Building Integrity:
Preventing and Avoiding MWBE Fraud in New York
BUILDING INTEGRITY:

PREVENTING AND AVOIDING M/WBE FRAUD IN NEW YORK

April 4, 2016

Presented to the Columbia Law School, Center for the Advancement of Public Integrity, by Louis Coletti, President & CEO: Building Trades Employers’ Association
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Over 7 years ago, Building Trades Employers’ Association issued a report called “A Blueprint for Successful Growth” regarding MWBE Businesses. Here were the barriers that this report identified:

1. THE M/WBE CONTRACTOR CERTIFICATION & QUALIFICATION PROCESS IS BURDENSOME, TIME CONSUMING & FAILS TO ACHIEVE THE PRIME OBJECTIVES OF BOTH M/WBE & PRIME CONTRACTORS.

2. M/WBE CONTRACTORS LACK ACCESS TO FINANCIAL & WORKING CAPITAL WHICH LIMITS OPPORTUNITIES FOR CONTRACT AWARDS.
Over 7 years ago, Building Trades Employers’ Association issued a report called “A Blueprint for Successful Growth” regarding MWBE Businesses. Here were the barriers that this report identified: (continued)

3. **M/WBE CONTRACTORS ARE UNABLE TO OBTAIN PERFORMANCE OR PAYMENT BONDS BECAUSE OF THE LACK OF FINANCIAL CAPITAL**

4. **MWBE’S ARE UNABLE TO OBTAIN OR AFFORD GENERAL LIABILITY INSURANCE BECAUSE OF THE 240 SCAFFOLD LAW & ITS STRICT LIABILITY PROVISION**
Major Causes of M/WBE Fraud

- The Certification Process
- Limited information about M/WBE Qualifications on City/State Certification Lists
- The City & State Legislative/Regulatory Framework
M/WBE Fraud: A Public Works Scam

“Corruption and Racketeering in the New York City Construction Industry
The Final Report of the New York State Organized Crime Taskforce,
December 1989”

“While M/WBE or LBE Programs have laudable goals, they have been plagued by fraud. In 1984, the State Commission of Investigation concluded that illegitimate M/WBE Contractors outnumbered legitimate ones.” (P. 111-112)
**Fundamental Deficiencies of the Certification Process**

- New York City & New York State use different Commodity Codes in classifying M/WBE Contractors by type of Construction Work
  
  **NYC:** National Institute of Government Policy  
  **NYS:** State Industry Classification

- Compliance with the Commercially Useful Function Standard – A Public or Private Responsibility?  
  Does not provide information to assist Prime Contractors in determining the capacity of an M/WBE firm to perform a scope of work
The Legislative/Regulatory Environment And M/WBE Fraud

NYC Local Law 1
Requires M/WBE suppliers to “Supply & Install” in order for Prime Contractors to count participation towards the goal.

NYS Executive Order 15A
Allows Prime Contractors to receive credit towards achieving the M/WBE goal by counting:

1) Contractors Participation
2) Suppliers Participation
3) Brokers to purchase Materials/Supplies

Regulatory Public Agency Framework
Liquidated Damage contract clauses for the failure to attain M/WBE Goals

Poor performance rating for prime contractors who fail to achieve goals in being considered for their next bid

Lack of consistency and clarity in defining acceptable “Best Efforts” to achieve goals
Potential Solutions to Reduce M/WBE Fraud

1) Provide City/State Agencies sufficient financial resources to ensure M/WBE Firms on certification lists are, in fact, in full compliance with M/WBE Ownership Requirements.

   - Manhattan District Attorney Grand Jury Report on reform to assist M/WBE Programs: November 24, 2014

Provide a “Commercially Useful Function” Indemnification to prime contractors if they hire Firms from Agency Certification lists that are later proven to be fraudulent.

2) Amend the NYS Procurement law to require prequalification of all City/State M/WBE’s:

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3) Amend NYS Executive Order 15A, and eliminate the M/WBE Credit for suppliers and brokers.

4) Provide clear and consistent procedures for determining best efforts and grant waivers in all cases where the procedure is followed and goals can’t be achieved.

5) Eliminate Liquidated Damage Contract Clauses and negative Contractor reviews which affect future bidding opportunities.

6) Provide incentives rather than penalties in seeking to achieve/exceed goals.

7) Administer NYC/NYS M/WBE Programs consistent with the law based on the Croson V Richmond US Supreme Court ruling which states that M/BWE goals be “Aspirational”.
Best Practices for Compliance Programs

Presented by Jack A. Callahan, CPA
Partner, Construction Industry Practice Leader
CohnReznick LLP

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Our mission:
To help our construction clients grow and succeed by providing insight, ideas, and advice driven by our construction industry expertise.

