had MBE/ESB participation goals

During audit testing, several system glitches or issues were noted which resulted in the system's failure to capture several prime contracts that had MBE/ESB participation goals. As a result, OMBD did not conduct compliance monitoring for these contracts. As such, unless the prime contractor voluntarily reported the MBE/ESB subcontractor payments, these expenditures and the corresponding prime contract expenditures were not captured in the year-end reported figures and the participation percentage. Therefore, the reported amounts of minority participation and percentage are misstated. Upon inquiring with OMBD management about the missing contracts, the Department conducted a manual reconciliation and determined that 25 contracts with prime contract expenditures totaling approximately \$4.7 million were not captured.

- Prime contracts for which at least \$15,000 of payments had not posted against contracts prior to the contract end- date were not

captured in the OMBD database. In several cases, it was noted contracts in which \$15,000 or more had posted against the contract prior to the end date and the contract still was not captured in the database. An explanation for those occurrences could not be provided.

- Prime contracts for which MBE/ESB goals were not keyed for renewal periods were not captured in OMBD database. According to OMBD staff, the pledged participation applies to the entire life of the contract. Thus, a goal should have been keyed for the renewal periods.
- Reported MBE/ESB subcontractor payments are posted to the month in which they were paid not when they are keyed. The data entry date is not being captured. As such, payments reported and keyed after the fiscal year end in which payment were made are not captured in the year end reported figures.
- The prime contractor used the same minority subcontractors for two projects. The contractor reported the total payment of approximately \$2.4 million. However, in reality, the contractor incurred only approximately \$1.2 million which was reported twice. This situation erroneously inflates the minority participation.

Upon inquiring with DIT, the auditors observed that a system manual and data dictionary do not exist for this system. Also, there is only a limited understanding of how the system operates since the system creator is no longer employed with the City, and there is limited system documentation. The database is also operating on Microsoft 2003 and cannot be upgraded to a new version. If the City does an upgrade, this system will become inoperable in the future.

Recommendation:

- 6. Address the Access database limitations by working with DIT, using the RAPIDS Solution or by replacing the system.***

Internal Controls

According to Government Auditing Standards, internal control, in the broadest sense, encompasses the agency's plan, policies, procedures, methods, and processes adopted by management to meet its mission, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It also includes systems for measuring, reporting, and monitoring program performance. An effective control structure is one that provides reasonable assurance regarding:

- Efficiency and effectiveness of operations
- Accurate financial reporting
- Compliance with laws and regulations

Internal controls need enhancement

Based on the results and findings of the audit methodology employed, the auditors concluded that the internal controls need enhancement.

OMBD's policies and procedures need enhancement

OMBD has formal policies and procedures outlining daily operational tasks. However, the current policies and procedures do not address:

- The timeframe for prospective minority vendors to seek certification from the state or federal agency.
- Registration requirements or certification procedures related to validation procedures to ensure that firms meet eligibility requirements.

OMBD's policies and procedures do not address certain issues

- Procedures to follow when a non-certified firm requests to be registered as a minority with the City.
- The timeframe prime contractors are given to get MBE/ESB firms registered and certified if they haven't done so prior to execution of the contract.
- Denials or revocations of certifications.

Without the above enhancements, staff expectations may be unclear and job performance may be inconsistent. In addition, policies and procedures ensure continuity of operations during employee turnover.

Recommendations:

- 7. Enhance the existing policies and procedures manual to address the entire process from goal- setting to closing out of the contracts.***
- 8. Train staff once the policy is enhanced.***

What can the City do to cure the current situation?

The foregoing discussion in this report indicates that the effectiveness of the City's MBE program needs to be improved. The City has made some progress in encouraging minority businesses. However, the *J. A. Croson v. City of Richmond* case limits remedies that the City may use to meet the objectives of MBE/ESB programs. The City needs to make changes in the program that would meet the legal tests and be beneficial to the minority and emerging small businesses.

