
PERFORMANCE AUDIT OF THE PURCHASING AND CONTRACTING DEPARTMENT'S SMALL LOCAL BUSINESS ENTERPRISE PROGRAM

Office of the
City Auditor

City of San Diego



The Program's Design and
Insufficient Oversight Limit Efforts to
Increase Diversity and Small
Business Development in City
Contracting

Performance Audit of the Purchasing and Contracting Department's Small Local Business Enterprise Program

The Program's Design and Insufficient Oversight Limit Efforts to Increase Diversity and Small Business Development in City Contracting

Why OCA Did This Study

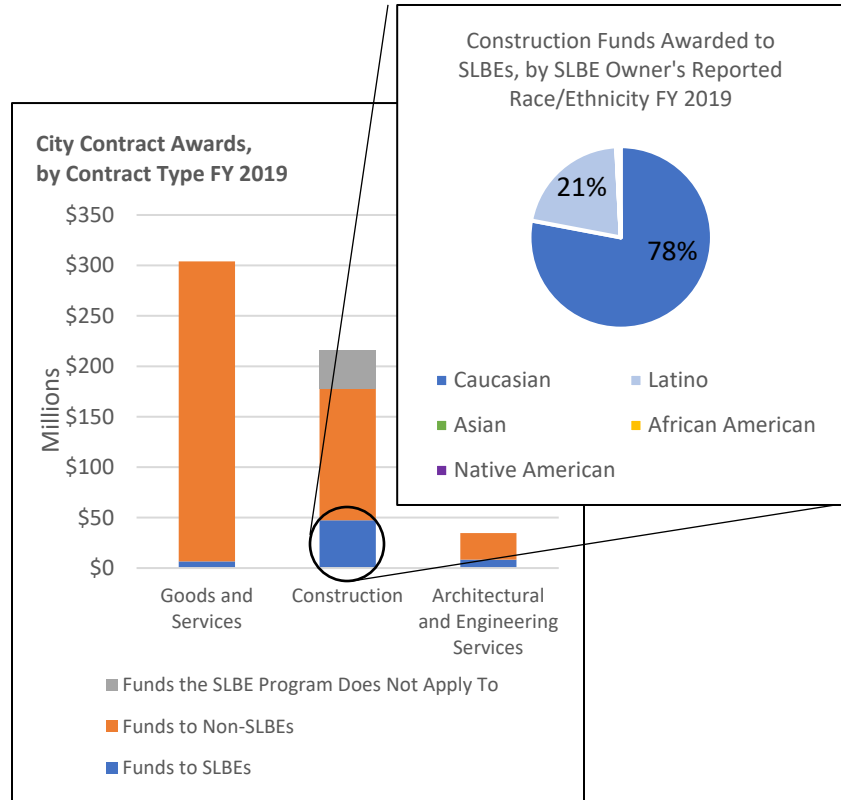
The City of San Diego adopted the Small Local Business Enterprise (SLBE) program to enhance competition for City contracts, establish and build new business capacity, and remove barriers to and eliminate disparities in the use of minority- and women-owned businesses in City contracting. The City designed these objectives because it has historically had a lack of diversity among contractors and desires to provide contracting opportunities to a broader cross-section of the community. Because of limitations in the California Constitution, the SLBE program gives preference in contracting based on the size and location of a business, rather than the race, ethnicity, or gender of the business's owner. The overall objective of this audit was to review the efficiency and effectiveness of the SLBE program.

What OCA Found

Finding 1: The SLBE program's performance has been stagnant over time and the benefits of the program primarily go to a handful of the certified small, local businesses. The SLBE program has not shown to be an effective mechanism to eliminate disparities in the award of City contracts, as a significant majority of SLBE contracts go to Caucasian-owned SLBEs and male-owned SLBEs. In addition, the percentage of funds awarded to women-owned and minority-owned SLBEs has largely decreased or remained stagnant over time. Policy and legal constraints on the program's design, lack of oversight, and underutilization of available tools to accomplish program objectives have limited the program's economic benefits.

Finding 2: The current implementation of the program potentially limits the dollars awarded to SLBEs. First, the City awards more dollars in goods and services contracts than any other type of contract, but does not have any annual goals for SLBE participation in goods and services contracts. Second, the program caps the percentage of each construction contract that is required to go to SLBEs well below the apparent availability of many types of SLBE firms in the region.

Finding 3: The SLBE program's annual reports to the City Council do not provide sufficient information on the SLBE program for the City Council to judge the efficacy of the program. Key information is missing from the annual reports, much of the data presented in the report does not have clear and consistent methodologies, and errors in the report indicate a lack of quality control.



Source: OCA created with data from SLBE program management

What OCA Recommends

We made a total of 12 recommendations to address the issues outlined in the report. Our recommendations to the City include:

- Increase transparency in the distribution of funds among SLBEs.
- With the results of the disparity study, consider narrowly tailored race- and gender-conscious contracting preferences to alleviate disparities, if disparities in contracting exist.
- Reposition oversight of the program outside the management of the program.
- Develop a plan for increasing outreach and participation in the SLBE program.
- Track and report staffing and contracting costs applicable to the SLBE program.
- Create annual performance goals for the percent of goods and services contracts awarded to SLBEs.
- Annually evaluate caps on SLBE subcontracting requirements for construction projects.
- Track and present program-specific data over time in its annual report that highlight trends in program performance.

The Purchasing and Contracting Department agreed with all 12 recommendations.

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THE CITY OF SAN DIEGO

November 24, 2020

Honorable Mayor, City Council, and Audit Committee Members
City of San Diego, California

Transmitted herewith is a performance audit of the Purchasing and Contracting's Small Local Business Enterprise Program. This report was conducted in accordance with the City Auditor's Fiscal Year 2020 Audit Work Plan, and the report is presented in accordance with City Charter Section 39.2. The Results in Brief are presented on page 1. Audit Objectives, Scope, and Methodology are presented in Appendix B. Management's responses to our audit recommendations are presented after page 78 of this report.

We would like to thank staff from the Purchasing and Contracting and Engineering and Capital Projects Departments. All of their valuable time and efforts spent on providing us information is greatly appreciated. The audit staff members responsible for this audit report are Carissa Nash, Chris Kime, Danielle Knighten, and Kyle Elser.

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Results in Brief

The City of San Diego (City) spent approximately \$555 million in fiscal year (FY) 2019 on a variety of contracts for construction, goods, services, and consultants to support a wide range of City functions. To increase the diversity of businesses that receive contracting opportunities, the City adopted the Small Local Business Enterprise (SLBE) program in 2010 to:

- Enhance competition for City contracts;
- Establish and build new business capacity;
- Remove barriers to utilization of minority-owned¹ businesses and women-owned businesses in City contracts; and
- Eliminate disparities in the use of available minority- and women-owned businesses in City contracting.

The City designed these objectives because the City has historically had a lack of diversity among contractors and desires to provide contracting opportunities to a broader cross-section of the community, according to Council Policy 100-10.

Because of Proposition 209, passed by California voters in 1996, the City cannot lawfully grant preferential treatment on the basis of race, sex, color, ethnicity, or national origin. Therefore, the SLBE program gives preference in contracting based on the size and location of a business, rather than the race, ethnicity, or gender of the business's owner.

Although the City designed the SLBE program objectives to decrease disparities in contracting with women-owned and minority-owned businesses while being race- and gender-neutral, we found that the SLBE program has not effectively achieved the economic benefits described in the program

¹ When referring to minority-owned businesses, the program policies are referring to racial-ethnic minority groups.

objectives and changes to the current program's implementation may expand the economic benefits the program generates. In addition, City leadership and the public are not given sufficient quality information on the performance of the program to make informed management and oversight decisions.

Finding 1: The SLBE Program Has Not Effectively Achieved the Economic Benefits of Its Program Objectives

The SLBE program sets out specific economic benefits in its objectives: enhancing competition, building new business capacity, and removing barriers to the use of available minority-owned and women-owned businesses in City contracting.

To meet these objectives, the program provides preference in contracting to City-certified small local business enterprises (SLBEs). To ensure the program is effective at meeting its objectives, program policies require City management to conduct regular evaluations of the program using availability and utilization data to determine if any program changes are needed to better meet the objectives.

We found that the SLBE program's performance monitoring and reporting is insufficient. We analyzed the program's performance and found that it has been stagnant over time and the benefits of the program primarily go to a handful of the City's certified small, local businesses. While the City awarded approximately \$62 million to SLBEs in FY 2019, the SLBE program has not shown to be an effective mechanism to eliminate disparities in the award of City contracts, as the vast majority of SLBE contracts go to Caucasian-owned SLBEs and male-owned SLBEs. In addition, funds awarded to women-owned and minority-owned SLBEs have largely decreased or remained stagnant from FY 2015 to FY 2019.

The City spends at least an estimated \$2.2 million on the program annually, but policy and legal constraints on the program's design, lack of oversight, and underutilization of available tools to accomplish program objectives, have limited the program's economic benefits. To help the program meet its objectives, we recommend revisiting the program design, restructuring oversight, improving monitoring of program

performance, and developing a business outreach plan in conjunction with program stakeholders to reach a more diverse pool of businesses and expand the program.

Finding 2: Changes to the Current Program's Implementation May Expand Its Economic Benefits

In addition to increasing the number and diversity of businesses that benefit from the SLBE program, the effectiveness of the program also requires maximizing the program's participation rate, which is the percentage of total contract dollars awarded to SLBEs. However, we found ways in which the current implementation of the program likely limits the dollars awarded to SLBEs below their potential. Specifically, we found:

- The City awards more dollars in goods and services contracts than any other type of contract, totaling more than \$300 million in FY 2019. However, the SLBE program does not have any specific goals or requirements for the percentage of goods and services contract dollars that go to SLBEs, and does not include goods and services contracts when reporting the program's participation rate for SLBEs. We found that only 2.2 percent of City goods and services contract funds went to SLBEs in FY 2019, significantly reducing the overall program participation rate.
- For construction contracts, the SLBE program establishes specific requirements for the percentage of each contract that should go to SLBEs. However, the program caps these required percentages well below the apparent availability of many types of SLBE businesses in the region, and the caps have not increased since 2011.

As a result, we found that only 12 percent of City contract dollars are awarded to SLBEs. To increase the program participation rate, we recommend setting performance goals for goods and services contracts and documenting the basis for SLBE subcontracting goal caps in construction contracts.

Finding 3: City Leadership is Not Given Sufficient Quality Information on the Performance of the Program to Make Informed Management and Oversight Decisions

City management, oversight bodies, and the public need reliable and relevant data to make informed decisions and evaluate the program's performance in achieving key objectives. To that end, City Council Policy and the Municipal Code require the Mayor to annually report the impact and costs of the SLBE program to the City Council. Program policies also commit the City to "regularly evaluating the progress of the program using accumulated availability and utilization data to determine specific program provisions that require modification, expansion, and/or curtailment."

However, we found that the Business Diversity Annual Reports (annual reports) from the Purchasing and Contracting Department to City Council do not provide sufficient information on the SLBE program for City Council to judge the efficacy of the program.

Specifically, the annual reports do not include information that would allow City Council to understand basic elements of program performance, such as whether or not the program has achieved its stated objectives and what the program costs the City. Key information is missing from the annual reports, such as the diversity of available SLBE owners and program-specific data over broad time horizons. In addition, much of the data presented in the report does not have clear and consistent methodologies, and errors in the report indicate a lack of quality control.

We make recommendations to increase the information provided to City management and City Council on the SLBE program's performance, and ensure the information presented is consistent over time and reasonably free from errors.

We make a total of 12 recommendations to improve the structure, oversight, monitoring, and transparency of the program to help the program better meet its objectives. Management agreed to implement all 12 of the recommendations.

Background

In accordance with the Office of the City Auditor's Fiscal Year (FY) 2020 Audit Work Plan, we conducted a performance audit of the City of San Diego (City) Purchasing and Contracting Department's Small Local Business Enterprise (SLBE) program. The overall objectives of this audit were to determine if the SLBE program is achieving the economic benefits described in policy, to determine if the cost of contracting with City-certified small local business enterprises (SLBEs) is captured and weighed against the economic benefits of the program, and if the annual reports were an accurate and complete representation of the SLBE program's performance.

Purchasing and Contracting Department's Equal Opportunity Contracting Division

The Equal Opportunity Contracting (EOC) division within the City's Purchasing and Contracting Department administers the SLBE program. The City budgeted \$1.2 million for EOC within the Purchasing and Contracting Department's \$29.8 million FY 2020 budget. The FY 2020 City budget included 13 staff for EOC, several of which were unfilled at the end of FY 2020 according to the program manager. EOC staff are responsible for equal employment opportunity compliance through a variety of activities including bid and proposal evaluations, interview panels, certified payroll reviews, labor code violation reviews, project site visits, invoice reviews, employment report reviews, and public contract code violations.

SLBE Program

In 2010, the City adopted the Small Local Business Enterprise program to enhance competition for City contracts, establish and build new business capacity, remove barriers to utilization of minority-owned businesses and women-owned businesses in City contracts, and eliminate disparities in the use of available minority- and women-owned businesses in City contracting, according to program policies. Municipal Code Section 22.3601, which applies the SLBE program to public works contracts, states that San Diego City Council created the program to "enhance diversity in City contracts, increase competition, and stimulate the local economy." Council Policy

100-10, which applies the SLBE program to goods, services, and consultant contracts, says the City "desires to provide contracting opportunities to a broader cross-section of the community in order to enhance diversity and increase competition."

To accomplish this, the program gives preference in City contracts to small local businesses or contractors who plan to subcontract with small local businesses. The program is race and gender neutral; preference is given to City certified businesses based on their revenue and business location.

EOC certifies small, local businesses in two categories: small local business enterprises (SLBEs) and emerging local business enterprises (ELBEs).² To qualify to be certified, businesses must meet all of the following requirements:

- Average gross annual receipts in the prior three years do not exceed the revenue threshold set by the SLBE program, listed in **Exhibit 1**, or demonstrate certification by the State of California as a Microbusiness or Disabled Veteran Business Enterprise;
- The business is an independently owned and operated for-profit enterprise that is not a subsidiary of another business;
- The principal place of business is located in San Diego County and is where the firm maintains a physical office through which it obtains at least 50 percent of its overall customers or sales dollars;
- At least 25 percent of the business's total employees live in San Diego County; and
- The business has been in operation for at least 12 consecutive months.

Exhibit 1, below, shows the SLBE revenue limits for various types of businesses.

² However, unless specifically noted, in our report we will use "SLBE" to capture all businesses certified by the SLBE program and will therefore include both SLBEs and ELBEs.

Exhibit 1:

SLBE Program Revenue Limits

To participate in the program, average gross annual revenue for the past three years cannot exceed these limits:		
Type of Business	SLBE Certification	ELBE Certification
Construction	\$7 million	\$3.5 million
Specialty Construction	\$4.5 million	\$2.25 million
Trucking	\$4.5 million	\$2.25 million
Goods, Materials, and Services	\$4.5 million	\$2.25 million
Professional Services	\$3.5 million	\$1.75 million

Source: OCA generated based on information from EOC.

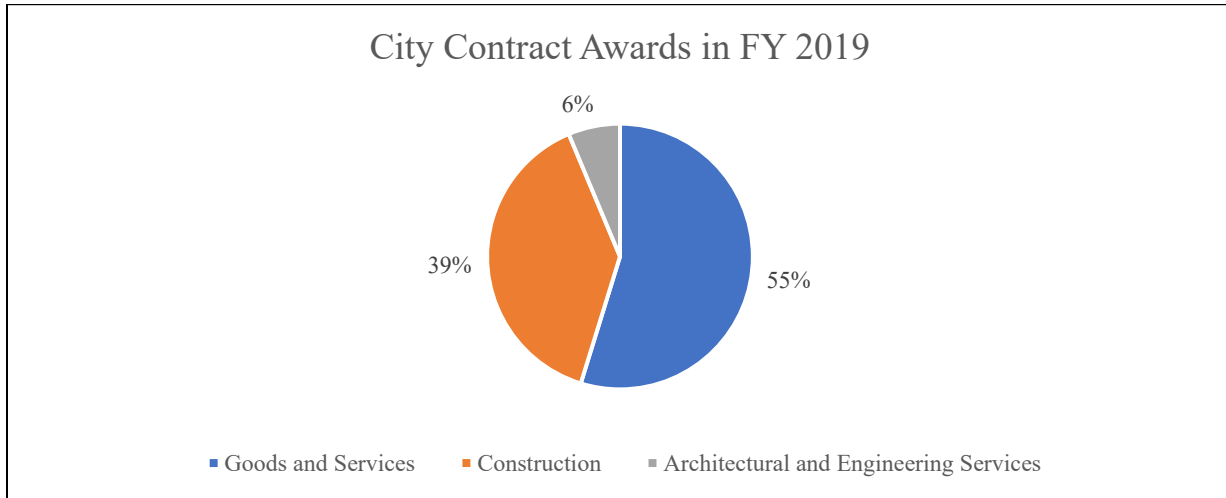
If necessary, EOC can conduct audits and job site or office inspections to ensure businesses meet the eligibility standards. Once certified, businesses are certified for two years and EOC lists the business on the City's SLBE certified vendor list online. Certified businesses list the services they provide by the North American Industry Classification System (NAICS) code. NAICS codes range from architectural services and video production services to commercial building construction and electrical contractors. Small businesses certified with the City can provide a range of goods and services, including community outreach services, landscape maintenance, graphic design, office furniture, project management, digital printing, trade show booth development, exterior painting, endangered species nest monitoring, and aerial photography.

City Contracting

City contracting for SLBE program purposes is generally classified into three categories: construction, architectural and engineering services, and goods and services. In FY 2019, the City awarded about \$304 million in goods and services contracts, \$216 million in construction contracts, and \$35 million in architectural and engineering services contracts for a total of about \$555 million, as illustrated in **Exhibit 2**.

Exhibit 2:

The City Awarded \$555 Million in Contracts in FY 2019



Source: OCA generated based on data from EOC.

Construction Contracts

The Engineering and Capital Projects Department (formerly the Department of Public Works) oversees most construction contracting for the City. The City has several different types of construction contracts, including design-bid-build contracts, design-build contracts, multiple award contracts, job order contracts, sole-source contracts, and emergency contracts. According to EOC, all types of construction contracts except sole-source contracts and emergency contracts are subject to SLBE program requirements.

The majority of construction projects are funded by the City in an average year, but some construction contracts are also funded by the federal government, state government, or grant funds. If a construction project is funded in part or in full by the federal government, the project is not subject to the SLBE program as the federal government has set requirements for its construction projects that the City must meet. For example, projects funded by the Department of Housing and Urban Development require 5 percent of the funds go to federally certified women-owned businesses and 5 percent go to federally certified disadvantaged businesses. If state- or grant-

funded projects do not have separate subcontracting goals, the City will apply SLBE program goals to the project.

In FY 2019, the City awarded \$216 million across 97 construction contracts. The SLBE program requirements applied to 81 of those construction contracts and \$178 million of the awarded amount. Of the 16 contracts excluded from program requirements, 5 were federally-funded contracts totaling \$30.9 million, 8 were emergency contracts totaling \$6.7 million, and 3 were sole-source contracts totaling about \$316,000. Of the \$178.2 million of construction contracts the SLBE program applied to, the City awarded \$47.3 million (27 percent) to SLBEs.

For all construction contracts valued greater than \$1 million, Municipal Code 22.36 requires bidding prime contractors subcontract out a portion of the project to SLBEs. EOC sets the amount the contractors must subcontract to SLBEs on a contract-by-contract basis, depending on the type of work the contract requires. In order to be considered as a subcontractor, SLBEs must perform a commercially useful function to the contract. If the bidding prime contractor fails to meet the subcontracting requirement, the bidder may submit a good faith effort document to show that they put forth a good faith effort to meet the subcontracting goal. If EOC determines that the bidder met the good faith effort requirements set by EOC, the bid is responsive. If EOC determines the bidder did not meet the good faith effort requirements, the bid is nonresponsive and may not be considered for contract award. For construction contracts valued greater than \$1 million, the City does not award a bid discount for SLBEs in addition to the mandatory subcontracting participation rate, but SLBEs that are prime bidders may count their own participation toward meeting the mandatory subcontracting goal if they are self-performing more than 51 percent of the contract obligations.

