



Office of the Inspector General

Commonwealth of Massachusetts

The Commonwealth's Contractor Certification System: A Status Report

Robert A. Cerasoli

Inspector General

November 2000



The Commonwealth of Massachusetts
Office of the Inspector General

ROBERT A. CERASOLI
INSPECTOR GENERAL

November 2000

JOHN W. McCORMACK
STATE OFFICE BUILDING
ROOM 1511
TEL: (617) 727-9140
FAX: (617) 723-2334

MAILING ADDRESS:
STATE HOUSE STATION
P.O. BOX 270
BOSTON, MA 02133

His Excellency the Governor

The Honorable President of the Senate

The Honorable Speaker of the House of Representatives

The Honorable Chair of the Senate Ways and Means Committee

The Honorable Chair of the House Ways and Means Committee

The Honorable Chairman of the Senate Post Audit and Oversight Committee

The Honorable Chairman of the House Post Audit and Oversight Committee

The Directors of the Legislative Post Audit and Oversight Bureaus

The Secretary of Administration and Finance

Members of the General Court

Omnibus ad quos praesentes literae pervenerint, salutem.

I am today releasing a report concerning the Commonwealth's contractor certification system administered by the Division of Capital Asset Management (DCAM). The purpose of this review was to identify and evaluate improvements to the contractor certification system that have been implemented since the publication of my Office's August 1998 report on the contractor certification system, *Qualifying Contractors for Public Building Projects: A Case Study and System Review*.

DCAM's recent changes to the contractor certification system have strengthened safeguards in some areas, and DCAM is continuing to update and improve its procedures and standard forms. However, other important aspects of the contractor certification system have not been reformed. Although both my Office and the Administration's Construction Reform Task Force called for more stringent contractor eligibility standards in 1998, DCAM's financial eligibility standards continue to be inadequate to protect Massachusetts awarding authorities from contractors that are

financially unstable, undercapitalized, or overextended. In addition, significant progress has not been made since 1998 in reducing DCAM's contractor certification backlog. More broadly, DCAM continues to lack sufficient resources to ensure that the contractor certification system serves its intended purpose: to screen and prequalify contractors for public building projects.

I urge the Administration to devote the monetary resources necessary to employ the appropriate expertise for meaningful contractor certification reform. A relatively small investment can have a tremendous impact on the performance of, and the public's confidence in, the public construction contracting process. Such an investment is long overdue. Massachusetts awarding authorities and citizens deserve an efficient, effective contractor certification system.

Sincerely,

Robert A. Cerasoli
Inspector General

Table of Contents

Executive Summary	i
Introduction	1
Findings	7
Conclusion and Recommendations	17
Appendix A: DCAM's Response	23

Massachusetts Office of the Inspector General

Address:

Room 1311
John McCormack State Office Building
One Ashburton Place
Boston, MA 02108

Mailing Address:

P.O. Box 270
State House Station
Boston, MA 02133

Phone:

(617) 727-9140
(617) 523-1205 (MCPPO Program)
(800) 322-1323 (confidential 24-hour
hotline)

Internet and Fax:

www.state.ma.us/ig
(617) 723-2334 (fax)

Executive Summary

In the public sector, most governmental jurisdictions are subject to laws mandating competitive bidding for construction contracts. Competitive bid laws can and do save taxpayer money and enable contractors to compete for public contracts on a level playing field – but only if the implementation of these laws includes a reliable mechanism for qualifying contractors. Obtaining the best value for the public dollar requires that public agencies award contracts only to qualified contractors.

All contractors bidding on public building projects subject to M.G.L. c. 149¹ must first be certified by the Division of Capital Asset Management (DCAM). Thousands of state and local agencies and governments across Massachusetts rely on DCAM to prequalify their contractors for public building contracts. The success of building construction projects to provide essential public facilities such as public safety buildings, schools, libraries, and prisons depends heavily on DCAM's ability to screen out unqualified contractors and to certify qualified contractors in a timely manner.

In September 1997, the Office of the Inspector General initiated a review of deficient construction projects in three municipalities undertaken by a contractor that had been deemed qualified to bid by DCAM and by the three municipalities. The Office's investigation identified weaknesses in the current system for qualifying public building contractors, including inadequate review of contractors' financial conditions, overly generous limits on the dollar value of public work that contractors may undertake, and understaffing of the Commonwealth's contractor certification function.

