



Subcontracting Requirements for Government-Assisted Projects: A Review of DSLBD's Compliance Monitoring Function

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A Report by the Office of the District of Columbia Auditor
Kathleen Patterson, District of Columbia Auditor

The Honorable Phil Mendelson, Chairman
Council of the District of Columbia
1350 Pennsylvania Avenue, NW, Suite 504
Washington, D.C. 20004

Letter Report: Subcontracting Requirements for Government-Assisted Projects: A Review of DSLBD's Compliance Monitoring Function

Dear Chairman Mendelson:

For each construction project where the District provides government assistance to a private developer performing work in excess of \$250,000, D.C. law¹ stipulates that at least 35 percent of the dollar volume of the work must be subcontracted to a Small Business Enterprise (SBE). SBEs are one of nine categories of Certified Business Enterprises (CBE) in the District of Columbia.²

For the purposes of this review, projects receiving "government assistance" are defined as those projects receiving a "grant, loan, tax increment financing or other financial assistance" from the District.³ Historically, the Office of the District of Columbia Auditor (ODCA) has performed an annual evaluation of this function; assessing developer compliance with the District's subcontracting goals. ODCA's reports repeatedly noted that the District's developers were not achieving their subcontracting goals and that the Department of Small and Local Business Development (DSLBD) was not administering the program effectively or efficiently. This year, rather than restating the same findings from previous annual reports, ODCA examined DSLBD's administration of the program in order to identify specific gaps in DSLBD's compliance function and provide detailed recommendations for improvement.

Objective, Scope and Methodology

The objective of this analysis was to:

1. Review and assess the processes that DSLBD currently uses to comply with statutory subcontracting requirements⁴, which seek to provide Small Business Enterprises (SBE) with the opportunity to participate in government-assisted construction projects.

This review was performed from January to May of 2016 and the scope of our work reflects an analysis of the program as it was designed and implemented at the time of our review. We began our analysis with a review of the D.C. Code provisions that established the District's subcontracting requirements for

¹ D.C. Code § 2-218.46.

² If there are insufficient qualified Small Business Enterprises (SBEs) to completely fulfill this requirement, the subcontracting requirement may be satisfied by subcontracting 35% of the dollar volume to any qualified certified business enterprises. Pursuant to D.C. Code § 2-218.31 et seq., CBEs include the following subtypes: Local Business Enterprises (LBEs), Small Business Enterprises (SBEs), Disadvantaged Business Enterprises (DBEs), Local Business Enterprises with Principal Offices Located in an Enterprise Zone (DZEs), Resident-Owned Businesses (ROBs), Longtime Resident Businesses (LRBs), Local Manufacturing Business Enterprises (LMEs), and Veteran-Owned Business Enterprises (VOBs).

³ D.C. Code § 1-301-181.

⁴ D.C. Code § 2-218.46 (a).

construction projects. We also interviewed DSLBD management and staff members across the organization's functional departments, including the agency's legal and compliance teams. We designed interviews to yield process flow diagrams reflecting the current state of DSLBD's operations.

We did not conduct the examination as an audit as defined by the Government Accountability Office's Government Auditing Standards.

Background

The Department of Small and Local Business Development (DSLBD) seeks to "stimulate and foster the economic growth and development of businesses based in the District of Columbia."⁵ The District has established several programs that are designed to achieve this policy objective. This review focuses on one such program in which the prime contractor for each construction project, valued at more than \$250,000, must subcontract at least 35 percent of the project to a Small Business Enterprise (SBE).⁶

Historically, DSLBD has used Certified Business Enterprise Agreements (CBEAs) to manage the District's initiatives to increase SBE participation on large government-assisted construction projects. These CBEAs, executed between DSLBD and the District's developers, required developers to meet specific expenditure goals.⁷ The agreements also required developers to submit quarterly reports to both DSLBD and ODCA, to inform both of their progress towards meeting these goals.

Although DSLBD has discontinued its use of CBEAs to manage SBE participation on large government assisted construction projects, a number of these agreements remain active. Currently, DSLBD is working to build new systems and processes for its compliance and monitoring function. ODCA will examine these new systems and processes when DSLBD has completed their design and implementation.