For construction contracts valued greater than \$500,000 but less than \$1 million, EOC sets a mandatory subcontracting goal based on a contract-by-contract basis similar to the greater than \$1 million contract process. However, within this

category, the City offers a 5 percent bid discount for prime bidders that are SLBEs—meaning that the bid amount submitted by an SLBE would be evaluated at a 5 percent lower bid amount when compared to other bids. However, the bid discount does not apply if the bid amount exceeds the low bid by \$50,000. A bid discount would also apply to prime contract bidders that are not SLBEs if the bidder meets or exceeds the mandatory SLBE subcontracting goal.

For minor construction projects, those valued \$500,000 or less, the City restricts bidding to just SLBE program certified businesses.³ Both SLBEs and ELBEs can bid on contracts valued between \$250,000 and \$500,000. Only ELBEs can bid on contracts valued at \$250,000 and below. If the City does not receive responsive bids, the Engineering and Capital Projects Department can rebid the contract and open it to all contractors.

Once the Engineering and Capital Projects Department awards the contract, EOC ensures the prime contractor maintains the SLBE subcontracting participation level indicated when performing the work. To ensure prime contractors met the indicated subcontracting participation level, EOC requires prime construction contractors to submit a Final Summary Report that documents payments made to subcontractors. According to EOC, program staff emails the listed subcontractors separately to confirm they received the payments. If the prime contractor fails to maintain the SLBE subcontracting participation level indicated, the Engineering and Capital Projects Department may take action against the prime contractor through fines, contract suspension, termination, and/or debarment. If participation levels must be reduced due to City modification in the scope of work, EOC must approve.

³ According to EOC, sole-source and emergency contracts are not included in this category.

Architectural and Engineering Services Contracts

The City awarded \$34.7 million across 60 contracts for architectural and engineering services in FY 2019. Of that, the City awarded \$8.3 million (24 percent) to SLBEs. The SLBE program applies to architectural and engineering service contracts valued \$50,000 and above.

Unlike some construction contracts, many architectural and engineering services contracts are awarded based on a point scoring system, with points awarded based on various factors. City Council Policy 100-10 incentivizes prime bidders to subcontract out to SLBEs by awarding additional points to their bid evaluation for subcontracting. Bidders receive 5 additional points (5 percent of the possible evaluation points) if the bidder plans to contract out 20 percent of the contract value to SLBEs. Bidders receive 10 additional points if the bidder plans to contract out 25 percent to SLBEs. If the prime bidder is an SLBE, the Engineering and Capital Projects Department awards 12 points.

Goods and Services Contracts

The Purchasing and Contracting Department awards goods and services contracts. City Council Policy 100-10 incentivizes prime bidders to subcontract out to SLBEs by awarding additional points to their proposal evaluation for subcontracting or applying a bid discount on a bid.

The City awarded \$304 million across 609 goods and services contracts in FY 2019. Of that, the City awarded \$6.6 million (2.2 percent) to SLBEs. The SLBE program applies to goods and services contracts for which the purchasing agent is required to advertise for sealed bids or proposals in the City's official newspaper (generally goods and services valued at \$50,000 and above).

If the contract requires proposals, bidders receive five additional points (5 percent of the possible evaluation points) if the bidder plans to contract out 20 percent of the contract value to SLBEs. Bidders receive 10 additional points if the

bidder plans to contract out 25 percent to SLBEs. If the prime bidder is an SLBE, the Purchasing and Contracting Department awards 12 points.

If the contract requires bids, the Purchasing and Contracting Department applies a bid discount. If the prime contractor subcontracts out at least 20 percent of the project cost to SLBEs, the prime contractor receives 5 percent off of the bid price. If the prime contractor is an SLBE, they receive 5 percent off of the bid price when comparing the bid to other responsive bids as well, but would not be required to subcontract to SLBEs. Neither discount would apply if the award to the discounted bidder would result in a total contract cost \$50,000 in excess of the low, non-discounted bidder.

**Other SLBE Program
Activities**

EOC participates in other activities to promote greater participation in the SLBE program. According to EOC, staff attended 31 outreach events and industry meetings in FY 2019. Examples of events attended include CalCon Expo, a Pure Water Outreach event, and a National Black Contractors Chat and Chew event.

EOC staff also participates in the California Department of Transportation's Calmentor program and the Construction and Commodities Mentor Protégé program as steering committee members and pairing facilitators. Mentor-protégé programs are designed to pair established businesses with small businesses in the same field to assist in business development.

**Proposition 209 and the
Disparity Study**

Because of Proposition 209, passed by California voters in 1996 and codified in California Constitution Article 1, Section 31, the City cannot lawfully grant preferential treatment on the basis of race, sex, color, ethnicity, or national origin. When the City chose to create the SLBE program in 2010, the program's objectives were in part to remove barriers to and eliminate disparities in the use of minority-owned businesses and women-owned businesses in City contracting. To achieve these objectives, the City created the SLBE program to give preference based on the size and location of a business,

rather than the race, ethnicity, or gender of the business's owner.

According to a 2015 City Attorney report, to lawfully give contracting preference to businesses owned by women and people of color, the City would likely need to prove that the City intentionally discriminated against these businesses, that the purpose of the contracting preference was to remedy the discrimination, that the preference is narrowly tailored to address the discrimination, and that the race- or gender-conscious preference is necessary to rectify the past discrimination. According to the same report and other past City Attorney reports, the first step to implement race- and gender-conscious preference in City contracting is to conduct a disparity study specific to the San Diego marketplace. The study would identify which, if any, areas of City contracting have this disparity and if the disparity is centered within specific race/ethnicity or gender groups.

In the FY 2020 budget, the City set funds to contract for a disparity study. According to the Purchasing and Contracting Department, the study is underway and the department expects the study to be complete in January 2021. The City last conducted a disparity study in 1995.

Other Business Designations

Other contracting entities, such as the State of California or the federal government, certify other businesses that can overlap with SLBE program designations. The federal government certifies minority business enterprises, women business enterprises, and disadvantaged business enterprises. A business that has a government certification as one of these businesses does not automatically qualify as an SLBE. The State of California certifies disabled veteran business enterprises. Disabled veteran business enterprises qualify as SLBEs as long as they also meet the requirements to qualify as a local business—they are located in the county and have most of their staff in the county—regardless of their annual revenue.

**Previous Review of the
SCOPE Program,
Precursor to the SLBE
Program**

Prior to the adoption of the SLBE program in 2010, EOC administered the Subcontractor Outreach Program (SCOPE). The City adopted SCOPE in response to the City's most recent disparity study (1995), to address issues raised in the disparity study, to level the playing field and provide contracting opportunities for all segments of the contracting community, and to allow the City to collect data on subcontractor bids. We reviewed SCOPE in our Performance Audit of the Subcontractor Outreach Program, issued April 30, 2010.⁴ At that time, we found that EOC was not tracking sufficient data to provide information on the performance of the program and was not meeting City Council's directive to compile necessary information for an updated disparity study. Finally, we found that SCOPE's goal setting process and management could be enhanced. Some of the recommendations from the April 2010 report were:

- The City should collect accurate and comprehensive data that measures the contracting practices in the City.
- The City should perform a comprehensive disparity study.
- The City should create policies and procedures for collecting and reporting on data that may be used in a disparity study.
- Management should establish an annual goal for City-funded projects in order to measure the progress (or lack thereof) that prime contractors subcontract to the various historically underrepresented contractor groups.
- Management should review the approaches to increasing contractor diversity outlined in nominations to the State Agency Recognition Awards and continue to consult with other entities for best practice guidelines on how to increase the diversity of subcontractors and document the communications.

⁴ <https://www.sandiego.gov/sites/default/files/10-019.pdf>

In summary, we found in 2010 that the SCOPe program increased subcontracting but did not increase subcontracting with women-owned and minority-owned businesses.

Audit Results

FINDING 1: The SLBE Program Has Not Effectively Achieved the Economic Benefits of Its Program Objectives

Finding Summary

The Small Local Business Enterprise (SLBE) program sets out specific economic benefits in its objectives:

- Enhancing competition;
- Building new business capacity;
- Removing barriers to the use of available minority-owned businesses and women-owned businesses in City of San Diego contracts; and
- Eliminating disparities in the use of minority-owned and women-owned businesses in City of San Diego contracts.⁵

The City of San Diego (City) designed this program because the City has historically had a lack of diversity among business owners it contracts with and desires to provide contracting opportunities to a broader cross-section of the community, according to Council Policy 100-10.

To meet these objectives, program policies require City management to conduct regular evaluations of the program using availability and utilization data to determine if any program changes are needed to better meet the objectives.

We found that the SLBE program's performance as measured by the SLBE participation rate has been stagnant over time and the benefits of the program primarily go to a handful of the City's certified small, local businesses. The SLBE program has not shown to be an effective mechanism to eliminate disparities in the award of City contracts, as the majority of

⁵ When referring to minority-owned businesses, the program policies are referring to racial-ethnic minority groups.

SLBE contracts go to Caucasian-owned SLBEs and male-owned SLBEs. In addition, funds awarded to women-owned and minority-owned SLBEs largely decreased or remained stagnant from fiscal year (FY) 2015 to FY 2019.

We estimate the City spends at least an estimated \$2.2 million on the program annually, but policy and legal constraints on the program's design, lack of oversight, and underutilization of available tools to accomplish program objectives, have limited the program's economic benefits. To help the program meet its objectives, we recommend revisiting the program design, restructuring oversight, and developing an outreach plan in conjunction with program stakeholders.

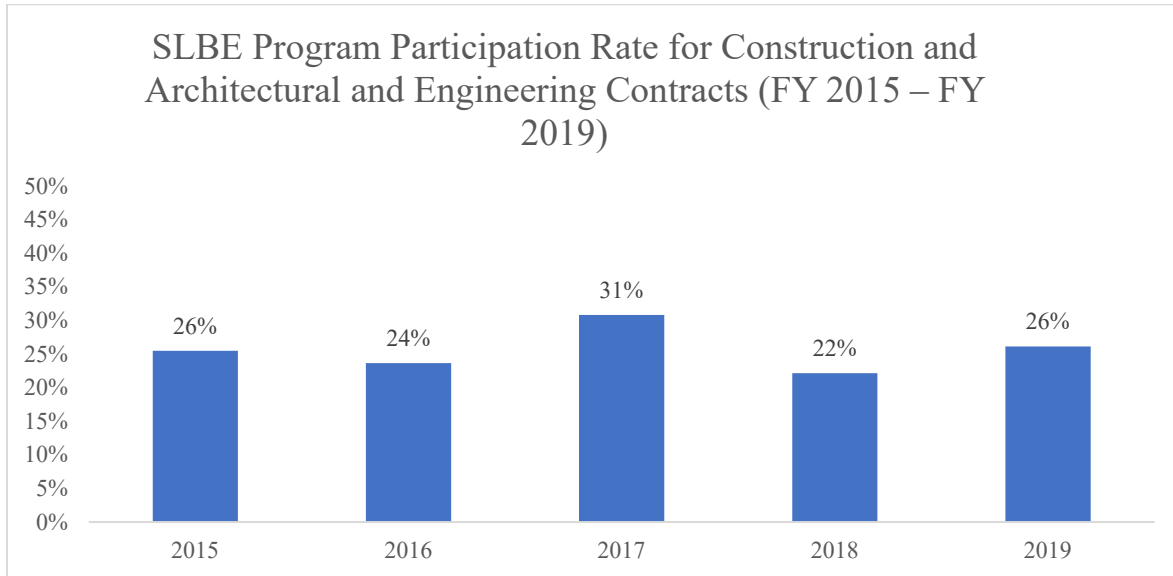
**The SLBE Program's
Performance Has Been
Stagnant and the
Benefits of the Program
Primarily Go to a
Handful of the City's
Certified Small, Local
Businesses**

We found that funds awarded to SLBEs have remained stagnant over the last five years.

Because the first two goals of the program stated in Municipal Code Section 22.3601 are to enhance diversity and increase competition, a successful program would show progress over time. The participation rate is the main SLBE program performance measure reported to the San Diego City Council. The participation rate is defined as the funds paid to SLBEs as a percentage of all applicable construction contracts and architectural and engineering services contracts. As illustrated in **Exhibit 3**, the participation rate for construction contracts and architectural and engineering services contracts together remained around 26 percent from FY 2015 to FY 2019, with the exception of FY 2017.

Exhibit 3:

Program Participation Rate Has Remained Stagnant Across Five Years



Source: OCA generated based on data from EOC.

The majority of funds the City awarded to SLBEs went to a small portion of the available SLBEs.

In FY 2019, 8 SLBEs received more than 50 percent of all the construction funds the City awarded to SLBEs. The 8 SLBEs made up less than 4 percent of the 228 SLBEs certified for construction work.

In FY 2018, 11 SLBEs received more than 50 percent of all SLBE construction funds. The 11 SLBEs receiving the majority of the funds made up 6 percent of all certified construction SLBEs in FY 2018.

For architectural and engineering services contracts, five SLBEs received more than half of all architectural and engineering services funds awarded to SLBEs in FY 2019. The same pattern held in FY 2018.

City leadership and the public are not informed that relatively few businesses receive the majority of SLBE contract funds.

Although the program objectives include establishing new business capacity and enhancing competition, the City does not report how many of its SLBEs were awarded contract funds and if the funds centered on a small number of businesses. Without this information, the City would not know if the economic benefits of the program were spread across certified and available SLBEs or if the benefits of the program are limited to a small portion of SLBEs.

The SLBE Program Has Not Shown to be an Effective Mechanism to Eliminate Disparities in the Award of City Contracts

In addition to analyzing the number of businesses that capture the majority of SLBE contract funds, we also reviewed the percentage of SLBE funds that were awarded to minority- and women-owned SLBEs. As stated in program policies, one of the SLBE program's objectives is to eliminate disparities between the availability of minority- and women-owned businesses and the City's use of minority- and women-owned businesses. The objectives also seek to decrease barriers these businesses may face in being awarded contracts. City Council established the SLBE program 10 years ago, so an effective program would potentially demonstrate eliminating disparities in contracting and reduced barriers to contracting through increased participation of minority- and women-owned businesses over time.

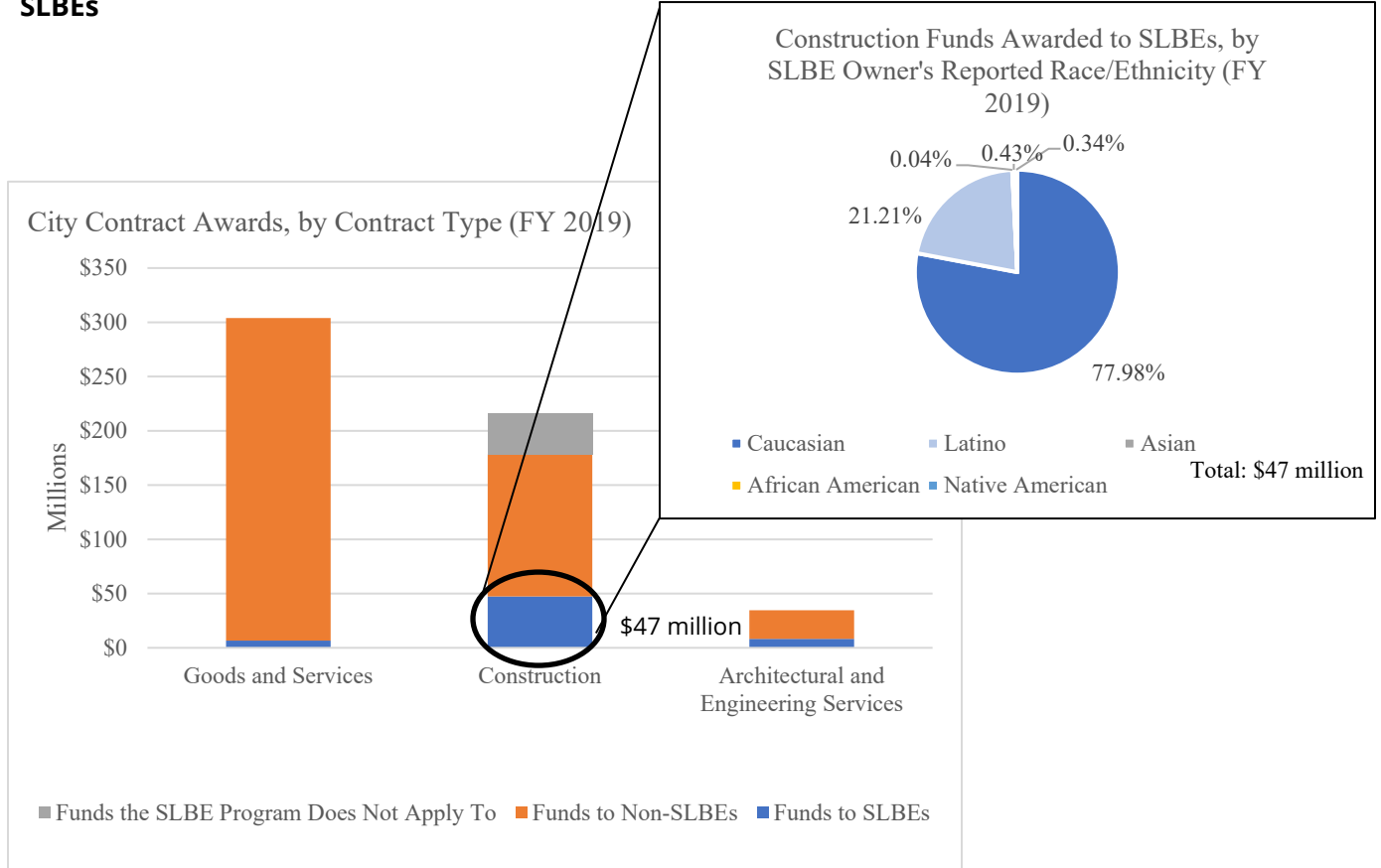
However, in examining the SLBE program funds—just the funds awarded to SLBEs, not City contracting as a whole—we found that the funds the City awards to SLBEs primarily goes to SLBEs owned by Caucasian people and men, not SLBEs owned by women or people of color.

Exhibit 4 highlights the results of our analysis of funds awarded specifically within the SLBE program. Although the City spent \$216 million in construction contracts and \$35 million in architectural and engineering contracts in FY 2019, we looked closely at the \$47 million awarded to SLBEs in construction contracts and \$8 million awarded to SLBEs in

architectural and engineering contracts and examined the diversity trends within the SLBE-awarded dollars specifically.

Exhibit 4:

In Construction Contracts, the City Awarded \$47 Million Out of a Total \$216 Million to SLBEs



Source: OCA generated based on data provided by EOC.

