

## MINORITY WOMEN-OWNED BUSINESS ENTERPRISES – THE PLOT THICKENS

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Compliance is nothing new to the construction industry. Regulators have targeted construction companies for years, viewing the industry as inherently corrupt (in a stereotypical and incorrect fashion), making it easy for them to assess monetary fines for non-compliance with mandatory project requirements, safety violations, or not following contract language to the last dotted “I”. The industry has pushed back, citing best efforts to meet lofty and onerous requirements. However this has been met with resistance, the end result of regulators not understanding the industry in which they are policing.

One area which has been an ongoing source of compliance controversy is the Minority/Women Owned Business Enterprise (“M/WBE”) utilization requirements. According to current New York State law, a qualified M/WBE has at least 51% ownership by a protected class/woman. But the ownership must be real (not just on paper), in that majority owner has the power to exercise authority and independently control the day-to-day operations. Further, ownership cannot have a personal net worth greater than \$3.5 million after certain allowable deductions.

### The Current M/WBE Landscape

The inauguration of the changes can be traced back to Governor Andrew Cuomo, who took office in 2011, and started his initiative to transform the State’s M/WBE program. Under his plan there is a 30% M/WBE participation goal which must be met on **ALL** State funded contracts, not just those issued by agencies and authorities (which have their own participation requirements in place). The real impact has been on cities, counties and towns which rely on State funding to build/improve their communities. These municipalities have had to change their building process to be in compliance.

More recently, New York City, under Mayor Bill de Blasio has followed the State’s precedent by creating the Mayor’s office of M/WBE’s, which will be focused on the success of M/WBE’s. An interesting function of the new Office is to also serve as a one-stop-shop for M/WBE’s to connect and seek the support of the various City agencies. And in light of the Mayor’s ambitious goal of awarding at least 30% of the dollar amount of City contracts to M/WBEs by 2021, this function makes sense.

As mentioned above, certain New York based agencies have their own M/WBE requirements in place; one such agency is the School Construction Authority (“SCA”). The SCA stipulates that contractors must demonstrate a good-faith effort to subcontract 20% of the work to an M/WBE and 10% to Locally Based Enterprises (this is an entity that derives 25% or more of its gross receipts from business conducted in economically disadvantaged areas, hires protected classes of works to comprise at least 25% of their labor and have an average annual gross construction receipts of under \$2.167 million).

Granted, no one can argue with the spirit of these programs, which is to increase the opportunities for minority and women business owners across New York State and City. (The statistics since 2011 support this, with more than 4,300 M/WBE certifications and \$6.3 billion of in-state contracts awarded to these firms.<sup>1</sup>)

### How This Is Impacting the Construction Contractors

The impact of the discussed requirements related to M/WBE’s is real and comes with costly consequences for non-compliance. The simplest solution is to comply, crossed “T” and dotted “I”. These requirements can be met in various ways for contractors whether it be subcontracting a portion of the contract to an M/WBE contractor and/or using a second-tier M/WBE subcontractor for materials or supplies.

But in order to comply, or establish a good faith attempt, has required the construction companies to drastically shift their bidding process to meet the new protocols. This has included moving away from long standing relationships with subcontractors to attempting to create new ones with M/WBE’s in order to fill contract requirements. The issue at hand is that there are not enough qualified M/WBE’s to perform the scoped work. Where do we find them? There are State provided lists, but industry experience has proved these companies are loosely vetted. The construction company is responsible for ensuring that the M/WBE is legit; yet another cost. Others are relying on industry word-of-mouth to connect with qualified M/WBE contractors-vendors in order to have a valid bid package and continue to be awarded work. However, there is a backlog capacity issue that the qualified M/WBE’s are facing in that they may not have the capital resources, needed equipment and/or skilled labor to properly perform on these projects. The trickledown effect, the general contractor has to complete the project, on time, and has to either incur the additional cost or deal with the delay ramifications, lower profits and take a potential reputational black eye.

As with any lofty requirement, the potential for M/WBE fraud is great. Within the last 10 years, there have been 30 arrests for M/WBE fraud resulting in \$110 million in fines and forfeitures in New York<sup>2</sup>. M/WBE fraud can occur in a variety of ways, but the most common occurs when a contractor claims s/he is using a qualified M/WBE to perform work or provide materials. The contractor passes billing documents through the M/WBE creating the illusion that the subcontracted work was being performed, when in reality it was either self-performed or subbed out to another contractor entirely. In order to combat this, New York has imposed criminal penalties to M/WBE fraud convictions, but is that enough to deter this behavior for those who view M/WBE fraud as the only way to compete in a broken system?

### Where Do We Go From Here?

In order for these programs to succeed, the lawmakers must be open to change if certain requirements are proven too costly and exceptionally hard for the industry to meet. The contractors who rationalize M/WBE fraud have to be willing to take a hard look in the mirror and revamp their business practices. With all of the capital spending occurring in New York today, there is no reason everyone cannot have a taste of success.

*For more information about MWBEs contact Carl Oliveri, Partner-in-Charge of Construction Practice at Grassi & Co., at [coliveri@grassicpas.com](mailto:coliveri@grassicpas.com).*

<sup>1</sup> Michalos, Maria. “Empire State Development Announces 2016 Disparity Study to Maximize Minority And Women-Owned Business Participation Across New York State.” January 2016.

<sup>2</sup> Jorgensen, Jillian. “Grand Jury Report Finds ‘Systemic Criminal Conduct’ in MWBE Contracts”. Observer. November 2014.