The City needs to conduct a comprehensive legal analysis to make appropriate changes to the program in order to better enforce some of the contractual provisions. In addition, the City Auditor's Office

The Tenth Circuit Court considered disparity studies as a tool for governments to establish an affirmative action program that can endure legal scrutiny

conducted limited research and discussions with the City’s OMBD that identified the possibility of overhauling the current program after conducting a “disparity study.” The Tenth Circuit, in its 2003 decision, considered disparity studies as a tool available for governments to establish an affirmative action program that can endure legal scrutiny.

The City Auditor’s Office was informed that these studies could cost a substantial amount of money. Therefore, like any other government decisions, careful consideration must be given to the expected outcomes of the study by thoroughly researching similar studies elsewhere.

What is included in the study?

The auditors found a disparity study conducted for the City of Memphis, TN. The results of this study are used to compile this section of the report. The Memphis study utilized the following procedures to prepare a race and gender neutral program and narrow the race and gender based remedies:

- legal analysis;
- policy and procurement process review and race-neutral program analysis;
- market area analyses;
- utilization analyses;
- determined the availability of qualified firms;
- the utilization and availability of data analysis for disparity and significance;
- private sector analysis including credit and self-employment analysis;

- Anecdotal information analysis

What are the pertinent legal rulings impacting the program?

In the Croson v. Richmond decision, the Supreme Court referred to "strict scrutiny" of local programs that grant or limit government opportunities based on race. This case provided two tests for government programs:

1. The public entity must have a compelling government interest in establishing a race-based program and
2. It must narrowly tailor those programs to achieve the government's interest.

According to the Memphis study:

"Strict scrutiny requires a strong basis in evidence of either active participation by the government in prior discrimination or passive participation by the government in discrimination by the local industry. 17 Croson, 488 U.S. 469, 504, 109 S.Ct. 706, 727. ... "

- The Croson case requires the City to first consider race-neutral measures and evaluate its effectiveness prior to offering a race-based program. Richmond does offer the ESB program for small businesses. However, the ESB program is limited to businesses with annual gross receipts of \$500,000 or less for construction businesses and \$250,000 or less for non-construction businesses. In addition, it has several other restrictions, such as including the business locations in a very limited area of the City. Compared to the above requirements, race-based minority owned firms have only two requirements:

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- At least 51% ownership and participation in operations of the business, and
- Must be a US citizen who is a member of specified race.

These firms can be of any size and do not have limitations of operating within City. The following table shows that only 39% of the minority subcontractors were located in the City.

OMBD’s FY 2011 annual report indicated the following for MBE/ESB payments:

<i>Category</i>	<i>City Firms</i>	<i>Metro Firms</i>	<i>Statewide</i>	<i>Out-of-State</i>
Prime Contractors	3,470,928	1,702,719	392,935	982,338
Subcontractors	5,205,015	8,832,754	473,183	1,261,822
Total	8,675,943	10,535,473	866,118	2,244,160
Percentage of total payments	39%	47%	4%	10%

The ESB participation in this business was very limited. The above City numbers included business offered to only one ESB for approximately \$113,000. This represents 0.5% of the total MBE/ESB payments. Overall, the City has only seven registered ESBs compared to 1,337 active MBEs listed in the City’s database. This represents only 0.5% ESBs compared to total active minority subcontractors.

In *Ensley Branch NAACP v. Seibels*, 31 F.3d 1548 (11th Cir. 1994), the Eleventh Circuit U.S. Court of Appeals also held that four factors should be taken into account when evaluating whether a race- or ethnicity-conscious affirmative action program is narrowly tailored:

- “1) the necessity for the relief and the efficacy of alternative remedies;
- 2) the flexibility and duration of the relief, including the availability of waiver provisions;
- 3) the relationship of the numerical goals to the relevant labor market; and
- 4) the impact of the relief on the rights of innocent third parties”

The rights of innocent third parties may include prime contractors and firms that could not get the City’s business due to the existing restrictions.