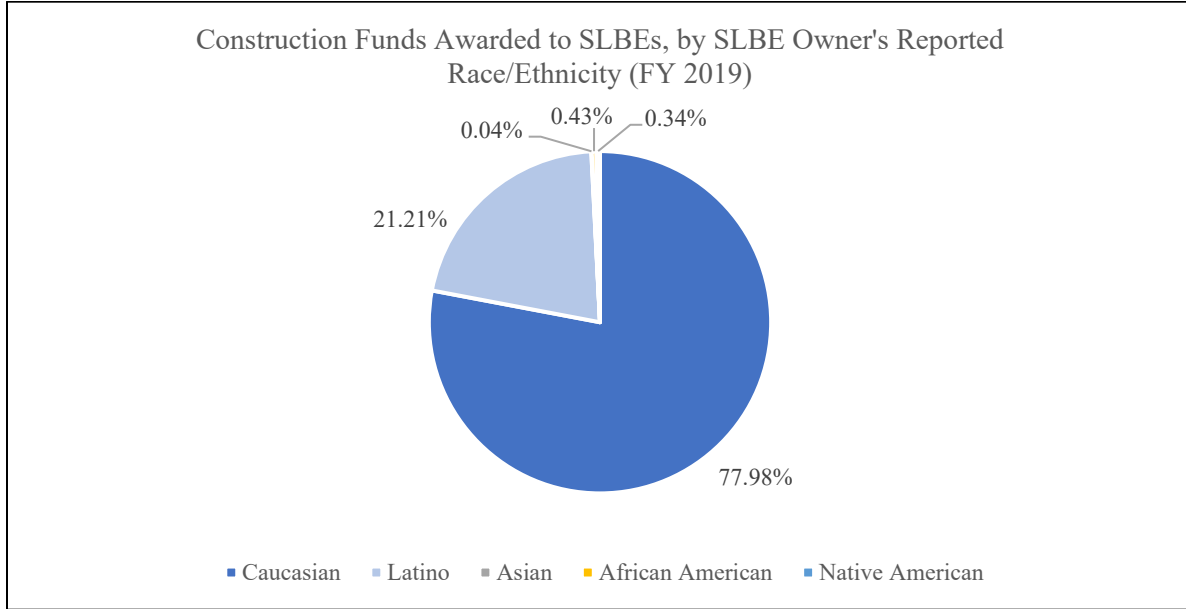
The majority of funds awarded to SLBEs go to SLBEs owned by Caucasian people and men.

Despite the program's objectives to increase diversity in contracting, on average, 70 percent of construction funds awarded to SLBEs went to SLBEs owned by Caucasian people, while 30 percent went to SLBEs owned by people of color from FY 2015 to FY 2019. **Exhibit 5** illustrates that this trend remained true in FY 2019, when 78 percent of SLBE construction funds went to SLBEs owned by Caucasian people. Similarly, along gender lines, 83 percent of the construction funds awarded to SLBEs went to SLBEs owned by men while

17 percent went to women-owned SLBEs on average from FY 2015 to FY 2019.

Exhibit 5:

The Majority of Funds Awarded to SLBEs Went to Caucasian-Owned SLBEs



Source: OCA generated based on data provided by EOC.

In that same period (FY 2015 to FY 2019), on average, less than 1 percent of construction funds paid to SLBEs went to African American-owned SLBEs, despite African American San Diegans making up about 5 percent of the county's population and 2.5 percent of the county's construction and extraction workforce.⁶ As detailed later in this finding, the City has contracted for a disparity study to examine in detail the race and gender makeup of the ownership of available contractors in the area. Workforce data is not a perfect comparison, but county population and workforce data provide a benchmark for reference the City can easily access to determine how

⁶ This data is from the United States Census Bureau, which puts construction and extraction work in one category. Trades within the construction and extraction workforce category include, but are not limited to, electricians, construction laborers, cement masons, building inspectors, oil derrick operators, mining machine operators, and first-line supervisors of construction and extraction workers.

diverse its contractor pool is compared to the county's population and relevant workforce.

On average, from FY 2015 to FY 2019 the City awarded 21 percent of the SLBE construction funds to Latino-owned SLBEs, despite 33 percent of the county's population and 51 percent of the county's construction and extraction workforce identifying as Hispanic/Latino.

Caucasian (White, non-Hispanic) SLBE owners were awarded 70 percent of the funds awarded to SLBEs for construction contracts; this group makes up an estimated 47 percent of the county's population and 33 percent of the county's construction and extraction workforce.

Funds awarded to women-owned and minority-owned SLBEs have largely decreased or remained stagnant over time.

On average, although the City awarded about the same percent of contract funds to SLBEs from FY 2015 to FY 2019, the City awarded less of the funds to minority-owned SLBEs over time. Within construction contract dollars that went to SLBEs, the City awarded 36 percent to minority-owned SLBEs in FY 2015 and 22 percent to minority-owned SLBEs in FY 2019—a 14 percentage point decrease over 5 fiscal years, as illustrated in **Exhibit 6**.

Although more variable, the same pattern persisted in contracts for architectural and engineering services, depicted in **Exhibit 7**. From FY 2015 to FY 2019, the portion of architectural and engineering service dollars awarded to SLBEs that went to minority-owned SLBEs peaked in FY 2016 at 51 percent. However, the share decreased from 50 percent in FY 2018 to 18 percent in FY 2019. The dotted lines in both **Exhibit 6** and **Exhibit 7** represent the linear trendline, displaying an overall decreasing trend in SLBE dollars awarded to minority-owned SLBEs.

Exhibit 6:

The Percent of SLBE Construction Contract Funds Awarded to Minority-Owned SLBEs Declined

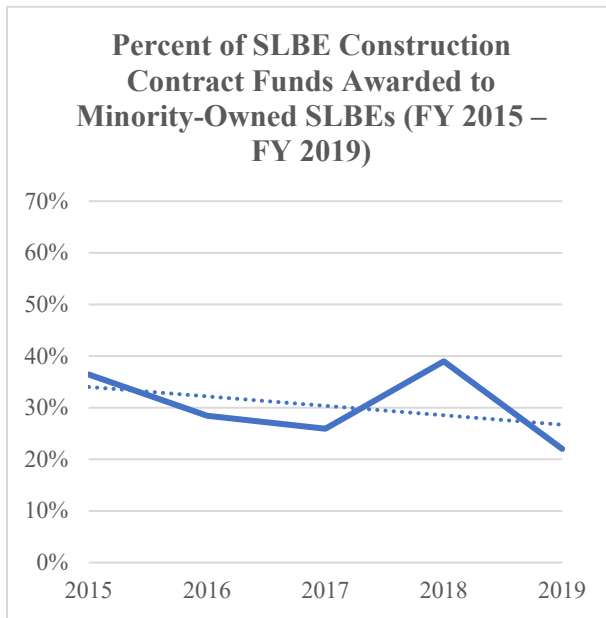
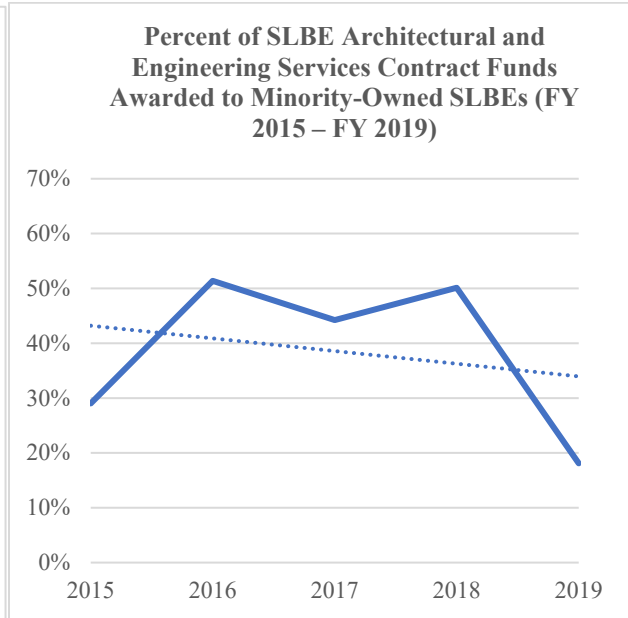


Exhibit 7:

The Percent of SLBE Architectural and Engineering Services Contract Funds Awarded to Minority-Owned SLBEs Declined



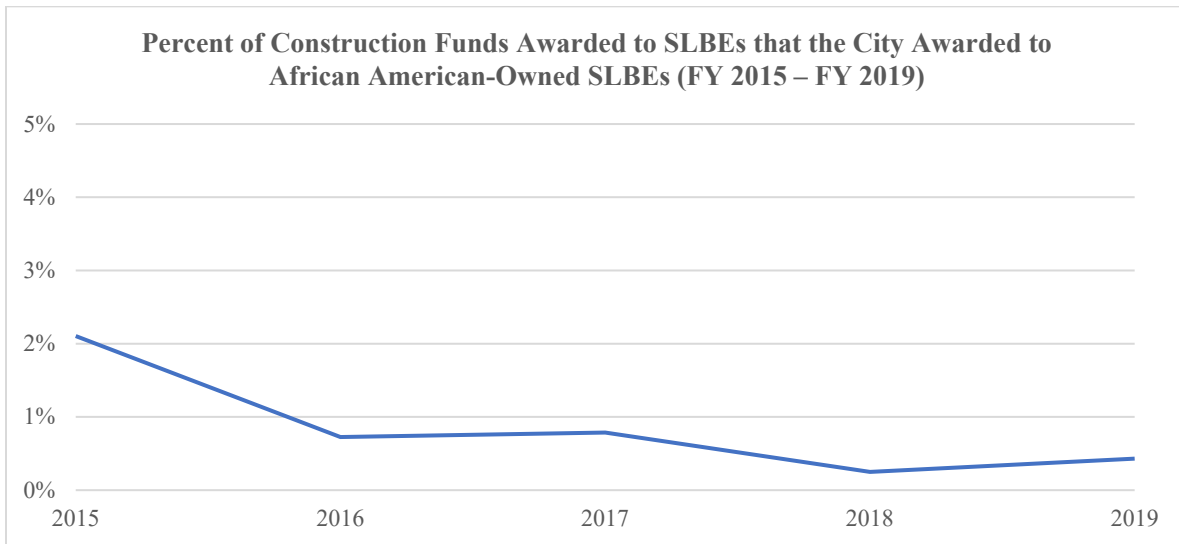
Note: The dotted lines in both Exhibit 6 and Exhibit 7 represent the linear trendline.

Source: OCA generated based on data from EOC. Source: OCA generated based on data from EOC.

Within construction contracts awarded to SLBEs, the percent of SLBE funds awarded to Latino-owned SLBEs remained fairly stable around 21 percent. The percent awarded to African American-owned SLBEs decreased from 2.1 percent in FY 2015 to 0.4 percent in FY 2019, as shown in **Exhibit 8**.

Exhibit 8:

The Percent of Construction Funds Awarded to SLBEs that the City Awarded to African American-Owned SLBEs Declined from FY 2015 to FY 2019



Source: OCA generated based on data from EOC.

To provide further detail, **Exhibit 9** details the trends in construction contract dollars awarded to SLBEs and **Exhibit 10** details the same data for architectural and engineering services contracts.

Within construction funds awarded to SLBEs, funds awarded to SLBEs owned by Caucasian people increased from 64 percent to 78 percent from FY 2015 to FY 2019 and funds awarded to women-owned SLBEs remained fairly stagnant. Women-owned SLBEs received 25 percent or less of dollars awarded to SLBEs in construction funds in each year from FY 2015 to FY 2019.

Exhibit 9:

Construction Contract Dollars Awarded to SLBEs, by SLBE Owner's Reported Race/Ethnicity and Gender (FY 2015 – FY 2019)

Construction Contract Dollars Awarded to SLBEs, by SLBE Owner's Reported Race/Ethnicity and Gender (FY 2015 – FY 2019)										
Reported Race/ Ethnicity of SLBE Owner	FY 2015		FY 2016		FY 2017		FY 2018		FY 2019	
	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded
Caucasian	\$33,093,834	64%	\$54,165,317	72%	\$64,608,256	74%	\$35,857,337	61%	\$36,919,745	78%
Latino/ Hispanic	\$11,601,698	22%	\$17,823,466	24%	\$15,323,400	18%	\$12,828,729	22%	\$10,041,801	21%
Asian	\$1,173,372	2%	\$307,580	0.4%	\$6,357,841	7%	\$9,277,436	16%	\$20,400	0.0%
African American	\$1,095,951	2%	\$549,682	0.7%	\$685,991	0.8%	\$146,600	0.2%	\$204,083	0.4%
Native American	\$5,104,800	10%	\$2,852,632	3.8%	\$246,353	0.3%	\$658,718	1%	\$161,069	0.3%
Total	\$52,069,655		\$75,698,677		\$87,221,841		\$58,768,820		\$47,347,099	
Reported Gender of SLBE Owner	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded
Male	\$39,025,983	75%	\$67,350,798	89%	\$76,003,814	87%	\$47,113,842	80%	\$35,497,254	75%
Female	\$13,043,672	25%	\$8,347,879	11%	\$11,218,027	13%	\$11,654,978	20%	\$11,849,845	25%
Total	\$52,069,655		\$75,698,677		\$87,221,841		\$58,768,820		\$47,347,099	

Source: OCA generated based on data from EOC.

As shown in **Exhibit 10**, in architectural and engineering services contracts, the percent of funds awarded to SLBEs owned by Caucasian people increased from 71 to 82 percent from FY 2015 to FY 2019, while women-owned SLBEs received 29 percent of dollars awarded to SLBEs in FY 2015 and 33 percent in FY 2019—a 4 percentage point increase over 5 years.

Exhibit 10

Architectural and Engineering Services Contracts Awarded to SLBEs, by SLBE Owner's Reported Race/Ethnicity and Gender (FY 2015 – FY 2019)

Architectural and Engineering Services Contracts Awarded to SLBEs, by SLBE Owner's Reported Race/Ethnicity and Gender (FY 2015 – FY 2019)										
Reported Race/ Ethnicity of SLBE Owner	FY 2015		FY 2016		FY 2017		FY 2018		FY 2019	
	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded
Caucasian	\$2,993,955	71%	\$6,020,870	49%	\$13,783,289	56%	\$7,098,015	50%	\$6,823,502	82%
Latino/ Hispanic	\$794,690	19%	\$1,487,243	12%	\$3,842,811	16%	\$3,408,695	24%	\$918,716	11%
Asian	\$396,508	9%	\$4,533,718	37%	\$6,774,979	27%	\$926,445	7%	\$483,503	6%
African American	\$33,900	0.8%	\$342,554	3%	\$34,605	0.1%	\$1,657,726	12%	\$47,792	0.6%
Native American	\$0	0%	\$0	0%	\$281,355	1%	\$1,120,000	8%	\$58,096	0.7%
Pacific Islander	\$0	0%	\$0	0%	\$0	0%	\$21,447	0.2%	\$0	0%
Total	\$4,219,053		\$12,384,385		\$24,717,039		\$14,232,329		\$8,331,610	
Reported Gender of SLBE Owner	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded	Dollars Awarded	Percent Awarded
Male	\$3,016,620	72%	\$6,799,113	55%	\$20,502,237	83%	\$10,455,997	73%	\$5,542,644	67%
Female	\$1,202,434	29%	\$5,585,272	45%	\$4,214,802	17%	\$3,776,331	27%	\$2,788,965	33%
Total	\$4,219,053		\$12,384,385		\$24,717,039		\$14,232,329		\$8,331,610	

Source: OCA generated based on data from EOC.

The pool of all City-certified SLBEs is less diverse than the estimated workforce, which may hinder the program's diversity efforts.

To count toward the SLBE goals, contractors must use SLBEs certified by the City. If the pool of City-certified SLBEs contractors has few SLBEs owned by women and people of color, it makes the program's objective difficult to meet, as the program sets out to increase diversity in contracting.

To qualify as an SLBE, the program primarily verifies that the business's gross receipts are below a certain threshold and that the business is based in San Diego County. The program sorts the SLBEs into six categories: general construction, specialty construction, professional services (which includes

architectural and engineering services), general services, suppliers, and brokers.

In FY 2020, owners of 67 percent of SLBEs that perform construction services identified as Caucasian, as illustrated in **Exhibit 11**. Comparatively, an estimated 33 percent of the construction and extraction occupation workforce in San Diego County identified as Caucasian. Hispanic/Latino San Diegans owned 24 percent of the construction SLBEs, but made up about 51 percent of the construction and extraction workforce.

As shown in **Exhibit 12**, Caucasian people owned 72 percent of the professional services SLBEs.⁷ Comparatively, Caucasian people made up an estimated 48 percent of the engineering and architectural occupation workforce in San Diego County. About 13 percent of professional services SLBEs were Asian-owned, while Asian San Diegans held 25 percent of the engineering and architectural occupations in the county. African Americans owned none of the professional services SLBEs in FY 2020, but made up an estimated 2.4 percent of the engineering and architectural services workforce.

⁷ Professional services is one of the categories the SLBE program sorts its SLBEs into. Professional services include architectural and engineering services as well as other professional services, such as management consultants. There is no separate SLBE category for architectural and engineering services, so this comparison is an approximation and not a perfect comparison.

Exhibit 11

67 Percent of Construction SLBE Owners Identified as Caucasian

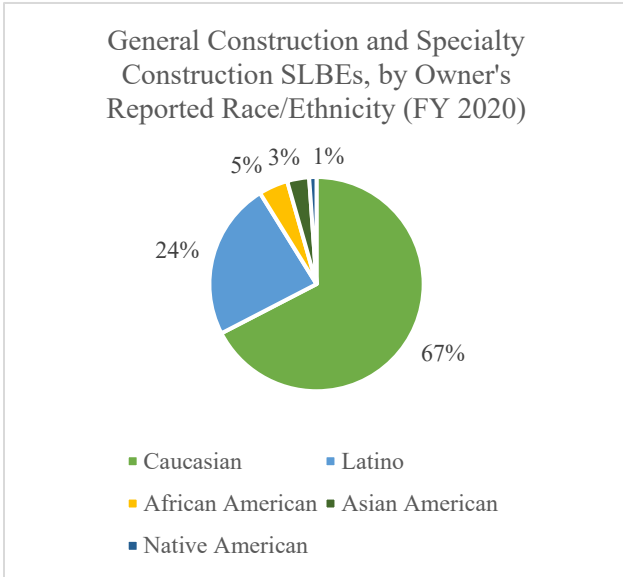
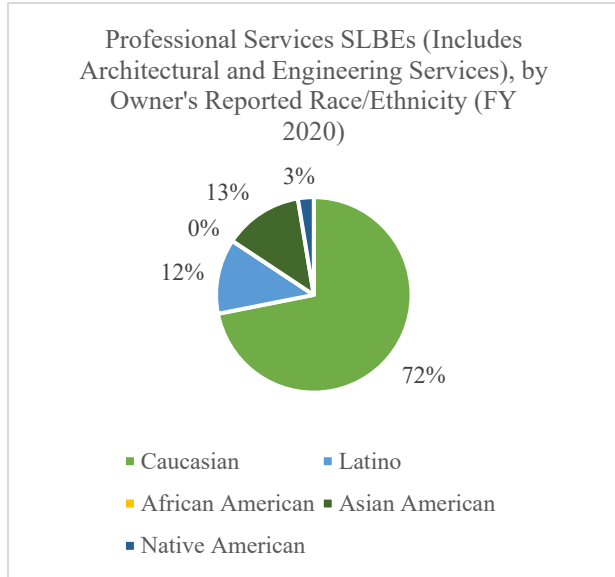


Exhibit 12

72 Percent of Professional Services SLBE Owners Identified as Caucasian



Source: OCA generated based on data from EOC. Source: OCA generated based on data from EOC.

The pool of all SLBEs may also be getting less diverse in other ways. In FY 2018, women owned 31 percent of all SLBEs and 22 percent of all construction SLBEs; in FY 2020, women owned 26 percent of all SLBEs and 18 percent of construction SLBEs. In FY 2018, African Americans owned 7 percent of the construction SLBEs; in FY 2020 African Americans owned 4 percent. An increasingly less diverse SLBE pool could indicate the program may need additional outreach efforts to foster a more diverse set of SLBE owners, or that the design of the program is fundamentally limited in meeting the intended objectives of the program.

Policy Constraints and the Program's Design Limit the Program's Ability to Meet Policy Objectives

Several factors have contributed to the program not demonstrably meeting its objectives to enhance competition, build new business capacity, remove barriers to use of minority-owned and women-owned businesses in City contracts, and eliminate disparities in the use of available minority-owned and women-owned businesses in City

contracts. Some of the reasons the SLBE program has not met its objectives include:

- The program is race- and gender-neutral, while seeking to reduce disparities in contracting with minority-owned and women-owned businesses;
- The program does not measure its performance in meeting all of its objectives; and
- Oversight of the program is structured ineffectively and is lacking needed insight.

