

City of Philadelphia
OFFICE OF THE INSPECTOR GENERAL



POLICY RECOMMENDATION REPORT
Managing Contract Risk:
Hart Enterprises and Associates

October 24, 2013

POLICY RECOMMENDATION REPORT

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Managing Contract Risk

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I. INTRODUCTION

At the request of the Philadelphia International Airport (Airport), the Office of the Inspector General (OIG) investigated the circumstances surrounding a restroom renovation contract awarded to Hart Enterprises & Associates (HEA), a general contracting firm owned and managed by John Hart (Hart). The OIG expanded its investigation to all City contracts awarded to HEA and Hart since 2006.

OIG investigation determined that between 2011 and 2012 the City awarded five valuable construction and demolition contracts to HEA. On these same five contracts, HEA and Hart made numerous material misrepresentations to the City at various stages of the contracting process. The company had a severely negative credit history, an unstable financial status, an owner with a relevant criminal conviction record, and owed over \$21,000 in City taxes. Hart also forged and submitted ten surety bonds, required as part of the contracting process, but the City did not properly screen these instruments for potential fraud. Because HEA and Hart successfully deceived the City, the significant risk associated with the award of these contracts was not properly flagged. The company performed poorly, causing approximately \$153,000 in damages that the City was left to address with limited remedies. And, HEA was paid approximately \$275,000 in connection with these contracts, despite the fact that it was tax delinquent and failed to pay its workforce over \$123,000 in hourly wages, in violation of City law.

Following the investigation of Hart and HEA, and referral to the Philadelphia District Attorney's Office for potential criminal prosecution, the OIG conducted an evaluation of the City's contract risk management process to determine the weaknesses that allowed such a reckless party to participate in valuable City contracts. The OIG interviewed and consulted with officials from various City departments, including: the Department of Procurement (Procurement), the Department of Revenue (Revenue), the Department of Finance (Finance), the Department of Licenses and Inspections (L&I), the Airport, the Department of Public Property (Public Property), the Risk Management Unit of the Department of Finance (Risk), the Department of Labor Standards (Labor Standards), the Law Department (Law), and the Philadelphia Industrial Development Corporation (PIDC).

This report substantiates the need for new policies and initiatives designed to protect the integrity of the City's contracting process and better identify the risks associated with potential contractors. Section II presents the City's current method of managing contract risk, including the review of potential contractors' qualifications, surety bonding requirements, and the payment hold system. Section III presents the specific circumstances under which HEA and Hart were awarded five lucrative City contracts, highlighting the failures of the contract risk management process. Section IV presents several recommendations to improve the process and protect the City from the hazards of contracting with an irresponsible party, including more stringent qualification review, a surety bond verification process, and improved synchronization across departments involved in the payment hold process.

II. BACKGROUND – MANAGING CONTRACT RISK

A City contract is a valuable asset. Whether it is for a high-dollar project or the procurement of a few small supplies, City contracts offer companies and individuals lucrative opportunities to build steady and secure business. Because these opportunities are so valuable, and because the City wants to get a fair bargain, the contracting process often involves competitive bidding with multiple potential options for the City to choose

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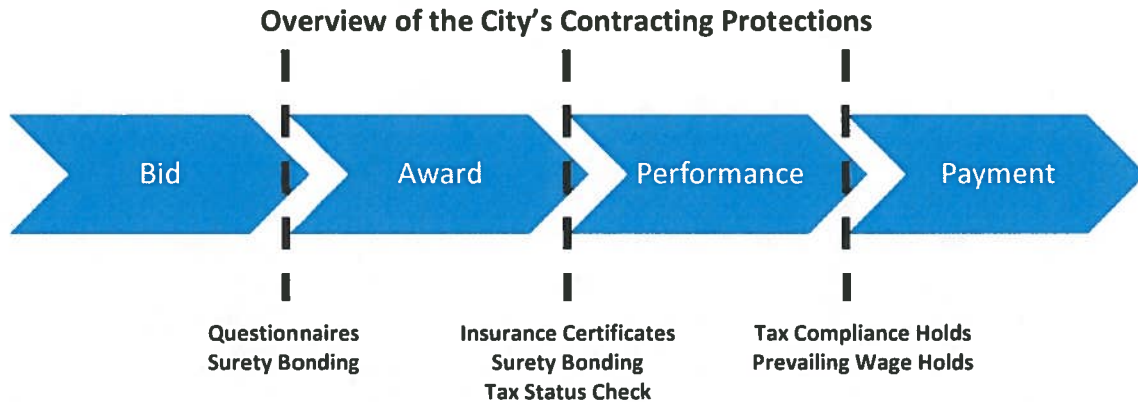
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from. City employees and officials who oversee the contracting process must closely scrutinize all of these options and evaluate the different bidders' qualifications and respective abilities to perform the job at hand. Depending on the type of contract, whether Public Works, Services Supplies & Equipment (SS&E) or Professional Services, this evaluation process involves many different considerations, beyond the bottom-line price.

