

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General



September 18, 2015

The Honorable Muriel Bowser
Mayor of the District of Columbia
Mayor's Correspondence Unit
The John A. Wilson Building
1350 Pennsylvania Avenue, N.W., Suite 316
Washington, D.C. 20004

The Honorable Phil Mendelson
Chairman
Council of the District of Columbia
The John A. Wilson Building
1350 Pennsylvania Avenue NW, Suite 504
Washington, D.C. 20004

Dear Mayor Bowser and Chairman Mendelson:

The Office of the Inspector General (OIG) is issuing this Management Implication Report¹ (MIR 14-A-03) to advise you of procurement practices in the District, which have resulted in awarding contracts to, and purchasing from, non-responsible contractors.

We discovered this deficiency during the *Audit of the Office of Tax and Revenue's (OTR) Collections of Franchise Taxes From Out-of-State Construction Contractors for Tax Year 2011*, OIG No. 13-1-02AT (*report in draft*). We reviewed several contractor tax records, which indicated contractors had not filed required franchise tax returns in calendar year (CY) 2011 even though these contractors had received payments from the District government during that year. Auditors determined that the Clean Hands certification and tax verification processes used by the Office of Contracting and Procurement (OCP) are not an effective control to ensure that: 1) prospective District contractors are in compliance with franchise tax requirements; and 2) the District receives all eligible franchise tax revenue.

This MIR outlines the relevant criteria, findings, conclusions, and recommendations to correct this condition.

¹ The OIG issues MIRs on matters of priority concern that affect multiple District agencies.

CRITERIA

The applicable DCMR and D.C. Code sections related to this condition are as follows:

27 DCMR § 2200.2	“The contracting officer shall not make a purchase or award unless the contracting officer has determined in writing that the prospective contractor is responsible in accordance with the provisions of this chapter [22].”
27 DCMR § 2200.4	“To be determined responsible, a prospective contractor shall meet all of the following requirements [including, but not limited to]... (f) Compliance with the applicable District licensing and tax laws and regulations”
27 DCMR § 2204.1	“Before making a determination of responsibility, the contracting officer shall possess or obtain information sufficient to satisfy the contracting officer that a prospective contractor currently meets the applicable standards and requirements for responsibility set forth in this chapter [22].”
27 DCMR § 2204.6	“Any prospective contractor who submits a bid or proposal for any contract exceeding one hundred thousand dollars (\$100,000) shall submit an affidavit indicating whether the prospective contractor has complied with the filing requirements of District of Columbia tax laws, and . . . paid taxes due the District of Columbia or is in compliance with any payment agreement”
27 DCMR § 2204.7	“Before making an affirmative determination of responsibility for any contract exceeding one hundred thousand dollars (\$100,000), the contracting officer shall obtain certification from the Department of Tax and Revenue that the prospective contractor has complied with the filing requirements of District of Columbia tax laws. . . .”
D.C. Code § 47-1810.01(a)	“It is the purpose of this chapter to impose: . . . (2) A franchise tax upon every corporation, financial institution, and unincorporated business for the privilege of carrying on or engaging in any trade or business within the District and of receiving such other income as is derived from sources within the District”

RESULTS OF THE AUDIT

We found the Clean Hands certification² and tax verification processes that the OCP used to determine prospective contractors' compliance with District tax filing requirements was not effective. Specifically, when awarding contracts, contracting officials did not obtain sufficient information to validate the prospective contractor's self-reported compliance with these filing requirements.

To determine whether contractors filed all applicable tax returns during the audit period, we obtained a file containing contractor payment information for CYs 2011-2013 for three contractors from the District's System of Accounting and Reporting (SOAR). Next, we compared the contractor payment information in SOAR to tax records contained in the Office of Tax and Revenue's (OTR) Integrated Tax System (ITS). By comparing information contained in these two systems, we determined that the three contractors had failed to file franchise tax returns and pay franchise taxes for payments received from the District. Table 1, below, summarizes our findings.

Table 1: Contractors Who Failed to File Franchise Tax Returns for Payments Received From the District Government for Calendar Years 2011, 2012, and 2013

Contractor	CY	District Payments Made to Contractors ³	Contracting Agency
A	2011	\$3,800,000	Department of General Services (DGS) ⁴
		\$323,110	District Department of Transportation (DDOT)
	2012	\$3,200,000	DGS
		\$860,905	DDOT
	2013	\$2,000,000	DGS
		\$566,362	DDOT
	Total Payments	\$10,750,377	

² The Clean Hands legislation prohibits the District from issuing a license or permit to applicants who have failed to file District tax returns (D.C. Code § 47-2862(a)(8) (Supp. 2015)). According to its website at <http://otr.cfo.dc.gov/page/clean-hands>, OTR receives applications for Clean Hands certifications from District agencies and researches its system to determine whether applicants for licenses or permits have failed to file District tax returns (last visited June 24, 2015).

³ Payment information obtained from SOAR.

⁴ The DGS is not subject to the authority of the Chief Procurement Officer (CPO) at OCP. However, the DGS must conduct its procurement activities in accordance with District government procurement laws. See D.C. Code § 2-352.01(b)(11) (Supp. 2015).

Contractor	CY	District Payments Made to Contractors ³	Contracting Agency
B	2011	\$8,000,000	DDOT
	2012	\$174,463	
	Total Payments	\$8,174,463	
C	2011	\$5,300,000	DDOT
	2012	\$13,400,000	
	2013	\$1,400,000	
	Total Payments	\$20,100,000	

We interviewed DGS and DDOT contracting officers to determine whether they awarded subsequent contracts to these contractors. DGS' Contracting and Procurement Division indicated they made payments to Contractor A for a contract awarded in CY 2008.⁵ Tax records indicated that Contractor A has not filed franchise tax returns since CY 2008.