The program is designed to decrease disparities in contracting with women-owned and minority-owned businesses while being race- and gender-neutral.

Because of Proposition 209, passed by California voters in 1996 and codified in California Constitution Article 1, Section 31, the City largely cannot grant preferential treatment on the basis of race, sex, color, ethnicity, or national origin. To minimize disparities in contracting with businesses owned by women and people of color, the City chose to grant contracting preferences to small, local businesses through the SLBE program.

According to a 2015 City Attorney report summarizing a California Supreme Court case, to lawfully give contracting preference to businesses owned by women and minorities, the City would likely need to prove that:

- 1) The City intentionally discriminated against these businesses;
- 2) The purpose of the contracting preference was to remedy the discrimination;
- 3) The preference is narrowly tailored to address the discrimination; and
- 4) The race- or gender-conscious preference is necessary to rectify the past discrimination.

According to the same report and other past City Attorney reports, the first step to potentially implement race- and gender-conscious preference in City contracting would be to

conduct a disparity study. The disparity study would need to be specific to the San Diego marketplace and would assess if there is a disparity between the availability of women- and minority-owned businesses and the amount the City contracts with women- and minority-owned businesses.⁸

In FY 2020, the City contracted for a disparity study.⁹ According to EOC, the firm selected has experience designing legally defensible disparity studies.

With a detailed disparity study, the City could consider enacting a contracting preference based on race and/or gender to ensure any documented disparities are reduced. According to the City Attorney's 2015 report to City Council, even with a disparity study that demonstrates disparities in City contracting, the prohibitions set forth in Proposition 209 would make it uncertain whether the City could legally enact even a narrowly-tailored race- and gender-conscious contract preference.

The City has experience working with race- and gender-conscious contracting programs, as federally-funded construction projects set goals related to contracting with minority-owned small businesses and women-owned small businesses.

Additionally, cities themselves can have race- and gender-conscious contracting programs that successfully increase diversity in contracting. For example, the City of San Antonio

⁸ The City last contracted for a disparity study in 1995 and the report concluded that the City had disparities in contracting and a sound legal basis for implementing a narrowly-tailored race- and gender-conscious program to ensure that minority- and women-owned businesses achieve fair and equitable participation in City contracts. However, the City Attorney's Office in 1996 concluded that the 1995 disparity study's evidence was insufficient to justify an enforceable race- or gender-based contracting program, but concluded there was evidence for the City to take race- and gender-neutral actions to address the discrimination in the marketplace, which the City has been doing ever since. The City Attorney's Office recommended the City conduct a disparity study in several documents since then—at least in 2007, 2009, and 2015—to determine whether there is evidence of discrimination necessitating race- or gender-based remedies. Additionally, the Office of the City Auditor recommended the City conduct a disparity study in 2010.

⁹ According to the Purchasing and Contracting Department, the study is underway, and the department expects the study to be complete at the end of March 2021.

implemented a contracting preference for minority- and women-owned businesses. From 2011 to 2014, with a race- and gender-neutral program like the City of San Diego's, the City of San Antonio's contracting with minority- and women-owned businesses increased from 13 percent to 22 percent. After the City of San Antonio applied a race- and gender-conscious program in 2016, contracting with minority- and women-owned businesses increased by 28 percentage points, from 22 percent to 50 percent.

However, a race- and gender-conscious preference built in response to a disparity study alone would not necessarily make the SLBE program successful in meeting its objectives. If left unaddressed, challenges due to limited monitoring and reporting on program performance, insufficient oversight, and lack of focus on outreach and reducing barriers to participation would continue to hinder the program.

EOC does not have performance measures sufficient to capture all of the program's objectives.

According to the Government Accountability Office (GAO) Standards for Internal Control in the Federal Government, management should use quality information to make informed decisions and evaluate the program's performance in achieving its objectives. As mentioned, EOC's key performance measure for the SLBE program is the participation rate—the percent of the City's contract funds the City awards to SLBEs. The participation rate could speak to the program's performance in increasing competition for City contracts. However, the program does not report performance for its other objectives: establishing and building new business capacity, removing barriers to use of minority-owned and women-owned businesses in City contracts, and eliminating disparities in the use of available minority-owned and women-owned businesses in City contracts. Additional performance measures that could capture these objectives include:

- The number of SLBEs that increase revenue and grow out of the program every year;
- The degree to which the SLBE pool reflects the makeup of the county population;
- The number of employees an SLBE has when it first applies compared to when it renews its application;
- The percent of new SLBE applications where the applicant indicates they attended an SLBE outreach event; and
- The percent of SLBEs and City contractors involved in the mentor-protégé program.

The oversight of the SLBE program is housed within the management of the SLBE program, but should be separate to enable an objective evaluation of the program.

Oversight for the program lies with the EOC manager, who is also the person managing and implementing the program. Although the Purchasing and Contracting Department Director oversees the EOC program manager, in practice the oversight of the SLBE program falls to the EOC manager.

Oversight should be separate from management. According to the GAO Standards for Internal Control in the Federal Government, oversight bodies should provide constructive criticism to management and make oversight decisions so that the program achieves its objectives. Further, the GAO standards recommend that sufficient oversight should identify when a program is failing to meet its objectives and provide direction on how to address this issue, especially if the program touches many organizational units.

For oversight, SLBE program policies direct the creation of a Goal Setting Committee comprised of the EOC manager and representatives from the Purchasing and Contracting Department, the Engineering and Capital Projects Department, and other City departments as deemed appropriate and approved by the City's Chief Operating Officer.¹⁰ Program

¹⁰ The Engineering and Capital Projects Department was formerly the Department of Public Works.

policies direct the Goal Setting Committee to develop the methodology for setting goals for SLBE participation on contracts, forward recommendations to the City's Executive Team for maximizing use of the SLBE program through sizing and delivery methods for construction projects, and monitor implementation of the program. Program policies require the Goal Setting Committee to meet at least biannually, but the committee has not met in several years. Instead, the EOC manager has taken on the committee's role.

Additionally, according to GAO standards, program oversight should understand the program's objectives and have the specialized skills necessary to question and evaluate management. The SLBE program oversight is essentially housed within the Purchasing and Contracting Department, which is responsible for City contracting. However, the objectives of the program go beyond contracting and center on business development and increasing access for minority-owned and women-owned businesses.

The Citizens Equal Opportunity Commission is not able to provide intended oversight.

The Citizens Equal Opportunity Commission is designed to offer this insight, and according to its bylaws the commission was established to monitor EOC and make recommendations to improve the City's equal opportunity contracting. However, the commission is an advisory body that has struggled to meet regularly. The commission met for 5 of its scheduled 12 meetings in 2019 and in our 2017 audit on City advisory boards, we found that the commission had trouble meeting due to a lack of quorum. Although the commission's makeup and input positions it to be valuable, the commission is designed to provide advisory input to the EOC manager, and therefore would not sufficiently separate program oversight from program management.

Without oversight separate from program management, the entity largely responsible for setting the program's goals is also the entity responsible for evaluating the achievement of those goals. Without expertise in the program's objectives,

oversight would not question and evaluate management. Another entity within the City with this specialized knowledge and similar priorities is the newly formed Office of Race and Equity, whose mission is to recognize and mitigate barriers to the just distribution of resources, access, and opportunity. Gaining race and equity expertise and elevating oversight of the program could better situate the program to evaluate and meet its objectives.

The City Spends at Least an Estimated \$2.2 Million on the SLBE Program Annually, but the Program Cost is Not Weighed Against Program Benefits

We identified two main, measurable costs to the program: additional costs of contracts and staff time. Program policies direct the independent review of the SLBE program to potentially include a cost-benefit analysis. Council Policy 100-10 and Municipal Code 22.3622 also direct the Mayor's Office to annually report the costs of the program to City Council. EOC does not currently report the cost of the program.

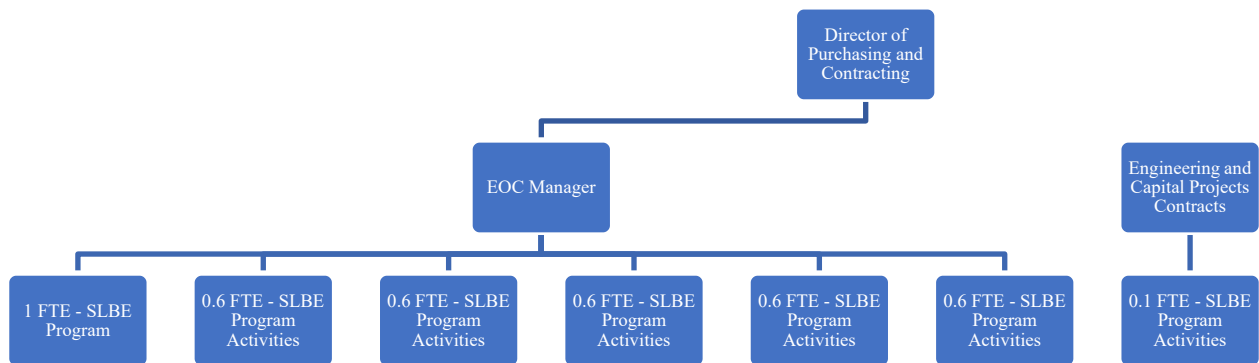
We estimate the City spent approximately \$1.6 million in additional contracting expenditures in FY 2018. For construction contracts with a design-bid-build model, the bid goes to the lowest responsive bidder. If a bidder is the lowest bidder but fails to meet the SLBE program requirements, the contract goes to the next-lowest bidder. In FY 2018, we reviewed all design-bid-build contracts and found that the City did not award the bid to the lowest bidder due to SLBE compliance in 9 out of 39 design-bid-build construction contracts with SLBE requirements. The difference between the low bid and the awarded bid in those contracts totaled about \$1.6 million—which was an increased cost of about 5 percent on each of the 9 contracts.

In addition to additional contracting costs, we calculated the City spends approximately \$657,000, or 8,790 staff hours, to administer the program each year. The program has one full-time staff member, but as noted in **Exhibit 13**, several employees within the Purchasing and Contracting Department and the Engineering and Capital Projects Department dedicate part of their time to administer the SLBE program. The City dedicates some employee time to SLBE program outreach, but staff must balance outreach time with other program and contracting demands and the City does not strategically review

its outreach efforts to determine which efforts provide the best return on invested time. EOC does not track staff time spent administering the program, so we calculated the number of hours based on estimates from each of the divisions impacted.

Exhibit 13

Several Employees Within Two Departments Dedicate Part of Their Time to Administer the SLBE Program



Source: OCA generated based on information from EOC and the Engineering and Capital Projects Department.

Although the City spends at least \$2.2 million for a program that ensures small, local businesses receive an average of at least \$77 million in contracts annually, the majority of the \$77 million spent on the program goes to just a handful of subcontractors each year and the program is not furthering its objectives over time. The City may need to invest further in outreach and oversight for the program to meet its objectives and for small, local businesses owned by women and people to color to see the intended benefits of the program.

Similar Programs at the State Level or in Other Cities Use Race- and Gender-Neutral Tools to Increase Contracting to

As discussed in the City's most recent disparity study (1995), the City Attorney's 2007 memorandum of law, and the 2010 audit of the precursor to the SLBE program, race- and gender-neutral programs may need to use tools outside of contracting preference to increase participation in the program among

**Small, Local Businesses
Owned by Women and
People of Color**

minority-owned and women-owned businesses. Tools such as adjusting bonding and insurance requirements and offering technical assistance are authorized in Council Policy 100-10 and Municipal Code 22.36. The SLBE program does conduct outreach and participate in a mentor-protégé program, but the program does not report any meaningful outcome measures for these tools to determine which events or programs within its limited resources are getting the most return on investment.

These issues are not unique to the City's program. In a similar statewide program, the California State Auditor found that the California Department of Veterans Affairs reported information, such as the outreach events staff attended, but did not provide any meaningful analysis regarding the quality, efficiency, and effectiveness of such activities, such as the correlation between a specific outreach event and the resulting program applications received. State law requires the California Department of Transportation to develop race- and gender-neutral efforts to decrease disparities in contracting through a plan that includes business outreach and communication, technical assistance and training, improved contracting processes, finance and bonding programs, prompt payment, and data collection, monitoring, and reporting. The City of Seattle's program for increasing diversity in contracting emphasizes prompt payment and other business practices. The City of San Antonio's program reports clear performance measures for its mentor-protégé program and loan interest buydown program.

To address the issues identified above, we make the following recommendations:

Recommendation 1

To increase transparency into the distribution of funds among SLBEs, we recommend Equal Opportunity Contracting list each Small Local Business Enterprise (SLBE) program-certified contractor by the number of prime contracts the City awarded the SLBE, the number of subcontracts the City awarded the SLBE, and the total dollar amount the City awarded the SLBE across those contracts in that year. The list should be included as an addendum to the annual report and made publicly

available on the program's website. This recommendation would allow the City and SLBE participants to monitor where the economic benefits of the program are centered and if the funds could be distributed among a broader array of SLBEs. (Priority 2)

Recommendation 2 We recommend that once the disparity study is complete, the Purchasing and Contracting Department should provide full copies of the study to City Council. With the results of the disparity study, if disparities in contracting exist, San Diego City Council and the Mayor's Office should consider changes to the Small Local Business Enterprise program to include narrowly tailored race- and gender-conscious contracting preferences to alleviate those disparities. (Priority 2)

Recommendation 3 We recommend that Equal Opportunity Contracting (EOC) compare the amount awarded in each contract type for each race/gender group to the race/gender makeup of contractors available in the region. Once the disparity study is complete, EOC could use the disparity study's analysis of the makeup of business owners in the region to estimate the anticipated percentage of contract funding that could possibly be awarded to each group in each contract type (construction, architectural and engineering services, and goods and services). If the disparity study is not complete or does not provide sufficient information, EOC management should use countywide race/ethnicity and gender data (either workforce or population data) to make this estimation. EOC should include this comparison in its annual reports. This recommendation does not recommend any preference in contracting based on race or gender, nor does it create or imply a required goal or quota of race or gender in contracts with the City. (Priority 2)

Recommendation 4 We recommend the Mayor's Office reposition oversight of the Small Local Business Enterprise (SLBE) program outside the management of the program. Oversight should include necessary expertise on decreasing barriers for businesses owned by women and people of color and should not solely rely upon City contracting expertise or fall to an advisory

commission that cannot compel management to action.

Oversight should, at minimum, include:

- a. Reviewing and approving the SLBE program's performance measures, including the goods and services participation rate in Recommendation #7.
- b. Ensuring the performance measures and goals of the program align with the program's objectives.
- c. Reviewing the program's progress at meeting performance measures and goals, and increasing the goals at a steady rate to ensure program progress.
- d. Reviewing and approving the goal setting methodology for construction contracts.
- e. Reviewing and approving the template for the annual report to City Council, as referenced in Recommendation #11, to ensure the information is presented in a manner that is clear and details the program's performance.
- f. Reviewing, approving, and seeking regular updates on the progress of the outreach plan in Recommendation #5. (Priority 2)

Recommendation 5 We recommend that Equal Opportunity Contracting develop a written, evidence-based plan consistent with the results of the disparity study for increasing outreach and participation in the Small Local Business Enterprise (SLBE) program for small, local businesses and those owned by women and people of color to the extent allowable under the law.

- The plan should include outcome-based performance measures for each program objective. Measures to be considered should include:
 - registration by businesses owned by women and people of color

- the number of businesses that grow out of the emerging local business enterprise category each year
- the number of businesses that grow out of the small, local business enterprise category each year
- the number of employees the organization has when applying initially, when renewing their application, and when growing out of the program
- The plan should be presented to the Citizens Equal Opportunity Commission for input and should include a public hearing with invited speakers from the pool of current registered SLBEs, SLBEs that successfully grew out of the program, and affiliated stakeholder groups, including industry associations and chambers of commerce.
- The plan should create goals and performance measures related to other tools designed to reduce barriers and increase competition in contracting included in the program, such as the mentor-protégé program and the bonds/insurance assistance program.

This recommendation does not recommend any preference in contracting based on race or gender, nor does create or imply a required goal or quota of race or gender in contracts with the City. (Priority 2)

Recommendation 6 We recommend that Equal Opportunity Contracting (EOC), along with other departments inputting staff time including Engineering and Capital Projects Department and Purchasing and Contracting Department, track staffing and any additional design-bid-build contract costs of the Small Local Business Enterprise (SLBE) program. EOC should report these data, and the method the program used to calculate and track the data, to the City Council in the SLBE program annual report, as

required in council policy and municipal code. Based on this information, San Diego City Council could determine if additional resources are necessary for success of the program.
(Priority 2)

Finding 2: Changes to the Program's Implementation May Expand Its Economic Benefits

Finding Summary

In addition to increasing the number and diversity of businesses that benefit from the Small and Local Business Enterprise (SLBE) program, the effectiveness of the program also requires maximizing the program's participation rate, which is the percentage of total contract dollars awarded to City-certified small local business enterprises (SLBEs). However, we found ways in which the current implementation of the program likely limits the dollars awarded to SLBEs below their potential. Specifically, we found:

- The City awards more dollars in goods and services contracts than any other type of contract, totaling more than \$300 million in fiscal year (FY) 2019. However, the SLBE program does not have any specific goals or requirements for the percentage of goods and services contract dollars that go to SLBEs, and does not include goods and services contracts when reporting the program's participation rate for SLBEs. We found that only 2.2 percent of City goods and services contract funds went to SLBEs in FY 2019, significantly reducing the overall program participation rate.
- For construction contracts, the SLBE program establishes specific requirements for the percentage of each contract that should go to SLBEs. However, the program caps these percentages well below the apparent availability of many types of SLBE businesses in the region and the caps have not increased since 2011.

As a result, we found that only 12 percent of City contract dollars are awarded to SLBEs. To increase the program participation rate, we recommend setting performance goals for goods and services contracts, collecting more SLBE program information on goods and service contractors, and

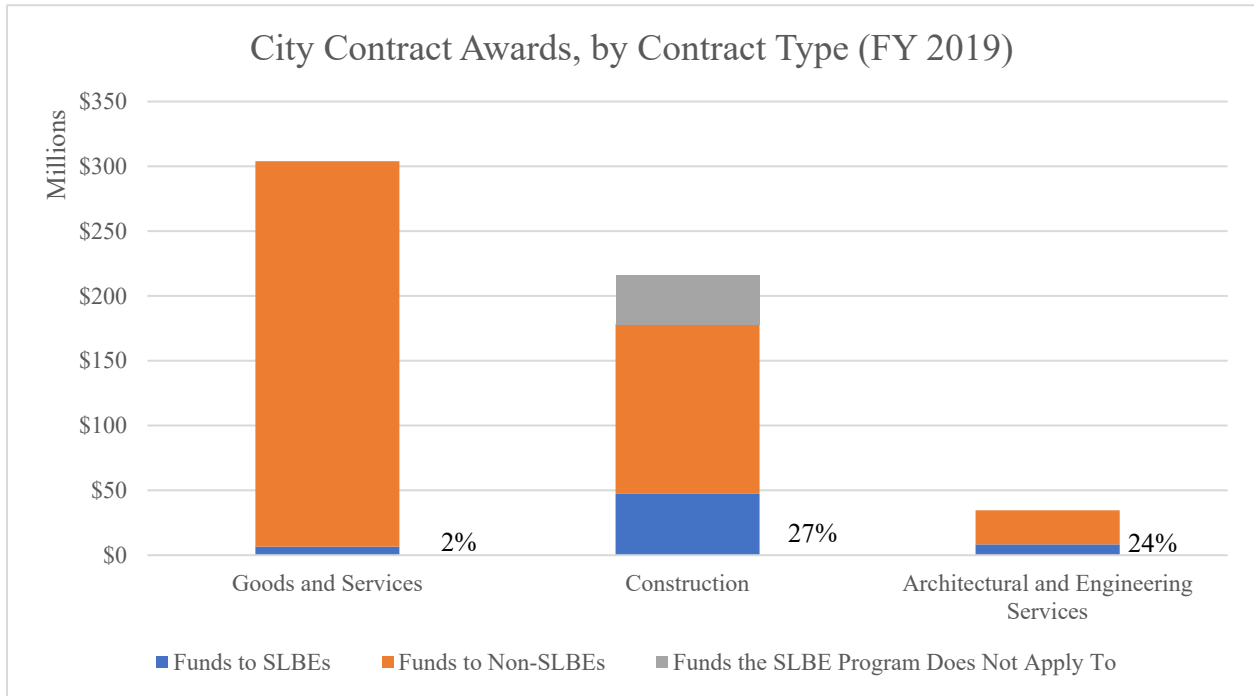
documenting the basis for SLBE subcontracting goals in construction contracts.

