



ARLENE BARRERA
AUDITOR-CONTROLLER

COUNTY OF LOS ANGELES DEPARTMENT OF AUDITOR-CONTROLLER

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June 15, 2020

TO: Joseph M. Nicchitta, Director
Department of Consumer and Business Affairs

Selwyn Hollins, Acting Director
Internal Services Department

FROM: Robert G. Campbell, Chief
Office of County Investigations

SUBJECT: **IMPROVEMENT OPPORTUNITIES NOTED DURING LIMITED REVIEW
#2015-10649**

NUMBER OF RECOMMENDATIONS
PRIORITY 1 2 CORRECTIVE ACTION REQUIRED WITHIN 90 DAYS
PRIORITY 2 4 CORRECTIVE ACTION REQUIRED WITHIN 120 DAYS
PRIORITY 3 0 CORRECTIVE ACTION REQUIRED WITHIN 180 DAYS

During a limited review at the Internal Services Department (ISD), and during various other limited reviews involving multiple County Departments, we noted areas where the Department of Consumer and Business Affairs (DCBA) and ISD can strengthen internal controls over the Local Small Business Enterprise Preference Program. Please see Attachment I, Table of Findings and Recommendations for Corrective Action, for details of our observations and recommendations.

Review of Report

We discussed our report with DCBA and ISD management. The Departments' responses (Attachments II and III) indicate general agreement with our findings and recommendations.

We thank ISD and DCBA management and staff for their cooperation and assistance during our review. If you have any questions please call me at (213) 893-0058, or your staff may contact Greg Hellmold at (213) 893-0243.

RGC:GH:SL:glS

Attachments (3)

c: Arlene Barrera, Auditor-Controller
Audit Committee
Audit Division

REPORT #IOR-2015-10649

LOS ANGELES COUNTY AUDITOR-CONTROLLER

Attachment I
Page 1 of 4

Peter Hughes
ASSISTANT AUDITOR-CONTROLLER

Robert G. Campbell
DIVISION CHIEF

Office of County Investigations

Report #IOR-2015-10649

**DEPARTMENT OF CONSUMER AND BUSINESS AFFAIRS
INTERNAL SERVICES DEPARTMENT
IMPROVEMENT OPPORTUNITIES NOTED DURING LIMITED REVIEW #2015-10649**

BACKGROUND

In Fiscal Year 2018-19, the County Local Small Business Enterprise (LSBE) Preference Program assisted 731 vendors in receiving 141,353 procurement awards totaling over \$575 million. We have seen repeated abuses of the program and fraudulent activities by LSBEs, sometimes in coordination with County employees. This had the effect of preventing legitimate LSBE and non-LSBE vendors from competing for and obtaining County business, and resulted in losses to the County in the form of additional unnecessary, illegitimate and illegal, non-value added costs. These fraudulent procurements fundamentally compromised the County's competitive purchasing process and violated County and ISD procurement policies. The Department of Consumer and Business Affairs (DCBA) and Internal Services Department (ISD) can reduce the likelihood of future abuses and fraud by strengthening internal controls as we recommend in this report.

TABLE OF FINDINGS AND RECOMMENDATIONS FOR CORRECTIVE ACTION

	ISSUE	RECOMMENDATION
1	<p>Certification of LSBE Vendors – The County's process for certifying LSBE vendors does not provide sufficient assurance that the certified LSBEs are legitimate businesses, or that vendors receiving preferential treatment when obtaining County awards under the LSBE program perform a "commercially useful function" as required by County Code (CC) Section (§) 2.204 (et seq).</p> <p>We noted several examples where LSBE vendors systematically abused the Preference Program to fraudulently obtain County business, via a number of departments, by purporting to be legitimate providers of goods and services, but serving only as pass-through entities (i.e., intermediaries or extra participants in the transaction that do not add value or serve a commercially useful function) to create the appearance that the transactions were with a qualifying LSBE. This expressly violates the County Code. Some of these purchases were facilitated by County employees in exchange for kick-backs. These improper transactions resulted in unnecessary markups to the County of as much as 200% compared to prices commonly available from legitimate vendors for the same goods and services, without providing any additional value.</p> <p>Impacts:</p> <ul style="list-style-type: none"> Undermines the Board's intent and the provisions of CC § 2.204 Defeats the intended purpose and jeopardizes the continued viability of the LSBE program 	<p>Priority 1 – DCBA, in consultation with ISD and County Counsel, strengthen the LSBE vendor certification process to provide reasonable assurance that vendors receiving preferential treatment under the LSBE program meet ordinance and program requirements, such as having a legitimate principal place of business and serving a commercially useful function.</p> <p>Department Response: Agree Implementation Date: August 2020</p>