While City contracts represent highly sought-after business opportunities for private parties, they can also expose the City to a great deal of risk. Should the contractor perform poorly, fail to take the appropriate precautions, act negligently, or otherwise breach the terms of the contract, the City could find itself exposed to significant liability or in a severely compromised position without recourse. To manage this risk, before awarding a contract to a business or individual, the City must have adequate assurance that the contractor is responsible, trustworthy, and capable of performing high-quality work. Then, to ensure that the contractor remains in compliance with all City requirements as the job progresses, the City must closely monitor its payments for services rendered and counterbalance these disbursements with any outstanding liabilities. Otherwise, the City is at risk of losing funds that it is rightly owed.

As the life of the contract progresses in stages, from *bid* to *award* to *performance* to *payment*, the City has various protections in place to evaluate contractors' qualifications and adequately minimize the risk of contracting with an irresponsible or negligent party. These protections are implemented at various times and in different forms for Professional Services, Public Works, and Service, Supply, and Equipment (SS&E) contracts. For ease of understanding, the following diagram presents the primary components of these contracting protections in a generalized form:



First, during the bidding process but before the contract is awarded, potential City contractors must complete questionnaires addressing their contract history, financial solvency, tax status, and other relevant details related to their fitness for the particular job. Then, after the contract award but before beginning performance, contractors must certify that they have obtained the required level of insurance. At this time, some contractors are also evaluated and reviewed for their City tax status; with any outstanding liabilities resolved as a condition to contract with the City. At both the bid and award stages, many contractors are required to obtain different types of surety bonds, guaranteeing certain aspects of the bid or subsequent contract performance. Lastly, once performance is completed and the City is ready to issue payment for services rendered, the City must ensure that contractors have paid all outstanding liabilities, including unpaid taxes or prevailing wage violations. To avoid unjust enrichment, contractor payments are held until these liabilities are settled.

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Part A of this section presents the specifics of the City's contractor qualification review process, including Pre-Qualification Questionnaires, tax status checks, and insurance certificates. Part B presents the various surety bonding requirements and the City's process for validating these instruments. Part C presents the City's current process for holding contractor payments to settle unpaid taxes or outstanding prevailing wage citations.

A. Contractor Qualification Review

At the outset, prior to the award of the contract, City departments closely scrutinize a potential contractor to ensure that the business or individual is qualified, responsible, reputable, and otherwise fit to perform whatever the particular job requires. The evaluation process for Public Works contracts and some SS&E contracts generally includes: (i) a Pre-Qualification Questionnaire that the bidder submits to the City, designed to obtain relevant information about the company's history and financial stability; (ii) a review of the bidder's City tax status; and (iii) submission of various insurance certificates, to confirm that the contractor has the proper liability protections in place prior to beginning work on the project.

1. Pre-Qualification Questionnaires

First, before potential City contractors may bid on a Public Works or some SS&E contracts, they must complete a hard copy "Pre-Qualification Questionnaire" and submit it to the relevant City department for review. Through "Yes" or "No" questions, this Pre-Qualification Questionnaire asks the bidder to provide specific information in an effort to assess the bidder's fitness and the risk associated with awarding a contract. Some of the information requested through the Pre-Qualification Questionnaire includes: (i) prior City contract defaults or terminations, (ii) prior criminal convictions of the executive officers of the company, (iii) liens or claims filed against the contractor, and (iv) tax indebtedness to the City.