SLBE Participation in Goods and Services Contracts is Low, but EOC Excludes Goods and Services Contracts from Its Key Performance Indicator

In FY 2019, the City awarded about \$304 million in goods and services contracts, compared to about \$216 million in construction contracts and \$35 million in architectural and engineering contracts. However, as illustrated in **Exhibit 14**, the City awarded only 2.2 percent of goods and services contract funds to business certified through the SLBE program, compared to 26.6 percent of construction contract funds subject to the SLBE program and 24 percent of architectural and engineering service funds.

Exhibit 14

Only 2 Percent of Goods and Services Dollars Go to SLBEs



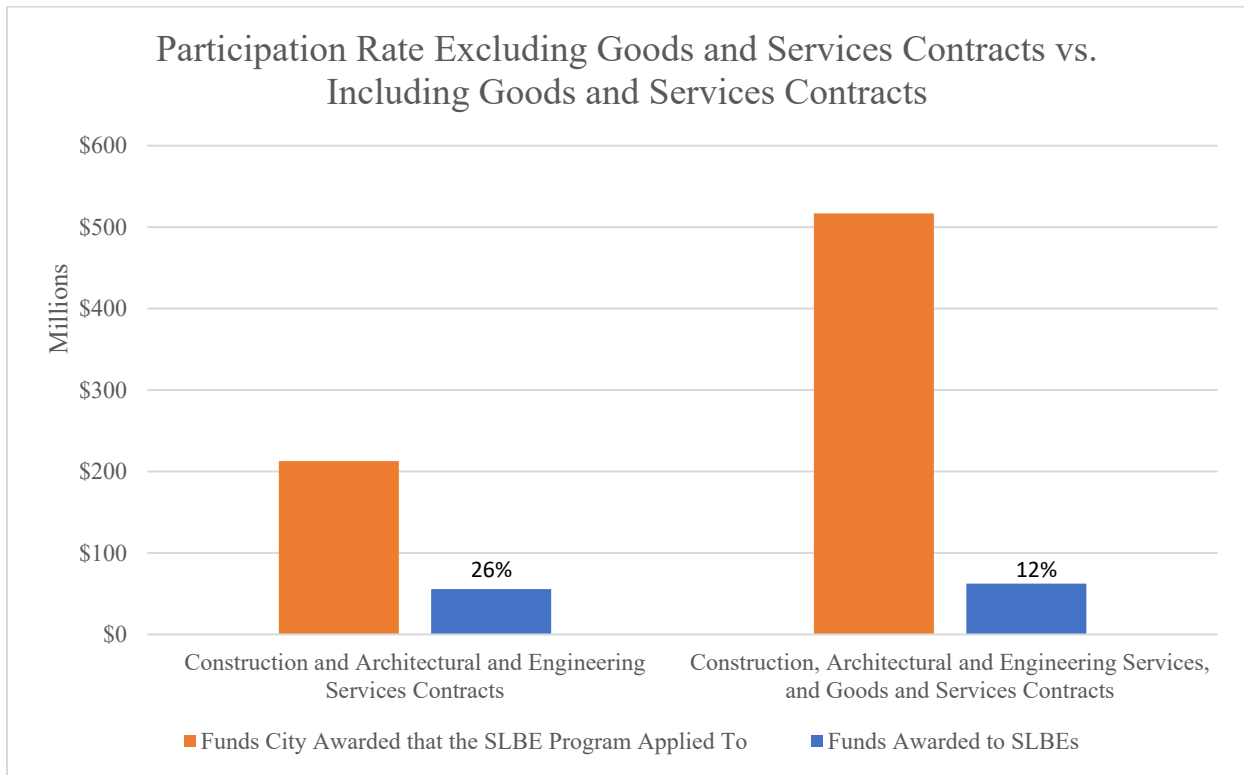
Source: OCA generated based on data provided by EOC.

Equal Opportunity Contracting's (EOC) key performance indicator for the SLBE program is the percentage of contracts, based on total dollar value, awarded to SLBEs. EOC's goal for the percentage, also called the participation rate, is 20 percent annually, but the key performance indicator as calculated by EOC includes construction contracts and architectural and

engineering services contracts and excludes goods and services contracts. Excluding goods and services contracts, the SLBE program reports that it exceeded the goal of 20 percent by awarding 25 percent of funds to SLBEs. However, when the \$304 million the City awarded through goods and services is included in the goal, the SLBE program's participation rate is 12 percent, as illustrated in **Exhibit 15**.

Exhibit 15

Including Goods and Services in the Participation Rate Lowers the Participation Rate from the Reported 26 Percent to 12 Percent



Source: OCA generated based on data from EOC.

Since goods and services contracts made up 55 percent of the City contract funds awarded in FY 2019, not including goods and services contracts in the key performance indicator leaves a large portion of City contracting out of the SLBE program. According to EOC, goods and services contracts do not usually have subcontracting opportunities and often go to large companies, such as Adobe Inc. or Staples Inc. However,

Council Policy 100-10 does not require the use of SLBEs to be limited to subcontracting—the prime contractor itself could be an SLBE and thus meet SLBE contracting goals. Additionally, the City purchases goods and services outside of software licensing and office supplies. For example, the City has certified SLBEs that provide landscaping services, digital printing, janitorial services, exterior painting, and security services. Establishing SLBE participation rate goals for goods and services contracts such as these may increase the City's overall SLBE participation rate. For example, increasing participation within goods and services from 2.2 percent to 10 percent would mean \$24 million in additional funds awarded to SLBEs and would raise the City's overall participation rate to 17 percent, while expanding the business capacity of SLBEs.

In goods and services contracts, Council Policy 100-10 grants 5 to 10 percent additional points in the proposal analysis to bidders who subcontract out to SLBEs and 12 percent additional points to prime contractors who are SLBEs. However, in the sample of goods and service contract bidding documents reviewed, the City asks the bidding business to report how much it plans to contract out to SLBEs, but does not ask if the bidder (i.e., the prime contractor) is an SLBE itself.^{11,12} However, as noted above, Council Policy 100-10 does not require use of SLBEs to be limited to subcontracting, and thus the City may be missing opportunities to contract with or record funds awarded to SLBE prime contractors.

**Caps on Program Goals
May Diminish SLBE
Participation in
Construction**

We also found areas where the City could increase the SLBE participation rate for construction projects. Each major construction project requires the prime contractor to subcontract a portion of the work to SLBEs, per San Diego Municipal Code 22.3609. If the bid from the prime contractor does not meet the SLBE subcontractor participation requirement, the prime contractor must demonstrate a good

¹¹ Sampling methodology is included in Appendix B.

¹² After the exit conference for this report, the Purchasing and Contracting Department provided the updated document for goods and services contractors that does ask the bidders themselves if they are certified as SLBEs, as of April 2018.

faith effort to have met the requirement or the City will deem the bid nonresponsive and ineligible for the award.

In FY 2019, the Engineering and Capital Projects Department estimated that, on average, 35 percent of the work on construction projects could go to available SLBEs. However, because of caps on required SLBE subcontracting rates, Engineering and Capital Projects reduced the required SLBE subcontracting rate on each contract from 35 percent to 21 percent on average, meaning potentially as much as \$36 million less was awarded in contract funds to SLBEs due to the caps.

***SLBE Participation Requirement
Caps, by Project Type***

- Signals and Streetlighting: 10.0%
- Sidewalks: 14.4%
- Paving: 15.1%
- System Rehabilitation: 15.3%
- Water/Sewer Pipelines: 22.3%
- Curb Ramps: 23.7%
- Surface Improvements: 25.1%

Ultimately, the required SLBE subcontractor participation rate, or percent of the contract dollars that must be subcontracted to SLBEs, is approved on a project-by-project basis by the EOC manager.

First, the Engineering and Capital Projects Department recommends a participation rate for each project, based on a set formula. Engineering and Capital Projects' formula estimates the percent of the project that could be performed by SLBEs by looking at the type of work to be performed and the percent of the market that performs that work category that is made up of SLBEs.¹³

Engineering and Capital Projects then compares the formula's estimation of the percent of the work that could be performed by SLBEs to the cap Engineering and Capital Projects has set for that type of project. Engineering and Capital Projects set maximum required SLBE subcontractor participation rates (caps) for different project types, listed in the textbox. The caps for the majority of projects have not increased since Engineering and Capital Projects set the caps in FY 2011. If the percent of the project that could be performed by SLBEs is higher than the cap for that type of work, Engineering and

¹³ The City uses North American Industry Classification System (NAICS) codes to categorize the elements of work on construction projects.

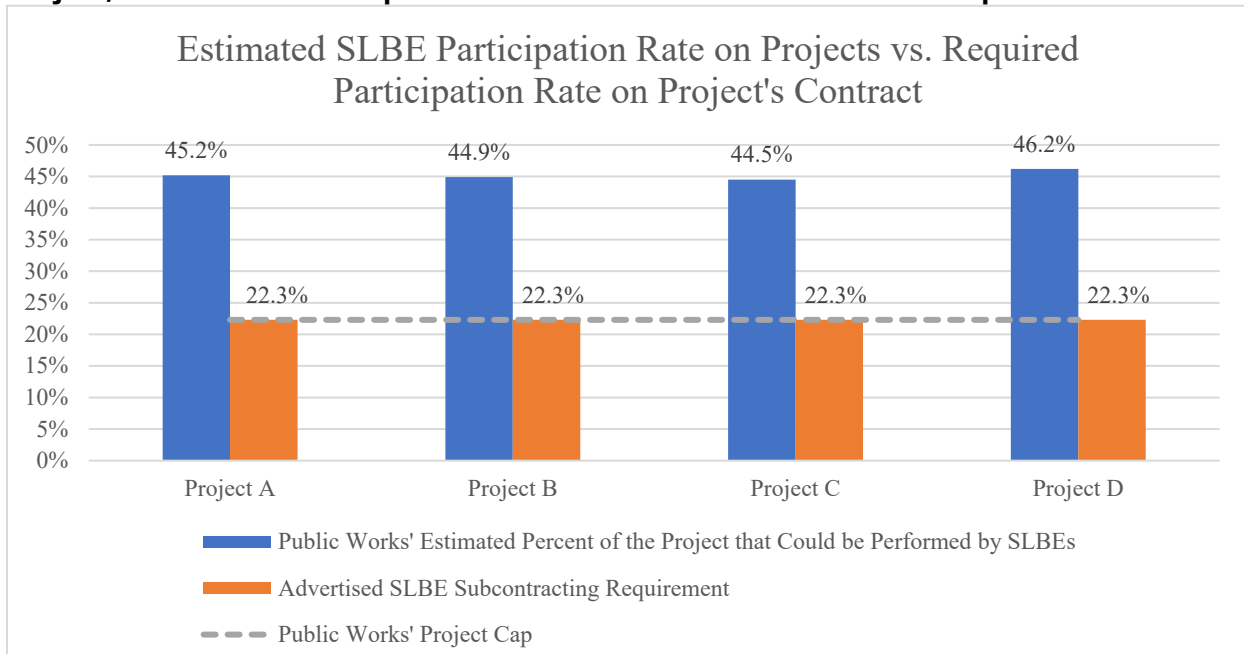
Capital Projects reduces the required amount the prime contractor must subcontract out to SLBEs.

Finally, Engineering and Capital Projects submits the recommended participation rate for the project to EOC for its approval. EOC decides if the recommended participation rate is too high or too low for the project, but according to EOC the Engineering and Capital Projects recommended participation rates are approved most of the time.

For example, **Exhibit 16** shows four actual water and sewer line construction projects from FY 2018. In each of the projects, Engineering and Capital Projects calculated that about 45 percent of the project could be completed by available SLBEs. However, because the cap on water and sewer line construction projects is 22.3 percent, the required subcontracting rate put in each request for proposal was 22.3 percent.

Exhibit 16

Engineering and Capital Projects Calculates SLBEs Could Perform 45 Percent of the Project, but Lowers the Requirement to 22.3 Percent Because of Its Caps



Source: OCA generated based on Engineering and Capital Projects Department data

As a more detailed example of how this process works, Project A in **Exhibit 16** is a Mid-City Pipeline Phase 2 project.

Engineering and Capital Projects estimated SLBEs could perform 45.2 percent of the work, based on the number of businesses in the area that could do this type of work and the percent of those businesses that are SLBEs. However, because the calculated 45.2 percent SLBE availability rate is higher than the 22.3 percent cap Engineering and Capital Projects set for water and sewer pipeline projects, Engineering and Capital Projects requires that only 22.3 percent of the project be subcontracted out to SLBEs. Instead of SLBEs receiving 45 percent, or about \$1.8 million of the project's estimated cost, SLBEs would only receive about \$892,000 to meet the 22.3 percent cap. As a result of the participation cap, Engineering and Capital Projects reduced the funds potentially awarded to SLBEs by half.

Many caps on required SLBE participation have not been increased since 2011, despite procedures stating they are reviewed every six months.

Engineering and Capital Projects states in its Standard Operating Procedure for SLBE goal calculations that the caps are statistically evaluated and fine-tuned every six months. In addition, Engineering and Capital Projects' Standard Operating Procedure for SLBE subcontracting goal calculations describes a 2 percent increase annually as realistic.

However, many of the caps have not changed since Engineering and Capital Projects set them nine years ago. As the number of registered SLBEs has grown, the availability of SLBEs to perform work on construction contracts has also grown, but Engineering and Capital Projects continues to set SLBE subcontracting rates significantly lower than calculated SLBE availability. Over time, if EOC had raised the caps by 10 percent (i.e., from an average of 21 percent to an average of 23.1 percent), SLBEs would have potentially received 10 percent more of the contract awards—or about \$5.9 million in additional awarded funds in FY 2018. If EOC had raised the caps just 2 percent per year from 2012 to 2018, each cap would have increased by about 15 percent—potentially translating to \$8.8 million in additional funds to SLBEs in FY 2018.

To address the issues identified above and improve the City's SLBE participation rate, we make the following recommendations:

- Recommendation 7** We recommend the Small Local Business Enterprises (SLBE) program management work with the Purchasing and Contracting Department to create annual performance goals for the percent of goods and services contract dollars awarded to SLBEs. The evaluation of appropriate goods and services SLBE contracting goals should include reviewing the portion of goods and services contracts that are for services that could likely be provided by local businesses. (Priority 2)
- Recommendation 8** We recommend the Purchasing and Contracting Department collect more information from goods and service contract bidders, including asking if the bidding contractor (prime contractor) is certified by the Small Local Business Enterprise (SLBE) program or if the business thinks they may qualify to be certified by the SLBE program. (Priority 2)
- Recommendation 9** We recommend Small Local Business Enterprise (SLBE) program management, in consultation with the appropriate oversight bodies, evaluate the caps on SLBE subcontracting requirements for construction projects annually. Program management should then include the caps in the annual report, with a detailed description of the methodology used to justify the cap, and should include the previous cap amounts over time. This recommendation, however, should not conflict with City policies that require the prime contractor to perform at least 50 percent of the contract. (Priority 2)

Finding 3: City Leadership is Not Given Sufficient Quality Information on the Performance of the Program to Make Informed Management and Oversight Decisions

Finding Summary

City of San Diego (City) management, oversight bodies, and the public need reliable and relevant data to make informed decisions and evaluate the program's performance in achieving key objectives. To that end, City of San Diego Council Policy 100-10 and Municipal Code Section 22.3622 require the Mayor to annually report the impact and costs of the Small Local Business Enterprise (SLBE) program to the City Council. Program policies also commit the City to "regularly evaluating the progress of the program using accumulated availability and utilization data to determine specific program provisions that require modification, expansion, and/or curtailment."

However, we found that the Business Diversity Annual Reports from the Purchasing and Contracting Department and the Equal Opportunity Contracting Division (annual reports) to the San Diego City Council do not provide sufficient information on the SLBE program for City Council to judge the efficacy of the program.¹⁴

Specifically, the annual reports do not include information that would allow the City Council to understand basic elements of program performance, such as whether or not the program has achieved its stated objectives and what the program costs the City. Key information is missing from the annual reports, much of the data presented in the report does not have clear

¹⁴ The FY 2019 annual report can be found at:

https://onbase.sandiego.gov/OnBaseAgendaOnline/Documents/ViewDocument/Business%20Diversity%20Annual%20Report%20Staff%20Report_updated.pdf?meetingId=3865&documentType=Minutes&itemId=186937&publishId=362857&isSection=false

and consistent methodologies, and errors in the report indicate a lack of quality control.

We make recommendations to increase the information provided to City management and City Council on the SLBE program's performance, and ensure the information is consistent over time and free from errors.

**Key Program
Performance
Information is Missing**

The annual report does not include information on the diversity of available SLBE owners.

In FY 2019, the program reported 712 City-certified small local business enterprises (SLBEs), with increases in construction, general services, and professional service providers from the previous year. However, the annual report does not include the percentage of SLBEs that were owned by women and/or people of color. The report, therefore, does not give clear indication on the availability of minority-owned or women-owned SLBEs and if this diversity measure is increasing or decreasing—despite the fact that both measures relate directly to program objectives and can identify trends affecting program performance.

For example, when we conducted these analyses based on data received from the Equal Opportunity Contracting (EOC) division, we found that in FY 2018, men owned 69 percent of all SLBEs and women owned 31 percent. Comparatively, in FY 2020, men owned 74 percent of SLBEs and women owned 26 percent.

In FY 2018, 69 percent of all SLBEs were owned by business owners who identified as Caucasian, 15 percent were Latino-owned, 8 percent were Asian-owned, 6 percent were African American-owned, 2 percent were Native American-owned, 1 percent was Pacific Islander-owned, and 1 percent was owned by people who identified as Other. The percent of Asian-owned SLBEs decreased slightly from 8 percent in FY 2018 to 7 percent in FY 2020; the percent of African American-owned

SLBEs decreased from 6 percent to 5 percent in the same time. The remaining groups remained stable.¹⁵

The annual report excludes the goods and services contract participation rate from the program's key performance measure.

As discussed in Finding 2, the key performance measure for the SLBE program is the participation rate, or the percent of contract dollars awarded to SLBEs within City-funded contracts, excluding emergency and sole-source construction contracts. The FY 2019 and FY 2018 annual reports highlight the goal of the SLBE program to award 20 percent of contract dollars to SLBEs. However, the participation goal as set by EOC includes construction contracts and architectural and engineering services contracts but leaves out the more than \$300 million the City awarded in goods and services contracts. Combining construction contracts' participation rate with architectural and engineering services contracts' participation rate, while excluding goods and services contracts' participation rate, makes the City's overall participation rate less clear for City management and City Council.

In the FY 2019 annual report, EOC reported the participation rate as 25 percent—exceeding the 20 percent goal. However, with goods and services included, the City's participation rate was actually only 12.1 percent—markedly less than the program's selected key performance measure target.