DDOT's Contracting Officer indicated that payments to Contractor B were in connection with a contract awarded in CY 2003. Tax records indicated that Contractor B has not filed franchise tax returns since CY 2001. Contractor C purchased Contractor B in CY 2011. DDOT has not awarded Contractor B any subsequent contracts since its purchase.

DDOT made payments to Contractor C in CY 2011 for two contracts, which totaled approximately \$15 million. DDOT awarded both contracts in the same year. Tax records indicated that Contractor C did not file franchise tax returns for CY 2011 payments totaling \$5.3 million. DDOT awarded Contractor C another contract in CY 2012 for \$4.7 million, even though Contractor C had not filed franchise tax returns for payments received in CY 2011.

Clean Hands Certification⁶

We inquired about OCP's process for verifying prospective contractors' compliance with District tax requirements. OCP officials indicated that they use OTR's Clean Hands certification for contracts between \$100,000 and \$1 million and the OTR tax verification for contracts over \$1 million. We asked OCP officials about its use of the

⁵ Prior to 2011, out-of-state construction contractors invoked the "physical presence" interpretation of D.C. Code § 47-1801.04(6)(A)(2001) as a defense against paying franchise taxes for income derived in the District. This section of the D.C. Code was amended for tax years beginning 2011, removing the "physical presence" requirement. Fiscal Year 2012 Budget Support Act of 2011, D.C. Law 19-21, §§ 8001-8004 (effective for taxable years beginning after Dec. 31, 2010).

⁶ See Office of Tax and Revenue at <http://otr.cfo.dc.gov/page/clean-hands> ; see also Certificate of Clean Hands (formerly Certificate of Good Standing) at <http://dcforms.dc.gov/webform/certificate-clean-hands-formerly-certificate-good-standing> (last visited June 2, 2015).

Clean Hands certification in the procurement process and they responded “while a ‘Clean Hands Compliance Status’ report from OTR is not technically intended for contract compliance purposes, it is nonetheless a valid, efficient and independent tool for assessing ... whether a contractor is responsible overall.” We asked OCP officials for a copy of the directive implementing the Clean Hands certification process to verify tax filing compliance and they responded that they could not locate the directive. However, OCP officials indicated that they had used the Clean Hands certification process “at least since 2011.”

OCP officials also indicated that they contacted the OTR to inquire whether the Clean Hands certification “means that the entity has complied with the District’s tax filing requirements.” The OTR responded that it “does not have a system to track non-filers.” In addressing OTR’s response, OCP officials advised us, “If OTR doesn’t track this, it’s not reasonable to expect OCP to do so.” OCP officials further stated that the OCP is not a taxing authority and does not have “the tax and legal knowledge, resources, or information to determine whether or not a prospective or active contractor has filed taxes in the District.” The OCP maintained that it performs a variety of tests to determine contractor responsibility. For example, the OCP indicated that it verifies that a contractor is licensed to conduct business in the District and possesses all required licenses. Further, the OCP obtains a Tax Certification Affidavit from the contractor in which he/she certifies compliance with the District’s tax filing requirements.

In addition, each request for proposal (RFP) and invitations for bids (IFB) includes a “Bidder/Offeror Certification Form.” The form requires a contractor to state whether he/she has failed to file tax returns in the past 3 years. However, our testing revealed that the Clean Hands certification and tax verification processes did not prohibit the District from doing business with contractors who failed to file the required District franchise tax returns. As a result, the OCP did not effectively determine whether potential contractors were in compliance with District of Columbia franchise tax filing requirements before awarding contracts.

CONCLUSION

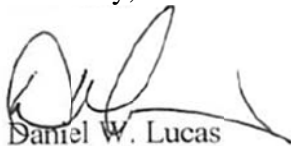
The District did not establish effective controls to prohibit contractors who failed to file required District franchise tax returns from doing business with the District. OTR’s Clean Hands certification and tax verification processes did not detect potential contractors who did not comply with the District’s tax filing requirements. Additionally, contracting officers were not utilizing contractors’ payment information to identify prospective contractors who received payments and are subject to District franchise tax filing requirements but failed to file franchise tax returns. As a result, there was no reasonable assurance that the applicable 9.975% franchise tax was assessed on contractor income that resulted from \$39,024,840 in District payments. Although the issues discussed in this MIR are attributable to three contractors, the lack of adequate controls puts the District at risk for continuing to do business with non-responsible contractors and failing to receive all applicable franchise tax revenue.

We recommend that the Mayor enforce compliance with the District's procurement laws and regulations and franchise tax requirements to ensure the District does business with responsible contractors. Enhanced internal controls, beyond a contractor's affidavit in the form of the "Clean Hands Certification or the "tax verification response," could include:

- (1) Automating the exchange of information between the ITS and SOAR. This would allow contracting officers to automatically determine if prospective contractors had received District payments to determine if the contractors are in compliance with all District tax filing requirements.
- (2) Pending the automated information exchange between the ITS and SOAR, contracting officers should utilize the contractor payment information contained in SOAR to identify prospective contractors who received District payments and are subject to District franchise tax filing requirements.
- (3) Establishing a process within the OTR to monitor and track franchise tax non-filers who have or currently are doing business with the District.

If you have questions or need additional information, please contact me or LaDonia M. Wilkins, Acting Assistant Inspector General for Audits, at (202) 727-2540. Thank you in advance for your attention to this matter and your continued cooperation.

Sincerely,



Daniel W. Lucas
Inspector General

DWL/rp

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