We strive to deliver forward-thinking solutions based on our understanding of the construction business environment and provide tailored services to help our clients meet their business objectives.

Who we serve:
CohnReznick provides services to a broad cross-section of the construction industry:

- General contractors
- Alternative energy contractors
- Specialty contractors
- Engineering and architecture firms
- Construction management firms
- Heavy highway contractors
- Construction joint ventures
- Builders and real estate developers

Quick Facts On CohnReznick’s Construction Industry Practice

- One of the nation’s largest construction accounting practices
- More than 100 professionals with construction expertise
- Serve hundreds of clients across all major construction segments
- Established fiscal controls for many of the country’s largest projects

April 2016
SPEAKERS BIOGRAPHY

Jack Callahan, CPA, Partner, Construction Industry Practice Leader

- Over 30 years of experience providing attest services to construction companies
- Services clients in most specialties, including: general contractors, construction management firms, heavy/highway, specialty contractors, engineering firms, and equipment/supply companies
- Has established excellent relationships with the major surety, banking, and legal providers to the industry
- Leads the Firm’s fiscal and integrity monitoring services initiative working with contractors and owners to improve the profitability, safety, and integrity of construction projects
- Member of the Construction Financial Management Association, Association of General Contractors, and the Utility Transportation Contractors Association
• Compliance Programs
  • Civil and criminal exposures to both prime contractors and minority contractors
  • Identify FAR requirements
  • Compliance program overview
  • M/W/DBE compliance best practices
The 2007 FAR amendment required government contractors and subcontractors, with contracts over $5 million, and a performance period of 120 days or more to:

• Have a written code of ethics and business conduct
• Establish an employee awareness and training program to support the code of ethics and business conduct
• Implement an internal controls system; and
• Display a federal agency fraud hotline poster or establish an internal employee reporting process
FAR REQUIREMENTS - SPECIFIC GUIDANCE ON INTERNAL CONTROL SYSTEMS

Although the 2007 FAR Amendment required federal contractors to implement an internal control system, it provided limited guidance on the details of such a system. In contrast, the 2008 FAR Amendments mandate specific characteristics for an internal controls system as follows:

• Establish standards and procedures to facilitate timely discovery of improper conduct in connection with government contracts
• Ensure that corrective measures are promptly instituted and executed
• Assign responsibility to a high-ranking individual at the company with sufficient resources to ensure the effectiveness of the business ethics and compliance program
• Prevent individuals who previously violated the company’s code of ethics and business conduct from serving in senior leadership positions
• Include a periodic audit and review of the company’s business practices, procedures, and policies for compliance with the code of ethics and business conduct and other government contracting requirements.
THE CONSEQUENCES OF NON-COMPLIANCE

- Breach of public and/or shareholder trust
- Increased media scrutiny and a tainted company image
- Impact the company’s ability to successfully manage future projects
- Inability to obtain bonds
- Inability to bid on public projects
- Fines and jail time
- **Protect Yourself – Take active measures to prevent fraud!**
IDENTIFY AND EXPLAIN THE APPLICABLE RULES

• Simply handing out a copy of the Code of Federal Regulations or State laws is not a “best practice”
• “Best Practice” is:
  • Explaining the purpose, meaning, and intent of the law in “plain language”
  • Providing guidance on how to interpret and apply the rules
  • Using “real life” examples to illustrate application of the rules
  • Assign responsibility to specific individuals
DOCUMENT COMPLAINECE

- Compliance with all program requirements is NOT enough
- Programs must be verifiable and auditable
- PROOF of compliance is the difference between a good M/W/DBE and a BEST PRACTICES program
TRAINING IS CRITICAL

- Ignorance of the law is not an excuse
- Rules are always changing
- There are many gray areas
- Who and when to train
- New hires
- New projects
- Workers promoted
- Workers assigned new responsibilities
A “best practices” M/W/DBE compliance program is:

- Set forth **IN DETAIL IN WRITING** in the company’s Policies and Procedures Manual
- An **INTEGRATED** set of policies, practices, and procedures which assure that an organization complies with applicable rules and regulations
SCREENING OF M/W/DBEs

