

Memorandum



To:
SABRINA WATTS-JEFFERSON
Acting Assistant Director
Office of Civil Rights Caltrans

Date: June 29, 2020

File: P3010-0652

From:
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Subject: Final Audit Report For Good Faith Efforts

Attached is the Independent Office of Audits and Investigations' final audit report on the Good Faith Efforts Audit. Your response has been included as part of the final report. This report is intended for your information and for Department Management.

Please provide our office with status reports on the implementation of your audit finding dispositions 60, 180, and 360 days subsequent to the transmittal date of this memorandum.

Senate Bill 1 requires the Inspector General to report at least annually, or upon request, to the Governor, the Legislature, and the California Transportation Commission with a summary of audit findings and recommendations. The summary along with this report and the status reports will be posted on the Independent Office of Audits and Investigations' Internet Web site.

SABRINA WATTS-JEFFERSON

June 29, 2020

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We thank you and your staff for their assistance provided during this audit. If you have any questions or need additional information, please contact Alice Lee, Audit Chief, at (916) 323-7953, or me at (916) 323-7863.

Attachment

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Good Faith Efforts Audit

Background

Good Faith Effort (GFE) is a process where a bidder on a federally-funded project demonstrates compliance with requirements for Disadvantaged Business Enterprise (DBE) participation goals. Bidders can demonstrate GFE either by showing they obtained enough DBE commitments to meet the participation goal, or if the goal is not met, they can document how adequate efforts were made to meet the goal. A DBE is a for-profit small business that is at least 51 percent owned by one or more individuals who are both socially and economically disadvantaged and whose management and daily business operations are controlled by one or more of the disadvantaged individuals who own it.

As required by federal regulation, Caltrans sets an overall goal for DBE participation on its federally-assisted contracts. The current goal is 17.6 percent. In order to meet this overall goal, individual contract goals for DBE participation are established on federally-funded contracts that have subcontracting possibilities. When a DBE participation goal is established, the contract award can only be made to the winning bidder if Caltrans determines the bidder documented GFE to meet the goal.

Key Findings

Caltrans GFE policies and procedures generally comply with federal regulations and Caltrans generally complies with GFE requirements through its policies and procedures such as the Caltrans DBE Program Plan, and the Office of Civil Rights' (OCR) Operational Procedure and Administrative Reconsideration Guidelines. However, we found 12 of 65 (18%) DBEs tested were not certified for the correct NAICS code to count toward DBE contract participation goals.

Key Recommendations

- Caltrans should update its Standard Specifications and Statement of Qualification Submittal Instructions for bidders to state that appropriate NAICS codes are required to count for DBE participation work on contracts.
- Caltrans should expand OCR's operational procedures to include steps that ensure DBEs are certified for the NAICS code(s) applicable to the kind of work performed on the contract so that DBEs are properly counted towards DBE participation goals.
- OCR should confirm with FHWA if Caltrans' current GFE procedure to allow either a work code or NAICS code certification is acceptable for meeting DBE contract participation goals.



California Department Of Transportation Good Faith Efforts

AUDIT REPORT

P3010-0652

JUNE, 2020



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P3010-0652

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IOAI'S Comments on the Response from the Office of Civil Rights

Summary, Objectives, Scope, Background, Methodology

Summary

The Independent Office of Audits and Investigations completed an audit of the California Department of Transportation's (Caltrans) Good Faith Efforts policy, practices, and procedures. For federally-assisted contracts, bidders are responsible to make adequate good faith efforts (GFE) to meet Caltrans' established Disadvantaged Business Enterprise (DBE) participation goal for contracts. To demonstrate GFE, bidders are required to either 1) document enough DBE participation to meet the contract goal or 2) if the goal is not met, document that it made adequate effort to meet the goal. Caltrans is responsible for determining whether bidders made adequate GFE to be awarded a contract. Our audit found that Caltrans policies and procedures generally comply with federal GFE regulations, and the policies and procedures are followed; however, improvements can be made to ensure DBEs are certified with specific federally required codes associated with the kind of work the contractor would perform on a contract.

Objectives And Scope

The objectives of the audit were to determine if:

- Caltrans' Disadvantaged Business Enterprise (DBE) policy and procedures comply with federal regulations for determining GFE.
- Caltrans is following its GFE policy and procedures.