Unfortunately, City departments do not independently verify the large majority of the information that the bidder provides on the Pre-Qualification Questionnaire. Departments will generally check bidders' references and verify that they have the proper equipment and licenses. But, beyond this basic information, the City does not review the other qualification information requested in the questionnaires, unless a bidder discloses adverse information in response to a question. Otherwise, departments take the bidders' representations at face value and wholly rely on them to honestly disclose all facts. So, if a contractor misrepresents material facts like criminal history or outstanding liens, there is currently no procedure in place for the City to independently check the veracity of these representations or otherwise call that information into question. As a result, the City is quite vulnerable to contracting with an irresponsible party, which may lead to performance issues or increased costs for the City at a later time.

2. Tax Status of Prospective City Contractors

For Public Works and some SS&E contracts, the Pre-Qualification Questionnaire asks:

Is your organization or any of its parent or subsidiary organizations currently indebted to the City of Philadelphia for any delinquent City taxes, taxes collected by the City on behalf of the School District of Philadelphia, liens, judgments fees, or other debts? If YES, attach an explanation describing the nature and amount of the debt, lien, judgment,

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or fee, the dates of any notices from the City, and any written agreement or payment plan with the City for its disposition.

Just as it does with most other information provided on the Pre-Qualification Questionnaire, the City wholly relies on bidders to truthfully disclose if they owe outstanding taxes to the City. If potential vendors or contractors disclose that they owe back taxes, the contracting department must refer the matter to Revenue. Otherwise, for Public Works and SS&E contracts, the City conducts no further independent review of the bidder's tax status.

These Public Works and SS&E protocols stand in stark contrast to the process for Professional Services contracts. For Professional Services contracts, Revenue researches all awardees to see if they owe back taxes to the City. Public Works and SS&E contracts, however, do not follow the same protocol, allowing tax delinquent vendors to assume lucrative City contracts while the City is not repaid money it is owed.

3. Insurance Certificates

Upon preliminary award of a City contract, contractors City-wide must verify that they carry the sufficient amount of insurance protection. To prove that the proper coverage is in place, contractors must provide an insurance certificate to the City department awarding the contract. These certificates are generated by insurance agents or brokers and list the types of coverage, insurance policy numbers, effective dates, coverage amounts, and carriers associated with a contractor's various forms of insurance protection. The City Risk Management Division (Risk) reviews insurance certificates for Public Works and SS&E contracts. City contracting departments review the insurance certificates for professional services contracts. Risk only reviews the insurance certificates for professional services contracts when City contracting departments ask for assistance or as a secondary review.

Risk and City contracting departments review insurance certificates to verify that the insurance complies with a contract's insurance coverage requirements (i.e. workers compensation, general liability, automobile, etc.) But, neither Risk nor City departments contact insurance companies, agents, or brokers, to verify the validity of insurance coverage. This creates an opportunity for a contractor to misrepresent the existence of necessary insurance coverage, and the City is potentially vulnerable to contracting with a party who does not carry the appropriate insurance coverage.

B. Surety Bonding

Similar to insurance, surety bonds guarantee certain elements of a contract for the City. Bidders and contractors must provide different bonds at different stages of the contracting process, depending on the value and nature of the contract. Some of the relevant bonds include: bid bonds, proposal security bonds, performance bonds, payment bonds, and fidelity bonds. Generally, these bonds guarantee that the representations of a bidder are accurate and that the performance of the contract will be completed according to the proper standards. As an important part of the City's contracting protections, these surety bonds shield the City from the costs associated with a contractor's inability to complete a job or otherwise meet the obligations of a contract.

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Much like the qualification review process, the City does not independently verify any bonds that bidders or vendors submit as part of the contracting process. City departments forward the physical bonds to the Law Department, but only to check that the information printed on the face of the bond meets the requirements of the particular contract. No City employees contact surety companies to verify whether those companies actually issued a bond or to confirm that a bond number appears in their official records. Similarly, no City employees contact any attorney listed on a bond or supporting documentation to verify that the documents were actually signed by the attorney. The City currently has no fraud-protection controls in place to prevent vendors from creating, submitting, and using altered or forged bonds. As a result, the City is exposed to significant risk of fraud and the high costs associated with a contractor's possible breach.

C. Processing Holds on Payments to City Contractors

Once a bid is accepted and the contract is awarded, the contractor will begin performance and receive the appropriate compensation from the City as work on the contract is completed. Generally, the City pays contractors on a periodic basis, issuing checks based on invoices submitted by the contractor. But, before payment is finalized, the City must be sure that a contractor does not owe any City-related debts or liabilities. To ensure that the City is recouping money that it is rightly owed, contractor payments are often held to settle the appropriate debt.