Results of the Auditor's Examination

ODCA interviewed a variety of staff and management personnel at DSLBD. During these interviews, ODCA worked with DSLBD staff and management to document the process DSLBD uses to manage subcontractor participation on its construction projects. Based on the information that was gathered, ODCA constructed two process flow diagrams to represent the Planning/Budgeting and Compliance/Monitoring phases of each project. Both of these diagrams, representing the process as it currently exists, have been included at Appendix I. Once documentation had been completed, the audit team examined DSLBD's process and identified gaps, or activities that ODCA believed should have been part of the process.

⁵ D.C. Code § 2-218.13(a).

⁶ D.C. Code § 2-218.46.

⁷ Note that if there are insufficient qualified Small Business Enterprises to completely fulfill this requirement, the subcontracting requirement may be satisfied by any qualified Certified Business Enterprise.

ODCA identified 10 gaps in DSLBD's process.

1. DSLBD has no process in place to confirm that it has been informed of all government-assisted construction projects in excess of \$250,000.
2. When the developer (prime contractor) meets with the DSLBD compliance team, its budget typically has not yet been finalized with the subsidizing agency. At that point in the project DSLBD does not have any way to verify the total dollar amount of the project. If the developer misstated the total dollar amount of the project, DSLBD would not know.
3. DSLBD is not always informed of the final agreement between the District and the developer. Without this knowledge, DSLBD cannot verify the total dollar amount of the work or any other identifying details about the project.
4. DSLBD does not have a process in place to update SBE goals should there be a change to the agreement between the District and the developer. For example, if the scope of a project changes, particularly if the contract value increases, DSLBD may not be aware of the resulting change in subcontracting requirements for the project.
5. DSLBD management cannot demonstrate that they are monitoring and reviewing the work of the agency's compliance specialists. For example, DSLBD management cannot demonstrate they reviewed and approved the work that DSLBD compliance specialists perform each quarter (expenditure reports). If a compliance specialist entered the wrong amount for an expenditure, DSLBD management would not know.
6. DSLBD does not appear to have the resources it needs to perform actual site visits for the projects it oversees. Without physically visiting the site of each project, DSLBD cannot verify that SBEs are performing the work they have been contracted to perform with their own staff.
7. Compliance specialists are not always involved in the initial meeting between the developer and DSLBD, which occurs after the acknowledgement letter has been sent (i.e. the 10 day meeting). This is problematic because DSLBD's compliance specialists are tasked with the day-to-day oversight of each project. They should have all project related information available to them in a timely manner.
8. A lack of standardized procedures for storing information about projects has led to gaps in the type of documentation available for some projects, including basic project details, contacts and amounts.
9. A lack of standardized procedures within DSLBD's compliance function means processes are not standardized among different specialists. Different specialists will perform the compliance function using different procedures. Additionally, because these processes have neither been standardized, nor documented, DSLBD cannot ensure that new employees will be trained properly.
10. DSLBD is not employing its information technology (IT) equipment in the most efficient and effective manner. For example, currently, DSLBD employees are spending large amounts of time manually entering quarterly expenditure data into DSLBD's databases. This data could be provided in a standardized format and uploaded each quarter, or perhaps DSLBD could have developers enter the data directly into DSLBD's databases. Either way, without improved processes that fully utilize DSLBD's systems, DSLBD cannot demonstrate that it is functioning as efficiently as possible.

Recommendations:

1. DSLBD needs to redesign its compliance and enforcement mechanisms to ensure that the District's developers are complying with subcontracting requirements.⁸ DSLBD should ensure that its process is robust enough to deal with each of the gaps ODCA has identified; from DSLBD's inability to confirm that it is monitoring a complete population of projects, to a lack of standardized procedures and practices among the group.
2. As DSLBD redesigns its processes, it needs to ensure that its IT equipment is designed and used in an efficient and effective manner.

Some projects are granted more than \$1 in credit for \$1 in spending.

The District has set specific objectives for increasing SBE participation on its large construction projects. In its most basic form, the program calls for at least 35 percent SBE participation on all District funded construction projects in excess of \$250,000. However, the audit team noted that in the past, some developers signed agreements with DSLBD which granted more than \$1 in credit for each \$1 spent with a CBE subcontractor. For example, one agreement that ODCA reviewed credited the developer with between \$1.25 and \$1.50 for each \$1 that the developer subcontracted, depending on the scope of work.

The additional credit that these developers receive from DSLBD results in inflated spending totals for those projects that employ the agreement. ODCA asked DSLBD why these agreements were used and requested that DSLBD identify where the D.C. Code authorized such a change. DSLBD responded that the additional credit was granted in order to encourage CBE subcontractor participation on its large construction projects, particularly in areas where their participation has historically been limited. However, DSLBD could not identify any legal authorization for the additional credit and ODCA's own search through the legislative history of the program also did not turn up any evidence to support the practice.