In August 1998, the Office issued a report, *Qualifying Contractors for Public Building Projects: A Case Study and System Review*,² summarizing its findings and setting forth detailed recommendations for systemic reform. After the report was issued, the

¹ M.G.L. c. 149 governs all contracts estimated to cost more than \$25,000 for the construction, reconstruction, installation, demolition, maintenance, or repair of a building by a public agency. [M.G.L. c. 149, §§44A-M]

² The August 1998 report may be viewed or downloaded from the Office's website at www.state.ma.us/ig.

Inspector General filed legislation incorporating the legislative reforms recommended in the report.

In November 1997, the Executive Office for Administration and Finance convened a Construction Reform Task Force to review the Commonwealth's public construction procurement and management practices. The Office participated on Task Force subcommittees and was a member of the Construction Reform Advisory Board, whose other members included representatives of private companies, industry groups, professional associations, and public authorities. The Advisory Board advised the Task Force that contractor prequalification standards were too low, that too few contractors were debarred, and that fear of personal liability made it difficult to obtain accurate contractor evaluations from municipal officials. The Construction Reform Task Force issued its final report in May 1998. The Task Force's final report provided specific recommendations for strengthening contractor prequalification. Chapter 159 of the Acts of 2000, enacted in July 2000, incorporated many of the revisions recommended by the Inspector General and the Task Force.

In February 2000, the Office initiated a follow-up review of the contractor certification system. The purpose of the follow-up review was to identify and evaluate the adequacy of changes to the contractor certification system that had been instituted since 1998. In conducting the follow-up review, the Office reviewed documents and information provided by DCAM. The Office also interviewed officials from DCAM's contractor certification office and legal department. The Office appreciates DCAM's cooperation and assistance with this review. The report findings are summarized below.

Finding 1. Recent procedural improvements in the contractor certification system have strengthened safeguards against unqualified contractors.

In recent months, DCAM has instituted changes to the contractor certification system that will strengthen DCAM's capacity to reject applicants and reduce the vulnerability of the contractor certification system to inaccuracy, bias, and fraud. Improvements made by DCAM include:

- **The Contractor Qualification Statement and Update Statement now require contractors to disclose demands for direct payment filed by their subcontractors.**
- **The Contractor Qualification Statement and Update Statement now require contractors to disclose family and financial relationships with owners and designers of current and completed projects.**
- **Contractors are now required to sign the Contractor Qualification Statement under the pains and penalties of perjury, as required by M.G.L. c. 149.**
- **DCAM has reportedly instituted safeguards for certification extensions.**

Finding 2. The contractor certification system continues to lack stringent standards for evaluating applicants' financial condition and capacity to undertake public work.

Other needed reforms to the contractor certification system have not been instituted. Although both the Inspector General and the Administration's Construction Reform Task Force called for more stringent contractor eligibility standards in 1998, DCAM's financial eligibility standards continue to be inadequate. Contractors that are financially unstable, undercapitalized, or overextended pose substantial risks to Massachusetts awarding authorities in the form of project delays, corrective construction work, and legal fees. According to a national Dun & Bradstreet study, the business failures of more than 80,000 construction contractors between 1990 and 1997 left \$21 billion in unfinished work on public projects.³ The Commonwealth has an obligation to protect Massachusetts awarding authorities by raising eligibility standards in this area.

- **Current standards for assessing each applicant's financial condition continue to be vague and unreliable.**

³ Ryan, Jessica. "Surety's Role in Public Construction." *American City and County*, February 1999, vol. 114, p. 8.

- **Contractor certification limits continue to be excessively generous.**

Finding 3. The Commonwealth's investment of resources has been inadequate to ensure an effective contractor certification system.

To date, the Administration has not devoted the necessary resources to institute meaningful reform of the contractor certification system.

- **DCAM's contractor certification function continues to lack sufficient staff resources to process the certification workload.**
- **DCAM continues to lack sufficient resources to provide awarding authorities with computerized access to important contractor certification information.**

The following recommendations, many of which were first recommended by the Inspector General in 1998, are aimed at addressing the remaining areas of vulnerability through systemic improvements.

- 1. DCAM should develop clear, reliable standards for assessing each contractor's financial capability.**
- 2. DCAM should develop more restrictive methods for calculating contractor certification limits.**
- 3. DCAM should revise the contractor evaluation form to solicit information on contractor failure to pay subcontractors and to identify biased references.**
- 4. DCAM should revise the written contractor certification procedures to include specific protocols governing all significant decisions affecting the evaluation process.**
- 5. The Administration should invest sufficient resources to ensure an effective contractor certification system.**

Implementing these recommendations will require the commitment of additional resources and expertise to ensure that the contractor certification system serves its intended purpose: to screen and prequalify contractors for public building projects. Such an investment is long overdue. Massachusetts awarding authorities and citizens deserve an efficient, effective contractor certification system.

