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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

March 7, 2014

Mr. Anthony J. Annucci
Acting Commissioner
Department of Corrections and Community Supervision
Building 2
1220 Washington Avenue
Albany, NY 12226-2050

Re: Selected M/WBE Purchases by Various
Facilities
Report 2013-S-30

Dear Acting Commissioner Annucci:

According to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law, we audited minority- or women-owned business enterprise (M/WBE) purchases by Department of Corrections and Community Supervision (Department) facilities from one vendor, American Indian Woman Incorporated (AIW).

Background

State Executive Law charges State agencies with establishing business participation goals for minorities and women. As part of this effort, agencies must prepare an annual plan establishing goals for M/WBE participation in their discretionary purchases throughout the year. An M/WBE is defined as an entity that is at least 51 percent owned and controlled by the minority members and/or women whose ownership interest is real, substantial and continuing, and who control the day-to-day business decisions. These enterprises must also be authorized to do business in New York State and registered under the State's M/WBE program, which is administered by Empire State Development (ESD). For 2013, the Department's M/WBE program goal is to direct a minimum of 10 percent of its discretionary purchase amounts to minority-owned businesses and another 10 percent to women-owned businesses, for a combined annual total of 20 percent.

Our analysis of State expenditure patterns identified that, in February 2013, three Department facilities (Coxsackie, Greene and Ulster) began directing what appeared to be a series of routine maintenance supply purchases through AIW, a registered M/WBE vendor. The purchases

were for miscellaneous supplies such as paint, padlocks, plumbing supplies, electrical supplies, batteries, sheetrock and safety equipment. These purchase transactions were for relatively low dollar amounts - typically under \$2,500. In September 2013, two additional facilities (Marcy and Mid-State) also began purchasing similar supplies through AIW. In total, between February and September 2013, these five facilities made about \$21,000 in purchases through AIW.

Available information raised questions about the substance of these transactions, as it appeared some of these items were actually being supplied by non-M/WBE businesses. We initiated our audit to determine the true nature of the transactions and to determine whether they were undertaken in compliance with existing law and regulation.

Results of Audit

We found the Department's purchases through AIW complied with all existing M/WBE rules and requirements, and that AIW is a legitimate, qualified M/WBE vendor certified by New York State. At the same time, although we found these transactions to be legitimate, their nature raises certain issues that we believe warrant further consideration by management and ESDC officials, including the extent to which these transactions are consistent with the core intent of the State's M/WBE program.

For each of the transactions we identified, we found AIW served as an intermediary or "broker" for the facility, a role that is not prohibited by any rule or regulation and is, in fact, sanctioned by M/WBE program policy. In most cases, we found discretionary purchases from AIW began with facility staff obtaining a price quote from a vendor that they had previously used for needed products. Usually these vendors were nearby stores, including large chains such as Lowe's or Ace Hardware, or large material suppliers like Grainger. Purchasing staff at the facility then contacted AIW and directed it to purchase the specific item(s) from the specified vendor. AIW, in turn, ordered the products from the vendor and arranged either for delivery to the facility or for pickup by facility staff, as directed by the facility. Our review of billing records showed that AIW then billed the facility for the products at a price that included a markup above its cost.

Although not specifically required by M/WBE rules or regulations, the extent of any "value added" by AIW's role in these transactions is not readily apparent, especially in cases where facility staff still did the work of obtaining prices, selecting vendors and picking up the purchased products. Instead, a question can be raised regarding whether the real value added by these transactions is in the facilities' ability to count them toward achieving the Department's M/WBE goals. It is also important to note that the functional role an M/WBE vendor fulfills is relevant to the extent to which a purchase can be applied toward that M/WBE goal. According to guidance issued by ESD, agencies can only claim the full value of purchases when they are made from M/WBE suppliers. When they are made through M/WBE brokers, only 25 percent of the cost of purchases can be claimed.

We met with AIW officials, who told us that their primary objective is simply to meet the needs of their customer. They indicated the company offers a wide range of services and is prepared to undertake as much or as little of the work involved in a procurement as their

customer requires. They stated that AIW does have some warehousing facilities outside New York and could take possession of the goods being purchased, and thereby function as a supplier, if necessary. However, for lower dollar purchases, they stressed that it is usually more cost effective for a facility if AIW simply brokers the purchase and has the items drop-shipped to the facility or picked up by facility staff.

We also met with Department and facility staff to get their perspectives on both the nature and intent of these transactions. While acknowledging that these purchases help the Department achieve its M/WBE goals, they also discussed the facilities' role as an economic engine in some of the communities where facilities are located and the frequent lack of certified M/WBE businesses in many of these rural areas. They indicated that the use of an M/WBE broker is one way in which they can balance these competing priorities.

Issues for Further Consideration

Although we found the purchases we examined were appropriate in the context of current rules and regulations, the use of M/WBE firms as brokers poses some issues that relate to the intent of the program, as well as to agency efforts to balance competing priorities. The use of brokers would likely make it much easier for agencies that are not located in areas with large numbers of M/WBE businesses, including many correctional facilities, to use M/WBEs and meet their goals while still investing in their communities. At the same time, these arrangements could also impact the extent to which more traditional opportunities are made available directly to M/WBEs.

Even though the extent of purchases that we identified and examined (\$21,000) was not significant, this figure could increase if more facilities adopt such practices. Currently, there is limited guidance available on the use of M/WBE firms as brokers. As a result, the following issues warrant consideration by the Commissioner and other Department officials, possibly in consultation with ESD, should this type of purchasing continue to expand:

- Does the use of brokers, especially in cases where the substance of the transactions is essentially unchanged from traditional purchasing patterns, reduce the incentive for agencies or facilities to identify and do business directly with other M/WBE firms who might compete for such purchases and contracts?
- How does the use of M/WBE firms as brokers for transactions advance the overall program goals of promoting access and opportunities for minority- and women-owned businesses and in eradicating the barriers that have unreasonably impaired their access to traditional contracting opportunities?
- To what extent should brokers be required to add value to a transaction and how could that value be quantified or measured?

We respectfully pose these questions for the Department's consideration in context to our observations.

Audit Scope, Objective and Methodology

We audited the Department's purchases from AIW for the period February 1, 2013 through September 20, 2013. The objective of our audit was to determine if the Department complied with M/WBE procurement rules and other State purchasing requirements. To accomplish our audit objective, we reviewed pertinent State laws, procurement guidelines and Department directives. We examined the Department's procurement files for the purchases through AIW. We also interviewed Department officials about the purchases, both at the Department's Central Office and at the three correctional facilities we visited (Coxsackie, Greene and Ulster). Additionally, we contacted several third party vendors from which AIW obtained the products it sold to the Department. We also interviewed AIW officials and sought guidance from ESD officials who administer the State's M/WBE program.

We conducted our performance audit according to generally accepted government auditing standards. These standards require that we plan and perform our audits 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.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

Major contributors to this report include Danielle Rancy, Michele Krill, Todd Seeberger and Steve Goss.

A draft copy of this report was provided to Department officials for their review and comment. Their comments were considered in preparing this final report and are attached in their entirety at the end. Department officials stated they have already shared our observations with ESD and will continue to have conversations with them regarding the policy issues raised in this report to ensure that all parties are meeting the intent of the M/WBE program.

Very truly yours,

John F. Buyce, CPA
Audit Director

cc: Vanessa Norton, DOCCS

Agency Comments



STATE OF NEW YORK

**DEPARTMENT OF CORRECTIONS
AND COMMUNITY SUPERVISION**

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ANTHONY J. ANNUCCI
ACTING COMMISSIONER

OSBOURNE A. MCKAY
DEPUTY COMMISSIONER
CORRECTIONAL INDUSTRIES & ACCREDITATION

January 10, 2014

Mr. Todd J. Seeberger, CIA, CFS
Office of the State Comptroller
110 State Street
Albany, New York 12236

Re: Preliminary Observations
Selected M/WBE Purchases by Facilities

Dear Mr. Seeberger:

Thank you for your preliminary report on the audit on Selected M/WBE Purchases by Facilities and for the opportunity to comment on this report.

First, the Department would like to correct two misimpressions from paragraph 2 of the "Results of Audit" section of the report, which implies that "...discretionary purchases from AIW began with facility staff obtaining a price quote from a vendor that they had previously used for needed products," and also purchases made from AIW always "included a mark up above its cost." Our analysis of purchases from AIW illustrates that often, their prices were the lowest among those from the other available vendors. In addition, while there have been instances where staff obtained quotes from a vendor that was previously used, this should not suggest that the Department is not following the State Finance Law, the State Procurement Guidelines and our internal policy directives as it relates to discretionary purchases.

Second, the Department has shared the report with Empire State Development (ESD) and will continue to have further conversations with them regarding the policy issues raised to ensure that we are meeting the intent of the M/WBE Program. Also, the Department will continue to follow the existing procurement guidelines to ensure that we are getting the best value when procuring goods and

services. The Department is also committed to conducting business with New York State businesses, subcontractors, and suppliers.

The Department would like to thank the OSC auditors for their time and for the opportunity to comment on this matter.

If there are any questions, please contact Vanessa Norton, Acting Director of Internal Controls, at (518) 485-1394. Thank you.

Sincerely,

A handwritten signature in black ink, appearing to read "Osbourne A. McKay". The signature is stylized and cursive.

Osbourne A. McKay
Deputy Commissioner

cc: Daniel F. Martuscello, III, Deputy Commissioner
Maureen E. Boll, Deputy Commissioner and Counsel
Robert Kennedy, Assistant Commissioner
Deborah Nazon, Director of Diversity Management
Sandra Downey, Director of Budget and Finance
Vanessa Norton, Acting Director of Internal Controls
Jeff Nesich, Director of Internal Audit