



**COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER**

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November 1, 2023

TO: Kelly LoBianco, Director
Department of Economic Opportunity

FROM: Greg Hellmold, Chief *Greg Hellmold*
Office of County Investigations

SUBJECT: IMPROVEMENT OPPORTUNITIES NOTED DURING LIMITED REVIEW (REPORT #IOR-2015-10649) – SECOND FOLLOW-UP REVIEW

We completed a second follow-up review of the Local Small Business Enterprise (LSBE) Preference Program (Program) Improvement Opportunities Noted During Limited Review (Report #IOR-2015-10649) issued to the Department of Consumer and Business Affairs (DCBA) and Internal Services Department (ISD) on June 15, 2020. In October 2021, DCBA's functions related to the certification and oversight of LSBEs transferred to the Department of Workforce Development, Aging and Community Services (WDACS) Office of Small Business (OSB). In July 2022, the same functions were subsequently transferred to the newly formed Department of Economic Opportunity (DEO). Accordingly, we inquired with the DEO in conducting our follow-up.

As summarized in Table 1, DEO partially implemented two outstanding Priority 1 and four Priority 2 recommendations. DEO indicated that they are working with ISD and County Counsel to fully implement the six outstanding recommendations as soon as possible.

Table 1 - Results of Second Follow-up Review

RECOMMENDATION IMPLEMENTATION STATUS				
PRIORITY RANKINGS	TOTAL RECOS OUTSTANDING	FINAL OUTSTANDING RECOMMENDATIONS		
		FULLY IMPLEMENTED	PARTIALLY IMPLEMENTED	NOT IMPLEMENTED
PRIORITY 1	2	0	2	0
PRIORITY 2	4	0	4	0
PRIORITY 3	0	0	0	0
TOTAL	6	0	6	0
			6	

For details of our review and the Department's corrective actions, see Attachment.

Between 2015 and the date of this report, the Office of County Investigations (OCI) opened four criminal investigations of procurement fraud involving 13 County vendors who cumulatively received more than \$41.5 million while engaging in improper, conflicted, and fraudulent procurement schemes against the County's LSBE Program. We also received information that seven additional County vendors who the County cumulatively paid more than \$27 million may have also violated LSBE Program requirements. OCI referred these seven vendors to DCBA and subsequently DEO for further review. Two of the seven vendors were found to not meet LSBE Program requirements, while the results for the remaining five are pending.

The recommendations we made in our June 15, 2020 report were developed in consultation with the involved departments to address the fundamental control and business process weaknesses which have repeatedly been exploited by vendors - sometimes in collusion with County employees - to abuse the LSBE Program and defraud the County. Corrective actions are needed to reduce the risk of future abuse of the LSBE Program and to ensure it achieves the goals and objectives established by the Board of Supervisors.

The LSBE Program was transferred from WDACS to DEO's OSB on July 1, 2022. DEO management informed us that they have not fully addressed all our recommendations, as the lengthy Department formation process took priority. We plan to conduct additional follow-up beyond the two normally indicated by our process to ensure that all the recommendations are fully implemented, and that the actions taken result in meaningful and lasting improvements to the LSBE Program.

We thank DEO management and staff for their cooperation and assistance during our review. If you have any questions please contact me at (213) 893-0243 or ghellmold@auditor.lacounty.gov, or your staff may contact Supervising Investigator Kenneth Diaz at (213) 948-2936 or kdiaz@auditor.lacounty.gov.

GH:SL:kd

Attachment

c: Oscar Valdez, Auditor-Controller
Audit Committee
Audit Division

Robert G. Campbell
ASSISTANT AUDITOR-CONTROLLER

Greg Hellmold
DIVISION CHIEF

OFFICE OF COUNTY INVESTIGATIONS

Report #F2-2015-10649

**DEPARTMENT OF ECONOMIC OPPORTUNITY
IMPROVEMENT OPPORTUNITIES NOTED DURING LIMITED REVIEW
(REPORT #IOR-2015-10649)
SECOND FOLLOW-UP REVIEW**

	RECOMMENDATION	A-C COMMENTS
1	<p>Certification of Local Small Business Enterprise Vendors (Priority 1) – Department of Consumer and Business Affairs (DCBA), in consultation with the Internal Services Department (ISD) and County Counsel, strengthen the Local Small Business Enterprise (LSBE) vendor certification process to provide reasonable assurance that vendors receiving preferential treatment under the LSBE Preference Program (Program) meet ordinance and program requirements, such as having a legitimate principal place of business and serving a commercially useful function (CUF).</p> <p>Original Issue/Impact: We noted examples where LSBE vendors systematically abused the LSBE Program to fraudulently obtain County business 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 CUF) to create the appearance that the transactions were with a qualifying LSBE. This violates County Code Section 2.204.030 and decreases opportunities for legitimate small businesses to obtain County procurement awards, and jeopardizes the continued viability of the LSBE Program.</p>	<p>Recommendation Status: Partially Implemented</p> <p>To strengthen the preference vendor certification process, the Department of Economic Opportunity’s (DEO) Office of Small Business (OSB) now requires such vendors to self-certify/attest that they meet LSBE Program requirements. DEO management, in consultation with ISD, developed an update to the County’s LSBE certification portal whereby LSBE applicants attest that they understand and meet the LSBE Program requirements (including that they will provide a CUF on any bid undertaken). The updated certification portal went live on September 30, 2023.</p> <p>In addition, DEO and ISD management indicated that they developed an alternative process to meet the objectives of the recommendation whereby certification of the preference vendor serving a CUF will take place by the departmental procurement officer (buyer) each time they utilize a preference vendor. Although these buyer requirements have not yet been formally established, DEO and ISD trained and notified County procurement managers that they and their staff must now obtain and review a new CUF/vendor attestation form each time they utilize a preference vendor.</p> <p>DEO management also informed us that they host webinars the third Thursday of every month to educate vendors and buyers on CUF and other preference vendor requirements.</p> <p>However, DEO and ISD have not yet created a process to verify information vendors provide in their application for certification (e.g., place of business in Los Angeles County, revenues within the small business threshold, meets ownership test) before admitting them to the County’s preference program.</p> <p>DEO management stated they plan to fully implement this recommendation by June 30, 2024.</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.