Introduction

Successful completion of a construction project depends on multiple factors. Some factors, such as the adequacy of project planning, are within the project owner's control; others are not. Of all the controllable factors affecting the outcome of a project, whether private or public, the qualifications and experience of the selected general contractor are among the most important. In the public sector, most governmental jurisdictions are subject to laws mandating competitive bidding for construction contracts. Competitive bid laws can and do save taxpayer money and enable contractors to compete for public contracts on a level playing field – but only if the implementation of these laws includes a reliable mechanism for qualifying contractors. In the words of the Massachusetts Supreme Judicial Court: “Bidder prequalification is no mere formality; it is a cornerstone of the competitive bidding statute.”⁴ Obtaining the best value for the public dollar requires that public agencies award contracts only to qualified contractors.

The Commonwealth of Massachusetts and most other public jurisdictions in the state, including cities, towns, and districts, are required by M.G.L. c. 149 to ensure that only “responsible” contractors undertake public building projects. A responsible contractor demonstrably possesses the skill, ability, and integrity necessary to faithfully perform the work called for by a particular contract, based upon a determination of competent workmanship and financial soundness.⁵ All contractors bidding on public building projects subject to M.G.L. c. 149⁶ must first be certified by the Division of Capital Asset Management (DCAM). Awarding authorities are required to make a separate and final determination of whether the contractor submitting the lowest bid on a specific building project is qualified to undertake that specific project.⁷

⁴ *The Modern Continental Construction Co., Inc. v. City of Lowell*, 391 Mass. 829 (1984).

⁵ M.G.L. c. 149, §44A(1).

⁶ M.G.L. c. 149 governs all contracts estimated to cost more than \$25,000 for the construction, reconstruction, installation, demolition, maintenance, or repair of a building by a public agency. [M.G.L. c. 149, §§44A-M]

⁷ M.G.L. c. 149, §44D(6).

In September 1997, the Office of the Inspector General initiated a review of deficient construction projects in three municipalities undertaken by Anchor Contractors, Inc., which had been deemed qualified to bid by DCAM and by the three municipalities. The Office's investigation revealed that:

- The certification applications and bids submitted by Anchor Contractors contained false statements and omissions.
- DCAM had increased the limit on the dollar value of a single public construction project Anchor Contractors was certified to undertake by 2,150 percent in a six-year period on the basis of a reference with undisclosed family and financial ties to Anchor Contractors.
- DCAM had increased the limit on the cumulative dollar value of public work that Anchor Contractors was certified to undertake by 1,500 percent with minimal analysis of its financial capacity.
- Because of DCAM's application backlog, Anchor Contractors was eligible to continue bidding on public projects for four months after its 1996 certification had expired.
- Contractor certification standards and staffing of the contractor certification function were inadequate to protect Massachusetts awarding authorities from unqualified construction contractors.
- Awarding authorities did not always submit required contractor evaluations to DCAM and were reportedly reluctant to provide unfavorable evaluations of contractors' performance on public contracts.

In August 1998, the Office issued a report, *Qualifying Contractors for Public Building Projects: A Case Study and System Review*,⁸ summarizing its findings and setting forth detailed recommendations for systemic reform. After the report was issued, the Inspector General filed legislation incorporating the legislative reforms recommended in the report.

In November 1997, the Executive Office for Administration and Finance convened a Construction Reform Task Force to review the Commonwealth's public construction

⁸ The August 1998 report may be viewed or downloaded from the Office's website at www.state.ma.us/ig.

procurement and management practices. The Office participated on Task Force subcommittees and was a member of the Construction Reform Advisory Board, whose other members included representatives of private companies, industry groups, professional associations, and public authorities. The Advisory Board advised the Task Force that contractor prequalification standards were too low, that too few contractors were debarred, and that fear of personal liability made it difficult to obtain accurate contractor evaluations from municipal officials. The Construction Reform Task Force issued its final report in May 1998. The report emphatically recommended that the current contractor prequalification system be revamped:

We need to reward excellence and make past performance count:

- Most contractors who seek prequalification get it – only a handful (less than 5%) are rejected.
- Grades can be inflated when contractors don't get evaluated or aren't honestly evaluated.
- Contractors need to know that their performance on one job will affect their ability to get future work. [Emphasis in the original.]