Priority Ranking: Recommendations are ranked from Priority 1 to 3 based on the potential seriousness and likelihood of negative impact on the Agency's operations if corrective action is not taken.

TABLE OF FINDINGS AND RECOMMENDATIONS FOR CORRECTIVE ACTION		
	ISSUE	RECOMMENDATION
	<ul style="list-style-type: none"> • May challenge continued funding from certain program sources • Reduced opportunities for legitimate small businesses to obtain County awards • Increased County costs from unaccountable markups • Reduced accountability and limited recourse to address product and service quality • Increased risk of fraud 	
2	<p>Suspension/Revocation of LSBE Certification – The County does not have any process to suspend or revoke the LSBE certifications of vendors that violate program provisions and ordinance requirements. Non-compliant vendors retain the benefits of LSBE certification, including pricing preferences and reduced competition.</p> <p>While LSBE vendors may be debarred, that is a lengthy process and does not appear to serve as a meaningful deterrent to program abuse, nor does it protect departments from continued use of non-compliant vendors that have not been debarred. County Counsel indicated that until a procedure is developed and put in place to provide LSBEs with due process, the County may not suspend a vendor's certification and access to LSBE program benefits without going through the vendor debarment process.</p> <p>Impacts:</p> <ul style="list-style-type: none"> • Reduced program integrity and accountability since non-compliant vendors retain the benefits of certification 	<p>Priority 1 – DCBA, in consultation with ISD and County Counsel, establish a process to promptly suspend and/or revoke the LSBE certifications of vendors that violate one of the Preference Program's requirements.</p> <p>Department Response: Agree Implementation Date: August 2020</p>
3	<p>LSBE Conflicts of Interest – During the LSBE certification process, the County does not put vendors on notice or make it abundantly clear that they must adhere to County conflict of interest and gratuity policies or require prospective LSBEs to disclose relationships or potential conflicts with County employees or other vendors. We noted examples of various significant conflicts involving LSBE vendors, including:</p> <ul style="list-style-type: none"> • LSBE principals/owners that have familial, personal and/or financial relationships with County procurement decisionmakers, and who engaged in conflicted transactions • A single individual owning/operating and/or controlling multiple LSBEs, directly or through family members, to rig bids and create the appearance of a competitive process <p>Impacts:</p> <ul style="list-style-type: none"> • Reduced program integrity and accountability • Loss of opportunities for legitimate small businesses due to rigged bids 	<p>Priority 2 – DCBA, in consultation with ISD and County Counsel, establish formal conflict of interest disclosure requirements as part of the LSBE certification process, including the obligation of LSBEs to report potential conflicts, such as financial, familial or other relationships with County procurement decision-making personnel and other County vendors. The requirements should specify sanctions for engaging in conflicted transactions and/or failing to disclose conflicts, such as revocation of LSBE certification, debarment, civil liability for false claims, and criminal prosecution.</p> <p>Department Response: Agree Implementation Date: September 2020</p>

Priority Ranking: Recommendations are ranked from Priority 1 to 3 based on the potential seriousness and likelihood of negative impact on the Agency's operations if corrective action is not taken.