The scope of the audit included reviewing GFE determinations on federally funded contracts awarded between October 1, 2018 and September 30, 2019. The extent of our audit covered the GFE process between advertisement and award. Our audit did not cover processes related to GFE that take place prior to advertising such as DBE goal setting or after contract award, such as the monitoring of DBE utilization.

We conducted our audit from December 18, 2019 through March 24, 2020. Changes after these dates were not tested, and accordingly, our conclusions do not pertain to changes arising after March 24, 2020.

Background

GFE is a process where the winning bidder on a federally-funded project demonstrates compliance with requirements for DBE participation goals. Bidders can demonstrate these efforts in one of two ways; 1) the bidder can show they obtained enough DBE commitments to meet the participation goal, or 2) if the bidder does not meet the goal, it can document how adequate efforts were made to meet the goal. A DBE is a for-profit small business that is at least 51 percent owned by one or more individuals who are both socially and economically disadvantaged and whose management and daily business operations are controlled by one or more of the disadvantaged individuals who own it.

As a recipient of federal financial assistance from the United States Department of Transportation, Caltrans is required by federal law to establish and implement a DBE program. The DBE program is designed to remedy ongoing and past discrimination in federal-assisted highway, transit and airport contracts. Among its objectives is the use of DBEs in all types of federally-assisted contracts and procurement activities. As required by federal regulation, Caltrans sets an overall DBE goal triennially. Currently, the overall goal is 17.6 percent of all federal contract dollars. In order to meet the overall goal, individual contract goals for DBE participation are established on federally-funded contracts that have subcontracting possibilities. Individual contract goals are based on the type and location of the contract work and the availability of DBEs to perform the particular type of work. The contract goal is set and approved by Caltrans Office of Civil Rights (OCR) prior to contract advertisement. When a DBE participation goal is established, the contract award can only be made to the winning bidder if OCR determines GFE was met by the bidder either meeting the goal or documenting an adequate GFE to meet the goal. The award cannot be denied to a bidder who failed to meet the goal but documented adequate GFE to meet the goal.

If a winning bidder does not meet the goal and does not document adequate GFE to meet the goal, the bidder must be provided an opportunity for administrative reconsideration. As part of the reconsideration, the bidder has the opportunity to provide written documentation or argument to support how it either met the goal or how it demonstrated adequate GFE. Caltrans then provides the DBE with a written response and explanation on its reconsideration decision. Caltrans' GFE determination process is shown in the flowchart at Attachment A.

OCR, the program responsible for GFE review procedures, developed the DBE Program Plan, Operational Procedure and Administrative Reconsideration Guidelines to comply with federal regulations and to provide guidance for

Caltrans to determine whether a DBE demonstrates GFE. The Caltrans Division of Engineering Services is responsible for awarding major construction contracts and the Division of Procurement and Contracts is responsible for awarding other contracts such as minor construction contracts, architecture and engineering, and service contracts.

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.

We reviewed Caltrans GFE policies and procedures for compliance with Title 49 of the Code of Federal Regulations, Part 26 (49 CFR 26) and Appendix A to 49 CFR 26. We reviewed OCR documentation to support that GFE was met either through 1) the winning bidder meeting the DBE participation goals or 2) the winning bidder not meeting the goal but showing that adequate effort was made to meet the goal. For bidders that OCR determined did not show GFE, we reviewed the files to determine if the bidders were offered an opportunity for reconsideration.

For the audit period of October 1, 2018 to September 30, 2019, Caltrans awarded a total of 296 contracts that had DBE participation goals. This consisted of 239 major construction contracts and 57 other contracts. To determine if GFE determinations were supported, we tested a sample size of 30 contracts; 24 major construction contracts and six other contracts, representing about 10 percent from each type of contract. Of the 30 samples, 16 contracts were awarded to winning bidders that met the DBE participation goal and 14 contracts were awarded to winning bidders that did not meet the participation goal but were determined to have documented adequate GFE.

Federal requirements state that for DBEs to count towards meeting participation goals, they must have a North American Industry Classification System (NAICS) code (a six-digit code used by state and federal agencies to classify business activities within an industry) for the work performed on the contract. Therefore, we selected 16 contracts out of the 30, which included a total of 65 participating DBEs, to determine if each of the DBEs were certified for the federally required NAICS code associated with the DBE's work code to be performed.

