



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

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May 11, 2022

TO: Otto Solórzano, Acting Director
Workforce Development, Aging and Community Services

Rafael Carbajal, Director
Department of Consumer and Business Affairs

Selwyn Hollins, Director
Internal Services Department

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

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

We completed a follow-up review of the Local Small Business Enterprise (LSBE) Preference Program Improvement Opportunities Noted During Limited Review (Report #IOR-2015-10649) issued to the Department of Consumer and Business Affairs (DCBA) and Internal Services Department (ISD) on June 15, 2020. In October 2021, DCBA's functions related to the certification and oversight of LSBEs transferred to the Department of Workforce Development, Aging and Community Services (WDACS) Office of Small Business (OSB). Accordingly, our follow-up included inquiries of DCBA, ISD, and WDACS. As summarized in Table 1, we found that no recommendations have been implemented thus far. However, WDACS has shared its commitment to implementing the newly transferred recommendations and indicated that planning is underway to proceed with the recommendations in coordination with and ISD.

Table 1 - Results of First Follow-up Review

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

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

REPORT #F1-2015-10649

Between 2015 and 2022, the Office of County Investigations opened three criminal investigations of procurement fraud involving ten County vendors who cumulatively received more than \$40 million while engaging in improper, conflicted, and fraudulent procurement schemes against the County's LSBE program. We also received information that seven additional County vendors who the County cumulatively paid more than \$27 million may also be violating LSBE program requirements.

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

The LSBE Preference Program will be transferred from WDACS to the new Department of Economic Opportunity on July 1, 2022. Accordingly, we plan to delay our second follow-up review until December 2022 to provide additional time for the involved departments to act on these recommendations. We also plan to conduct additional follow-ups beyond the two normally indicated by our process to ensure that all the recommendations are fully implemented, and that the actions taken result in meaningful and lasting improvements to the LSBE program.

We thank DCBA, ISD, and WDACS - OSB management and staff for their cooperation and assistance during our review. If you have any questions please contact me at (213) 893-0058 or rcampbell@auditor.lacounty.gov, or your staff may contact Steven Lee at (213) 893-0551 or slee2@auditor.lacounty.gov.

RGC:GH:sl

Attachment

c: Arlene Barrera, Auditor-Controller
Audit Committee
Audit Division
Kelly LoBianco, Executive Director, Economic and Workforce Development, WDACS

LOS ANGELES COUNTY AUDITOR-CONTROLLER

Oscar Valdez
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Robert Campbell
DIVISION CHIEF

Office of County Investigations

Report #F1-2015-10649

**DEPARTMENT OF WORKFORCE DEVELOPMENT, AGING AND COMMUNITY SERVICES
DEPARTMENT OF CONSUMER AND BUSINESS AFFAIRS
INTERNAL SERVICES DEPARTMENT
IMPROVEMENT OPPORTUNITIES NOTED DURING LIMITED REVIEW (REPORT #IOR-2015-10649)
FIRST FOLLOW-UP REVIEW**

	RECOMMENDATION	A-C COMMENTS
1	<p>Priority 1 – Department of Consumer and Business Affairs (DCBA), in consultation with the Internal Services Department (ISD) and County Counsel, strengthen the Local Small Business Enterprise (LSBE) vendor certification process to provide reasonable assurance that vendors receiving preferential treatment under the LSBE program meet ordinance and program requirements, such as having a legitimate principal place of business and serving a commercially useful function.</p> <p>Original Issue/Impact: We noted examples where LSBE vendors systematically abused the Preference Program to fraudulently obtain County business by purporting to be legitimate providers of goods and services, but serving only as pass-through entities (i.e., intermediaries or extra participants in the transaction that do not add value or serve a commercially useful function) to create the appearance that the transactions were with a qualifying LSBE. This expressly violates the County Code and undermines the Board of Supervisors’ intent and provisions of County Code and defeats the intended purpose and jeopardizes the continued viability of the LSBE program.</p>	<p>Recommendation Status: Not Implemented</p> <p>DCBA and subsequently the Department of Workforce Development, Aging and Community Services (WDACS), Office of Small Business (OSB) have not yet strengthened the vendor certification process. During the transition of this program from DCBA to WDACS, OSB continues to rely primarily on external certifications (e.g., from the State of California or the Metropolitan Transit Authority) in certifying LSBEs.</p> <p>OSB management has agreed to add, as part of the County’s business certification application, a section which notifies and requires the applicant to attest that they: 1) will provide a commercially useful function on any bid undertaken; and 2) understand there must be no conflict of interest when they submit a bid. OSB management indicated they will ensure LSBE vendors are aware OSB is available to answer questions related to commercially useful function and conflicts of interest. OSB management stated that they plan to complete this update to the business certification application by July 2022.</p> <p>In addition, OSB and ISD management indicated that they have developed an alternative process to accomplish the objectives of this recommendation, whereby purchasing departments are trained and provided a commercially useful function certification form which includes a narrative section allowing the vendor to confirm they understand and meet program requirements, provide a description of how they intend to perform a commercially useful function for their respective bid, and attest that they have no conflicts of interest in a particular solicitation.</p> <p>For purchases under \$5,000, OSB and ISD management indicated that vendors will submit a commercially useful function form with each quote. ISD will lead training and</p>