- **CAVEAT:** Certification by agency is no guaranty that M/W/DBE is in compliance with all applicable rules and regs
- Due Diligence is **MANDATORY**
- Confirm that the M/W/DBE contractor is listed in the applicable M/W/DBE directory
- Obtain all available information necessary to VERIFY entity is in compliance with qualification rules and regs.
  - E.g., ownership, revenue and income requirements
- Verify M/W/DBE is operating under the NAICS codes for which it was certified
- When possible, interview interested firms in-person
- Visit M/W/DBE place of business and inspect facilities
- “**Best Practices**” **Note:** If possible, assign someone F/T to interview M/W/DBEs, inspect M/W/DBE facilities and monitor commercially useful function (“CUF”)
ACTION STEPS FOR A DISADVANTAGED BUSINESS

• Prepare a binder or electronic file to include:
  • Copies of all your agency certifications
  • Your company history when formed
  • Your corporate organization chart
  • Work history type and size of work
  • Agency prequalification letters
  • Certificates of participation in programs
  • Pictures of facilities, equipment, job sites
  • Letters of recommendation

• Document your outreach efforts
  • Events attended
  • Contacts made need names and dates
  • Follow up
A DBE performs a commercially useful function (CUF) when it is:

"Responsible for execution of the work of the contract or a distinct element of the work . . . by actually performing, managing, and supervising the work involved."

DBE participation credit may only be taken when the DBE is performing a CUF

“Best practices” employs a multi-faceted approach utilizing:
- Document reviews
- Documented field observations
- Worker interviews
- Audits
- Technology
COMMERCIAL USEFUL FUNCTION

“BEST CUF PRACTICES”

• **Observe performance** of work by M/W/DBE subcontractors on a regular basis

• **Verify** M/W/DBE’s management and supervision of work

• **Identify** the labor, equipment, materials, and supplies used to perform the work

• **Interview** workers/truckers/dealers/manufacturers as necessary to verify the performance of CUF

• **Visit/inspect** offices, storage facilities, and physical plant of Dealers/Manufacturers

• **Document** observations/findings with daily reports, checklists and photographs as much as possible
## KEY ISSUES

### Management
- Does the M/W/DBE manage and supervise its work with its own managers and superintendents, including:
  - Negotiating contracts;
  - Scheduling the work;
  - Ordering equipment and materials;
  - Preparing and submitting paychecks/certified payrolls;
  - Hiring and firing workers

### Supervision
- Does the M/W/DBE supervise daily operations?
- Does the M/W/DBE have a full time, skilled and knowledgeable superintendent on-site?
- Is the superintendent employed by and paid wages by the M/W/DBE?
- Is the superintendent acting independently of the prime contractor?
- Note: Mere performance of administrative duties is not considered supervision of daily operations.

### Labor
- Did the M/W/DBE perform the work with its own employees?
- Did the M/W/DBE use the workforce of the prime contractor or any non-M/W/DBE company?
- Did the M/W/DBE subcontract any of its work to a non-M/W/DBE?
- Did the M/W/DBE utilize employees or former employees of the prime contractor?

### Equipment
- Did the M/W/DBE utilize its own equipment, materials, and supplies to perform the work?
- Did the M/W/DBE rent/lease equipment from the prime contractor or any non-M/W/DBE?
- Does the equipment have the M/W/DBEs markings or signs?
- Is the operator of the leased equipment the DBE’s employee?
- Did the M/W/DBE pay for the materials and supplies?
TAKEAWAYS - SIMPLY BEING GOOD, ISN’T GOOD ENOUGH

To Demonstrate “Best Practices”:

- Have an integrated set of detailed policies and procedures contained in a user-friendly Manual
- Train employees regularly
- Dedicate someone F/T to verify M/W/DBE _bona fides_ & CUF
- Use forms/checklists
- Integrate technology
- Document adherence with program procedures so compliance can be verified
- Communicate with agencies regularly
- Periodically audit compliance with “best practices” and industry standards by hiring a reputable M/W/DBE program consultant
**GOOD FAITH EFFORTS**

49 CFR § 26.53

- **Good Faith Efforts (GFE)** are **MEANINGLESS** unless they can be verified
  - Agency **CANNOT IGNORE** *bona fide* good faith efforts
  - Agency **CAN IGNORE** *bona fide* good faith efforts that are not provable
- Requires **PROOF** that:
  - Contractor took all necessary and reasonable steps to achieve a DBE goal which, by their scope, intensity, and appropriateness to the objective, could reasonably be expected to obtain sufficient DBE participation, even if not fully successful
  - *Pro forma* efforts are not good faith efforts

29 April 2016
DEMONSTRATING GFE

• **ADVERTISING** in newspapers, industry publications, trade papers, and minority focus publications, e.g., *ENR News Record, Minority Commerce Weekly, Minority Directory*
  - Maintain copies of all advertisements, announcements, notices in publications