Two of the more frequent reasons that the City might hold a payment are: (i) to recover outstanding taxes; and (ii) to enforce the City's prevailing wage requirements. If a contractor is tax delinquent, the City can effectively and efficiently recover the taxes owed by withholding any payments until the matter is settled. Similarly, if a contractor is not paying his or her employees a proper wage, the City can withhold payment, effectively forcing the contractor to comply with the prevailing wage law by releasing payments directly to the workers. Both of these payment hold processes are an invaluable method of enforcement, but require significant cross-departmental coordination that is often prone to error.

1. Tax Holds

As contractors perform, Finance issues payment vouchers for services rendered. Every day, Revenue employees in the Tax Delinquency Unit monitor these vouchers and flag all of those vouchers associated with tax delinquent vendors. The flagged vouchers are compiled into a report, and the report is reviewed and updated daily by the Tax Delinquency Unit. This unit sends a hard copy of the report to the Pre-Audit Section of the City Controller's Office, the entity tasked with holding City payments. For each and every individual voucher listed in Revenue's report, the Controller's Office enters a hold, freezing payment until the tax matter is settled. Once the tax matter is resolved, Revenue will instruct the Controller to release the voucher for payment.

Unfortunately, because the hold process requires such coordination across departments, the system is vulnerable to delays, high volume, and miscommunication; hindering its effectiveness. At times, Revenue's report does not reach the Controller for several days, even though it is supposed to be provided daily. This delay occasionally allows for the release of a payment that should have been held. Additionally, the report can number well over 20 pages and the number of vouchers flagged per vendor can sometimes exceed 100, increasing delay. Sometimes, Revenue instructs the Controller to release payments just a few days after a hold

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was entered, or to re-hold vouchers after the Controller has already released them for payment, often on an emergency basis. As a result, tax delinquent vendors are able to receive City money, while the City fails to recoup the tax revenue it is rightly owed.

2. Prevailing Wage Holds

All City contractors are required to pay their employees a prevailing wage, as established by City ordinance. Labor Standards is tasked with monitoring and enforcing the City's prevailing wage ordinance for all Public Works contracts and contracts at three quasi-City agencies. If Labor Standards employees discover a discrepancy on a contractor's certified payrolls, Labor Standards issues a citation to the contractor. Labor Standards sends a copy of its citation to the City department where the delinquent contractor is working, in order to have the department withhold any payments otherwise owed to the contractor. Labor Standards will also contact the Controller to place a hold on any payment vouchers already processed for that particular contractor.

However, due to staffing limitations, Labor Standards has encountered heavy delays in reviewing certified payrolls and assessing violations of the City's prevailing wage ordinance. These delays can result in the issuance of a citation after payment has already been rendered, making recovery far more difficult. Also, the citations that Labor Standards sends to the individual departments do not expressly instruct the department to withhold payment until the wage matter is resolved. Rather, this withholding requirement is implied. In some cases, the lack of explicit language has resulted in City departments processing payments despite the receipt of a Labor Standards citation. As a result, contractors may continue to receive City money on a project, even when their workforce is being denied appropriate wages in violation of City requirements.

III. ISSUES – HART ENTERPRISES

The City's process for managing contract risk is highly vulnerable, as highlighted by one specific example. Hart Enterprises & Associates (HEA) is a general contracting firm owned by John Hart (Hart), who also serves as the company's President and project manager. Since 2006, HEA has held various City construction, electrical, plumbing and demolition contracts, primarily administered through L&I. Between 2011 and 2012, HEA was awarded five City contracts: three demolition contracts with L&I; one restroom renovation contract with the Airport; and one sprinkler contract with Public Property.

Unfortunately, the City awarded HEA these lucrative opportunities despite the fact that the company was subject to several adverse judgments and outstanding liens. HEA was also tax delinquent at the time, owing more than \$21,000 to the City. In fact, the company's negative history and financial instability was so severe that HEA and Hart were unable to secure the necessary bonds, required as part of the contracting process. So, Hart committed an act that was consistent with his prior conviction history: he forged the bonds.