EOC does not separately report the participation rate for goods and services contracts awarded to SLBEs.

The FY 2019 and FY 2018 annual reports state the percentage of goods and services contracts awarded to all certified businesses, rather than specifically SLBE-program businesses. The FY 2019 annual report states that the City awarded 3 percent of \$334.6 million of goods and services contracts formally solicited to certified businesses. However, the 3 percent figure includes businesses that are not part of the

¹⁵ The FY 2020 data does not include information on SLBE business owners who identified as Pacific Islander and Other.

SLBE program—such as Disadvantaged Business Enterprises certified by the federal government. If the participation rate for goods and service contracts was calculated including only SLBE-certified businesses, the participation rate would be 2.2 percent. Including businesses that are not SLBEs in the SLBE program annual report makes the program's actual performance less clear. Without clear information on the program's performance, the City Council cannot determine if EOC has effectively achieved the objectives of the program.

The annual reports mix program-specific data with non-program data, misrepresenting the program's impact.

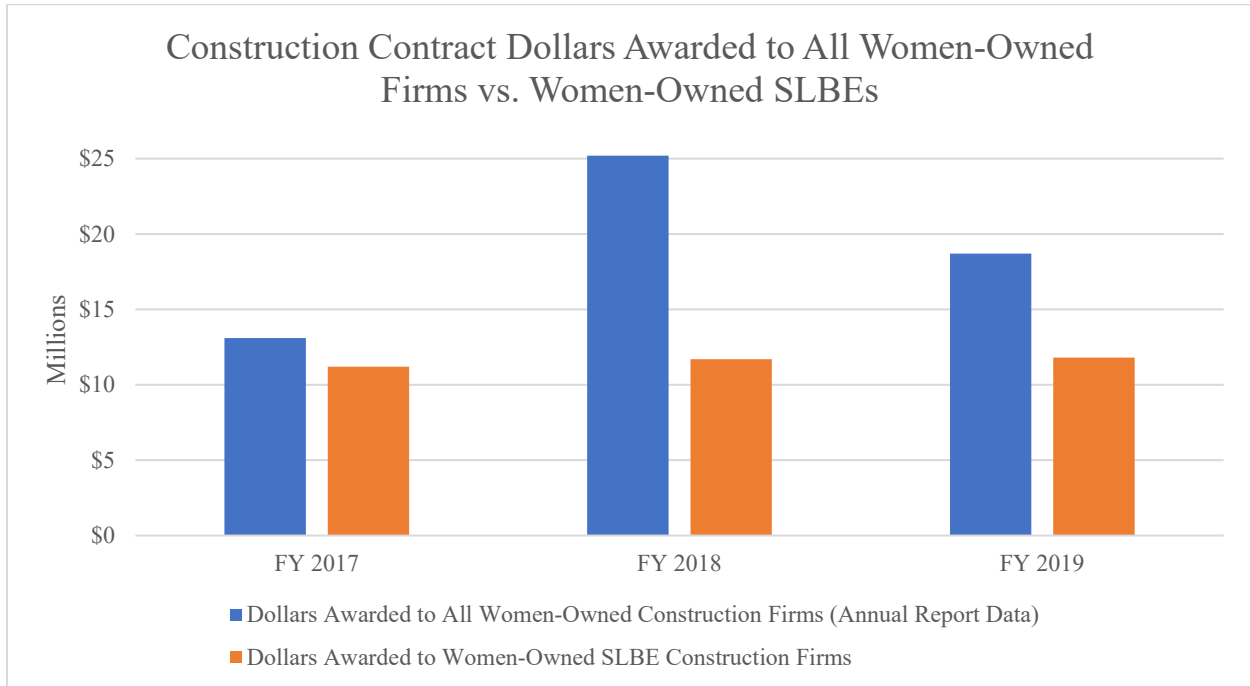
The mixing of program-specific data with data from outside the program is a trend that extends outside of goods and services contract analysis in the annual report. Although the annual reports include information on the City's construction contracts with minority-owned and women-owned businesses, the data includes all projects—including federally-funded projects where a portion of the funding must go to minority-owned and women-owned businesses.

Including all projects and not specifically reporting the diversity within the SLBE program funds may overstate the diversity in contracting resulting from the program and not clarify the performance of the SLBE program. For example, the FY 2019 annual report states that the City awarded women-owned construction businesses \$13.1 million in FY 2017 and \$18.7 million in FY 2019—a 43 percent increase. However, within just the funds awarded to SLBEs, women-owned construction SLBEs were awarded \$11.2 million in FY 2017 and \$11.8 million in FY 2019—only an actual 6 percent increase.

Exhibit 17 includes the total dollars awarded to all women-owned construction businesses, which EOC includes in the annual report, compared to the dollars awarded to women-owned SLBEs.

Exhibit 17

By Mixing Program-Specific Data with Non-Program Data, the Annual Report Overstates the Dollars Awarded to Women-Owned SLBEs



Source: OCA generated based on FY 2019 Business Diversity Annual Report and data provided by EOC.

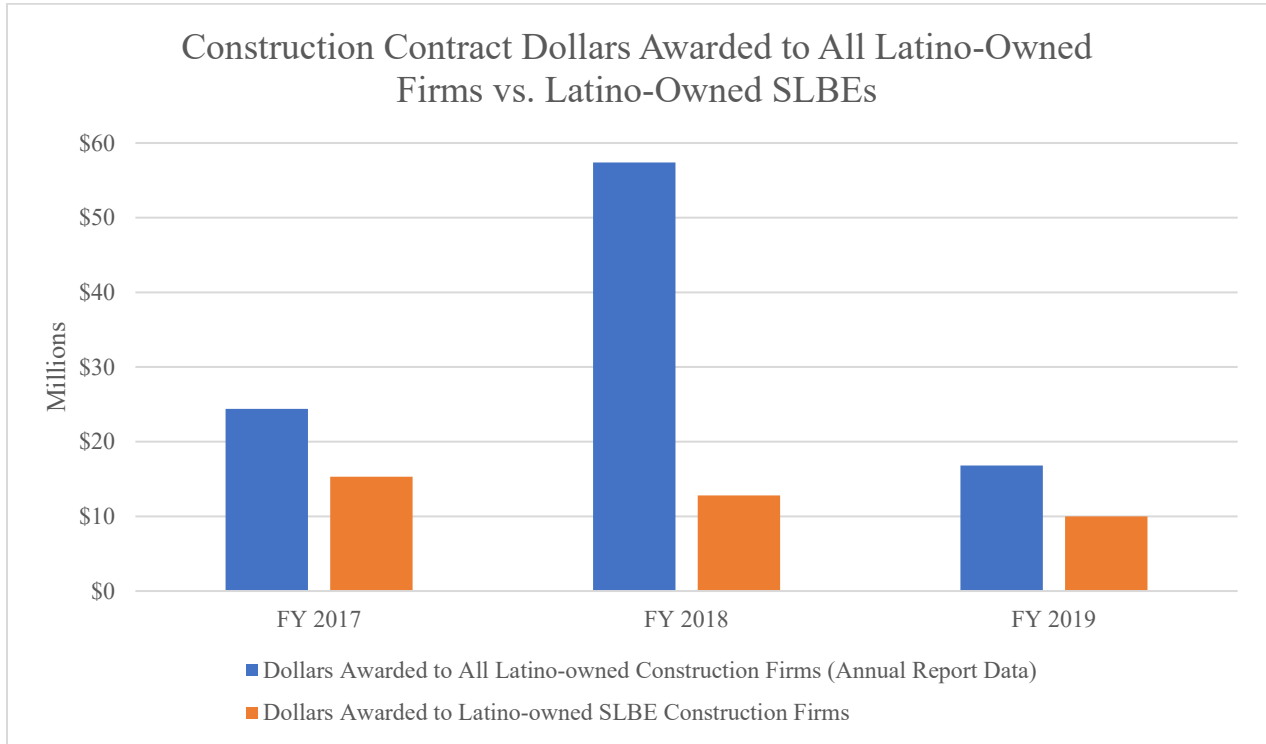
EOC reports on the construction contract funds awarded to minority-owned businesses in the same manner. The charts include all projects, not specifically reporting the diversity within funds that went to SLBEs.

When assessing the SLBE program's performance, looking at the data in the annual report it may appear that funds awarded to Latino-owned businesses vary over time. However, when looking specifically at funds awarded within the SLBE program, it appears that funds awarded to Latino-owned businesses within the SLBE program decreased each year. For example, **Exhibit 18** compares the funds EOC reported the City awarded to Latino-owned construction businesses to the funds the City awarded to Latino-owned SLBEs. Without program-specific data presented in a clear format, City management and City Council do not have sufficient

information to determine if the program is successful or if changes are necessary.

Exhibit 18

By Mixing Program-Specific Data with Non-Program Data, the Annual Report May Overstate the Dollars Awarded to Latino-Owned SLBEs



Source: OCA generated based on FY 2019 Business Diversity Annual Report and data provided by EOC.

The annual reports do not include information on the program's performance over a broad time horizon.

In addition to presenting insufficient categories of information, we also found that the annual reports do not display data over a sufficient time period to recognize trends. The annual reports present the participation rate for construction contracts and architectural and engineering services contracts for that year and the previous two years, but that provides insufficient context for the performance of the program over time. As illustrated in Finding 1, a longer time horizon would note that the actual participation rate increased 0.6 percentage points from FY 2015 to FY 2019. The FY 2019

annual report looks at three years of time, where the participation rate decreased 7 percentage points.

The annual report does not track other important measures over time in an understandable format, such as the percent of contract dollars awarded to SLBEs that went to minority-owned and women-owned SLBEs. If the annual report had done so, for example, the report would make clear that the percent of funds awarded to African American-owned SLBEs in construction decreased from 2.1 percent in FY 2015 to 0.4 percent in FY 2019. The Government Accountability Office's Standards for Internal Control in the Federal Government states that management should communicate quality information to achieve the entity's objectives. Without long-term trend analysis in the annual report, City Council cannot evaluate the program's performance over time.

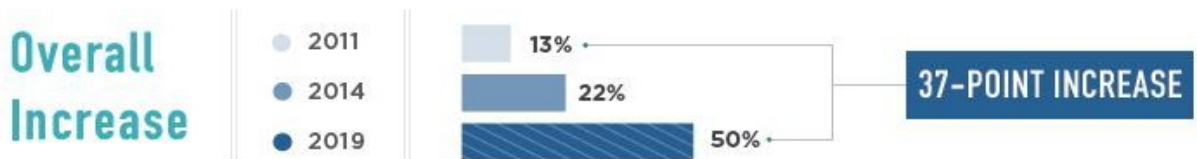
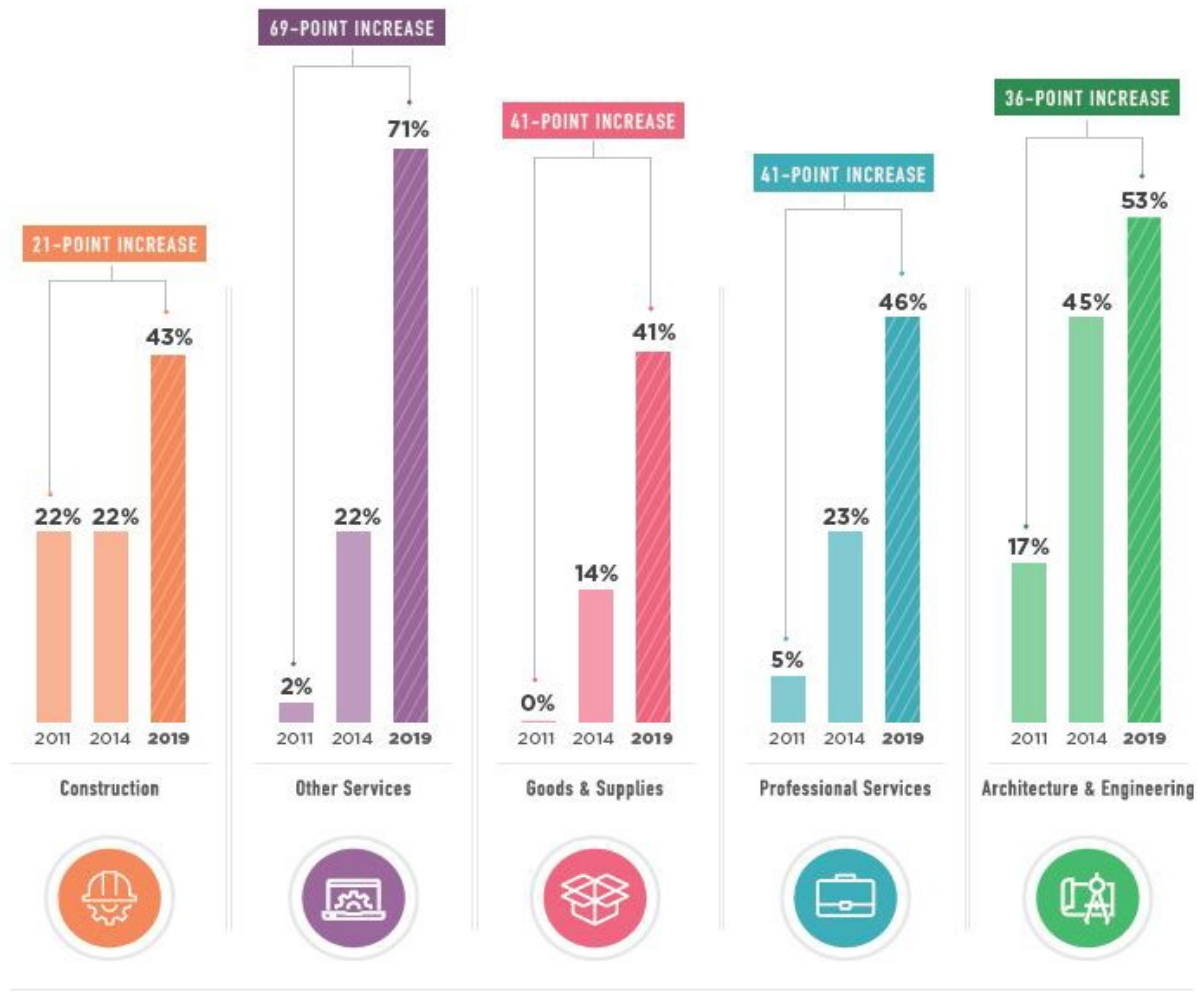
The City of San Antonio has a similar program that tries to increase diversity in city contracting and use of small, local businesses. The City of San Antonio's annual report includes information on the performance of the program at key milestones over the life of the program and clearly illustrates the progress of the program in meeting its objectives. **Exhibit 19** is taken from the City of San Antonio's FY 2019 annual report and highlights how the City of San Diego could more clearly report its key performance measure over time within each contract category.

Exhibit 19

The City of San Antonio's Annual Report Includes Clear Charts Illustrating Program Performance

SBEDA M/WBE UTILIZATION PROGRESS

2011 - SBEDA Ordinance Revisions | 2014 - SBEDA Race-Conscious Application



Note: SBEDA is the Small Business Economic Development Advocacy Program. M/WBEs are minority-owned and women-owned business enterprises.

Source: City of San Antonio Small Business Office Annual Report FY 2019.

EOC does not track or report the cost of the program.

Both Council Policy 100-10 and Municipal Code Section 22.3622 require the Mayor to annually report the cost of implementing the SLBE program. Staff from Purchasing and Contracting, EOC, and two different divisions at the Engineering and Capital Projects Department all administer components of the SLBE program, but EOC does not capture and report the time the staff in the various departments take to administer the program. We calculated this cost as approximately \$657,000, or 8,790 staff hours, annually.

In addition to administrative costs, the SLBE program potentially increases the cost of City contracts and EOC does not track or report that data either. For example, as detailed in Finding 1, all City-funded construction contracts valued greater than \$500,000 require prime contractors to subcontract out a portion of the contract to SLBEs. For design-bid-build construction contracts, the lowest bidder wins the contract as long as they can fulfill the contract and meet the SLBE requirements. If the lowest bidder fails to meet this requirement, the City contracts with the next-lowest bidder, which may be more expensive. EOC does not track how often this happens or what the total cost to the City is when the City contracts with the lowest bidder that meets the SLBE requirements, rather than with the overall lowest bidder. We calculated this cost as \$1.6 million in FY 2018. Goods and services contracts and architectural and engineering services contracts also may result in increased cost to the City through bid discounts, but EOC does not track or report when the bid discount results in an increased cost to the City. Without tracking and reporting the cost of the program, City management cannot weigh the costs of the program against the economic benefits of the program and make changes to best achieve the objectives of the program.

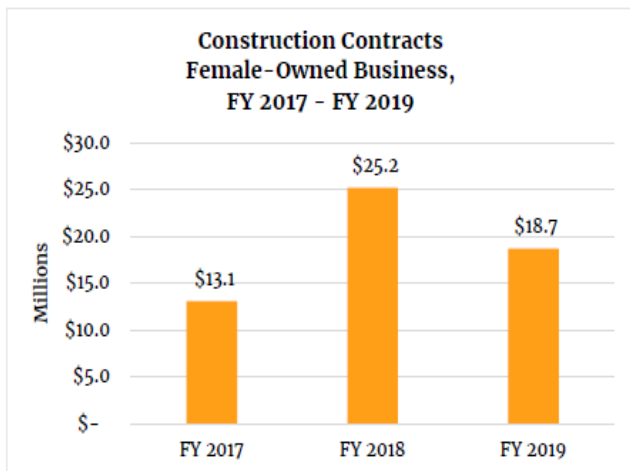
Reporting Lacks Clarity and a Consistent Methodology

The data in the report is not presented in a manner that is clear and understandable.

The annual report often presents dollars awarded without context of the overall contracts awarded that year, as illustrated in **Exhibit 20** from page 7 of the FY 2019 annual report. EOC’s chart says that the City awarded \$25.2 million in construction contracts to women-owned businesses in FY 2018 and \$18.7 million in FY 2019. However, the total amount of money the City spends on construction contracts can vary widely from year-to-year. The City’s awards to women-owned construction businesses decreased from FY 2018 to FY 2019, but the chart lacks context. The City awarded less construction contracts in FY 2019, but more of the funds went to women-owned businesses. As illustrated in **Exhibit 21**, if the data were presented as a percentage of the total construction awards in each year, it is clear that the percent of the City’s awards to women-owned construction businesses increased from FY 2018 to FY 2019.

Exhibit 20

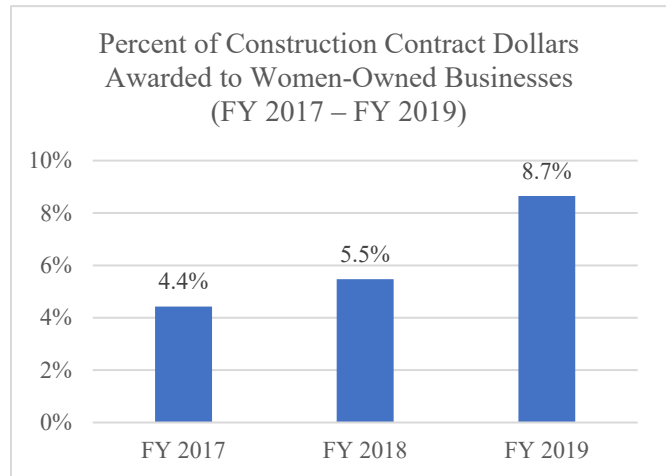
EOC’s Annual Report States the Dollars Awarded to Women-Owned Businesses without Context of the Total Dollars Awarded that Year



Source: EOC’s FY 2019 Business Diversity Annual Report.