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

	RECOMMENDATION	A-C COMMENTS
		<p>commercially useful function certification form distribution for departments, with the support of OSB, and OSB will lead vendor-focused training and communication.</p> <p>OSB will provide a projected timeline for implementing this recommendation before our next follow-up review.</p>
2	<p>Priority 1 – DCBA, in consultation with ISD and County Counsel, establish a process to promptly suspend and/or revoke the LSBE certifications of vendors that violate one of the Preference Program’s requirements.</p> <p>Original Issue/Impact: The County does not have any process to suspend or revoke the LSBE certifications of vendors that violate program provisions and ordinance requirements. Non-compliant vendors retain the benefits of LSBE certification, including pricing preferences and reduced competition. This reduced the LSBE program integrity.</p>	<p>Recommendation Status: Not Implemented</p> <p>DCBA management indicated that, in conjunction with ISD and County Counsel, they began drafting ordinance amendments for the LSBE Preference Program to: (1) authorize OSB to revoke an LSBE certification for non-compliance; and (2) establish a process whereby certified LSBE vendors can appeal OSB’s findings. OSB indicated that the draft ordinance is in progress with implementation on hold while the ordinance is finalized.</p> <p>OSB management indicated that they will provide a projected timeline for implementing this recommendation before our next follow-up review.</p>
3	<p>Priority 2 – DCBA, in consultation with ISD and County Counsel, establish formal conflict of interest disclosure requirements as part of the LSBE certification process, including the obligation of LSBEs to report potential conflicts, such as financial, familial, or other relationships with County procurement decision-making personnel and other County vendors. The requirements should specify sanctions for engaging in conflicted transactions and/or failing to disclose conflicts, such as revocation of LSBE certification, debarment, civil liability for false claims, and criminal prosecution.</p> <p>Original Issue/Impact: During the LSBE certification process, the County does not put vendors on notice or make it abundantly clear that they must adhere to County conflict of interest and gratuity policies or require prospective LSBEs to disclose relationships or potential conflicts with County employees or other vendors. This reduced program integrity and accountability.</p>	<p>Recommendation Status: Not Implemented</p> <p>OSB has not yet established a conflict of interest disclosure for LSBEs to acknowledge as part of the certification process. In conjunction with the corrective actions planned to address Recommendations #1 and #4, OSB management indicated they will work with County Counsel to develop a comprehensive description of the County’s existing conflict of interest disclosure requirements in a format that is easy for small business owners to understand. They will also ensure that they obtain a signed acknowledgment of understanding and agreement to follow these requirements from the principal of each small businesses during the LSBE certification application process.</p> <p>As noted above, DCBA also developed a commercially useful function certification form that includes a limited conflict of interest disclosure to be signed by LSBE vendors when responding to a County solicitation. ISD and OSB have agreed to provide training to departments and vendors, respectively on this certification.</p> <p>OSB management stated that they plan to update the LSBE certification application by July 2022 and will follow up with a projected timeline for implementing the balance of this recommendation prior to our next follow-up review.</p>