Views of Responsible Officials

We requested and received a written response from the OCR who disagreed with the finding and recommendations. Please see Attachment B for the response and Attachment C for the Independent Office of Audits and Investigations' comments to the response.

Results, Findings and Recommendations

Results

Based on our testing, we determined Caltrans GFE policies and procedures generally comply with federal regulations and Caltrans generally complies with GFE requirements through its policies and procedures such as the Caltrans DBE Program Plan, and the Office of Civil Rights' (OCR) Operational Procedure and Administrative Reconsideration Guidelines. We found that Caltrans' procedures generally assessed GFE properly for bidders that met Disadvantaged Business Enterprises (DBE) participation goals as well as for bidders that did not meet participation goals. Additionally, when bidders did not show GFE, we found adequate documentation to reasonably support OCR's determination. We also determined Caltrans appropriately offered reconsideration when the bidder did not document adequate GFE.

However, as noted below, we found instances where Caltrans did not document that DBEs were certified for the specific NAICS code associated with the Caltrans work code identified by the prime bidder.

FINDING 1 – DBEs Are Not Certified For The Specific NAICS Code Required To Count Towards DBE Participation Goals

We selected 16 contracts with 65 DBEs to determine if the DBEs were certified with the specific NAICS code required for the work activity or work code identified by the winning contract bidder. We found 12 out of 65 (18%) DBEs were not certified for the correct NAICS code to count toward DBE participation goals.

Caltrans' Standard Specifications for construction contractors and Statement of Qualifications (SOQ) Submittal Instructions for architectural and engineering contracts do not require NAICS codes but allows prime contractors the option to use either a NAICS code or a Caltrans work code on the DBE commitment form. Though federal regulation allows contractors to use other codes in addition to NAICS codes, such as Caltrans work codes, federal NAICS codes are always required to count toward DBE participation goals.

Without an applicable NAICS code, DBE participation percentages may be improperly counted towards satisfying GFE when meeting the contract goal. In addition, though not directly related to GFE, if DBEs are not properly certified in

a NAICS code, they are unable to use the certification in other states to bid on projects within that same NAICS code's work activity.

49CFR26.53(b) states, "In your solicitations for DOT-assisted contracts for which a contract goal has been established, you must require the following: A description of the work that each DBE will perform. To count toward meeting a goal, each DBE firm must be certified in a NAICS code applicable to the kind of work the firm would perform on the contract."

Recommendations

- A. OCR, the Division of Engineering Services, and the Division of Procurement and Contracts should work together to update the Standard Specifications and SOQ Submittal Instructions to state that the appropriate NAICS codes are required to count for DBE participation work on contracts.
- B. OCR should expand operational procedures to include steps that ensure DBEs are certified for the NAICS code(s) applicable to the kind of work performed on the contract so that DBEs are properly counted towards DBE participation goals.
- C. OCR should confirm with FHWA if Caltrans' current GFE procedure to allow either a work code or NAICS code certification is acceptable for meeting DBE contract participation goals.