All of these issues painted a clear picture of how the contract risk management process failed and allowed an irresponsible contractor who should not have been awarded a City job to obtain five contracts. Hart's numerous misrepresentations and forged instruments caused the City to award HEA the contracts. Not surprisingly, HEA performed poorly and caused the City approximately \$153,000 in damages. And, to make matters worse, HEA and Hart failed to comply with the City's prevailing wage requirements, owing their workforce over \$123,000

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in hourly wages. Despite the company's wage violations and tax delinquent status, the City paid HEA approximately \$275,000 for work performed in connection with these five contracts.

This section presents the specific circumstances of the City's process failures in awarding five contracts to an irresponsible, negligent, and fraudulent contractor. Part A addresses the contractor qualification review process and Pre-Qualification Questionnaires, noting that many of HEA's material misrepresentations were never independently checked. Part B presents the facts of Hart's surety bond forgery. Part C discusses the payment hold process that did not properly address HEA's outstanding tax debt or prevailing wage violations.

A. Qualification Review

HEA filled out the City's Pre-Qualification Questionnaires like all other Public Works contractors. The City reviewed the provided responses, verified the company's prior experience and job references, and approved HEA as a responsible bidder capable of performing each of the five contracts at issue. The City relied on HEA and Hart to be honest, but OIG investigation confirmed that HEA and Hart lied about their criminal convictions, negative judgments, outstanding liens, and back taxes owed to the City.

First, Hart failed to disclose that he had been convicted of numerous criminal offenses, including forgery and theft by deception. HEA also hid the fact that the company had several negative judgments and outstanding liens dating back to 2007. Most notably, HEA previously had a loan with the Philadelphia Industrial Development Corporation (PIDC), which the company failed to repay. This resulted in a negative judgment that was entered against HEA prior to the award of three City contracts in 2011 and 2012. And, company representatives again lied when they claimed that HEA was fully up-to-date on City taxes, when in fact the company owed over \$21,000 at the time.

Yet, the City was completely unaware of Hart's relevant criminal convictions or HEA's adverse judgments or back taxes because the information provided was never verified, and the City never coordinated with PIDC regarding the status of the loan. Had the City been aware of HEA and Hart's negative history and questionable repute, the City could easily have identified and avoided the sizeable risk associated with these five contracts.

B. Surety Bonding

As a result of HEA's financial instability and checkered past, by 2011 the company was unable to obtain the necessary credit or bonding from surety companies. But, HEA needed City contracts to bring capital into the company and repay outstanding debts. To get the contracts, Hart forged and submitted ten different bonds at various stages of the contracting process. City officials reviewed these bonds and approved them as facially sufficient, but nobody ever contacted the listed surety companies and there was never any further investigation of the bonds' authenticity. Because the City failed to independently verify any of the information on HEA's bonds, they were accepted at face value.

As a result, no surety company ever guaranteed HEA's performance or bid price. The City was thus forced to pay for HEA's performance deficiencies and the costs associated with re-bidding the contracts, resulting in damages of approximately \$153,000 that could have been mitigated.

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C. Payment Holds

After the contracts were awarded based on HEA and Hart's blatant fraud, the City eventually became aware of HEA's outstanding taxes and failure to pay its workforce the appropriate wages. However, due to delay and miscommunication, the payment hold process did not function properly and HEA received money that should have been redirected to satisfy other City-related liabilities.

1. Tax Holds

HEA was tax delinquent, owing over \$21,000 in back taxes at the time the five contracts were awarded, and company representatives lied about this on pre-qualification paperwork. Although this misrepresentation was not identified prior to the award of the contracts, Revenue later flagged a hold on a \$20,000 payment to HEA on August 16, 2012. Yet, for some reason the Controller's Office did not enter a hold and the payment was released to HEA even though the City would have recouped almost all of the back taxes owed at that time. Another payment to HEA was eventually held to recover the debt, but this hold was only processed because someone from HEA accessed the Revenue Department's website and attempted to apply for a vendor license, bringing the company's tax status back to the attention of Revenue. Had this not happened, HEA's tax status might never have been flagged.

2. Prevailing Wage Holds

HEA submitted hard copy payrolls directly to Labor Standards on a weekly basis and certified that these payrolls were true, accurate, and in compliance with the City's prevailing wage ordinance. Labor Standards discovered that HEA's payrolls were deficient and that the company failed to pay prevailing wages to its plumbing laborers on the Airport contract. Labor Standards forwarded the corresponding prevailing wage citation to the Airport, as notice for the Airport to stop paying HEA. But by this point it was too late; the Airport was about to terminate the contract, and there were no subsequent payments to HEA that could have been held to address the citation. Unfortunately, HEA had already received over \$200,000 in payments from the Airport, with over \$123,000 in unaddressed prevailing wage deficiencies.