TABLE OF FINDINGS AND RECOMMENDATIONS FOR CORRECTIVE ACTION		
	ISSUE	RECOMMENDATION
	<ul style="list-style-type: none"> Increased risk of improper transactions resulting in additional and unnecessary costs to the County 	
4	<p>LSBE Vendor Acknowledgement of Program Requirements – The County does not require LSBE vendors to acknowledge they received, understand, and agree to comply with program requirements (e.g., that LSBEs must perform a commercially useful function), policies on prohibited conduct, and/or sanctions for non-compliance. LSBE vendors also are not informed of or required to comply with the standard County requirement to report attempted or actual improper solicitations or procurement related misconduct to the Fraud Hotline.</p> <p>In addition, CC § 2.204.080 specifies that “...information furnished by each business requesting a LSBE Preference Program shall be under penalty of perjury,” but LSBE program documents do not describe this provision, or inform LSBEs that quotations, bids, and invoices they submit to the County are subject to this ordinance.</p> <p>Impacts:</p> <ul style="list-style-type: none"> Reduced program integrity and accountability Increased risk of improper purchases and fraud 	<p>Priority 2 – DCBA, in consultation with ISD management, develop a process to ensure that LSBEs are informed of and agree to comply with program requirements at the time of certification and periodically thereafter, and retain documentation of the acknowledgement as part of the vendor’s LSBE certification file.</p> <p>Department Response: Agree Implementation Date: September 2020</p>
5	<p>LSBE Program Compliance Monitoring – The County does not have a systematic plan or process for monitoring LSBE compliance with policies, procedures, and ordinance requirements. Such monitoring, particularly of LSBEs that have significant growth in County procurement activity, can identify vendors which are abusing the program or not performing a commercially useful function.</p> <p>Impacts:</p> <ul style="list-style-type: none"> Reduced program integrity and accountability Increased risk of fraud Reduced likelihood that non-compliant vendors will be detected timely 	<p>Priority 2 – DCBA management establish a risk- and activity-based program to periodically review a sample of LSBE vendors that receive County awards, to provide reasonable assurance that the LSBE program is functioning as intended and achieving its goals and objectives. This should include determining whether vendors are performing a commercially useful function and complying with other significant policies and program requirements.</p> <p>Department Response: Agree Implementation Date: September 2020</p>

TABLE OF FINDINGS AND RECOMMENDATIONS FOR CORRECTIVE ACTION		
	ISSUE	RECOMMENDATION
6	<p>Promoting LSBE Program Integrity – The County has a variety of administrative and legal remedies (e.g., placement in the Contractor Alert Reporting Database, Debarment, Administrative Fines, Civil Litigation) to promote integrity in purchasing and procurement and address contractor/vendor misconduct. However, these remedies are not consistently applied by all County departments to vendors participating in the LSBE Preference Program.</p> <p>Since the LSBE program has the effect of reducing the principal mechanism within the procurement process – competition – that the County relies upon to ensure that it receives fair value for goods and services purchased, vendors that receive such preferential treatment by participating in the program should be held to a high standard of business integrity and compliance.</p> <p>Impacts:</p> <ul style="list-style-type: none"> • Reduced program integrity and accountability • Increased risk of fraud • Misconduct and violations of program requirements are incentivized, harming compliant vendors 	<p>Priority 2 – DCBA, in consultation with ISD, consider revising existing guidelines and/or developing a new policy applicable to the LSBE program to ensure that administrative and legal remedies are pursued consistently by all County departments when an LSBE is found to have violated program requirements. DCBA should also evaluate applying the new policy to other preference programs it administers.</p> <p>Department Response: Agree Implementation Date: September 2020</p>

For more information on our auditing process, including recommendation priority rankings, the follow-up process, and management's responsibility for internal controls, visit auditor.lacounty.gov/audit-process-information.

Priority Ranking: Recommendations are ranked from Priority 1 to 3 based on the potential seriousness and likelihood of negative impact on the Agency's operations if corrective action is not taken.