• **Direct Solicitation:**
  - Written notices delivered via fax, text or email utilizing automated messaging systems, e.g., EZ Link
  - Voice messaging via telephone or automated voice messaging systems
    • Must allow sufficient time for DBEs to respond - record times and dates of invitation/inquiry
    • Follow-up required - Must determine with certainty if DBEs are interested – Need to get a “Yes” or “No”
DEMONSTRATING GFE

- **Attendance at pre-bid meetings**
  - Retain copies of invitations to meetings, sign-in/out sheets, video
- **Document Attendance at Outreach Events, Job Fairs, etc.**
  - If a sponsor, maintain copies of promotional materials with your company’s name/logo
  - Get copies of business cards from visitors to your booth/table
  - Have visitors sign a log and provide contact info for follow-up
DEMONSTRATING GFE

- Use of MWDBE community organizations, MWDBE contractors' groups, local, state, and Federal MWDBE assistance offices to reach out to DBEs
  - Keep in regular contact with such organizations and maintain a records of all communications with them

- Providing DBEs with adequate information about the plans, specifications, and requirements of the contract in a timely manner for no or reduced fee
  - Provide link to virtual document room, SharePoint site, etc.
  - Maintain copies of transmittals
  - Maintain sign-in/out sheets for access to document library
THANK YOU

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WHY COHN REZNICK?

- Nearly 100 years helping our clients manage and grow their business
- A commitment to client service and business insight as evidenced by our client service plan
- Technical expertise from dedicated engagement teams with active partner leadership and attention help clients strengthen relationships with the surety, banking, and legal communities
- A multi-disciplinary team of approximately 200 accounting, tax, and consulting professionals with in-depth knowledge of the construction industry as demonstrated by our many long-term client relationships
- The resources and commitment to excellence of a Big Four firm delivered in the streamlined structure of a leading nationally recognized firm. High staff retention permits engagement team continuity and links our efforts to learn your business to personalized and efficient service
- International reach and experience in over 100 countries
- Unmatched integrity and earned trust and confidence of our construction clients, the financial community, and our professional staff
Providing Solutions to M/WBE Issues

Presented by Liz Duncan-Gilmour, Esq. Executive Director
MISSION STATEMENT

Minority Business Development Institute (MBDI) assists the minority contractor population to develop socio-economic parity by solving business issues that create barriers to success.
Give a man a fish and you feed him for a day
Teach a man to fish and you feed him for a lifetime.

Chinese Proverb
Since 2009 The MBDI Team has:

- Mentored 273 emerging contractor firms
- Instructed 165 bonding/financial literacy & construction mentorship courses
- Provided bonding for 47 firms
- Obtained $126 million in surety credit for contractors
Does the current system incentivize cheating?

Prime contractors claim they can’t find qualified M/WBE subs

M/WBEs often can’t access Capital or Bonding to support public work

Majority firms sometimes don’t want to implement change or find qualified M/WBEs
MBDI Philosophy

- We believe in a leg up – not a hand out.
- Through education and hard work, emerging contractors can become credit worthy and bondable.
- Once credit worthy, contractors can realize opportunities for advancement that would not otherwise be possible.
Education for Change

- MBDI’s *educational platform* helps to create the sustainable systemic change necessary for *small* minority, woman and veteran owned businesses to qualify for bonding.

- Bonded contractors are better run businesses that have more opportunities for success.
New jobs created lead to potential wealth creation

Development of new Prime Contractors

Enhances economic revitalization in areas

New Prime Minority Contractors hire in local communities

Leads to job creation and growth

MBDI Goals

MBDI Education Programs
MBDI Results Oriented Approach

- Education
- One on One Consultations
- Partnerships with CDFIs, Banks and SBA to provide access to capital
- Creation of contract opportunities with/through various city, state and federal government/agencies
MBDI Educational Platform

Accounting & QuickBooks

Legal Issues

Underwriting Criteria

Project Management (Bidding, Estimating, Cash Flow Analysis)

Back Office (Scheduling, HR issues)
Program Overview

- Intensive Classroom studies with real time access options – Holland & Knight, Travelers, Liberty, Berkeley Surety, Cohn Reznick, Santander Bank etc. provide subject matter expertise and/or space for classes.

- One-on-one Strategic Consulting helps owners to achieve sustainable systemic change

- Continued follow-up keeps forms on track to optimize results
Invest in Parity for M/WBEs

- Build an online network of bondable, bankable contractors

- Presently we train 30-40 contractors at a time – we would like to expand this number – and expand scope of services

- Agencies and Primes, Unions – sponsor education programs! Unbundle projects to get M/WBES going!

- Use M/WBE goals to incentivize change – fines and penalties can pay for training
Thank you!

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