IV. RECOMMENDATIONS

Hart and HEA have exposed a number of different weaknesses in the City's management of contract risk. With HEA, the City failed to identify the potential hazards, and the consequences were substantial. The following recommendations are designed to help the City better screen contractors, recognize potential threats, and protect the integrity of the contracting process.

In crafting each of these recommendations, the OIG Contract Compliance Unit (OIG CCU) has consulted with numerous departments regarding the internal control failures within the contract risk management system. Additionally, two inter-departmental working groups are currently exploring these recommendations in detail, with the OIG CCU's ongoing participation. Of course, as with all recommendations, the costs and practical limitations should be carefully examined, and the need for specific variations or modifications is implicit. These recommendations represent an ongoing effort to improve the City's process, and the OIG CCU looks forward to working with all City departments in monitoring and further refining these systemic enhancements.

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Part A addresses the need for more stringent contractor qualification review, including proactive and independent verification of a bidder's representations and supporting contract documentation. Part B presents a surety bond verification process to assist in identifying instances of forgery and other forms of fraud. Part C addresses the payment hold process and presents a number of solutions to improve the cross-departmental synchronization that is necessary to adequately address outstanding taxes and prevailing wage violations.

A. More Stringent Contractor Qualification Review

First, and perhaps most importantly, the City cannot afford to rely solely on a bidder's representations. If the City is going to effectively minimize the risk of contracting with irresponsible, negligent, and potentially criminal individuals or businesses, there must be a stronger effort to verify relevant background information and supporting documentation. All of the questionnaires, certificates, and legal instruments required as part of the contracting process are clearly designed to help the City make an informed decision. But, the intended purpose of these requirements can be easily thwarted by a dishonest party. It makes little sense to require a potential contractor to answer detailed questions and furnish various certifications or legal instruments if there are few steps taken to check the veracity of these representations.

The OIG therefore recommends more stringent review of contractor qualifications, including: (i) proactive and independent verification of the information provided on the Pre-Qualification Questionnaires; (ii) more frequent use of Revenue's Tax Clearance Form; (iii) increased communication with PIDC; and (iv) independent review of the required insurance certificates.

1. Proactive and Independent Review of Pre-Qualification Questionnaires

As shown by the specific circumstances of Hart and HEA, the City currently verifies little information provided by potential contractors as part of the contract award process. And, what review the City does perform is fragmented and ad-hoc. Had the City independently verified the various representations that Hart and HEA made on the Pre-Qualification Questionnaires, the risk associated with an irresponsible and negligent contractor could have been avoided. As such, the OIG recommends additional protocols to proactively and independently review the accuracy of the information provided in the Pre-Qualification Questionnaires and supporting documents.

If possible, this process should include checks of criminal histories, outstanding judgments and liens, and other relevant data that could inform a decision regarding a particular bidder's honesty and reliability. In addition, the scope of these inquiries should be extended to address a potential contractor's bonding capacity, credit history, and negative civil or administrative judgments.

To assist the City in verifying contractor background and history, increased access to various databases will be helpful, and the centralization of responsibility can minimize some of the transaction costs associated with performing additional review. Ideally, qualification review for Public Works and SS&E contractors can take place within Procurement, but the information should be universally accessible to all City departments through electronic means. This could prevent ad-hoc qualification review by City departments and allow for uniform and accurate review of a potential contractor's qualifications.

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The need for independent verification is especially important with regard to City tax status. Currently, the representations of prospective contractors for Public Works and SS&E contracts are always accepted at face value, unlike Professional Services contracts where Revenue verifies the tax status of awardees. Similar protocols to those utilized in the Professional Services context should be extended to Public Works and SS&E contract opportunities. If the City continues to rely on contractors to disclose adverse information, valuable opportunities to collect outstanding revenue will be wasted. By checking the tax status of Public Works and SS&E contractors at the qualification review stage, the City can evaluate their fitness and any tax issue can be resolved before a contract is awarded. This will provide the proper incentives for all City businesses to stay up-to-date in their obligations and the City can better recoup money it is owed.