Although DSLBD should be recognized for their efforts to increase subcontractor participation on District projects, there is no legal authorization for the additional credit given to the District's developers. DSLBD informed ODCA that it is no longer issuing agreements that grant more than \$1 in credit for each dollar in spending. However, some legacy agreements that include this language are still active projects that DSLBD must monitor.

Recommendations:

3. As part of DSLBD's effort to redesign the processes it uses to monitor subcontracting requirements⁹, DSLBD must perform a review of the legislation governing the program to ensure strict compliance with District law.
4. Should DSLBD seek to redesign portions of the program, it should work with the Mayor and Council to present its point of view and recommend any changes believed to be necessary.

⁸ Ibid.

⁹ Ibid.

DSLBD cannot demonstrate that it performed a requirements analysis when it built its QuickBase database.

It is best practice to employ a structured methodology, commonly referred to as a Systems Development Life Cycle (SDLC), when an entity builds an IT system for its use. As noted in the GAO's Federal Information System Controls Audit Manual (FISCAM), an effective entity-wide SDLC methodology details the procedures that are to be followed when systems and applications are being designed and developed, as well as when they are subsequently modified. An SDLC breaks down the project into manageable phases, which include designing, developing, testing, and approving new systems and system modifications.

As part of the design phase, the entity should define the system's functional requirements. As the entity works to complete the requirements analysis phase of the project, they will identify and document how the system will be used to meet the needs of its users. This includes both the technical features of the system and the operational practices of the entity's staff. An entity that does not perform a requirements analysis increases the risk that they will develop IT systems that do not meet their needs.

Given how important this process is to a successful IT project and the large number of gaps that ODCA identified in the process that DSLBD currently uses, ODCA asked to review DSLBD's requirements analysis. Specifically, ODCA wanted to examine how this process was performed when DSLBD built the IT system it currently uses to manage SBE participation on District construction projects, also known as QuickBase. Upon inquiry, DSLBD replied that the individual in charge of developing the QuickBase IT system no longer worked at DSLBD, and there was no documentation available to demonstrate that a requirements analysis was ever completed for the system.

Recommendation:

5. DSLBD should ensure that it adheres to proper programming practice and perform a requirements analysis before it begins building a new IT system to manage SBE participation on its projects. By gathering functional requirements for the system before it is built, DSLBD can increase the likelihood that it will build an IT system that meets its needs.

Lack of proper compliance monitoring means that DSLBD is not enforcing subcontracting requirements¹⁰ as intended, nor are there any consequences for organizations that do not meet the District's subcontracting requirements.

For those projects in which developers do not meet District requirements for SBE participation, DSLBD should demonstrate that the agency is willing and able to enforce penalties where compliance is either lacking or non-existent. In prior years, ODCA often found that projects did not comply with the District's subcontracting requirements. For example, in FY 2014, ODCA issued a report showing that for nearly 80 percent of the 218 DSLBD projects reviewed, DSLBD did not even receive a report from the developer confirming how much they had spent with SBEs. These reports were required by the agreements each developer entered into with the District.

Depending on the infraction, the law¹¹ includes specific penalties for non-compliant developers. ODCA reached out to DSLBD to examine this enforcement mechanism and requested documentation

¹⁰ Ibid.

supporting any penalties that the District had assessed in the past. DSLBD noted that between 2009 and 2015, only one developer with an agreement was assessed a penalty. The individual who paid the fine acknowledged the lack of compliance and the fine noted was less than \$5,000. There is no evidence that DSLBD has ever assessed or collected a fine for any other project since the program was established.

Recommendation:

6. DSLBD must enforce compliance with subcontracting requirements¹² and issue fines to the District's developers where they are applicable.

Conclusion

The Office of the District of Columbia Auditor (ODCA) began its review of this specific subcontracting requirement¹³ by examining the process that the Department of Small and Local Business Development (DSLBD) currently employs to manage the program. This review identified a number of gaps in the process that DSLBD should address as it works to redesign its processes. These redesigned processes will require new IT systems, and DSLBD should ensure that these systems are designed in accordance with a structured development methodology. Although DSLBD may seek to work with the Mayor or Council to make changes to the program, it should design its processes with a strict adherence to District law. We again recommend that DSLBD design and implement an enforcement mechanism for those developers that do not comply with the law.