	RECOMMENDATION	A-C COMMENTS
2	<p>Suspension/Revocation of LSBE Certification (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 LSBE Program’s requirements.</p> <p>Original Issue/Impact: 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. This reduced the LSBE Program integrity.</p>	<p>Recommendation Status: Partially Implemented</p> <p>DEO OSB management indicated that, in partnership with ISD and County Counsel, they began drafting amendments to the LSBE Program ordinance to: (1) authorize DEO OSB to revoke an LSBE certification for non-compliance; and (2) establish a process whereby certified LSBE vendors can appeal DEO OSB’s findings.</p> <p>DEO OSB anticipates obtaining approval for changes to the LSBE ordinance and implementing the certification revocation and appeal processes by March 31, 2024.</p>
3	<p>LSBE Conflict of Interest (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>Original Issue/Impact: 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. This reduced program integrity and accountability.</p>	<p>Recommendation Status: Partially Implemented</p> <p>DEO OSB management indicated that they worked with County Counsel to develop a description of the County’s existing conflict of interest disclosure requirements. DEO OSB created conflict of interest and CUF disclosures which LSBE certification applicants must acknowledge as part of the County’s certification process. The acknowledgment is obtained under penalty of perjury and is collected electronically via the LSBE application portal and County procurement managers were instructed to obtain an updated conflict of interest disclosure each time a preference vendor is utilized.</p> <p>However, the conflict of interest disclosure does not clearly require preference vendors to report potential conflicts and does not describe the possible sanctions for failing to comply.</p> <p>DEO OSB anticipates implementing a revised conflict of interest disclosure by November 30, 2023.</p>
4	<p>LSBE Vendor Acknowledgment of Program Requirements (Priority 2) – DCBA, in consultation with ISD management, develop a process to ensure that LSBEs are informed of and agree to comply with LSBE Program requirements at the time of certification and periodically thereafter, and retain documentation of the acknowledgment as part of the vendor’s LSBE certification file.</p> <p>Original Issue/Impact: The County does not require LSBE vendors to acknowledge they</p>	<p>Recommendation Status: Partially Implemented</p> <p>DEO management updated the LSBE certification portal and informed us that they maintain a record of the vendor’s attestation, under penalty of perjury, that they understand and meet the preference program requirements at the time they submit their application.</p> <p>DEO management also informed us that they host webinars the third Thursday of every month to</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.

	RECOMMENDATION	A-C COMMENTS
	<p>received, understand, and agree to comply with program requirements (e.g., that LSBEs must perform a CUF), 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 County Fraud Hotline. This reduced program integrity and accountability and increased risk of improper purchase and fraud.</p>	<p>educate vendors and buyers on CUF and other preference vendor requirements.</p> <p>Furthermore, DEO and ISD management indicated that in advance of a formally established requirement, they trained and informed County procurement managers that they and their staff must now obtain and review a new attestation from vendors acknowledging that they are complying with the preference program requirements (including CUF) each time a preference vendor is utilized. DEO and ISD anticipate that the buyer requirements and procedures for utilizing the preference program will be formally established by June 30, 2024.</p>
5	<p>LSBE Program Monitoring (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 CUF and complying with other significant policies and program requirements.</p> <p>Original Issue/Impact: 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 CUF. This reduced program integrity and accountability and the likelihood that non-compliant vendors will be detected timely.</p>	<p>Recommendation Status: Partially Implemented</p> <p>DEO OSB consulted with us to gather information about red flags, verification steps, and examples of transactions which might indicate potential fraud, to help inform their development of a compliance monitoring program. DEO management indicated that they are in the process of drafting procedures for periodically reviewing a 10% sample of transactions awarded to preference vendors to ensure the vendor complied with program requirements, and the procurement officer followed proper procedures in utilizing the preference vendor.</p> <p>DEO management indicated that they plan to implement this recommendation by December 31, 2023.</p>
6	<p>Promoting LSBE Program Integrity (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>Original Issue/Impact: The County does not have guidelines and/or policy applicable to the LSBE Program in place to ensure that all County departments consistently pursue administrative and</p>	<p>Recommendation Status: Partially Implemented</p> <p>DEO management indicated that they have begun notifying County departments to report LSBE Program violations to their office or the County’s Fraud Hotline to ensure that administrative and legal remedies are pursued consistently when an LSBE is found to have violated program requirements. We reviewed training materials that show procedures for reporting instances of suspected program violations.</p> <p>DEO management also indicated that they are working with ISD and County Counsel to update the preference program ordinance to strengthen the</p>

RECOMMENDATION		A-C COMMENTS
	legal remedies when an LSBE is found to have violated program requirements.	<p>certification process and include guidelines for reporting alleged program violations, and will work collaboratively with relevant departments to ensure that administrative and legal remedies are pursued consistently when an LSBE is found to have violated program requirements.</p> <p>DEO management plans to fully implement this recommendation by June 30, 2024.</p>

We conducted our review in conformance with the International Standards for the Professional Practice of Internal Auditing. 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.