2. Tax Clearance Forms

As a supplement to the independent verification of a bidder's tax status, the OIG recommends that Public Works and SS&E contractors be required to provide Tax Clearance Forms with each bid. Tax Clearance Forms are officially generated from Revenue's website and instantaneously certify that a prospective bidder is tax compliant. These forms can be obtained easily and quickly from Revenue's website, and users only need their name and Social Security or EIN number to complete the process.

Of course, requiring these forms would not completely eliminate the risk of contracting with a tax delinquent party because the Tax Clearance Forms are not completely impervious to forgery or fraud, and businesses or contractors that are new to the City cannot obtain these certifications. Additionally, the information on the Tax Clearance Form is only valid for 30 days. But, requiring a bidder to complete this step would serve as an additional check in the qualification review process and allow the City a better opportunity to identify and collect outstanding debt.

3. Increased Communication with PIDC

HEA had defaulted on a loan with PIDC, resulting in a negative judgment. This information would have been useful for the City in assessing HEA's fitness for City contracts, but there was no line of communication between the City and PIDC. As a quasi-public entity that regularly interacts with many of the same businesses and individuals that might contract with the City, PIDC represents an important available resource in evaluating the risk associated with a potential contractor. The OIG therefore recommends that contracting City departments and PIDC communicate on a more regular basis, so the City may systematically obtain judgment information from PIDC about potential vendors.

If PIDC representatives can forward relevant judgments to Procurement as soon as they are filed, the City will be able to better assess a contractor's financial responsibility at the qualification review stage. Additionally, sending all PIDC judgment information to Procurement will create a central clearinghouse for the information throughout the City, accessible to all departments.

4. Independent Review of Insurance Certificates

Although not directly at issue with HEA and Hart, the current process for reviewing the required insurance certificates is potentially vulnerable to fraud. There is ample opportunity for vendors to misrepresent insurance

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certificates and create the appearance of proper insurance coverage. The OIG recommends that the City explore the feasibility of independent review of insurance certificates, similar to the bond verification process discussed in detail below. City departments or Risk could contact the issuing insurance agents or brokers to verify that 1) they generated the certificate and 2) a contractor has the proper liability protections in place before beginning work.

B. Surety Bond Verification Process

Hart submitted several forged bonds at various stages of the contracting process, but the City failed to identify these instruments. This investigation has clearly demonstrated an overwhelming need for a bond verification procedure to protect the City against fraud. Criminal implications aside, fraudulent bonds place the City at great risk and leave the City responsible for the costs of breach and poor contract performance.

Accordingly, the OIG recommends the following bond verification procedure, to be implemented at Procurement and any City department that administers a contract which requires a surety bond of any kind:

1. Dedicate staff to review bonds and supporting documentation for all contracts valued at or over \$1 million.
2. Contact the attorney who executes the bond and verify that the bond number appears in the attorney's records and that the bond and supporting documents were written for the appropriate contractor.
3. If an attorney cannot verify the bond, contact the surety company to verify the information.
4. When feasible, conduct randomized checks of bonds and supporting documents for City contracts valued below \$1 million.

With a clear process in place, Procurement can create a comprehensive list of distinguishing characteristics for each type of bond. Such a list will allow Procurement to better screen for fraudulent instruments, reducing time and increasing security.

C. Synchronize Payment Hold Activity Across Departments

Even with the additional steps discussed above, the City can never completely eliminate the risk of contracting with a tax delinquent party or a business that refuses to pay its workforce a living wage. Thus the payment hold process serves as an additional check and ensures that payment is only issued to contractors who are in full compliance with all City requirements, including taxes and prevailing wage laws. As such, it represents an important part of the City's risk management and overall enforcement regime.

But, as demonstrated by HEA and Hart, the payment hold system does not always function properly. For both tax holds and prevailing wage holds, many different City departments share responsibilities, including Revenue, Finance, Labor Standards, the Controller, and the respective contracting departments. Information must shift

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smoothly across all of these different players, and timing is paramount because the hold must be coordinated with the payment. If a justified hold is not identified and communicated prior to the release of payment, there is great risk that a delinquent contractor will be unjustly enriched while the City-related debt remains unsettled.