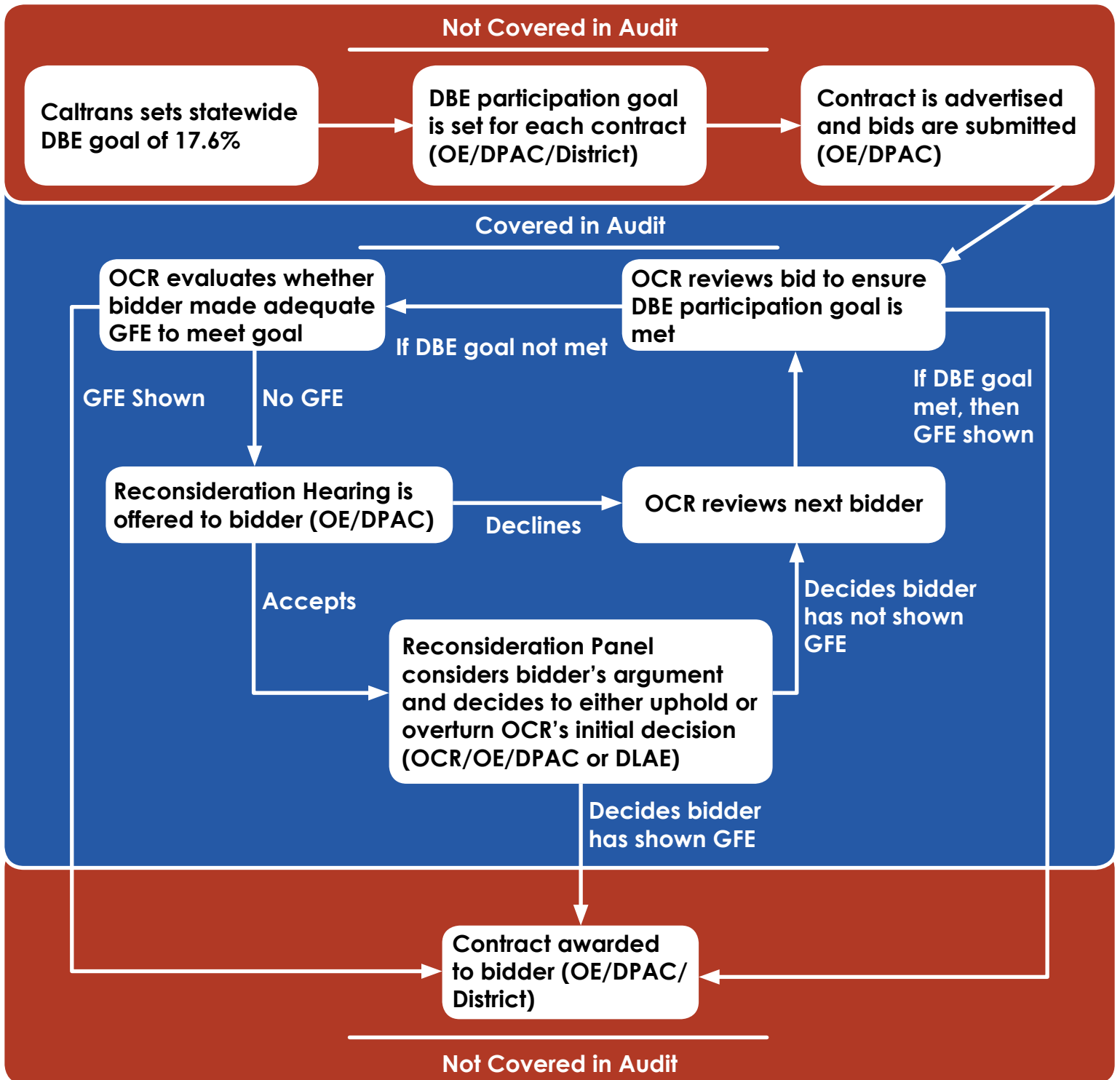
Caltrans' Office of Civil Rights' Response

The OCR disagrees with the finding and recommendations A and B. Please see Attachment B for details of their response. For brevity purposes, the OCR's attachments to their response were not included in this audit report.

Analysis of Caltrans' Office of Civil Rights' Response

The support provided by OCR in their response does not show FHWA's approval to allow Caltrans to waive the NAICS code requirement. However, OCR responded that they will confirm with FHWA on whether their current practice is acceptable; the audit report was edited to include this as a recommendation. Please see Attachment C for IOAI's comments to OCR's response.

ATTACHMENT A GFE PROCESS FLOWCHART



Key
 DBE = Disadvantaged Business Enterprise
 GFE = Good Faith Effort

OCR = Office of Civil Rights
 OE = Office of Engineering
 DPAC = Division of Procurement and Contracts

Attachment B

State of California
Independent Office of Audits And Investigations

California State Transportation Agency

*Making Conservation a California
Way of Life*

Memorandum

To:
RHONDA L. CRAFT
Inspector General
Independent Office of Audits and Investigations

Date: June 12, 2020

From:
SABRINA WATTS-JEFFERSON
Acting Assistant Director
Office of Civil Rights Caltrans

Subject: Office of Civil Rights Response to Good Faith Effort Audit

Thank you for the opportunity to provide a response to the draft report on Good Faith Effort. the objective of the audit was to determine if 1) Caltrans' Disadvantaged Business Enterprises (DBE) policy and procedures comply with federal regulations for determining good faith efforts (GFE) and 2) Caltrans is following its GFE policy and procedures. The Office of Civil Rights(OCR) is pleased that the auditors determined that Caltrans GFE policies and procedures generally comply with federal regulations and Caltrans generally complies with GFE requirements through its policies and procedures.

