



City of New York

OFFICE OF THE COMPTROLLER

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MANAGEMENT AUDIT

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Audit Report on the Department of
Small Business Services' Administration
of the Minority and Women-Owned
Business Enterprise (M/WBE)
Certification Program

MH12-100A

May 6, 2013

<http://comptroller.nyc.gov>



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May 6, 2013

To the Residents of the City of New York:

My office has audited the Department of Small Business Services (DSBS) to determine whether it has adequate controls to ensure that businesses certified as Minority and Women-Owned Business Enterprises (M/WBEs) meet the necessary qualifications. DSBS administers the M/WBE program, which was enacted in 2005 under Local Law 129 to promote fairness and equity in New York City's procurement and to strengthen the ability of certified enterprises to compete successfully. We audit programs such as this to ensure that City agencies are complying with applicable laws and regulations.

The audit found that DSBS has adequate controls to ensure that certified M/WBEs met the necessary qualifications with two exceptions. DSBS does not ensure that certified M/WBEs submit annual affirmation affidavits in a timely manner, as required by law, so that only qualified enterprises remain in the program. DSBS also does not have a third-party review process in place to evaluate the Division of Economic and Financial Opportunity (DEFO) director's decision to overrule analysts' recommendations to deny certification.

The audit made 11 recommendations, including that DSBS ensure that all M/WBEs submit their affirmations annually, revoke certification for the enterprises that do not, and remove such enterprises from its Online Directory of Certified Businesses. The audit also recommended that DSBS require the DEFO director to provide a detailed explanation to justify overruling analysts' recommendations to certify or deny an applicant and that the agency develop a third-party review process for when the director overrules analysts' recommendations to deny certification.

The results of the audit have been discussed with DSBS officials, and their comments have been considered in preparing this report. Their complete written response is attached to this report.

If you have any questions concerning this report, please e-mail my audit bureau at audit@comptroller.nyc.gov.

Sincerely,



John C. Liu

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THE CITY OF NEW YORK OFFICE OF THE COMPTROLLER MANAGEMENT AUDIT

Audit Report on the Department of Small Business Services' Administration of the Minority and Women-Owned Business Enterprise (M/WBE) Certification Program

MH12-100A

AUDIT REPORT IN BRIEF

The Minority and Women-Owned Business Enterprise (M/WBE) Program was enacted in 2005 under Local Law 129 to promote fairness and equity in New York City's (City) procurement and strengthen the ability of certified enterprises to compete successfully. The Department of Small Business Services (DSBS) administers the M/WBE program. Business enterprises that meet eligibility requirements may apply to DSBS for participation in the program. Certified M/WBEs have an increased opportunity to sell their products and services to City agencies endeavoring to meet participation goals promoted by the law.

All applicants seeking M/WBE certification must complete and submit to DSBS the M/WBE Certification Application along with the required supporting documentation. DSBS's Division of Economic and Financial Opportunity (DEFO) reviews these documents and decides whether the applicant should be certified or denied certification as an M/WBE. In the event of a denial, the applicant may appeal the determination to the Office of the General Counsel, which renders a final decision.

In Fiscal Year 2011, there were 626 newly certified M/WBEs. As of December 31, 2012, there were 3,597 certified enterprises in DSBS's *Online Directory of Certified Businesses*, which provides a detailed profile of each certified enterprise. This audit determined whether DSBS has adequate controls to ensure that businesses certified as M/WBEs meet the necessary qualifications.

Audit Findings and Conclusion

DSBS has adequate controls to ensure that businesses certified as M/WBEs meet the necessary qualifications with two exceptions noted below. Of the 40 sampled businesses that

applied for M/WBE certification, the case files contained sufficient evidence to support DSBS's determination for 36 (90 percent) of them. The case files for two businesses did not contain sufficient evidence or third-party review to justify the DEFO director's decision to overrule the analysts' recommendations to deny certification, increasing the risk that DSBS might inappropriately certify a business. The case files for the remaining two businesses were incomplete so we could not substantiate DSBS's initial determinations.

DSBS does not ensure that certified M/WBEs submit annual affirmation affidavits in a timely manner, as required by law, so that only qualified enterprises remain in the program. Our review of the certified enterprises in our sample that were required to have an annual affirmation affidavit by October 2012 revealed that only 16 percent of them submitted the affirmation.

DSBS also does not have a third-party review process in place to evaluate the DEFO director's decision to overrule an analyst's recommendation to deny certification. This control weakness increases the risk that DSBS might inappropriately certify a business. The audit also found that DSBS does not track the number of instances in which the director overrules analysts' recommendations.

Audit Recommendations

This report makes a total of 11 recommendations, including that DSBS should:

- Ensure that all M/WBE certified enterprises submit their affirmations annually.
- Ensure that certifications are revoked for those enterprises that do not submit their affirmations in a timely manner and remove them from DSBS's *Online Directory of Certified Businesses* website.
- Require that the DEFO director provide a more detailed explanation to justify overruling the reviewing analyst's recommendation to certify or deny certification of an applicant to the M/WBE program.
- Develop a third-party review process for when the DEFO director overrules the analysts' recommendations to deny the certification of a business.

Agency Response

In their response, DSBS officials generally agreed with eight of the report's 11 recommendations and disagreed with three pertaining to the lack of third-party review when the director overrules analysts' recommendations to deny certification.

INTRODUCTION

Background

The M/WBE Program was enacted in 2005 under Local Law 129. The intention of the law was to address the impact of discrimination and promote the public interest by encouraging participation of minority and women-owned business enterprises in the City's procurement process.

The M/WBE program, which is administered by DSBS, promotes fairness and equity in City procurement and strengthens the ability of certified enterprises to compete successfully. Business enterprises that meet eligibility requirements may apply to DSBS for participation in the program. Certified M/WBEs have the increased opportunity to sell their products and services to City agencies endeavoring to meet participation goals¹ promoted by the law. Certified M/WBEs also have additional access to contracting opportunities through classes and networking events provided by DSBS as well as technical assistance on how to be more competitive in City contracts. They also benefit from inclusion in the City's *Online Directory of Certified Businesses*,² which includes a detailed profile of each certified enterprise.

For purposes of M/WBE certification, a business enterprise must meet certain criteria, including:

- The business must be at least 51 percent owned, controlled, and operated by U.S. citizen(s) or permanent resident(s) who are member(s) of a designated minority group, including Blacks, Hispanics, Asian-Pacifics, and Asian-Indians, or women.
- The business must be authorized to do business in New York State.
- The business must have a real and substantial presence in the City, which means that it must either be located within the five boroughs of the City or in one of the surrounding counties.³
- The business must have been selling products or services for a period of at least one year prior to the date of application.

All applicants seeking M/WBE certification must first be registered with the City as a vendor and must complete and submit to DSBS the M/WBE Certification Application along with the required supporting documentation. Required supporting documentation to be submitted includes the following:

- Proof of U.S. citizenship or permanent resident alien status;
- Proof of ethnicity for each owner claiming minority group status;

¹ The citywide contracting participation goals for M/WBEs vary from 4.99 to 17.87 percent of total annual agency expenditures. These goals depend on the value and type of the contracts (such as contracts or subcontracts under \$1 million for construction, goods, professional services, or standard services) and the women or minority status of the M/WBE enterprises.

² The *Online Directory of Certified Businesses* website provides a searchable tool that helps both City buyers and private entities locate certified M/WBEs throughout the New York City tri-state area. Information on certified companies, including a brief description of their work history, contact information, and detailed information about what the companies sell, can be found in the directory.

³ The surrounding counties include Nassau, Putnam, Rockland, Suffolk, and Westchester within New York State, and Bergen, Hudson, and Passaic counties in New Jersey. Businesses located outside of the City must have significant ties to the City's business community (i.e., they must have derived 25 percent or more of their gross receipts from business conducted in the City and possess a license issued by the City).

- Résumés for each person with ownership interest, corporate shareholders, officers or members of the board of directors of the corporation, and personnel performing key managerial functions;
- Bank signature card identifying all persons authorized for the account;
- Current financial statement and business tax returns for the previous three years;
- Licenses, permits, or certifications required to operate the business;
- Lease agreements or proof of ownership for business locations;
- Three or more agreements within the past two years that show business activity; and
- Two or more completed and signed contracts or invoices for services performed within the five boroughs of the City during the past three years.

If the business is already certified as an M/WBE with one of DSBS's partner organizations⁴, the applicant may be able to submit an M/WBE Fast Track Application, which is a shorter application and may require less time to evaluate.

M/WBE applications are processed by DSBS's DEFO division. An analyst at DEFO reviews the application along with all supporting documentation. Once the review process is complete, the analyst makes a decision as to whether the applicant should be certified or denied certification as an M/WBE and forwards his/her recommendation to the DEFO director, who has the final authority to decide whether to approve or deny the certification, which includes reversing the analyst's recommendation. In the event of a denial, the applicant may appeal the determination to the Office of the General Counsel, which renders a final decision.

To remain certified, enterprises must submit a *Continuing Certification Affirmation* annually where any changes in ownership, operations, and/or management are declared. Every five years, M/WBEs must recertify by submitting a *Minority and Women-Owned Business Enterprise Program Recertification Application* with any supporting documentation and their Federal, State, and City tax returns for the prior two years. DSBS may revoke an enterprise's M/WBE status if the enterprise does not submit its annual affirmation, recertify every five years, or continue to meet the M/WBE requirements.

DSBS uses a centralized client management database called CTrack1 to store information from the M/WBE certification applications.

In Fiscal Year 2011, there were 626 newly certified M/WBEs. As of December 31, 2012, there were 3,597 certified enterprises in DSBS's *Online Directory of Certified Businesses*.

Objective

To determine whether DSBS has adequate controls to ensure that businesses certified as M/WBEs meet the necessary qualifications.

⁴ DSBS's partner organizations are: New York City School Construction Authority; Port Authority of New York and New Jersey; Women Presidents' Educational Organization; New York and New Jersey Minority Supplier Development Council Inc.; and New York State Department of Economic Development, Division of Minority and Women's Business Development.

Scope and Methodology Statement

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The primary audit scope period was Fiscal Year 2011. However, because of additional testing that we performed, we expanded our scope to October 31, 2012. Please refer to the Detailed Scope and Methodology at the end of this report for the specific procedures and tests that were conducted.

Discussion of Audit Results

The matters covered in this report were discussed with DSBS officials during and at the conclusion of this audit. A preliminary draft report was sent to DSBS officials and discussed at an exit conference held on March 13, 2013. On March 27, 2013, we submitted a draft report to DSBS officials with a request for comments. We received a written response from DSBS officials on April 17, 2013. In their response, DSBS officials generally agreed with eight of the report's 11 recommendations and disagreed with three pertaining to the lack of third-party review when the director overrules analysts' recommendations to deny certification.

The full text of DSBS's response is included as an addendum to this report.

FINDINGS AND RECOMMENDATIONS

DSBS has adequate controls to ensure that businesses certified as M/WBEs meet the necessary qualifications with two exceptions noted below. Of the 40 sampled businesses that applied for M/WBE certification, the case files contained sufficient evidence to support DSBS's determination for 36 (90 percent) of them. The case files for two businesses did not contain sufficient evidence to justify the DEFO director's decision to overrule the analysts' recommendations to deny certification. The case files for the remaining two businesses were incomplete so we were unable to ascertain whether DSBS's initial determinations were reasonable.

DSBS does not ensure that M/WBEs submit annual affirmation affidavits in a timely manner, as required by law, so that only qualified enterprises remain in the program. Our review of the certified enterprises in our sample that were required to have an annual affirmation affidavit by October 2012 revealed that only 16 percent of them submitted the affidavits.

DSBS also does not have a third-party review process in place to evaluate the DEFO director's decision to overrule an analyst's recommendation to deny certification. This control weakness increases the risk that DSBS might inappropriately certify a business. The audit also found that DSBS does not track the number of instances in which the director overrules analysts' recommendations.

We also found other control weaknesses that DSBS should address. DSBS does not maintain a log of complaints it receives regarding allegations of the ineligibility of a certified enterprise in the M/WBE program. Finally, we found that there were inadequate safeguards in place to protect applicants' personal information.

These weaknesses are discussed in more detail below.

Annual Affirmation Affidavits Are Not Submitted or Followed up on in a Timely Manner

DSBS is not following up on annual *Continuing Certification Affirmations* (affirmations) that certified enterprises are required to submit to maintain their M/WBE certification status. Our review of the certified enterprises in our sample that were required to have an annual affirmation affidavit by October 2012 revealed that only 16 percent of them submitted the affirmation.

According to Title 66, §11-24(b) of the *Rules of the City of New York*, a certified M/WBE must submit an annual affirmation. DSBS sends a letter via e-mail to the enterprise requesting that it provide its gross receipts for the previous fiscal year and indicate whether there have been changes in the firm's ownership, operations, or management, or any other material changes. Changes that might affect its certification status include changes in ownership or control of the enterprise. DSBS requests that the enterprises complete, sign, date, and return the affirmation via standard mail, e-mail, or fax by the anniversary of the certification date. Once DSBS receives the affirmation, it is reviewed for changes in status. If changes that might affect an enterprise's M/WBE status are reported, the DEFO director determines if the changes affect eligibility.

Of the 37 sampled M/WBEs we reviewed, 32 were required to submit an affirmation as of October 2012.⁵ On October 25, 2012, we requested from DSBS the affirmations for the 32 certified enterprises in our sample for which affirmations should have been submitted. On November 19, 2012, we received affirmations from DEFO for only five of those 32 enterprises. DSBS officials informed us that they were still waiting for the remaining enterprises to submit their affirmations. In January 2013, DSBS officials informed us that they are in the process of “creating an electronic report in CTrack1 of businesses that do not submit an affirmation.” According to DSBS, it will send final notices to companies that have not submitted their affirmation forms. If responses are not received within 30 days of the final notice, the list will be forwarded to the DEFO director for a final decision. As of January 11, 2013, the 27 enterprises had still not submitted their affirmations. Nevertheless, 26 of the 27 businesses⁶ were still listed on DSBS’s *Online Directory of Certified Businesses* website as certified M/WBE enterprises as of that date.

One possible cause for this deficiency is DSBS’s untimely notices to businesses as they near their affirmation due date. The agency does not even send the notice to a business until the day before its certification anniversary. More timely notices from DSBS (e.g., one month prior to the due date) would help to ensure that enterprises are aware that their affirmations are due shortly and may increase enterprises’ compliance with the requirement.

Without an effective centralized tracking system to ensure that all affirmations are submitted and reviewed, there is no assurance that enterprises that are not qualified to remain as certified M/WBE enterprises are removed from the program. By continuing to include in its online directory those enterprises that did not submit their annual affirmation affidavits, DSBS encourages those enterprises to disregard its annual affirmation policies.

Recommendations

DSBS should:

1. Send timely notices to M/WBEs that their annual affirmations are due by the anniversary of their certification date.
2. Ensure that all M/WBE certified enterprises submit their affirmations annually.
3. Determine which affirmations are still outstanding and follow up to ensure that they are submitted in a timely manner.
4. Ensure that the new protocols that DSBS is creating for tracking and reviewing affirmations are instituted.
5. Ensure that certifications are revoked for those enterprises that do not submit their affirmations in a timely manner and remove them from DSBS’s *Online Directory of Certified Businesses* website.

DSBS Response: “We generally agree with this finding and recommendations and have begun to implement changes to the current process to ensure the timely submission and tracking of annual affidavit of no material change in ownership or control submissions by certified M/WBEs. ...

⁵ Five M/WBEs were not required to submit affirmations because their certification expired before the annual affirmations were due or were only certified in 2012, and thus have not reached their one-year anniversary.

⁶ One business was never listed on the online directory because it failed to submit the proper codes on its vendor enrollment application as required.

“Although SBS acknowledges the Comptroller’s recommendation that certifications be revoked for those enterprises that fail to submit affidavits in a timely manner, we do not believe Section 11-24(b) expressly requires SBS to take such action. Rather, SBS believes this section provides us with the discretion to do so.”

Auditor Comment: Even though the Rules do not expressly state that DSBS should revoke a business’ certification, the purpose of the annual certification is to ensure that only qualified businesses remain certified. In fact, DSBS’s own *Continuing Certification Affirmation* form contradicts its position by stating: “Certification Rules Require Annual Verification of Company Information in Order for the Business to Remain Certified.” As a result, we reiterate our recommendation that DSBS revoke certification and remove from the online directory those businesses that fail to submit annual certifications in a timely manner.

Control Weaknesses over the Certification Process

Lack of Third-Party Review When Director Overrules Analysts’ Recommendations to Deny Certification

Of the 37 enterprises in our sample that were certified, the reviewing analysts recommended that the certifications for two of them be denied. The DEFO director overruled these recommendations and approved the two enterprises for certification. The director did not, however, include sufficient justification in the case files to support his decision nor was there evidence of a review of the decision by a third party to ensure that it was reasonable.

According to Comptroller’s Directive #1, *Principles of Internal Control*, control activities should exist at all levels and functions of an agency, and include activities such as approvals, authorizations, verifications, and the maintenance of records to provide evidence of the execution of these activities. These control activities should also be supported by ongoing monitoring at various organizational levels of the actions taken by employees in performing their duties, including the actions taken by management and supervisory personnel. Because employee mistakes, judgment errors, or collusion can occur, management needs to balance the cost of establishing controls to prevent or detect inappropriate actions that could affect an agency’s objectives with the risk that such actions could occur and go undetected.

According to DSBS officials, the DEFO director has the ultimate authority to decide which business enterprises should be certified. An analyst’s recommendation to deny certification contains a detailed description of the reasons justifying his/her decision to deny certification. It also includes the portions of the law, rules, or regulations that in his/her judgment were not satisfied. Once the analyst makes his/her recommendation, the matter is forwarded to the director for a final decision. However, the director’s decision to overrule an analyst’s recommendation is not explained in the case file nor in the *M/WBE Certification Approval Form* that contains the analyst’s recommendation and the director’s final determination. The specifics of the two cases cited above are as follows:

- In one instance, a woman sought to have her locksmith business certified as a WBE. (She was the majority owner of the business and her son was the other owner.) The business required licensed locksmiths to perform contracts; her son and another employee were licensed locksmiths. The major portion of the business’s income was derived from contracts, which were based on the son’s estimates. The woman owner

only ran the office and had no knowledge about the majority of the business aside from taking care of the books. The analyst recommended that certification be denied because the woman owner did not have the experience and technical competence in the business enterprise for which she sought certification. However, the DEFO director overruled the analyst's recommendation and approved M/WBE certification for this enterprise.

- In another instance, a minority applicant sought to have his electrical contracting business certified as an MBE. The jobs accepted by the business required that they be overseen by a licensed electrician, which the owner was not. According to the analyst in his recommendation to deny certification, industry safety standards require the licensee to be at least an officer of the business. The person with an electrician license that the business employed was not a principal in the business, but was hired on an as-needed basis. The analyst recommended that certification be denied because the owner did not demonstrate the working knowledge and ability needed to operate the business enterprise. However, the DEFO director overruled the analyst's recommendation and approved M/WBE certification for this enterprise.

Our review found no evidence to indicate that the justifications provided by the analysts in recommending that these two enterprises be denied certification for the M/WBE program were incorrect. Conversely, the only explanation that we found from the DEFO director for these two cases were short statements from the director appearing in DSBS's CTrack1 system that do not sufficiently justify his position or cite the sections of the law, rules, or regulations that would permit certification or justify overruling the analysts' recommendations to deny certification. Accordingly, we question DSBS's practice of allowing the director to overrule an analyst's recommendation — especially those to deny certification — without having to include sufficient justification or explanation and without a documented review of the decision by a third party. There is a risk of impropriety because the director could certify an enterprise to the M/WBE program for an inappropriate reason.

When we brought this matter to the attention of DSBS officials, they stated, "The Rules require the Director to make the final M/WBE certification determination based on a substantive review of the complete submission. The proper process for challenging the Director's basis for such a denial is an appeal to the Commissioner of SBS and/or his designee pursuant to Section 11-24 and 11-25 of the Rules. This appeal right is clearly stated in every written determination denying M/WBE certification." However, an enterprise would only exercise this right when it is denied certification. Our main concern is when a recommendation to deny certification is *overruled* by the director. In such a situation, which is where the greatest risk of possible impropriety exists, there is no opportunity for further review because the enterprise would be certified and would, therefore, have no incentive to file an appeal.

We also found during our review of these cases that DSBS does not track or maintain a tally of the instances in which the director overrules the analysts' recommendations. This poses a risk to management. Without a proper tracking mechanism in place, DSBS is hindered in determining the number of times the director overrules the analysts or identifying patterns that may reveal potential improprieties. This, in turn, limits DSBS's ability to assess the risk that these overrulings may pose and take necessary steps to reduce that risk.

Recommendations

DSBS should:

6. Require that the DEFO director provide a more detailed explanation to justify overruling the reviewing analysts' recommendations to certify or deny certification of applicants to the M/WBE program.
7. Develop a third-party review process for when the DEFO director overrules analysts' recommendations to deny the certification of a business.
8. Develop a mechanism to track instances in which the DEFO director overrules the analysts' recommendations.

DSBS Response: "SBS disagrees with the finding that there is a lack of third-party review when the Director overrules a recommendation made by an analyst. ... [T]he Rules make it clear that the Director is ultimately responsible for making the certification determination. The reasons supporting the determination are recorded in the firm's electronic file. However, this authority does not preclude the Director from consulting with the DEFO Assistant and/or Deputy Commissioner as well as SBS' legal counsel when a particularly complicated or unique issue regarding a pending certification application arises. In fact, the Director engages in this consultation process on a regular basis."

Auditor Comment: We acknowledged in our report DSBS's position that the DEFO director has the ultimate authority to decide which business enterprises should be certified and that CTrack1 contained short statements on the director's decisions to overrule analysts' recommendations to deny certification. However, these statements did not cite laws, rules, or regulations to sufficiently justify the director's decisions. We still maintain our position that there is a risk that impropriety may take place when such decisions are not well documented or when there is no further review of the director's decision to reverse an analyst's denial recommendation. The lack of evidence to document either the consultation process that DSBS claims regularly occurs or the decision-making process prevented us from ascertaining whether consultation indeed occurred and whether the final decision was appropriately reached. As a result, we stand by our recommendations.

Inadequate Tracking of Complaints

DSBS does not maintain a log of complaints it receives regarding allegations of the ineligibility of a certified enterprise in the M/WBE program.

According to Directive #1, "Internal control activities . . . should exist at all levels and functions of an agency. They include . . . the creation and maintenance of related records that provide evidence of the execution of these activities. . . . Management requires both operational and financial data to determine whether they are meeting their agencies' strategic and annual performance plans as well as achieving their goals for the effective and efficient use of resources." In addition, Title 66, §11-72 of the *Rules of the City of New York* requires the prompt investigation of complaints alleging violations of the M/WBE laws.

Complaints, which may include allegations that a certified M/WBE is not eligible for the program, may come in the form of e-mail, letters, or phone calls, which are all routed to the DEFO

director. Complaints may also be received from other agencies, including the City's Department of Investigation (DOI). According to the DEFO director, when DSBS receives an allegation, he notifies the M/WBE certified enterprise that it is under review and that its certification may be revoked. The enterprise is also informed of the basis for the review. The enterprise is provided the opportunity to respond within 28 days in writing to any allegations set forth in the notice. The DEFO director then reviews all the information and if he concludes that the enterprise is no longer M/WBE eligible, a letter revoking the certification is sent. The enterprise has 45 days to appeal the revocation.

When we requested a list of complaints received during Fiscal Year 2011, we received instead a batch of 11 notices sent by DSBS to enterprises that were supposedly the subjects of complaints or allegations. Subsequently, we learned that DSBS does not have a formal tracking system in place. DSBS does not formally record complaints in a log or similar mechanism at the point when they are first received. The DEFO director stated that he sometimes, but not always, enters the information in CTrack1 when he receives it. He also stated that he tracks in his Microsoft Outlook Calendar program the dates responses are due from M/WBEs to whom DSBS sent the notices. However, because DSBS does not formally track complaints when initially received, we are unable to ascertain whether DSBS addressed all the complaints it received.

Based on our review of the 11 notices obtained from DSBS, we found that four notices were outside the Fiscal Year 2011 period. Of the seven with Fiscal Year 2011 dates, three were *Notices of Intent to Revoke Certification* and refer to an "alleged claim" against the businesses. For the remaining four, three were letters de-certifying the businesses' M/WBE status and one was a "*Retraction of Prior Notice of Intent to Revoke MBE Certification*;" however, we were unable to ascertain whether DSBS took these actions because of complaints that it received. In addition, DSBS did not provide us with any evidence of the actual complaints it received pertaining to these seven notices.

The absence of documentation of complaints or a log tracking the complaints received prevents us from establishing the totality of complaints received in Fiscal Year 2011 or determining whether all the complaints received were adequately addressed and resolved. Without an effective centralized complaint tracking system, DSBS management is limited in its ability to ensure that all complaints it receives are properly addressed.

Recommendation

9. DSBS should ensure the implementation of new protocols for tracking, reviewing, and resolving complaints relating to allegations of the ineligibility of an enterprise or to other matters central to the M/WBE program.

DSBS Response: "SBS agrees in part with this recommendation. As the Comptroller notes, SBS investigates all complaints alleging violations of M/WBE rules and takes appropriate action. ... SBS is implementing a new protocol to record future cases in a central log to track the totality of complaints and any decisions rendered within a given time period to ensure that individual cases are processed in a timely manner."

Auditor Comment: We are puzzled by DSBS' statement. Nowhere in this report do we state that DSBS investigates all M/WBE-related complaints and takes appropriate action. In fact, we noted that, because DSBS does not record

complaints when received, we were prevented from establishing the number of complaints the agency received or determining whether they were all adequately addressed and resolved.

DSBS Safeguarding of Applicant Files Needs Improvement

DSBS needs to improve its safeguarding of applicant files. The case files for seven of the 40 in our sample were missing one or more key documents. Three of the seven files were missing documents that were required to be submitted with the application (e.g., financial statements and résumés), which contained critical applicant personal information. Two case files were missing critical review documents that are prepared by DEFO personnel during the application review process (e.g. notice of denial). Two case files, as discussed further below, were missing multiple documents that fell under both categories (such as the application, the analyst's record of the applicant's interview, and tax returns). In addition, other key documents that were missing from the case files include the appeals letter from the applicant and the appeals decisions issued by DSBS.

According to Directive #1, *Principles of Internal Controls*, "Access to agency resources and vital records should be subject to appropriate limitations and accountability for their custody and use should be clearly assigned and maintained. Periodic comparison of the resources with the recorded accountability should be made to reduce the risk of errors, fraud or misuse or unauthorized alteration."

During the course of the audit, we noticed that the storage cabinets where the files are maintained once the certification process is completed are kept unlocked. DSBS officials told us that cabinets were unlocked because the keys for the cabinets were missing. We also observed that the site where the DEFO personnel responsible for the M/WBE certification process work and the storage cabinets that store the applicants' files are situated in a large open area accessible to personnel not assigned to the M/WBE certification unit. Anyone in the vicinity of the work area or storage cabinets can retrieve files or documents to which they are not authorized to have access. In addition, these records can then easily be misplaced or lost without adequate safeguards to prevent unauthorized access to the records.

As noted above, the case files for seven of the 40 sampled businesses that were certified or denied were missing one or more key documents. For two of the businesses, the documents missing were such that we could not substantiate DSBS's initial determinations. For the first of these two applicant files, DSBS was initially unable to locate the file for a substantial period of time, and when it did so, it was missing many of the pertinent documents required to be submitted with the application, including the application itself, bank signature cards, and the three prior years of business tax returns. It was also missing proof of citizenship or permanent resident alien status, proof of ethnicity, and information on the sources of business capital. This case was ultimately certified during the appeals process after it was initially denied certification. The second case file was missing the application, the analyst's record of the applicant's interview, the *M/WBE Certification Approval Form*, and the certification letter sent to the applicant informing him/her that the business was certified. Although DSBS subsequently e-mailed us a copy of the certification letter, the fact remains the document was originally missing from the file and DSBS never provided us the other missing documents.

Without adequate safeguards to ensure that applicants' records are securely maintained, there is a risk that applicants' personal identifying information can be misused, which can lead to identity theft, bank and credit card fraud, or other crimes. In addition, missing documentation

could prevent the subsequent review by management or a third party to ensure that certifications or denials were appropriate. A case file tracking system that identifies persons who remove or access the case files would enable DSBS officials to more effectively locate the missing files and identify who might have misplaced or taken the missing records.

Recommendations

DSBS should:

10. Maintain locked storage cabinets for its application files.
11. Create a tracking system to record who and when someone removes a case file from the storage cabinets.

DSBS Response: “SBS strongly believes in maintaining a secure storage system to ensure the privacy of applicants’ records. ... SBS will also establish a tracking system to record when a business record is removed and to reference the staff member who is in receipt of the file.”

DETAILED SCOPE AND METHODOLOGY

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The primary audit scope period was Fiscal Year 2011. However, because of additional testing that we performed, we expanded our scope to October 31, 2012.

To obtain an understanding of the objectives, responsibilities, and laws governing the M/WBE program, we reviewed:

- Local Law 129, *Minority and Women-Owned Business Enterprises Program*;
- Title 66, *Rules of the City of New York*, §11-21 to 11-26;
- Chapter 56, *New York City Charter*;
- *M/WBE Certification Application & Instructions; Re-Certification Application instructions; and Fast Track Application instructions*; and
- CTrack1 Manual, *Standard Operating Procedures, Data Entry & Workflow, Certification Unit*.

In order to obtain general background information on the M/WBE program and the application and review processes, we met with and interviewed DSBS officials, including the First Deputy Commissioner of the Financial Management and Administration Division. We also met with the Assistant Commissioner and the Director of Certification at DEFO.

In order to evaluate DSBS's efforts to certify legitimate M/WBE enterprises and the controls in place, we met with an Administrative Assistant, the Application Intake Coordinator, a Certification Analyst, and the Certification Manager at DEFO. We also met with the Assistant Commissioner & Chief Information Officer for Technology Operations and the Director of Technology Operations. To get an overview of the appeals process, we met with the General Counsel. We also attended a workshop hosted by DEFO staff explaining the certification process to new applicants.

DSBS provided us with Excel spreadsheets listing the 626 businesses that were newly certified as M/WBEs in Fiscal Year 2011 and the 18 businesses that were denied certification in Fiscal Year 2011. DSBS also provided us with an Excel spreadsheet of all the M/WBE applications received by DSBS in Fiscal Year 2011, which included a breakdown of the businesses by application type and final decision category: certified, denied, rejected, canceled, or withdrawn.

To evaluate the completeness of the lists of certified and denied M/WBE businesses for Fiscal Year 2011 we received, we performed the following tests:

- From our original random sample of 35 certified and five denied businesses (which we obtained from the lists of 626 certified and 18 denied businesses, as discussed below),

we looked in CTrack1 to see if their certification status matched the information on the spreadsheets.

- We then selected a random sample of 50 of the 3,392 M/WBE certified enterprises reported in DSBS's *Online Directory of Certified Businesses* as of January 26, 2012, to determine if DSBS reported them as certified in CTrack1. Because the online directory contains certified enterprises that may have been certified outside our scope period, we identified seven enterprises from our sample of 50 that were certified in Fiscal Year 2011. We then confirmed that the seven were included on the list of 626 newly certified M/WBEs that DSBS provided to us.
- From the list of 18 denied businesses that we received from DSBS, we confirmed that all were reported as denied during Fiscal Year 2011 in the CTrack1 system.

To evaluate whether DSBS is adequately reviewing applications and certifying only those that are qualified M/WBEs, we randomly selected 35 enterprises that were M/WBE-certified from the Fiscal Year 2011 list of 626 newly certified enterprises, and from the list of 18 denials, we randomly selected five. We reviewed their case folders, including the applications, the documents the applicants were required to submit, any Notice(s) of Deficiency, and any desk audits/interviews that were conducted with the applicant. During our review of the case files, we determined whether all the pertinent documents were in the file, whether the DEFO certification review process was adequately documented, and whether DEFO's determinations of those that they qualified were adequately supported. In addition, for the three denied cases that submitted an appeal during Fiscal Year 2011, we reviewed their appeals and DSBS's decision.

To evaluate DSBS's handling of complaints, we requested any logs used by DSBS to track the receipt and resolution of complaints. In the absence of logs, we requested a list of all complaints received during Fiscal Year 2011 and a list of the enterprises whose certifications were revoked because of complaints. In lieu of those lists, we received and reviewed notices that DSBS sent to those enterprises that were the subject of certification reviews as a result of complaints. We also received and reviewed notices sent to enterprises decertifying them.

To determine whether the annual affirmation affidavits were being submitted in a timely manner and to evaluate DSBS's efforts to ensure their prompt submission, we calculated the number of affirmations that were due by October 2012 and requested that DSBS provide them to us. For the enterprises that DSBS could not provide us with evidence of their affirmations, we looked to see if they were still listed in DSBS's *Online Directory of Certified Businesses*. We also inquired as to DSBS's efforts to ensure that affirmations are submitted in a timely manner.



Robert W. Walsh
Commissioner

April 17, 2013

Hon. Tina Kim
Deputy Comptroller
City of New York
Office of the Comptroller
1 Centre Street, Room 1100
New York, New York 10007

Re: Audit Report on the Administration of the Minority and Women-owned Business Enterprise Program by the Department of Small Business Services. MH12-100A

Dear Deputy Comptroller Kim:

This letter represents the New York City Department of Small Business Services (SBS) response to the findings and recommendations contained in the Draft Audit Report (Report) issued by the Office of the New York City Comptroller (Comptroller) on March 27, 2013 regarding the administration of the Minority & Women-owned Business Enterprise (M/WBE) Certification Program.

The objective of the audit conducted by the Comptroller was to determine whether SBS has adequate controls to ensure that businesses certified as M/WBEs meet the necessary qualifications. We are pleased that the Comptroller's extensive review of our standard operating procedures generated overwhelmingly positive findings and that SBS operates in substantial compliance with all rules and regulations pertaining to the MWBE Certification Program. The Comptroller's findings demonstrate that SBS consistently administers a robust review standard for each program applicant and maintains strong controls throughout the certification process. SBS continues to increase the participation of M/WBE firms in City contracting by expanding its base of certified firms. To that end, we have worked hard to simplify certification without compromising review standards.

The Comptroller's Report identifies four findings and offers recommendations intended to assist SBS in improving the certification program by strengthening the annual validation review of certified firms, providing a third party review for certain certification decisions, centralizing complaints about vendors, and providing better safeguards to protect records. SBS addresses each of these findings and recommendations within the larger context of the recent and upcoming changes the agency has already begun to implement since Mayor Michael Bloomberg signed new legislation, Local Law 1 of 2013 on January 7, 2013. Local Law 1 of 2013 significantly enhances the M/WBE program by eliminating the \$1 million cap on contracts to which participation goals will apply and considerably increasing the overall number and value of contracts subject to participation goals. Among other administration-related changes, Local Law 1 requires SBS to collect more information from applicants during the certification process, publish additional applicant information in the Online Directory of Certified Businesses at www.nyc.gov/buycertified, and perform site visits in connection

with pending certification applications. The profile of certified firms will now include bonding capacity, union affiliation, and more detailed information on the extent to which the applicant performed a commercially useful function on previous jobs. SBS has already begun to define new rules and procedural elements within the certification process to comply with the requirements of Local Law 1, which takes effect on July 1, 2013.

SBS Responses to Specific Findings & Recommendations of the Report

Finding #1: Annual Affirmation Affidavits Are Not Submitted or Followed up on in a Timely Manner

Recommendation 1: SBS should send timely notices to M/WBEs that their annual affirmations are due by the anniversary of their certification date.

Recommendation 2: Ensure that all M/WBE certified enterprises submit their affirmations annually.

Recommendation 3: Determine which affirmations are still outstanding and follow up to ensure that they are submitted in a timely manner.

Recommendation 4: Ensure that the new protocols that SBS is creating for tracking and reviewing affirmations are instituted.

Recommendation 5: Ensure that certifications are revoked for those enterprises that do not submit their affirmations in a timely manner and remove them from SBS' Online Directory of Certified Business website.

SBS Response:

We generally agree with this finding and recommendations and have begun to implement changes to the current process to ensure the timely submission and tracking of annual affidavit of no material change in ownership or control submissions by certified M/WBEs. Under the current process, SBS emails an annual *Continuing Certification Affirmation* form to each certified company requesting that the business entity affirm that there has been no material change in ownership or control of the company. This form is sent on the firm's anniversary certification date. Although the intent of the *Continuing Certification Affirmation* form is to have certified business entities affirm that no ownership or control changes have occurred within the applicable period, it also enables SBS to capture applicable changes that may have taken place but have not yet been reported to the agency. These changes include, but are not limited to, changes to certified firm's business address and changes to the firm's business structure that may affect the company's eligibility. Responses received through the annual affirmation process are manually tracked and entered into SBS' certification management system, which are then uploaded to the online directory. Currently, SBS is soliciting a contract to develop a self-service portal at the Online Directory of Certified Businesses to enable certified firms to notify SBS of updates to key business information online, rendering many of our manual processes obsolete. The self-service portal will allow for both the notification of changes required within 45 days of any material change, as noted in Section 11-26 of the Rules, and the annual affidavit required as proof of continued eligibility in the certification program.

In the interim, SBS has developed a new report and more efficient process to track the receipt of annual affidavit responses. In this scenario, an initial notice will be sent to the certified firms requesting that the annual affidavit be completed and submitted to the agency. This notice will be

emailed 60 days in advance of the anniversary date. If SBS does not receive a completed affidavit within 30 days of the anniversary date, a Final Notice will be sent to the entity repeating the request and outlining potential consequences for failure to comply. This may include revocation of certification and removal from the Online Directory. Although SBS acknowledges the Comptroller's recommendation that certifications be revoked for those enterprises that fail to submit affidavits in a timely manner, we do not believe Section 11-24(b) expressly requires SBS to take such action. Rather, SBS believes this section provides us with the discretion to do so.