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RECOMMENDATION	A-C COMMENTS
<p>4 Priority 2 – DCBA, in consultation with ISD management, develop a process to ensure that LSBEs are informed of and agree to comply with program requirements at the time of certification and periodically thereafter, and retain documentation of the acknowledgment as part of the vendor’s LSBE certification file.</p> <p>Original Issue/Impact: The County does not require LSBE vendors to acknowledge they received, understand, and agree to comply with program requirements (e.g., that LSBEs must perform a commercially useful function), policies on prohibited conduct, and/or sanctions for non-compliance. LSBE vendors also are not informed of or required to comply with the standard County requirement to report attempted or actual improper solicitations or procurement related misconduct to the Fraud Hotline. This reduced program integrity and accountability and increased risk of improper purchase and fraud.</p>	<p>Recommendation Status: Not Implemented</p> <p>OSB has not yet developed a process to ensure that prospective LSBEs are informed of and agree to comply with program requirements at the time of certification. However, as indicated in the comments to Recommendation #1 OSB management has agreed to revise the application for applicants to acknowledge their obligations with respect to conflicts of interest and providing a commercially useful function on all County transactions. OSB reported they are updating the County Certification Portal and will add this functionality to the certification process by July 2022.</p> <p>OSB and ISD management also indicated that purchasing departments will be trained to obtain a commercially useful function certification during the solicitation process confirming that participating vendors understand and meet program requirements, documenting how they will perform a commercially useful function in their bid, and memorializing that they have no conflicts in a particular solicitation.</p> <p>OSB management indicated that they will provide a projected timeline for implementing this recommendation before our next follow-up review.</p>
<p>5 Priority 2 – DCBA management establish a risk- and activity-based program to periodically review a sample of LSBE vendors that receive County awards, to provide reasonable assurance that the LSBE program is functioning as intended and achieving its goals and objectives. This should include determining whether vendors are performing a commercially useful function and complying with other significant policies and program requirements.</p> <p>Original Issue/Impact: The County does not have a systematic plan or process for monitoring LSBE compliance with policies, procedures, and ordinance requirements. Such monitoring, particularly of LSBEs that have significant growth in County procurement activity, can identify vendors which are abusing the program or not performing a commercially useful function. This reduced program integrity and accountability and the likelihood that non-compliant vendors will be detected timely.</p>	<p>Recommendation Status: Not Implemented</p> <p>OSB has not yet implemented a program to periodically review a sample of LSBE vendors that receive County awards or LSBE vendors suspected of violating program requirements.</p> <p>OSB management indicated they plan to analyze data about LSBE program abuses and non-compliance from Departments and the Office of County Investigations (OCI) to identify the most effective and efficient approach to select a sample of LSBE vendors for review. OSB will then develop an action plan for following up, including suspending or revoking the certifications of non-compliant vendors.</p> <p>OSB management indicated that their review process will use the commercially useful function certification forms submitted with vendor bids to support vendor education and corrective actions when vendors are not meeting program requirements.</p> <p>Departments will also be instructed to report complaints and evidence of program non-compliance to OSB and</p>

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RECOMMENDATION		A-C COMMENTS
		<p>OCI, where appropriate. OSB management indicated they will review and follow up on complaints, and refer evidence of fraud or conflicts of interest to OCI.</p> <p>OSB management indicated they will provide an implementation plan and timeline before our next follow-up review.</p>
6	<p>Priority 2 – DCBA, in consultation with ISD, consider revising existing guidelines and/or developing a new policy applicable to the LSBE program to ensure that administrative and legal remedies are pursued consistently by all County departments when an LSBE is found to have violated program requirements. DCBA should also evaluate applying the new policy to other preference programs it administers.</p> <p>Original Issue/Impact: The County does not have guidelines and/or policy applicable to the LSBE program in place to ensure that all County departments consistently pursue administrative and legal remedies when an LSBE is found to have violated program requirements.</p>	<p>Recommendation Status: Not Implemented</p> <p>OSB has not consulted with ISD on guidelines and/or a new policy for County departments to report LSBE program violations to ensure that administrative and legal remedies are pursued consistently when an LSBE is found to have violated program requirements.</p> <p>OSB management committed to implementing this recommendation and will provide a timeline and implementation plan before our next follow-up review.</p>

We conducted our review in conformance with the International Standards for the Professional Practice of Internal Auditing. For more information on our auditing process, including recommendation priority rankings, the follow-up process, and management’s responsibility for internal controls, visit auditor.lacounty.gov/audit-process-information.

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