Exhibit 21

With Context, EOC’s Annual Report Would Show that Although Dollars Awarded Decreased Overall, But the Percent Awarded to Women-Owned Businesses Increased

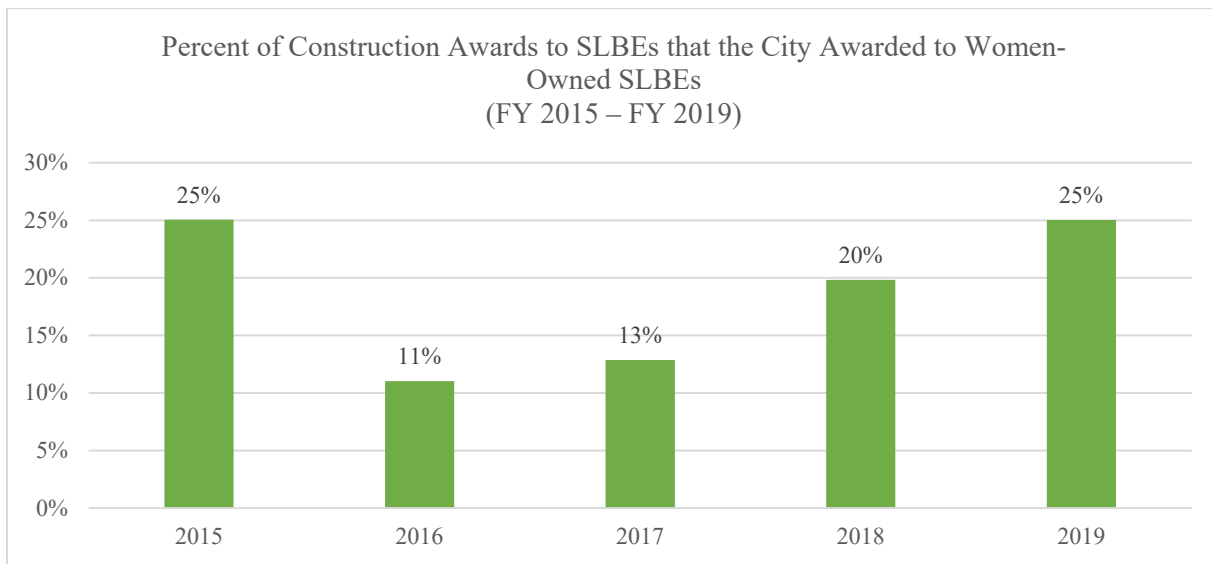


Source: OCA generated based on EOC annual report data.

Another issue is that the report data above is not program-specific; it reports all dollars awarded to women-owned construction businesses, regardless of whether or not the business is an SLBE. Thus, it is not the best measure of how the SLBE program itself is performing. As illustrated in Exhibit 22, if the data presented in the annual report were program-specific and encompassed a broader time horizon, the percent of construction funds awarded to SLBEs that were awarded to women-owned SLBEs was 25 percent in FY 2015, decreased to 11 percent the following year, and climbed back to 25 percent in FY 2019.

Exhibit 22

With Context, a Broader Time Horizon, and Focusing on SLBE Program-Specific Data, It’s Clear the Percent of Funds Awarded to Women-Owned SLBEs Decreased After FY 2015 and Returned to FY 2015 Levels in FY 2019



Source: OCA generated based on data provided by EOC.

In another example, as shown in **Exhibit 23**, EOC’s annual report illustrates where the City awarded construction contract funds by the business owner’s reported race/ethnicity over a three-year time period. However, without contextualizing the data within the overall budget, the chart does not make the trends in awards clear.

Exhibit 23

EOC's Annual Report Includes Charts Without Contextualizing the Data, Making Trends Unclear

Ethnicity	FY 2017		FY 2018		FY 2019	
	# Awarded	Dollar Amount	# Awarded	Dollar Amount	# Awarded	Dollar Amount
African-American	8	\$941,386	3	\$335,063	5	\$670,024
Asian Pacific	16	\$3,323,986	14	\$11,087,334	6	\$951,155
Asian Subcontinent	14	\$5,991,053	15	\$7,623,710	15	\$5,380,425
Caucasian	570	\$260,857,011	304	\$128,664,579	233	\$78,072,733
Latino	94	\$24,409,051	93	\$57,437,928	90	\$16,842,109
Native American	10	\$382,870	8	\$658,718	9	\$652,354
Unidentified ¹⁰	-	-	181	\$255,061,128	147	\$113,497,131
Total	712	\$295,905,358	618	\$460,868,460	505	\$216,065,931

Source: EOC's FY 2019 Business Diversity Annual Report.

With context, as in **Exhibit 24**, the percent of the total contract award that went to each identified group is clear. However, both charts display data from the construction contracts overall and do not center on the program-specific data over time, which would be ideal for the SLBE program annual report.

The annual report is the main avenue by which City Council receives information on the performance of the SLBE program. Without clear, understandable data, City Council cannot determine if the Mayor has implemented the program successfully or if the policy changes are needed to meet its objectives.

Exhibit 24

With Context, Trends in Diversity in Contracting Are More Clear

Race/ Ethnicity	FY 2017			FY 2018			FY 2019		
	# Awarded	Dollar Amount	% of Dollars Awarded	# Awarded	Dollar Amount	% of Dollars Awarded	# Awarded	Dollar Amount	% of Dollars Awarded
African-American	8	\$941,386	0.3%	3	\$335,063	0.07%	5	\$670,024	0.3%
Asian Pacific	16	\$3,323,986	1%	14	\$11,087,334	2%	6	\$951,155	0.4%
Asian Subcontinent	14	\$5,991,053	2%	15	\$7,623,710	2%	15	\$5,380,425	2%
Caucasian	570	\$260,857,011	88%	304	\$128,664,579	28%	233	\$78,072,733	36%
Latino	94	\$24,409,051	8%	93	\$57,437,928	12%	90	\$16,842,109	8%
Native American	10	\$382,870	0.1%	8	\$658,718	0.1%	9	\$652,354	0.3%
Unidentified	-	-	-	181	\$255,061,128	55%	147	\$133,497,131	62%
Total	712	\$295,905,358		618	\$460,868,460		505	\$216,065,931	

Source: OCA generated based on data from EOC's FY 2019 Business Diversity Annual Report.

EOC does not have a consistent, written methodology for producing the annual reports.

Lacking a written methodology can lead to changes in how the performance measures are calculated and reported year-to-year, meaning that program performance may be difficult to compare year-to-year. As mentioned earlier, a key performance measure EOC reports for the SLBE program is the participation rate. However, EOC stated that it does not have a written methodology for calculating the participation rate or other key data indicators included in the annual report. For example, the overall participation rate is calculated as the dollars awarded to SLBEs as a percentage of the total dollars awarded in City-funded construction and architectural and engineering consultant contracts.

However, the report does not specify that sometimes state-funded or grant-funded projects may be included, if they do not have other subcontracting requirements. Without a written method for calculating this key indicator, the denominator may shift over time as contracts are included or not included inconsistently, creating the appearance that the

program participation rate is higher or lower than it was the previous year. Other key data indicators without written methodologies include how the program reports the race, ethnicity, and gender diversity of the owners of SLBEs awarded contracts. For example, groups identified as Asian, Asian Pacific, Asian Subcontinent, and Pacific Islander appear in different places in the annual reports and underlying data—sometimes individually and sometimes grouped with subsets.

In addition, some methodologies used in the annual report make the program's performance unclear. For example, in the FY 2019 annual report, EOC states that the City awarded "SLBE (Only)" businesses \$2 million in architectural and engineering services contracts and "ELBE (Only)" businesses \$1.4 million. This data could lead one to believe that SLBE program-certified businesses (SLBEs and ELBEs) only received \$3.4 million in contract awards that year. However, according to the report, SLBEs and ELBEs received \$8.3 million in contract awards. The reason for the discrepancy is the methodology EOC uses to illustrate where the funds were awarded. EOC's current methodology takes any funds awarded to SLBEs with a second certification, such as an SLBE that is also a federally-certified Disadvantaged Business Enterprise, and categorizes the funds under that other certification, rather than under "SLBE only." This avoids counting funds twice, but does not provide clear information on the program's performance.

A Lack of Documented Methodology and Quality Control Has Also Contributed to Reporting Errors

The annual report contains a number of errors that indicate the quality control process for drafting and reviewing the report is insufficient. The Government Accountability Office's Standards for Internal Control in the Federal Government states that data provided to management should be reasonably free from error and bias and faithfully represent what they purport to represent. The annual report does not meet this bar. For example, the FY 2019 annual report says the participation rate was 25 percent for construction contracts and architectural and engineering services contracts. However, we calculated the participation rate defined by EOC to be 26.2 percent. It's likely EOC reported a 25 percent participation rate because it took the sum of the construction

contracts participation rate (26.6 percent) and architectural and engineering services contracts participation rate (24 percent) and divided by two (25.3 percent). To report the participation rate, EOC should calculate the average based on the total dollars awarded to SLBEs for both contract types divided by the total dollars awarded overall for both contract types. While this is a relatively small error, this is an error in the calculation of the program's key performance measure, which could distort the perceived performance of the program.

Some data EOC reported also do not align with the supporting documentation. For example, the FY 2019 annual report states that Caucasian-owned construction businesses received 233 contracts totaling \$78 million, whereas the raw data that EOC uses to create the annual report says Caucasian-owned construction businesses received 248 contracts totaling \$83 million. In the chart describing funds awarded to construction businesses owned by women, the FY 2019 annual report says the City awarded \$18.7 million, while the underlying data says the City awarded \$24.6 million in construction contracts to women-owned businesses. Also, the FY 2019 annual report states that the City awarded eight emergency contracts totaling \$6.5 million, while the underlying data says the eight emergency contracts totaled \$6.65 million. Additionally, the FY 2019 annual report states that the City awarded 670 goods and services contracts totaling \$344.6 million, while the underlying data says the City awarded 609 goods and services contracts totaling \$304 million.

Without a documented methodology to report program-specific data consistently from year-to-year over a broad time period, and without a quality control process to ensure the data is reasonably free of errors and omissions, decisionmakers cannot weigh the cost-benefit to judge the efficacy of the program. To address these issues, we make the following recommendations:

Recommendation 10

We recommend the Equal Opportunity Contracting (EOC) track and present Small Local Business Enterprise (SLBE) program-specific data over time in its annual report, to highlight trends in program performance. Items tracked and reported over at least a five-year time span should include, but are not limited to:

- Participation rate (defined as the percent of dollars awarded to SLBE program-certified contractors, regardless of other certifications, within City contracts with SLBE program goals) across all city contracts – construction, architectural and engineering services, and goods and services contracts combined.
- Participation rate (as defined above) within construction contracts.
- Participation rate (as defined above) within architectural and engineering service contracts.
- Participation rate (as defined above) within goods and services contracts.
- Percent of funds awarded to SLBE-certified firms that the City awarded to women-owned SLBEs over all contract types and broken out into each category of contracting (construction, architectural and engineering services, and goods and services).
- Percent of funds awarded to SLBE-certified firms that the City awarded to African American-owned SLBEs, Hispanic-owned SLBEs, Asian-owned SLBEs, Native American-owned SLBEs, and Caucasian-owned SLBEs, within each category of contracting and overall.

Additionally, the report should identify proposed changes to the program's design that would help the program better achieve its objectives. (Priority 2)

Recommendation 11

We recommend Equal Opportunity Contracting create a template for the Small Local Business Enterprise program's annual report that is clear and easy to understand, with

sufficient information presented to clearly highlight the program's performance relative to the program's objectives and the goals set. (Priority 2)

Recommendation 12

We recommend Equal Opportunity Contracting draft written policies for data tracking. Methodologies should be consistent year over year, with any changes documented, and the report should have a written quality control reviewing process to minimize errors and ensure the methodologies for the data used in the report do not distort the conclusions drawn from the data. (Priority 2)

Conclusion

The Small Local Business Enterprise (SLBE) program is a contracting preference program that affects millions of City contracting dollars each year and has broad objectives to encourage small business development and increase diversity in City contracting.

The SLBE program has not lived up to the objectives set forth when the program was created in 2010. City contracting has not become more diverse in the last five years, and although millions of City dollars go to small, local businesses through the program each year, the majority of these funds go to just a handful of businesses. We estimate the City spends at least \$2.2 million on the program annually, but policy constraints on the program's design, lack of oversight, and underutilization of available tools to accomplish program objectives have limited the program's economic benefits.

Additionally, we found that the current implementation of the program likely limits the dollars awarded to SLBEs and the program's reports do not include information that would allow City Council to understand basic elements of program performance, such as whether or not the program has achieved its stated objectives and what the program costs the City. Key information is missing from the annual reports, much of the data presented in the report does not have clear and consistent methodologies, and errors in the report indicate a lack of quality control.

The City has contracted for a disparity study to determine if there is a disparity between the available contractors and the contractors the City uses, which is a first step toward identifying and addressing necessary changes to increase use of the program and ensure the program reduces barriers to City contracting. However, a race- and gender-conscious preference built in response to a disparity study alone would not necessarily make the SLBE program successful in meeting its objectives. If left unaddressed, challenges due to limited

monitoring and reporting on program performance, insufficient oversight, and lack of focus on outreach and reducing barriers to participation would continue to hinder the program. To meet the goals of the program, we recommend the City take more direct, strategic steps to incentivize diversity in contracting at every level and measure, oversee, and report progress to City leadership.

Recommendations

- Recommendation 1** To increase transparency into the distribution of funds among SLBEs, we recommend Equal Opportunity Contracting list each Small Local Business Enterprise (SLBE) program-certified contractor by the number of prime contracts the City awarded the SLBE, the number of subcontracts the City awarded the SLBE, and the total dollar amount the City awarded the SLBE across those contracts in that year. The list should be included as an addendum to the annual report and made publicly available on the program's website. This recommendation would allow the City and SLBE participants to monitor where the economic benefits of the program are centered and if the funds could be distributed among a broader array of SLBEs. (Priority 2)
- Recommendation 2** We recommend that once the disparity study is complete, the Purchasing and Contracting Department should provide full copies of the study to City Council. With the results of the disparity study, if disparities in contracting exist, San Diego City Council and the Mayor's Office should consider changes to the Small Local Business Enterprise program to include narrowly tailored race- and gender-conscious contracting preferences to alleviate those disparities. (Priority 2)
- Recommendation 3** We recommend that Equal Opportunity Contracting (EOC) compare the amount awarded in each contract type for each race/gender group to the race/gender makeup of contractors available in the region. Once the disparity study is complete, EOC could use the disparity study's analysis of the makeup of business owners in the region to estimate the anticipated percentage of contract funding that could possibly be awarded to each group in each contract type (construction, architectural and engineering services, and goods and services). If the disparity study is not complete or does not provide sufficient information, EOC management should use countywide race/ethnicity and gender data (either workforce or population data) to make this estimation. EOC should

include this comparison in its annual reports. This recommendation does not recommend any preference in contracting based on race or gender, nor does it create or imply a required goal or quota of race or gender in contracts with the City. (Priority 2)

Recommendation 4 We recommend the Mayor's Office reposition oversight of the Small Local Business Enterprise (SLBE) program outside the management of the program. Oversight should include necessary expertise on decreasing barriers for businesses owned by women and people of color and should not solely rely upon City contracting expertise or fall to an advisory commission that cannot compel management to action. Oversight should, at minimum, include:

- a. Reviewing and approving the SLBE program's performance measures, including the goods and services participation rate in Recommendation #7.
- b. Ensuring the performance measures and goals of the program align with the program's objectives.
- c. Reviewing the program's progress at meeting performance measures and goals, and increasing the goals at a steady rate to ensure program progress.
- d. Reviewing and approving the goal setting methodology for construction contracts.
- e. Reviewing and approving the template for the annual report to City Council, as referenced in Recommendation #11, to ensure the information is presented in a manner that is clear and details the program's performance.
- f. Reviewing, approving, and seeking regular updates on the progress of the outreach plan in Recommendation #5. (Priority 2)

Recommendation 5 We recommend that Equal Opportunity Contracting develop a written, evidence-based plan consistent with the results of the disparity study for increasing outreach and participation in the

Small Local Business Enterprise (SLBE) program for small, local businesses and those owned by women and people of color to the extent allowable under the law.

- The plan should include outcome-based performance measures for each program objective. Measures to be considered should include:
 - registration by businesses owned by women and people of color
 - the number of businesses that grow out of the emerging local business enterprise category each year
 - the number of businesses that grow out of the small, local business enterprise category each year
 - the number of employees the organization has when applying initially, when renewing their application, and when growing out of the program
- The plan should be presented to the Citizens Equal Opportunity Commission for input and should include a public hearing with invited speakers from the pool of current registered SLBEs, SLBEs that successfully grew out of the program, and affiliated stakeholder groups, including industry associations and chambers of commerce.
- The plan should create goals and performance measures related to other tools designed to reduce barriers and increase competition in contracting included in the program, such as the mentor-protégé program and the bonds/insurance assistance program.

This recommendation does not recommend any preference in contracting based on race or gender, nor does create or imply

a required goal or quota of race or gender in contracts with the City. (Priority 2)

Recommendation 6 We recommend that Equal Opportunity Contracting (EOC), along with other departments inputting staff time including Engineering and Capital Projects Department and Purchasing and Contracting Department, track staffing and any additional design-bid-build contract costs of the Small Local Business Enterprise (SLBE) program. EOC should report these data, and the method the program used to calculate and track the data, to the City Council in the SLBE program annual report, as required in council policy and municipal code. Based on this information, San Diego City Council could determine if additional resources are necessary for success of the program. (Priority 2)

Recommendation 7 We recommend the Small Local Business Enterprises (SLBE) program management work with the Purchasing and Contracting Department to create annual performance goals for the percent of goods and services contract dollars awarded to SLBEs. The evaluation of appropriate goods and services SLBE contracting goals should include reviewing the portion of goods and services contracts that are for services that could likely be provided by local businesses. (Priority 2)

Recommendation 8 We recommend the Purchasing and Contracting Department collect more information from goods and service contract bidders, including asking if the bidding contractor (prime contractor) is certified by the Small Local Business Enterprise (SLBE) program or if the business thinks they may qualify to be certified by the SLBE program. (Priority 2)

Recommendation 9 We recommend Small Local Business Enterprise (SLBE) program management, in consultation with the appropriate oversight bodies, evaluate the caps on SLBE subcontracting requirements for construction projects annually. Program management should then include the caps in the annual report, with a detailed description of the methodology used to justify the cap, and should include the previous cap amounts over time. This recommendation, however, should not conflict

with City policies that require the prime contractor to perform at least 50 percent of the contract. (Priority 2)

Recommendation 10

We recommend the Equal Opportunity Contracting (EOC) track and present Small Local Business Enterprise (SLBE) program-specific data over time in its annual report, to highlight trends in program performance. Items tracked and reported over at least a five-year time span should include, but are not limited to:

- Participation rate (defined as the percent of dollars awarded to SLBE program-certified contractors, regardless of other certifications, within City contracts with SLBE program goals) across all city contracts – construction, architectural and engineering services, and goods and services contracts combined.
- Participation rate (as defined above) within construction contracts.
- Participation rate (as defined above) within architectural and engineering service contracts.
- Participation rate (as defined above) within goods and services contracts.
- Percent of funds awarded to SLBE-certified firms that the City awarded to women-owned SLBEs over all contract types and broken out into each category of contracting (construction, architectural and engineering services, and goods and services).
- Percent of funds awarded to SLBE-certified firms that the City awarded to African American-owned SLBEs, Hispanic-owned SLBEs, Asian-owned SLBEs, Native American-owned SLBEs, and Caucasian-owned SLBEs, within each category of contracting and overall.

Additionally, the report should identify proposed changes to the program's design that would help the program better achieve its objectives. (Priority 2)

Recommendation 11 We recommend Equal Opportunity Contracting create a template for the Small Local Business Enterprise program's annual report that is clear and easy to understand, with sufficient information presented to clearly highlight the program's performance relative to the program's objectives and the goals set. (Priority 2)

Recommendation 12 We recommend Equal Opportunity Contracting draft written policies for data tracking. Methodologies should be consistent year over year, with any changes documented, and the report should have a written quality control reviewing process to minimize errors and ensure the methodologies for the data used in the report do not distort the conclusions drawn from the data. (Priority 2)

Appendix A: Definition of Audit Recommendation Priorities

The Office of the City Auditor maintains a priority classification scheme for audit recommendations based on the importance of each recommendation to the City, as described in the table below. While the City Auditor is responsible for providing a priority classification for recommendations, it is the City Administration's responsibility to establish a target date to implement each recommendation, taking into consideration its priority. The City Auditor requests that target dates be included in the Administration's official response to the audit findings and recommendations.

Priority Class ¹⁶	Description
1	Fraud or serious violations are being committed. Significant fiscal and/or equivalent non-fiscal losses are occurring. Costly and/or detrimental operational inefficiencies are taking place. A significant internal control weakness has been identified.
2	The potential for incurring significant fiscal and/or equivalent non-fiscal losses exists. The potential for costly and/or detrimental operational inefficiencies exists. The potential for strengthening or improving internal controls exists.
3	Operation or administrative process will be improved.

¹⁶The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation that clearly fits the description for more than one priority class shall be assigned the higher priority.

Appendix B: Audit Objectives, Scope, and Methodology

In accordance with the Office of the City Auditor's Fiscal Year (FY) 2020 Audit Work Plan, we conducted a performance audit of the City of San Diego's Purchasing and Contracting Department's Small Local Business Enterprise (SLBE) program. The overall objective of the audit was to review the efficiency and effectiveness of the SLBE program. Specifically, our objectives were to:

- Determine if the annual reports are an accurate and complete representation of SLBE program objectives and results;
- Determine if the SLBE program is achieving the economic benefits described in policy; and
- Determine if the cost of contracting with SLBEs is captured and weighed against the economic benefits.

Internal Controls

The internal control principles significant to these audit objectives were oversight structure, establishment of an organizational structure to assign responsibility and delegate authority to achieve the entity's objectives, clearly defined objectives, design of control activities to achieve objectives, use of quality information to achieve objectives, internally and externally communicated quality information, and established monitoring activities to evaluate the results. Our findings, conclusions and recommendations are included in the audit report. Our methodology to evaluate these internal controls is described below.

Objectives Methodology

Determine if the annual reports are an accurate and complete representation of SLBE program objectives and results.

- Reviewed relevant SLBE program policies and procedures.
- Verified accuracy and completeness of the FY 2018 and FY 2019 Business Diversity Annual Reports from the Equal Opportunity Contracting (EOC) division by reviewing source data and re-calculating charts, figures, and conclusions.
- Benchmarked the SLBE program's annual reports against other cities' program's annual reports for completeness of information.
- Reviewed all FY 2018 construction contract Final Summary documentation to compare the amount awarded to SLBE subcontractors to the amount reportedly paid to SLBE subcontractors.
- Interviewed EOC staff on the process for compiling and reporting program data.

Determine if the SLBE program is achieving the economic benefits described in policy.

- Reviewed all FY 2018 construction contracts and supporting documentation to confirm EOC has controls in place for reviewing and accepting or rejecting good faith effort documentation.
- Reviewed EOC's data on racial/ethnic and gender diversity among SLBE contractors and calculated the diversity over time from FY 2015 to FY 2019, within construction contracts and architectural and engineering services contracts.
- Calculated the percent of SLBEs used in construction and architectural and engineering services contracts and the amount paid to each contractor across all contracts in FY 2018 and FY 2019 to determine if the majority of available SLBEs received contracts through the program and if the majority of the contract funds were going to a small portion of SLBEs.

- Reviewed the SLBE certification process and criteria, including a portion of SLBE applications, to confirm that eligibility criteria are reasonable and necessary.
- Emailed a questionnaire to a randomly selected judgmental sample of 30 SLBEs to confirm they had no substantive issues with the SLBE application and renewal process. In addition, we requested confirmation of work performed and paid on City-funded projects. Of the 13 respondents, all indicated there were no issues with payment and that they performed the services indicated. Additionally, EOC maintains an internal control to ensure all subcontractors were paid appropriately on City contracts.
- Reviewed the program waiver process and the only program waiver in FY 2018.
- Reviewed all FY 2018 construction contracts to compare the calculated availability rate of SLBEs to the required SLBE subcontracting goals in the contract.
- Compared best practices of local, state, and federal contracting programs designed to benefit segments of the population, including small businesses, businesses owned by veterans with disabilities, and historically underutilized businesses.
- Reviewed San Diego City Attorney opinions on the SLBE program and the City's previous contracting programs with similar goals.
- Interviewed the Chair and Vice Chair of the Citizens Equal Opportunity Commission.
- Interviewed EOC staff and Department of Public Works Contracting and Engineering divisions' staff on the process of administering the SLBE program contract preferences.

Determine if the cost of contracting with SLBEs is captured and weighed against the economic benefits.

- Reviewed all FY 2018 construction contracts to calculate the increased cost of contracts due to the SLBE program by comparing the low bid of all design-bid-build contracts to the cost of the bid that was awarded the contract due to SLBE program compliance.
- Reviewed all architectural and engineering services contracts in FY 2018 to confirm the SLBE program additional points for subcontracting to SLBEs were awarded appropriately.
- Reviewed a randomly selected judgmental sample of 40 goods and services contracts from FY 2019 to ensure additional points for subcontracting to SLBEs were awarded appropriately, and to confirm that some goods and services contracts could reasonably be expected to be awarded to SLBEs. The results were not extrapolated to the population of goods and service contracts, but did uncover some information missing on a contractor form.
- Estimated the cost to administer the program by totaling the Engineering and Capital Projects Department's and Purchasing and Contracting Department's estimated staff hours spent on the program and applying each employee's hourly rate per the employee's salary, fringe benefit costs, and other department costs.
- Reviewed the Purchasing and Contracting Department's budget and performance measures.

Compliance 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.



THE CITY OF SAN DIEGO

MEMORANDUM

DATE: November 23, 2020

TO: Andy Hanau, City Auditor

FROM: Claudia C. Abarca, Interim Director, Purchasing & Contracting Department

SUBJECT: Management Response to the Performance Audit of the Purchasing & Contracting Department Small Local Business Enterprise (SLBE) Program

The purpose of this memorandum is to provide City Management's response to the Office of the City Auditor's report entitled *Performance Audit of the Purchasing & Contracting Department Small Local Business Enterprise Program*.

The SLBE program is intended to remove barriers and eliminate disparities in the use of minority-owned and women-owned businesses in City contracting. In 2019, the City commissioned a disparity study to determine if companies that do business with the City reflect San Diego's diversity. The study will identify whether any gaps exist in the City's contracting with traditionally underrepresented groups and will include recommendations on how to remedy those gaps. The disparity study is expected to be completed by March 31, 2021.

The disparity study is necessary to properly assess the SLBE program within the current legal framework. California Proposition 209 prohibits programs that support a preference based upon gender or race unless supported by a disparity study that demonstrates that disparate treatment exists. Without a disparity study underpinning it, the City's SLBE program has had to, by law, operate as a race- and gender-neutral program. The release of the disparity study may involve changes to current contracting programs and policies, including the SLBE program.

In addition to changes to the SLBE program that may be necessitated by the disparity study, policy decisions from the incoming Mayoral administration and City Council may also result in significant realignment of the operations and focus of the SLBE program. As a result, while management agrees with the Auditor's recommendations, it is important to note that implementation and target timeframes for many of the recommendations are partially or wholly contingent on factors outside of SLBE program management's control; namely the disparity study and as-yet-unknown policy direction from the incoming Mayor and City Council. Nevertheless, management understands and agrees with the intent of the recommendations, and will provide updates, as needed, to the City Auditor and Audit Committee.

Details on Management's responses to each of the Auditor's recommendations are outlined in the sections below.

Recommendation 1:

To increase transparency into the distribution of funds among SLBEs, we recommend Equal Opportunity Contracting Program management list each Small Local Business Enterprise (SLBE) program-certified contractor by the number of prime contracts the City awarded the SLBE, the number of subcontracts the City awarded the SLBE, and the total dollar amount the City awarded the SLBE across those contracts in that year. The list should be included as an addendum to the annual report and made publicly available on the program's website. This recommendation would allow the City and SLBE participants to monitor where the economic benefits of the program are centered and if the funds could be distributed among a broader array of SLBEs (Priority 2).

Management's Response: Agree. P&C's Equal Opportunity Contracting Program (EOCP) staff will include the data elements noted in the recommendation in the forthcoming Fiscal Year 2020 Annual Report and post the data to the EOCP website. Additionally, EOCP will assess the feasibility of automating the collection and reporting of SLBE contract, subcontract, and award information for all formal solicitations, and making the data available on an ongoing basis.

Target Implementation Date: March 31, 2021, to coincide with the release and presentation of the Fiscal Year 2020 Annual Report.

Recommendation 2:

We recommend that once the disparity study is complete, the Department of Purchasing and Contracting should provide full copies of the study to City Council. With the results of the disparity study, if disparities in contracting exist, City Council and the Mayor's Office should consider changes to the Small Local Business Enterprise program to include narrowly tailored race- and gender-conscious contracting preferences to alleviate those disparities (Priority 2).

Management's Response: Agree. P&C will provide full copies of the City's disparity study and make publicly available when complete. Management anticipates that if the results of the study point to disparate treatment in City contracting that programmatic and policy changes, including to the SLBE program, would be forthcoming.

Target Implementation Date: P&C anticipates that the City's disparity study will be finalized and made publicly available by March 31, 2021. Changes to City contracting programs will be dependent upon the results of the disparity study and any subsequent legal challenges. Management would be prepared to present a plan for any program changes by July 31, 2021.

Recommendation 3:

We recommend that Equal Opportunity Contracting (EOC) compare the amount awarded in each contract type for each race/gender group to the race/gender makeup of contractors available in the region. Once the disparity study is complete, EOC should use the disparity study's analysis of the makeup of business owners in the region to estimate the anticipated percentage of contract funding that could possibly be awarded to each group in each contract type (construction, architectural and engineering services, and goods and services). If the

disparity study is not complete or does not provide sufficient information, EOC management could use countywide race/ethnicity and gender data (either workforce or population data) to make this estimation, as a descriptive data point for comparison. EOC should include this comparison in its annual reports. This recommendation does not recommend any preference in contracting based on race or gender, nor does it create or imply a required goal or quota of race or gender in contracts with the City. (Priority 2)

Management's Response: Agree. Department management anticipates that one change to EOCP staff review of contracts will be the comparison of business owner race and gender information to the data provided in the disparity study of the ownership of similar businesses available to bid for work with the City. If the report information is insufficient, an estimation will be made based on the available and appropriate county data.

Target Implementation Date: December 31, 2021. Changes to City contracting programs will be dependent upon the results of the disparity study and any subsequent legal challenges. Target implementation dates for those changes will depend upon the size and scope of the changes proposed.

Recommendation 4:

We recommend the Mayor's Office reposition oversight of the Small Local Business Enterprise (SLBE) program outside the management of the program. Oversight should include necessary expertise on decreasing barriers for businesses owned by women and people of color and should not solely rely upon City contracting expertise or fall to an advisory commission that cannot compel management to action. Oversight should, at minimum, include:

1. Reviewing and approving the SLBE program's performance measures, including the goods and services participation rate in Recommendation 7.
2. Ensuring the performance measures and goals of the program align with the program's objectives.
3. Reviewing the program's progress at meeting performance measures and goals, and increasing the goals at a steady rate to ensure program progress.
4. Reviewing and approving the goal setting methodology for construction contracts.
5. Reviewing and approving the template for the annual report to City Council, as referenced in Recommendation 12, to ensure the information is presented in a manner that is clear and details the program's performance.
6. Reviewing, approving, and seeking regular updates on the progress of the outreach plan in Recommendation 5 (Priority 2).

Management's Response: Agree. The SLBE program and associated laws, policies, and procedures are anticipated to be updated as a result of recommendations in the City's ongoing disparity study. Those changes, including any additional layer of oversight outside of the Department, will reflect the priorities of the new Mayoral administration, will also be presented to the Citizens Equal Opportunity Commission (CEOC) for input, and will be communicated to the City Council. Management understands the intent of the recommendation to strengthen oversight of the SLBE program and will determine whether to strengthen existing mechanisms or constitute a new oversight body external to the SLBE program.

Target Implementation Date: December 31, 2021 for a communication to the City Council regarding oversight of the SLBE program, or its replacement. Changes to City contracting

programs, including the SLBE program, will be dependent upon the results of the disparity study and potential legal challenges. Target implementation dates for those changes will depend upon the size and scope of what is proposed.

Recommendation 5:

We recommend that Equal Opportunity Contracting develop a written, evidence-based plan consistent with the results of the disparity study for increasing outreach and participation in the Small Local Business Enterprise (SLBE) program for small, local businesses and those owned by women and people of color to the extent allowable under the law.

- The plan should include outcome-based performance measures for each program objective. Measures to be considered should include:
 - registration by businesses owned by women and people of color
 - the number of businesses that grow out of the emerging local business enterprise category each year
 - the number of businesses that grow out of the small, local business enterprise category each year
 - the number of employees the organization has when applying initially, when renewing their application, and when growing out of the program
- The plan should be presented to the Citizens Equal Opportunity Commission for input and should include a public hearing with invited speakers from the pool of current registered SLBEs, SLBEs that successfully grew out of the program, and affiliated stakeholder groups, including industry associations and chambers of commerce.
- The plan should create goals and performance measures related to other tools designed to reduce barriers and increase competition in contracting included in the program, such as the mentor-protégé program and the bonds/insurance assistance program.

This recommendation does not recommend any preference in contracting based on race or gender, nor does create or imply a required goal or quota of race or gender in contracts with the City. (Priority 2)

Management's Response: Agree. When the disparity study has been completed, management will review the changes recommended and implement changes to the SLBE program as appropriate and include input from Mayor, City Council, the Citizens Equal Opportunity Commission (CEOC) and other stakeholders. Management expects to revisit this Audit Report to see which performance measures or other tools designed to reduce barriers and increase competition in contracting are appropriate.

Target Implementation Date: December 31, 2021.

Recommendation 6:

We recommend that Equal Opportunity Contracting (EOC), along with other departments inputting staff time including Engineering and Capital Projects Department and Purchasing and Contracting Department, track staffing and any additional design-bid-build contract costs of the Small Local Business Enterprise (SLBE) program. EOC should report these data, and the method the program used to calculate and track the data, to the City Council in the

SLBE program annual report, as required in council policy and municipal code. Based on this information, San Diego City Council could determine if additional resources are necessary for success of the program. (Priority 2)

Management's Response: Agree. Management will review and track all direct staff labor and Design-Bid-Build contract costs associated with SLBE program requirements.

Target Implementation Date: P&C will implement direct cost tracking by December 31, 2020 through the City's SAP system. Management will begin tracking contract costs for Design-Bid-Build contracts on January 1, 2021, and report results in the Fiscal Year 2021 Annual Report, which would likely be released in January 2022. Management will communicate progress to the City Auditor and Audit Committee in the interim as part of the audit recommendation follow-up process.

Recommendation 7:

We recommend the Small Local Business Enterprises (SLBE) program management work with the Department of Purchasing & Contracting to create annual performance goals for the percent of goods and services contract dollars awarded to SLBEs. The evaluation of appropriate goods and services SLBE contracting goals should include reviewing the portion of goods and services contracts that are for services that could likely be provided by local businesses (Priority 2).

Management's Response: Agree. Department management expects to update and create new performance measures based upon program changes as a result of the City's disparity study and policy direction

Target Implementation Date: The performance measures will be updated and communicated in the Fiscal Year 2021 Annual Report, which would likely be released in January 2022.

Recommendation 8:

We recommend the Department of Purchasing & Contracting collect more information from goods and service contract bidders, including asking if the bidding contractor (prime contractor) is certified by the Small Local Business Enterprise (SLBE) program or if the business thinks they may qualify to be certified by the SLBE program (Priority 2).

Management's Response: Agree. P&C already collects information on whether goods and services contract bidders are certified by the SLBE program and will inform businesses prior to bidding of the program and what is necessary to qualify.

Target Implementation Date: Partially implemented. Target to inform businesses of SLBE qualifications prior to bidding on a goods or services contract is June 30, 2021.

Recommendation 9:

We recommend Small Local Business Enterprise (SLBE) program management, in consultation with the appropriate oversight bodies, evaluate the caps on SLBE subcontracting requirements for construction projects annually. Program management should then include

the caps in the annual report, with a detailed description of the methodology used to justify the cap, and should include the previous cap amounts over time. This recommendation, however, should not conflict with City policies that require the prime contractor to perform at least 50 percent of the contract. (Priority 2)

Management's Response: Agree. EOCP will include the caps established and a discussion of methodology in the Fiscal Year 2021 Annual Report. In the interim, staff will consult with oversight entities, and research best practices on caps on SLBE subcontracting requirements for construction projects and update SLBE program codes, cap determination methodologies, and policies as appropriate.

Target Implementation Date: Information on caps will be updated and communicated in the Fiscal Year 2021 Annual Report, which would likely be released in January 2022.

Recommendation 10:

We recommend the Equal Opportunity Contracting (EOC) track and present Small Local Business Enterprise (SLBE) program-specific data over time in its annual report, to highlight trends in program performance. Items tracked and reported over at least a five-year time span should include, but are not limited to:

1. Participation rate (defined as the percent of dollars awarded to SLBE program-certified contractors, regardless of other certifications, within City contracts with SLBE program goals) across all city contracts – construction, architectural and engineering services, and goods and services contracts combined.
2. Participation rate (as defined above) within construction contracts.
3. Participation rate (as defined above) within architectural and engineering service contracts.
4. Participation rate (as defined above) within goods and services contracts.
5. Percent of funds awarded to SLBE-certified firms that the City awarded to women-owned SLBEs over all contract types and broken out into each category of contracting (construction, architectural and engineering services, and goods and services).
6. Percent of funds awarded to SLBE-certified firms that the City awarded to African American-owned SLBEs, Hispanic-owned SLBEs, Asian-owned SLBEs, Native American-owned SLBEs, and Caucasian-owned SLBEs, within each category of contracting and overall.

Additionally, the report should identify proposed changes to the program's design that would help the program better achieve its objectives (Priority 2).

Management's Response: Agree. However, as with several of the other responses, final determinations of the type of data may subject to the results of the disparity study and policy decisions

Target Implementation Date: Information will be updated and communicated in the Fiscal Year 2021 Annual Report, which would likely be released in January 2022.

Recommendation 11:

We recommend the Equal Opportunity Contracting create a template for the Small Local Business Enterprise program's annual report that is clear and easy to understand, with sufficient information presented to clearly highlight the program's performance relative to the program's objectives and the goals set (Priority 2).

Management's Response: Agree. Management will review the changes made to the SLBE program as a result of the disparity study and policy decisions and will update the format of the annual report as necessary and with the approval of the program oversight staff as outlined in Recommendation 4.

Target Implementation Date: Some changes will be forthcoming in the Fiscal Year 2020 report, which is scheduled to be released in January 2021. Additional changes will be reflected in the Fiscal Year 2021 Annual Report, which would likely be released in January 2022.

Recommendation 12:

We recommend Equal Opportunity Contracting draft written policies for data tracking. Methodologies should be consistent year over year, with any changes documented, and the report should have a written quality control reviewing process to minimize errors and ensure the methodologies for the data used in the report do not distort the conclusions drawn from the data (Priority 2).

Management's Response: Agree. Department management expects to update and create new points of data collection based upon program changes as a result of the City's disparity study.

Target Implementation Date: December 31, 2021 for data policies to be developed and implemented. Management will communicate progress to the City Auditor and Audit Committee in the interim as part of the audit recommendation follow-up process.

We appreciate the opportunity to provide comments on the audit and thank the City Auditor's team for their cooperation and professionalism throughout the audit process.



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