Recommendations:

- 9. Conduct a comprehensive legal analysis to evaluate the current program and make appropriate changes based on the results of the legal analysis to better enable the City to enforce contractual provisions related to MBE/ESB participation.***
- 10. Conduct a cost-benefit analysis to determine the appropriateness of conducting a disparity study. If found beneficial, conduct a disparity study.***

MANAGEMENT RESPONSE FORM
OFFICE OF MINORITY BUSINESS DEVELOPMENT

#	RECOMMENDATION	CONCUR Y-N	ACTION STEPS
1	<i>Revise the procedures and document monitoring of scoring to ensure the scoring is in compliance with policy.</i>	Y	MBD staff is updating our current scoring sheet to be more explicit , although the current process was approved in the 2005 audit by the City Auditor's Office. This update will be in conjunction with enhancements being made to the Policies and Procedures of MBD to be completed in the next 6 months.
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	Director		February, 2013
	IF IN PROGRESS, EXPLAIN ANY DELAYS		AUDITOR COMMENT
			The City Auditor's Office is not aware of the approval of the current process referred to by OMBD. The City Auditor was told by OMBD staff that the scoring sheet was presented to the former Acting City Auditor. However, reviewing just scoring sheet is insufficient to make judgment on the adequacy of the entire process.
			The finding is not about the design of the scoring sheet; it is about OMBD going outside of its pre-defined scoring scale without explanation or documentation.
#	RECOMMENDATION	CONCUR Y-N	ACTION STEPS
2	<i>Require additional documentation that demonstrates MBEs'/ESBs' eligibility for the respective programs.</i>	Y	In an effort to document the eligibility of the MBE/ESB firms MBD will continue to use the Commonwealth's certifications for existing businesses. But for start-up businesses which we see approximately 150 a year, there must be on-site verifications done which will require additional FTEs for MBD.
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	Director		February, 2013
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y-N	ACTION STEPS
3	<i>Ensure that minority contractors are certified within pre-established time frames by following up on pending certification procedures.</i>	Y	This measure is a part of the enhancements of the Policies and Procedures. The time frame will be 180 days or the end of the contract whichever is less with exceptions for contracts that have short duration.
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	Director and Program Development Manager		February, 2013
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y-N	ACTION STEPS

4	<i>Maintain the MBEs certification expiration date to ensure their certification has not expired when considering for contracts.</i>	Y	MBD will create an additional field to capture the expiration date of the certification upon the time of the business registration or upon the approval of the business's certification
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	MBD Administrator and Program Development Manager		February, 2013
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y-N	ACTION STEPS
5	<i>In order to capture accurate information about minority business support, ensure reporting of minority subcontractors payments.</i>	Y	Return the MBE-3 forms to the Primes if the subcontractor invoices are not included. The request for this information is provided in the pre-bid and pre-award meetings. This a request and not a requirement. MBD staff sends out
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	MBD Contract Compliance Officer and Director		
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y-N	ACTION STEPS
6	<i>Address the Access database limitations by working with DIT, using the RAPIDS Solution or by replacing the system.</i>		Staff is currently working with DIT to develop a system that will provide sufficient information.
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	MDB Administrator and Program Development Manager		June, 2013
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y-N	ACTION STEPS
7	<i>Enhance existing policies and procedures manual to address the entire process from goal-setting to closing out of the contracts.</i>	Y	Identify and implement additional steps to strengthen cument policies and procedures through the use of the Best Practices in the industry
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	Director		February, 2013
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y-N	ACTION STEPS
8	<i>Train staff once policy is enhanced.</i>	Y	The entire MBD staff will participate in developing the enhancements to the Policies and Procedures and will therefore will having a working knowledge immediately.
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	Director		February, 2013
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y-N	ACTION STEPS

9	<i>Conduct a comprehensive legal analysis to evaluate the current program and make appropriate changes based on the results of the legal analysis to better enable the City to enforce contractual provisions related to MBE/ESB participation.</i>	Y	Request the City's legal department to conduct a legal analysis of the current procedures utilized by MBD. MBD would make the appropriate changes accordingly.
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	Director and Deputy Director		Will work with Legal on timeframe
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y-N	ACTION STEPS
10	<i>Conduct a cost benefit analysis to determine the appropriateness of conducting a disparity study. If found beneficial, conduct a disparity study.</i>	Y	This request will be made once the legal analysis is complete and demonstrates a need to conduct a disparity study.
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	Director and Deputy Director		undetermined
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION