



## CONSTRUCTION

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# CONSTRUCTION - MINORITY PARTICIPATION GOALS: COMPLIANCE BURDEN FOR THE CONSTRUCTION CONTRACTOR

In recent years, many construction contractors have faced significant fines for non-compliance with minority participation goals contained within their construction contracts. Recently, several major contractors settled non-compliance cases for total payments in excess of \$100 million to avoid debarment and criminal prosecution. Clearly, the Offices of Inspector General at various public agencies are sending a message: non-compliance will not be tolerated and these cases will be investigated and prosecuted to the fullest extent of the law.

However, in today's political environment, prime contractors must deal with the ever increasing complexities of complying with the minority participation goals, and many construction industry professionals are questioning whether these goals are truly obtainable and what can be done to improve compliance.

The use of the Federal Disadvantaged Business Enterprise Program and Minority and Business Enterprise Program on the federal and state levels is dictated by the funding source that a contracting agency receives and uses for its construction projects. As a result, some state agencies and authorities use both the federal and state programs and some city agencies will use the federal, state, or city programs for their contract work. For the typical construction contractor, the presence of multiple funding sources on a project poses difficulties as contracting agencies interpret these various regulations differently and what is acceptable under one program may be considered a crime under another program.

## ABOUT THE PROGRAMS:

### **Federal Disadvantaged Business Enterprise (DBE) Program**

- The DBE program is a federal program operating under the guidance of the U.S. Department of Transportation (U.S. DOT) 49 CFR Part 26. In 1980, the U.S. DOT launched the DBE program to increase the participation of minority and disadvantaged business enterprises in federally funded public construction contracts.
- Initially, the Surface Transportation Assistance Act (STAA) of 1982, and subsequent transportation acts such as the Intermodal Surface Transportation Efficiency Act (ISTEA) of 1991, stated that to the fullest extent possible at least 10% of Federal Aid Highway funds be expended with small, disadvantaged business enterprises.

- In 1983, Congress enacted the first statutory DBE provision, applying primarily to small minority-owned firms. In 1987, the program was expanded to women owned firms.
- However, in 1999, new DBE program regulations were implemented that changed the direction of the program from the old philosophy of “maximum participation” by DBEs to that of creating a “level playing field” for DBEs to compete equally for contracts. These program changes were in response to the Supreme Court’s 1995 decision in *Adarand v. Peña* that affirmative action programs be “narrowly tailored to serve a compelling governmental interest,” which addressed discrimination.
- The U.S. DOT recently proposed rule changes to the DBE program which will make it more onerous for prime contractors to comply.

## Sample State Programs

### *New York*

The Certification Unit of the New York State (NYS) DOT is responsible for certifying DBE firms in New York State. Once certified, the firm is listed in the NYS Unified Certification Program’s Directory of Certified DBEs.

In addition, the Minority and Women Business Enterprise (M/WBE) Program in New York includes these specifications:

- The minority and women business programs known as M/WBE programs cover New York State and New York City funded programs. Other states have similar M/WBE programs as well.
- In the early 1990s, Mayor Dinkins and the City Council established an M/WBE program which Mayor Giuliani promptly dismantled in 1994.
- In response to a 2005 study that revealed significant disparities in the number of New York City contracts awarded to M/WBEs, the City Council passed Local Law 129 which codified a citywide M/WBE program and created a policy that would ensure fair and full participation for M/WBEs in the City’s procurement process.
- The Empire State Development, New York State’s economic development agency, administers the M/WBE State certification program. Once certified, a company is officially recognized by all New York State agencies and is listed in the Directory of Certified Minority and Women Owned Business Enterprises.

### *New Jersey*

In New Jersey, the Set Aside Act for small businesses, female businesses, and minority businesses (Set Aside Act), requires that contracting agencies shall increase the percentage of State contracting dollars that shall be set aside for small businesses from the previous minimum percentage of 15 percent to 25 percent.

### *Maryland*

In Maryland, the Small Business Reserve Program requires that certain state agencies structure their procurement process so that at least 10 percent of the total procurement dollars are spent on qualified small businesses.

### *Virginia*

The Virginia Unified Certification Program includes two certifying agencies: The Department of Minority Business Enterprise (DMBE) and the Metropolitan Washington Airport Authority. DMBE administers both the Small, Women owned, and Minority owned Business Certification Programs and a DBE program.

### The “Commercially Useful Function” Requirement:

- Under the DBE programs, prime contractors are allowed to count toward their DBE percentage goals only funds paid to DBE companies that perform a “commercially useful function.”
- A DBE performs a “commercially useful function” when it:
  - Is responsible for the execution of a distinct element of the work of a contract.
  - Carries out its responsibilities by actually performing, managing, and supervising the work involved.
  - Furnishes all supervision, labor, tools, equipment, materials, and supplies necessary to perform that distinct element of the contract work.
- A DBE does **not** perform a “commercially useful function” if its role is limited to that of an extra participation in a contract through which funds are merely passed in order to obtain the appearance of DBE participation in a contract.
- The prime contractor is responsible for making sure that a DBE subcontractor performs a “commercially useful function.”

## Complexities for the Prime Contractor:

Once a contract is awarded, the prime contractor has the burden of establishing the policies and procedures to ensure compliance with the minority participation goal requirements of the contract. Prime contractors are constantly struggling to comply with these requirements on a daily basis, in areas such as:

- **Unrealistic Minority Participation Goals:** There simply may not be enough qualified minority contractors to perform the work. Some states maintain a listing of certified MBE firms which are categorized by the type of work they perform. However, this listing is in itself not sufficient for the prime contractor to know if the subcontractor has the internal resources, experience, and expertise to perform the necessary scope of work required for the project at hand.
- **M/WBE/DBE Qualification:** Although the M/WBE/DBE programs list certified contractors at the time of the initial contract award and procurement process, it is the prime contractor's responsibility to verify that the subcontractor remains qualified throughout the duration of the project.
- **Good Faith Efforts:** Regulations allow the prime contractor to apply for a waiver to reduce the minority participation goal if the contractor proves that he has made a "good faith effort" to hire M/WBE/DBEs. However, there are differing interpretations amongst the various contracting agencies as to what constitutes a "good faith effort." A higher bid price from an M/WBE/DBE is not in itself sufficient grounds for a waiver where the bid price is reasonable in nature. The prime contractor needs to establish a transparent working relationship with the contracting agency's Compliance Officer to work through these issues.
- **Second-tier M/WBE/DBE Subcontractors:** As a general statement, second-tier subcontracting can be counted toward the minority goal requirements if the second-tier subcontractor is a qualified M/WBE or DBE (depending on the specific program) which performs a "Commercially Useful Function." The problem for the prime contractor is that there is no privity of contract with the second tier subcontractor, and therefore, it may be difficult for the prime contractor to verify minority goal compliance. In New York, the DOT has identified "D/M/WBE Subcontractors second-tier subcontracting" as a circumstance "that may potentially be fraud and may be further investigated."
- **DBE Suppliers:** Prime contractors need to determine whether or not a DBE supplier is in fact a supplier or a "regular dealer," as defined by federal regulations, as opposed to merely a "broker" which arranges or expedites the procurement of supplies. The distinction is significant because under federal regulations, a prime contractor receives credit equal to 60% of the value of goods purchased from a "regular dealer" and only the fee or commission amount that a DBE "broker" may earn from the transaction.
- **Efforts to Ensure Compliance:** Federal, state and city agencies have been aggressively searching for new ways to ensure that prime contractors are held accountable for the M/WBE/DBE subcontractor utilization, tracking and compliance requirements. Some agencies are requiring prime contractors to complete training for the minority participation goal requirements, to regularly certify that they are on track to meet their subcontractor goals, and to develop automated methods to allow the agencies to track payments to subcontractors. Certain agencies intend to add language in future contracts to set liquidating damages for prime contractors who do not make a good faith effort to meet these goals.

## HOW DO PUBLIC AGENCIES AND CONTRACTORS WORK TOGETHER?

If public agencies participate in joint efforts with the construction contractor to meet the goals rather than just enforcing the goals, we may see increased compliance. Specifically, public agencies should provide more information to the prime contractor on the work qualifications of the M/WBE/DBE subcontractor. Examples of where the public agencies can improve the process are as follows:

- **History of Completed Work:** A track record of completed work by the minority contractor would help the prime contractor evaluate if the subcontractor is capable of performing the scope of the proposed work.
- **Type of Construction Activity:** The current lists simply identify the type of work that the minority contractor performs and does *not* make a distinction between a building trades contractor as opposed to a contractor involved in heavy/civil construction activity. A painter involved in interior painting may *not* have any expertise with respect to painting bridges. Many certified minority contractors lack the necessary capital requirements required in performing heavy/civil construction. Simply stated, a building trades specialty subcontractor may *not* be the right fit for a sewer/water main prime contractor.

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- **Certification Process:** The application process appears to be flawed in that many certified minority contractors are *not* capable of performing the work for which they are certified. Contractors that lack office facilities, own little or no equipment, and employ few employees somehow slip under the radar of public oversight and continue to be listed as certified minority contractors.
  - **Commercially Useful Function:** The public agencies should take on more responsibility to monitor the certified minority subcontractors to ensure that they are performing a “commercially useful function”. Currently, the prime contractor has the responsibility to continually monitor this throughout the duration of the project and it is the prime contractor who can be prosecuted for misrepresentation.

## NEXT STEPS:

In today’s environment, there is too much responsibility placed on the prime contractor with not enough support from the public contracting agencies. The construction contracting community needs to open up communication channels with public agencies to properly address the complexities and difficulties of complying with the minority participation goal requirements, and contractors can do so by using their trade associations as a vehicle to interface with the agencies.

As contractors review their internal ethics policies and procedures, minority set aside programs should be among the areas examined. Your accounting firm can assist in reviewing internal policies and procedures related to all of the programs to help ensure compliance.

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