Agency Comments

On May 17, 2016, ODCA sent a draft copy of this report to the Director of DSLBD for review and written comment. DSLBD provided written comments dated June 29, 2016. The comments, in their entirety, are included within this report.

Auditor's Response to Agency Comments

ODCA thanks the Director of DSLBD for its written comments on a draft of this report. We appreciate the detailed and constructive response as well as the description of DSLBD's plans to act on ODCA's recommendations. DSLBD concurred with each finding and recommendation included in the draft report.

Sincerely,



Kathleen Patterson
District of Columbia Auditor

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¹¹ D.C. Code § 2-218.63.

¹² D.C. Code § 2-218.46.

¹³ Ibid.



June 29, 2016

Kathleen Patterson
Office of the District of Columbia Auditor
717 14th Street, N.W. Suite 900
Washington, D.C. 20005

Re: DSLBD Response to ODCA's Draft Letter Report on Subcontracting Requirements for Government-Assisted Projects: A Review of the Department of Small and Local Business Development Compliance Monitoring Function, dated June 14, 2016

Dear Ms. Patterson:

This letter provides a response to the Office of the District of Columbia Auditor's (ODCA's), June 14, 2016 "Draft Letter Report", entitled *Subcontracting Requirements for Government-Assisted Projects: A Review of the Department of Small and Local Business Development Compliance Monitoring Function*.

The Department of Small and Local Business Development (DSLBD) has reviewed the aforementioned report and offers the following general comments:

- As indicated at the onset of the review, DSLBD welcomes the opportunity to work with ODCA and the Council of the District of Columbia to assess program requirements and establish a robust compliance monitoring program. DSLBD agrees that the program is deficient and has been working aggressively to hire additional staff, acquire necessary resources, and address deficiencies.
- DSLBD admits that over the past year it has been unable to adequately implement compliance monitoring procedures in this area, due to a lack of resources and staff shortages.
- Upon taking office in 2015 Mayor Bowser announced her commitment to improving the overall operations and effectiveness of DSLBD, as a means of creating an environment in the District where small businesses can thrive and grow. During the past year, following an audit of agency compliance monitoring conducted by the Office of Inspector General (OIG), DSLBD has been dedicated to addressing the deficiencies OIG identified and making required programmatic and technological improvements.
- Due to prior shifts in organizational responsibilities, current staffing shortages and a lack of resources, our focus has primarily been on making improvements to agency goal setting and compliance monitoring procedures. However, staff has also been working aggressively to develop a master listing of all Public-Private Development (PPD) Projects, to identify all completed versus active projects and develop a system for prioritizing projects according project status, size, and overall program objectives.



The draft Letter Report identified ten (10) “gaps” in DSLBD procedures and contains six (6) recommendations. For ease of review, these “gaps” and recommendations are restated in bold and followed by DSLBD’s responses.

DSLBD’s response to ODCA Identified “Gaps” in the Process:

1. DSLBD is in the process of working with all agencies that provide funding, relief or support otherwise to Public Private Development (PPD) Projects to identify a list of all active projects as well as information and close-out documentation on projects that have been completed. Once the master list of all active projects has been developed, DSLBD will work with the agencies to develop or expand existing automated, online “pipeline” tools used to report and track compliance.
2. Under procedures established to-date, all communications with developers and contractors are initially facilitated through the funding agencies. DSLBD requires developers and contractors to submit all waiver requests through the funding agency, as a means of verifying information received. The “pipeline” reporting procedures described above will significantly enhance DSLBD’s ability to confirm project details.
3. DSLBD is in the process of upgrading its compliance tracking tools to ensure that agencies and contractors have the ability to upload copies of all contracts, amendments, etc.
4. The “pipeline” process will help to ensure that the agency provides DSLBD with all contract changes.
5. DSLBD is in the process of upgrading its tracking system for accountability purposes, with dashboards that focus on compliance-related issues and provide notifications as needed, to keep management informed of staff progress.
6. During the past year DSLBD has hired two (2) additional specialists and is in the process of hiring two (2) more additional staff who will significantly enhance DSLBD’s ability to fully implement compliance monitoring procedures; including conducting site visits. Staff will start conducting regular site visits this year.
7. As DSLBD continues to expand its staff, projects will be immediately assigned upon receipt and specialists will be responsible for scheduling the 10-day meetings and conducting all follow-up correspondence with developers and contractors. This was not always possible due to staffing shortages.
8. DSLBD is in the process of developing a new “Enterprise” System to accomplish all previously identified tasks. The current system is outdated, lacks required functionality, and is not capable of housing and manipulating the massive data required for ensuring overall compliance.
9. DSLBD is in the process of expanding and training staff, re-distributing assignments, and enhancing its tracking systems. User manuals will be created and shared with staff and end users as a means of developing standardized operating procedures.