BOARD OF SUPERVISORS

Hilda L. Solis
Mark Ridley-Thomas
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COUNTY OF LOS ANGELES
**DEPARTMENT OF CONSUMER
AND BUSINESS AFFAIRS**

"To Enrich Lives Through Effective and Caring Service"



Joseph M. Nicchitta
Director

Joel Ayala
Chief of Staff

Rafael Carbajal
Chief Deputy

May 12, 2020

To: Robert G. Campbell
Chief, Office of County Investigations
Department of Auditor-Controller

From: Joseph M. Nicchitta
Director

A handwritten signature in blue ink, appearing to be "J. Nicchitta", written over the printed name of the Director.

**SUBJECT: RESPONSE TO AUDITOR-CONTROLLER FINDINGS AND
RECOMMENDED CORRECTIVE ACTIONS – REPORT #2015-10649**

The Department has reviewed the Auditor-Controller's report and agrees with the findings and recommendations. Attached is the Department's plan of corrective action.

Should you have any questions concerning this matter, please contact Azusena Favela, Deputy Director, at 213-974-0133 or afavela@dcba.lacounty.gov, or Christian Olmos, Program Chief, at 213-626-9407 or colmos@dcba.lacounty.gov.

Attachment

DEPARTMENT OF CONSUMER AND BUSINESS AFFAIRS
IMPROVEMENT OPPORTUNITIES NOTED DURING LIMITED REVIEW #2015-10649
DEPARTMENT ACTION PLAN/RESPONSE

ISSUE 1: CERTIFICATION OF LSBE VENDORS	
A/C Recommendation	DCBA, in consultation with ISD and County Counsel, strengthen the LSBE vendor certification process to provide reasonable assurance that vendors receiving preferential treatment under the LSBE program meet ordinance and program requirements, such as having a legitimate principal place of business and serving a commercially useful function.
Priority	PRIORITY 1
Agree/Disagree	Agree
Department Action Plan¹	<p>DCBA in consultation with County Counsel, developed a Commercially Useful Function certification form. Certified local small business enterprises (LSBEs) bidding on County contracts wishing to receive a bid preference will need to acknowledge, under penalty of perjury, that they understand and meet each element of the commercially useful function requirement along with a written statement. This form will also require that the department buyer/procurement officer review and sign the form confirming that the bidder:</p> <ol style="list-style-type: none"> 1. Did or did not fill out the form completely; 2. Will provide a commercially useful function based on the information submitted; and 3. Apply or not apply the 15% bid preference accordingly. <p>DCBA will also implement an eligibility review process to review certified businesses who have been awarded a County contract to ensure that the business continues to meet the employee size, revenue size, and principal place of business requirement of our LSBE preference program, only. The reviews will be based on indicators of risk, including, but not limited to, a large number of awards below a certain threshold (indicating the business may be colluding with an employee to avoid internal departmental review requirements); and awards for goods or services that appear unrelated or inconsistent, or are not within the usual scope for a business of a similar type (indicating that the business may be using its certification to "broker" goods and services for other non-certified entities). These and other risk criteria will be established in guidelines issued by DCBA, should the Board adopt a proposed ordinance amendment authorizing DCBA to issue such guidelines.</p> <p>Additionally, DCBA is working with County Counsel to finalize a Board letter and ordinance amendment to implement additional safeguards in the event of noncompliance, including: (1) expressly authorizing DCBA to</p>

¹ In this section the Department should only describe the efforts they plan to take to implement the recommendation. The Department should include any other information in the Additional Information section that follows.

² In this section the Department can provide any background or clarifying information they believe is necessary.

ISSUE 1: CERTIFICATION OF LSBE VENDORS	
	investigate certain allegations of noncompliance; (2) authorizing the revocation of a certification for noncompliance; and (3) establishing an appeals process, whereby a certified business can appeal DCBA's finding that the business did not comply with the LSBE program parameters.
Planned Implementation Date	August 12, 2020
Additional Information (optional)²	The CUF certification form has been developed, DCBA will work with ISD to finalize, and implement. Because compliance with the commercially useful function is connected to the delivery of goods and services, the contracting department is in the best position to monitor the LSBE's performance, or lack of performance, on a contract or procurement. Therefore, any initial review of an LSBE's commercially use function should be the responsibility of the contracting department.