The auditors reviewed the Caltrans GFE policy and procedures and provided one finding and general recommendations. OCR believes the lack of understanding of a broader overview of the DBE program plan, the program's historic use of North American Industry Classification System (NAICS) code and its supplemental Work Codes and the continued working relationship with FHWA in the DBE program plan development, led to a finding that is only tangentially related to the GFE process. As a result, OCR needs to disagree with the finding in the Draft GFE Audit report submitted to OCR on May 18, 2020.

1. The finding, which in our opinion is DBE Certification centric, states, "DBE's are not certified for the specific NAICS code required to count towards DBE participation goals." The audit further states, "Without an applicable NAICS code, DBE participation percentages may be improperly counted towards satisfying GFE when meeting the contract goal." OCR disagrees with this finding based on the current practice of the use of NAICS Code and Work Codes to determine both certification and counting DBE participation.

"Provide a safe, sustainable, integrated and efficient transportation system to enhance California's economy and livability"

For historical perspective, the use of both NAICS Code and Work Codes - a descriptor from a classification scheme of equivalent detail and specificity (49 CFR 26.71 (n)(1)) - by Caltrans to certify firms and count towards DBE participation goals has been the practice for over 20 years. In 2018, the Caltrans Standard Specifications, Section 2, "Bidding," was revised to allow the Prime Contractor to supply the DBE firm's NAICS code or Work Codes in its DBE commitment submittal to assist with DBE participation in Caltrans projects.

2. Attached is documentation of communication between the FHWA and OCR that reinforces the collaborative work between FHWA and OCR to develop a DBE program that is narrowly tailored yet maximizes DBE participation in the state. The documentation includes notes from the previous FHWA Civil Rights Manager, Mr. Lance Yokota. The 2011 notes from Mr. Yokota indicates that he understood Caltrans DBE goal setting methodology and good faith effort procedures, which includes the use of work codes instead of NAICS codes.

2. Also attached is a training module presented by Mr. Yokota on Good Faith Effort. Slide 25 shows the trainee how to look at a work code to determine DBE participation. The challenge with the exclusive use of NAICS codes is the broad nature of the NAICS codes. Their exclusive use limits the participation of smaller DBE firms that are unable to receive certification under a broad NAICS code due to its greater requirements for certification. However, the same DBE firm can work on Caltrans projects as a certified DBE firm under a work code increasing the utilization of smaller DBE's companies throughout California.

The audit report also states, "thought not directly related to GFE, if DBEs are not properly certified in a NAICSs code, they are unable to use the certification in other states to bid on projects within that same NAICS code's work activity. With a properly certified NAICS code, a DBE's certification from Texas may be valid for the same type of work in California and vice versa. Within California, certifications and NAICS codes can also be used between different government agencies."

3. While we understand how this assumption can be made, this is not a completely accurate statement as interstate certification is more nuanced than a carte blanche reciprocity. Interstate Certification is based on 49 CFR 26.85 et al. and like most states, Caltrans has taken the option to certify out of state firms on a case-by-case basis as stipulated in §26.85(c). Caltrans does not allow for blanket approval solely based on the DBE firm holding a different state's certification under a NAICS code (§26.85(b)).

The reason being, some states have different requirements when it comes to licensing or qualification issues of applicant. For that reason, as §26.85(d) (iv) states, "...the State law of State B requires a result different from that of the State law of State A," one cannot assume what's valid in one state will be valid in another.

Within California, the certification process is jointly controlled by a group of certification agencies - the California United Certification Program (CUCP) - that reach consensus when determining changes to the certification processes. If Caltrans changes its certification process, the CUCP agencies need to have a voice in the implementation of the changes in the certification processes without consensus from other agencies.

4. Based on the June 4, 2020, meeting between OCR and on of A&I's concerns regarding Caltrans use of work codes centers around the lack of written documentation of FHWA concurrence. OCR will work with existing FHWA Civil Rights Manager to confirm that our current practice is acceptable.

5. In closing, to limit Caltrans ability to use work codes and require NAICS codes hurts Caltrans ability to include a wider array of DBE firms in California, prevents Caltrans from have a narrowly tailored DBE program as required by the FHWA, and meetings for past two years. The number of contracts approved based on GFE are minimal (statistically insignificant) compared to those that meet the goal requirement via prime contractors GFE process. Changes to the current practices will result in the need for a new DBE Program Plan, a complete change in the DBE goal setting process, coordination with the CUCP and changes to all related policies that involve the Division of Project Delivery, the Division of Procurement and Contracts, and the Division of Local Assistance.

If you have any questions, please contact me at (916) 926-3120 or at Sabrina.Watts-Jefferson@dot.ca.gov.

Attachments

1. 2011 note from Lance Yokota, FHWA
2. GFE Training Power Point from Lance Yokota, FHWA

c: James E. Davis, Chief Deputy Director, California Department of Transportation

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and Office Engineer

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ATTACHMENT C

IOAI'S Comments on the Response from the Office of Civil Rights

To provide clarity and perspective, we are commenting on the Office of Civil Rights' (OCR) response to our audit. The numbers below correspond to the numbers we have placed in the margin of OCR's response.

1. Though OCR's current practice allows the use of NAICS codes and work codes for certification and DBE goal setting, it does not require in all instances the use of a NAICS code as required by 49 CFR 26.53(b)(2)(ii). Based on our audit of OCR's practices, we found the OCR Contract Evaluation Branch determines DBE participation based on the DBE having either a work code **or** a NAICS code but not always requiring a NAICS code. The OCR's Contract Evaluation Branch Manager during the audit period stated that if a DBE was certified with a work code appropriate for the work to be performed on the contract, staff would perform no further review to determine whether the DBE was also certified in an applicable NAICS code.

2. As early as February 2020, IOAI requested documentation to support OCR's claim that the Federal Highway Administration (FHWA) approved the use of work codes instead of NAICS codes. The information was not provided during the audit. In its June 2020 response, OCR provided an email communication dated 1/3/11 and a power point presentation from 2005 titled "Tips for Evaluating Good Faith Efforts" from a former FHWA Civil Rights Manager as evidence. These documents, however, do not state FHWA's approval of the use of work codes instead of NAICS codes. The email communication does not specifically mention or reference work codes or NAICS codes. In addition, the power point slide (#25) that OCR provided showed trainees how to look at work codes to determine DBE participation but also clearly identified on the slide, a NAICS code associated with each work code.

Additionally, OCR states that the challenges of being required to exclusively use NAICS codes is the broad nature of the codes. However, the audit is not recommending the exclusive use of NAICS codes over work codes. As stated in our report, the federal regulation allows work codes in addition to required NAICS codes.

3. The IOAI understands that Caltrans certifications may not always be accepted by other states due to reasons such as differing licensing requirements. However, at a minimum, all DBEs are required to be certified with the proper NAICS code(s) associated with the work to be performed on a contract. The report was edited to remove the following: "With a properly certified NAICS code, a DBE's certification from Texas may be valid for the same type of work in California and vice versa. Within California, certifications and NAICS codes can also be used between different government agencies."

4. In working with the FHWA to confirm if Caltrans' current practice is acceptable, OCR should be clear to communicate that the current GFE process does not include verifying DBEs are certified for the NAICS code specifically associated with the work code used to meet DBE contract participation goals.

5. OCR states IOAI's recommendation limits Caltrans ability to use work codes and that by requiring NAICS codes, it hurts Caltrans ability to include a wider array of DBE firms in California, prevents Caltrans from having a narrowly tailored DBE program as required by FHWA, and prevents Caltrans from meeting its overall DBE goal. IOAI's recommendation is based on 49 CFR 26.71(n)(1), which does not limit the use of work codes but allows the use of work codes in addition to required NAICS codes, and 49 CFR 26.53(b)(2)(ii) that states that appropriate NAICS codes are required to count for DBE participation work on contracts. Additionally, 49 CFR 26.53(b)(2)(ii) specifically requires a NAICS code to count towards meeting DBE contract goals.