10. DSLBD is currently utilizing its limited resources to its maximum potential; with the addition of staff and technological improvements, DSLBD has assured that it will be able to streamline procedures, improve efficiency, and deliver on areas of accountability.

DSLBD's response to ODCA's recommendations:

Recommendation No. 1

DSLBD needs to redesign its compliance and enforcement mechanisms to ensure that the District's developers are complying with subcontracting requirements. DSLBD should ensure that its process is robust enough to deal with each of the gaps ODCA has identified; from DSLBD's inability to confirm that it is monitoring a complete population of projects, to a lack of standardized procedures and practices among the group.

DSLBD agrees with ODCA. As previously discussed, DSLBD is in the process of rebuilding and re-structuring its Public Private Development electronic data systems and operational procedures to ensure that District agencies and developers are complying with, and fully implementing, all SBE requirements. This includes developing and implementing standardized procedures and practices, which will be documented in user manuals and distributed to staff, agencies, developers, and contractors. The goal is to have user manuals available within the next six (6) months.

Recommendation No. 2

As DSLBD redesigns its processes, it needs to ensure that its IT equipment is designed and used in an efficient and effective manner.

DSLBD agrees with ODCA. DSLBD is in the process of re-structuring our Public Private Development Database to ensure that the PPD information is captured in a more efficient and effective manner. Also, DSLBD will be developing a new Enterprise System which will be more efficient and effective than Quickbase. The new replacement Enterprise System is scheduled to be completed during FY 2017 for full use starting in Fiscal Year 2018.

Recommendation No. 3

As part of DSLBD's effort to redesign the processes it uses to monitor subcontracting requirements, DSLBD must perform a review of the legislation governing the program to ensure strict compliance with District law.

DSLBD agrees with ODCA. DSLBD is currently reviewing the legislation governing the program to ensure strict compliance with District law.

Recommendation No. 4

Should DSLBD seek to redesign portions of the program, it should work with the Mayor and Council to present its point of view and recommend any changes believed to be necessary.

DSLBD agrees with ODCA. DSLBD will work with the City Administrator and the City Council regarding any revisions deemed necessary to ensure compliance with District law.

Recommendation No. 5

DSLBD should ensure that it adheres to proper programming practice and perform a requirements analysis before it begins building a new IT system to manage SBE participation on its projects. By gathering functional requirements for the system before it is built, DSLBD can increase the likelihood that it will build an IT system that meets its needs.

DSLBD agrees with ODCA. DSLBD will ensure that during the development process of the new Enterprise System it will be capable of managing SBE participation.

Recommendation No. 6

DSLBD must enforce compliance with subcontracting requirements and issue fines to the District's developers where they are applicable.

DSLBD agrees with ODCA. Once DSLBD has completed its analysis of existing projects and issues have been identified, DSLBD plans to issue notices of non-compliance to deficient projects and take appropriate enforcement actions where necessary to ensure full compliance.

Sincerely,

Ana Harvey
Director

A handwritten signature in blue ink, appearing to read 'Ana Harvey', is written over the printed name and title. The signature is fluid and cursive, with a long horizontal stroke extending to the right.