ISSUE 2: SUSPENSION/REVOCATION OF LSBE CERTIFICATION	
A/C Recommendation	DCBA, in consultation with ISD and County Counsel, establish a process to promptly review an LSBEs status if there are allegations of noncompliance with the preference program requirements.
Priority	PRIORITY 1
Agree/Disagree	Agree
Department Action Plan¹	<p>DCBA has implemented a complaint process to review a department's allegation that a business is not in compliance with LSBE program requirements. Departments can submit a formal complaint, via a complaint form, along with supporting documentation for formal review. Complaints are now being reviewed by DCBA's Consumer Investigations Unit, which is a separate division from DCBA's certification team to ensure there are no conflicts of interest. The Consumer Investigations Unit has in-depth experience conducting investigations at the level necessary to effectively evaluate allegations that the LSBE's preference program requirements have been violated.</p> <p>DCBA is working with County Counsel to finalize a Board letter and ordinance amendment to implement additional safeguards in the event of noncompliance, including: (1) expressly authorizing DCBA to investigate certain allegations of noncompliance; (2) authorizing the revocation of a certification for noncompliance; and (3) establishing an appeals process, whereby a certified business can appeal DCBA's finding that the business did not comply with the LSBE program parameters.</p>

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ISSUE 2: SUSPENSION/REVOCATION OF LSBE CERTIFICATION	
Planned Implementation Date	August 12, 2020
Additional Information (optional)²	DCBA also recommends that departments pursue all administrative and legal remedies against contractors and LSBEs that are found to have violated program requirements. This would include actions to recover payment and debarment proceedings which go beyond just revocation of LSBE certifications. Debarment is a powerful tool used by all government jurisdictions to protect taxpayers from potential waste, fraud and abuse by prohibiting the award of new contracts or grants to individuals and businesses that are bad actors. This debarment tool should be used consistently by each department in the enforcement of the LSBE program parameters.
ISSUE 3: LSBE CONFLICTS OF INTEREST	
A/C Recommendation	DCBA, in consultation with ISD and County Counsel, establish formal conflict of interest disclosure requirements as part of the LSBE certification process, including the obligation of LSBEs to report potential conflicts, such as financial, familial or other relationships with County procurement decision-making personnel and other County vendors. The requirements should specify sanctions for engaging in conflicted transactions and/or failing to disclose conflicts, such as revocation of LSBE certification, debarment, civil liability for false claims, and criminal prosecution.
Priority	PRIORITY 2
Agree/Disagree	Agree
Department Action Plan¹	DCBA is working with County Counsel to finalize a Board letter and ordinance amendment to implement additional safeguards in the event of noncompliance, including conflicts-of-interest requirements and disclosures. DCBA will incorporate appropriate conflict-of-interest disclosures during the certification process, as well.
Planned Implementation Date	September 12, 2020

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ISSUE 3: LSBE CONFLICTS OF INTEREST	
Additional Information (optional) ²	<p>The conflicts-of-interest provisions in existing code and in DCBA's proposed ordinance amendment must be policed and enforced by each department to be effective. Existing conflict-of-interest disclosures to which County employees must adhere have not deterred County employees from facilitating improper transactions as noted in recent cases conducted by the Office of County Investigations.</p> <p>DCBA therefore recommends that County departments incorporate additional layers of vetting during the purchasing and contracting process, including but not limited to evaluating the number of purchases and contracts entered into each quarter by each departmental purchasing agent to identify suspicious data and trends. This would ensure that additional safeguards are in place that would deter County employees from facilitating improper purchases in the future.</p>