Each of the following recommendations is intended to improve cross-departmental synchronization and minimize delay in the processing of contractor payment holds. To improve the tax hold process, the OIG recommends: (i) the use of an electronic database to reduce transfer time; (ii) holding payments based on vendor number to reduce volume; and (iii) holding only those payments equal to the amount of outstanding taxes. To facilitate the prevailing wage hold process, the OIG recommends: (iv) the use of an electronic database to reduce transfer time; (v) proactive reporting; and (vi) clear citation language to avoid miscommunication.

1. Electronic Reporting

Currently, Revenue generates a daily tax hold report in hard copy that is transferred to the Controller, where the payment hold is entered. This physical transfer allows for considerable delay. To improve efficiency, the OIG, in conjunction with the Controller, recommends that Revenue change its report to a weekly electronic format that can be updated and transferred more easily. Staggered and electronic dissemination gives the Controller and Revenue more time to review, modify, and implement holds before the City pays contractors.

2. Payment Holds Based on Vendor Number

Now, the tax hold report is organized by voucher number, requiring the Controller to research each individual payment and enter holds one-at-a-time. This causes significant delay in processing time, because any given tax delinquent vendor could have many vouchers pending for payment, and each of these vouchers must be flagged individually. The OIG, again in conjunction with the Controller, therefore recommends that tax holds be entered according to a contractor's assigned City vendor number. This would allow the Controller to hold all vouchers associated with a vendor when it receives Revenue's report, rather than holding each voucher one-by-one. This change would dramatically reduce processing time.

3. Hold Only the Amount of Outstanding Taxes

As the system currently operates, if a contractor is tax delinquent, all of the payments to that particular contractor are to be held until the outstanding balance is cleared. So, if a contractor owed only \$100 in back taxes, even a \$10,000 payment would be held until the matter is resolved. Although this provides a stronger incentive for the contractor to pay the debt, it also results in the need to process a disproportionate number of payment holds, resulting in considerable delay that can inhibit the process.

The OIG therefore recommends that the City hold payments from contractors in an amount equal to what they owe in back taxes. Such a reform, if feasible, would dramatically increase efficiency as information moves between Revenue and the Controller. By reducing the overall number of holds that would have to be processed, timing would improve.

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4. *Electronic Payroll Record System: LCPTracker*

Much like the transfer of Revenue's tax hold report, hard copies of prevailing wage certifications and citations are also physically transferred from contractors to Labor Standards or City departments. To improve transfer time and synchronization, the OIG recommends that Labor Standards implement the electronic payroll LCPTracker program. LCPTracker has been under contract with Labor Standards since 2011 and will help correct staffing and resource limitations. Vendors will be able to use the system to input their payroll information rather than mailing the payrolls in hard copy. Labor Standards will be freed to verify payrolls in a timely manner, avoiding lengthy delays in assessing citations.

5. *Proactive Communication and Reporting*

For the system to function properly, Labor Standards must be aware of ongoing projects in the City and contractors must provide certified payrolls in a timely fashion. Proactive communication between Labor Standards, City departments, and contractors regarding the status of City projects will allow Labor Standards to fulfill its oversight function by requesting and reviewing certified payrolls in a timely manner. Timely review of certified payrolls leads to earlier discovery of prevailing wage violations and faster dissemination of citations.


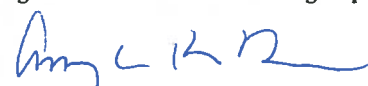
To this end, periodic reporting by the respective City departments could prove effective. On a monthly basis, City departments can inform Labor Standards about new and ongoing projects that involve outside contractors. Labor Standards can then more actively monitor these projects and follow up with contractors and City departments for the required documentation, including certified payrolls.

6. *Clear Withholding Language on Prevailing Wage Citations*

Lastly, the OIG recommends that Labor Standards' citations explicitly direct City departments to hold payments associated with contractors who have been in violation of prevailing wage requirements. Such language avoids a scenario in which a prevailing wage violation is assessed but miscommunication allows City payments to be disbursed to the delinquent contractor. All City departments should honor Labor Standards' citations and refuse to process invoices until any and all prevailing wage matters are resolved

V. CONCLUSION

The integrity of the City's contracting process is in danger. Without immediate attention, the City will continue to be exposed to unnecessary contract risk. This evaluation has identified a number of issues and set forth some potential solutions. Many of our recommendations have been implemented or will be implemented in the coming months. We are confident that this matter will continue to receive the immediate attention it deserves.

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