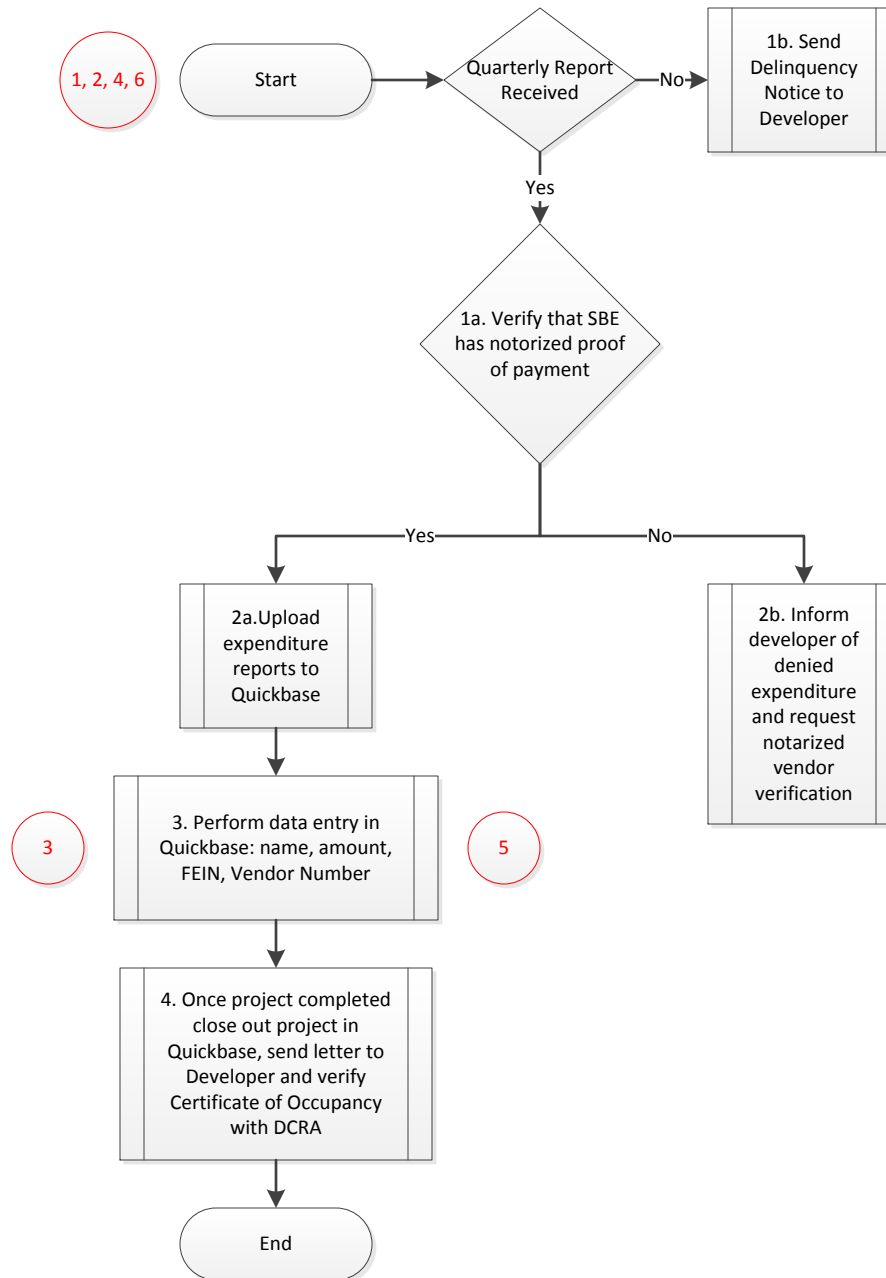
Appendix I

Compliance and Monitoring

DSLBD Compliance Team

The following gaps in the process were identified during our review of the Compliance and Monitoring process.

1. DSLBD management cannot demonstrate that they are monitoring and reviewing the work of the agency's compliance specialists.
2. DSLBD does not appear to have the resources it needs to perform actual site visits for the projects it oversees.
3. Compliance specialists are not always involved in the initial meeting between the developer and DSLBD, which occurs after the acknowledgement letter has been sent (i.e. the 10 day meeting).
4. A lack of standardized procedures for storing information about projects has led to gaps in the type of documentation available for some projects, including basic project details, contacts and amounts.
5. A lack of standardized procedures within DSLBD's compliance function means processes are not standardized amongst different specialists.
6. DSLBD is not employing its IT equipment in the most efficient and effective manner possible.



The following gaps in the process were identified during our review of the Planning and Budgeting process.

1. DSLBD has no process in place to confirm that it has been informed of all government assisted construction projects in excess of \$250,000.
2. When the developer (prime contractor) meets with the DSLBD compliance team, its budget has typically not yet been finalized with the subsidizing agency. At that point in the project DSLBD does not have any way to verify the total dollar amount of the project. If the developer misstated the total dollar amount of the project, DLSBD would not know.
3. DSLBD is not always informed of the final agreement entered into between the District and the developer. Without this knowledge, DSLBD cannot verify the total dollar amount of the work or any other identifying details about the project.
4. DSLBD does not have a process in place to update SBE goals should there be a change to the agreement between the District and the developer. For example, if the scope of a project changes, particularly if the contract value increases, DSLBD may not be aware of the resulting change in subcontracting requirements for the project.

Planning and Budgeting