Finding #2: Lack of Third-Party Review When Director Overrules Analysts' Recommendations to Deny Certification

Recommendation 6: SBS should require that the DEFO director provide a more detailed explanation to justify overruling the reviewing analyst's recommendation to certify or deny certification of an applicant to the M/WBE program.

Recommendation 7: Develop a third-party review process for the DEFO director's overrulings of analysts' recommendations to deny the certification of a business.

Recommendation 8: Develop a mechanism to track instances in which the DEFO director overrules the analysts' recommendations.

SBS Response:

SBS disagrees with the finding that there is a lack of third-party review when the Director overrules a recommendation made by an analyst. Upon receipt of an application, a Certification Analyst reviews the documents for completeness and presents a recommendation to certify, deny, reject, or withdraw. The checklist contained within the certification application is used by the analysts to help them account for the required supporting documents and to determine the completeness of the application. The "Analyst Recommendation to Grant/Deny Certification" template is used by the analyst to provide a recommendation to the Director as to whether the documents submitted satisfy the applicable standards that are enumerated in the Rules. Section 1304 of the New York City Charter and Sections 11-21 through 11-26 of Title 66 of the Rules of the City of New York also provide direct guidance to analysts and the Director in understanding "what to specifically look for in the submitted documents" in order for the analysts to make a recommendation to the Director as to whether to certify or deny a potential M/WBE certification applicant. Although the analyst recommendation is an important component of the certification process, the Rules make it clear that the Director is ultimately responsible for making the certification determination. The reasons supporting the determination are recorded in the firm's electronic file. However, this authority does not preclude the Director from consulting with the DEFO Assistant and/or Deputy Commissioner as well as SBS' legal counsel when a particularly complicated or unique issue regarding a pending certification application arises. In fact, the Director engages in this consultation process on a regular basis.

Finding #3: Inadequate Tracking of Complaints

Recommendation 9: SBS should ensure the implementation of new protocols for tracking, reviewing, and resolving complaints relating to allegations of the ineligibility of an enterprise or to other matters central to the M/WBE program.

SBS Response:

SBS agrees in part with this recommendation. As the Comptroller notes, SBS investigates all complaints alleging violations of M/WBE rules and takes appropriate action. It is important to note that the SBS process used to address M/WBE-related complaints and/or determine what constitutes “appropriate action” is based on certain provisions enumerated in Section 11-26 of the Rules. In general, the guidance offered by Section 11-26 of the Rules fall within two distinct categories: Section 11-26(b)-(d) of the Rules identify options and processes for SBS to follow when authorized to investigate a complaint or series of actions contained in a complaint directly; conversely, Section 11-26(e) of the Rules makes it clear that under certain defined circumstances, the “appropriate action” for SBS to take is a referral to the City’s Department of Investigation.

Complaints can originate within the business community, from a City agency, or from a certification partner, among other sources. In circumstances where SBS is charged with investigating an M/WBE-related complaint and taking appropriate action, the agency generally uses the following process: Director will review complaint and the allegations contained therein. Once reviewed, the Director informs the M/WBE firm identified in the complaint that a complaint identifying them has been filed, what the nature of the alleged actions contained in the complaint are and that the firm will be required to cooperate with SBS while it investigates the claim(s) made (and that failure to cooperate may result in revocation of M/WBE certification status). Additionally, the written notice to the subject firm indicates that the firm has 28 days to submit a written response to SBS to the allegations of the original complaint.

SBS is implementing a new protocol to record future cases in a central log to track the totality of complaints and any decisions rendered within a given time period to ensure that individual cases are processed in a timely manner. SBS has appointed a point person to track all complaints in an Excel Spreadsheet. The spreadsheet contains the company contact information, details of the complaint, SBS personnel addressing each complaint, next steps and resolution. This spreadsheet is available on the DEFO shared drive for review but is locked for editing to secure the file contents. Another option SBS is exploring is to leverage the complaint tracking function of the Customer Relationship Management (CRM) system currently available to and used by SBS staff in other context.

Finding #4: SBS Safeguarding of Applicant Files Needs Improvement

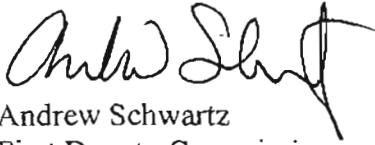
Recommendation 10: SBS should maintain locked storage cabinets for its application files.

Recommendation 11: Create a tracking system to record who and when someone removes a case file from the storage cabinets.

SBS Response:

SBS strongly believes in maintaining a secure storage system to ensure the privacy of applicants’ records. As the Comptroller’s Report notes, SBS maintains adequate controls to ensure that businesses certified as MWBEs meet the necessary qualifications, based on the evidence provided in the files sampled in the audit. Access to the department where certification applicant files are housed is restricted to SBS employees, who can enter only with an electronic access key. However, SBS has begun exploring additional safeguards such as a separate and distinct storage area that further restricts access to staff working within the certification unit. The storage space being considered will be locked when not in use by Certification staff and the access key will be held by only two certification unit staff. SBS will also establish a tracking system to record when a business record is removed and to reference the staff member who is in receipt of the file.

Sincerely,

A handwritten signature in black ink, appearing to read "Andrew Schwartz". The signature is fluid and cursive, with a prominent initial "A" and "S".

Andrew Schwartz
First Deputy Commissioner

c: Robert W. Walsh, SBS Commissioner
Anne Rascón, SBS Deputy Commissioner
Elizabeth Weinstein, Operations
Andrea Glick, MOCS