ISSUE 4: LSBE VENDOR ACKNOWLEDGEMENT OF PROGRAM REQUIREMENTS	
A/C Recommendation	DCBA, in consultation with ISD management, develop a process to ensure that LSBEs are informed of and agree to comply with program requirements at the time of certification and periodically thereafter, and retain documentation of the acknowledgement as part of the vendor's LSBE certification file.
Priority	PRIORITY 2
Agree/Disagree	Agree
Department Action Plan ¹	DCBA will develop educational materials including, but not limited to, providing businesses a commercially useful function FAQ, copy of the policy and sanctions, as well as the County's fraud hotline at the time of certification. DCBA may also include this information as part of our standard public presentations. Lastly, DCBA will identify a process to retain evidence that the LSBE has acknowledged and accepted the program requirements and disclosures.
Planned Implementation Date	September 12, 2020
Additional Information (optional) ²	

ISSUE 5: LSBE PROGRAM COMPLIANCE MONITORING	
A/C Recommendation	DCBA management establish a risk- and activity-based program to periodically review a sample of LSBE vendors that receive County awards, to provide reasonable assurance that the LSBE program is functioning as intended and achieving its goals and objectives. This should include determining whether vendors are performing a commercially useful function and complying with other significant policies and program requirements.
Priority	PRIORITY 2
Agree/Disagree	Agree

¹ In this section the Department should only describe the efforts they plan to take to implement the recommendation. The Department should include any other information in the Additional Information section that follows.

² In this section the Department can provide any background or clarifying information they believe is necessary.

ISSUE 5: LSBE PROGRAM COMPLIANCE MONITORING	
Department Action Plan¹	DCBA will implement a process to review certified businesses who have been awarded a County contract to ensure that the business continues to meet the employee size, revenue size, and principal place of business requirement of our LSBE preference program. The reviews will be based on indicators of risk, including, but not limited to, a large number of awards below a certain threshold (indicating the business may be colluding with an employee to avoid internal departmental review requirements); and awards for goods or services that appear unrelated or inconsistent, or are not within the usual scope for a business of a similar type (indicating that the business may be using its certification to “broker” goods and services for other non-certified entities). These and other risk criteria will be established in guidelines issued by DCBA, should the Board adopt a proposed ordinance amendment authorizing DCBA to issue such guidelines.
Planned Implementation Date	September 12, 2020
Additional Information (optional)²	Awarding departments must cooperate fully with DCBA’s reviews for these reviews to be performed successful.
ISSUE 6: PROMOTING LSBE PROGRAM INTEGRITY	
A/C Recommendation	ISD, in consultation with DCBA and CoCo consider revising existing guidelines and/or developing a new policy applicable to the LSBE program to ensure that administrative and legal remedies are pursued consistently by all County departments when an LSBE is found to have violated program requirements. DCBA should also evaluate applying the new policy to other preference programs it administers.
Priority	PRIORITY 2
Agree/Disagree	Agree
Department Action Plan¹	DCBA is working with County Counsel to finalize a Board letter and ordinance amendment to amend the LSBE, Disabled Veteran Business Enterprise, and Social Enterprise preference program ordinances to strengthen each the program’s safeguards. DCBA will support ISD and County Counsel to develop a separate policy that would ensure that administrative and legal remedies are pursued consistently by all County departments when an LSBE is found to have violated program requirements.
Planned Implementation Date	September 12, 2020
Additional Information (optional)²	As the County’s purchasing agent, ISD, is in the best position to issue policies and guidelines that direct departments on procurement and contracting practices.

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² In this section the Department can provide any background or clarifying information they believe is necessary.



SELWYN HOLLINS
Acting Director

**County of Los Angeles
INTERNAL SERVICES DEPARTMENT**

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June 1, 2020

TO: Robert G. Campbell, Chief
Office of County Investigations

FROM: Selwyn Hollins 
Acting Director

**RESPONSE TO AUDITOR-CONTROLLER FINDINGS AND RECOMMENDED
CORRECTIVE ACTIONS – REPORT #2015-10649**

The Department has reviewed the Auditor-Controller's report and agrees with the findings and recommendations. As recommended, we will continue to provide guidance and support to the Department of Consumer and Business Affairs.

If you have any questions, please contact me at (323) 267-2101, or your staff may contact Michael Owh, Purchasing & Contract Services General Manager, at (323) 267 2109, via email: mowh@isd.lacounty.gov.

SH:MO:ct