The Task Force's final report provided specific recommendations for strengthening contractor prequalification.

Chapter 159 of the Acts of 2000, enacted in July 2000, incorporated many of the revisions recommended by the Office and the Task Force. For example:

- M.G.L. c. 149, §44D now requires contractors to disclose financial or family relationships with any of the construction project owners listed in their certification applications.
- M.G.L. c. 149, §44D now subjects contractors to penalties of up to 20 years in prison and fines up to \$1,000 for any material false statements made in the certification application or the update information filed with the bid.
- M.G.L. c. 149, §44D now allows DCAM to reduce the classes of work and the amount of work on which a contractor can bid if DCAM receives additional information regarding the contractor's qualifications during its certification period.

- M.G.L. c. 149, §44D now explicitly provides qualified immunity from lawsuits to individuals responsible for completing contractor evaluation forms on behalf of awarding authorities. Awarding authorities are required to provide legal representation and indemnification for those individuals in lawsuits stemming from contractor evaluations.
- M.G.L. c. 149, §44D requires public agencies to complete and submit contractor evaluation forms to DCAM on completed projects in order to be eligible for state funding of subsequent public construction projects.

Objectives, Scope, and Methodology

In February 2000, the Office initiated a follow-up review of the contractor certification system. The purpose of the follow-up review was to identify and evaluate the adequacy of changes to the contractor certification system that had been instituted since 1998. In conducting the follow-up review, the Office reviewed DCAM's revised contractor certification regulations, procedures, and standard forms, as well as staffing figures and productivity reports provided by DCAM's contractor certification office. The Office also interviewed officials from DCAM's contractor certification office and legal department. The Office appreciates DCAM's cooperation and assistance with this review. In October 2000, the Office provided DCAM with a confidential draft of this report. DCAM's response is included in Appendix A of this report. This review was conducted in accordance with generally accepted government auditing standards.

Overview of the Contractor Certification System

The Commonwealth contractor certification system is governed by M.G.L. c. 149, §44D; by Massachusetts regulations (810 CMR 4.00); and by written procedures adopted by DCAM. Contractors apply to DCAM for certification in general building construction and/or 25 specialized categories of work.⁹ All applicants are required to complete and submit to DCAM a detailed application form called the Contractor Qualification Statement. Applicants whose applications are deemed to be complete and who meet minimum certification requirements are then evaluated on the basis of their performance

⁹ For each project to be bid, the awarding authority must designate the certification category in which the general contractor must be qualified and include this information in the published notices inviting bids.

on completed projects. To conduct this evaluation, DCAM relies on written and, if necessary, oral contractor evaluations provided by Massachusetts awarding authorities.¹⁰ Along with detailed project information, evaluators must provide narrative comments and numerical scores rating the contractor's quality of work, performance and accountability, and supervisory personnel. DCAM averages the numerical scores for all evaluations of projects completed by the contractor in the previous five years.¹¹ If the contractor's average score is 70 or higher, the contractor is certified.

DCAM issues a one-year Certificate of Eligibility to each certified contractor, which must submit a copy of the certificate with every bid submitted for a public building contract subject to M.G.L. c. 149. The Certificate of Eligibility contains three major pieces of information:

- the category or categories of work for which the contractor is certified;
- the contractor's Single Project Limit, which represents the highest dollar amount the contractor may bid on any single building project subject to M.G.L. c. 149;¹² and
- the contractor's Aggregate Work Limit, which represents the maximum dollar amount of construction that the contractor may obligate itself to complete at the time that it submits a bid on a project subject to M.G.L. c. 149.

¹⁰ Upon completion of every building project, public agencies are required to fill out a contractor evaluation form and submit it to DCAM, with a copy to the contractor. DCAM supplements the written evaluations submitted by public owners with telephone interviews to public owners who have not submitted the required evaluation forms and to private owners, when appropriate. M.G.L. c. 7, §38E, as amended by Chapter 159 of the Acts of 2000, requires DCAM to develop a designer evaluation form to be filled out by public agencies upon completion of every building project. According to the Commissioner of DCAM, a designer evaluation form will be available in November 2000.

¹¹ DCAM is required to consider evaluations of both public and private building projects completed by the contractor in the five years prior to the application for certification.

¹² In May 2000, DCAM adopted a new system whereby certain contractors are assigned a separate project limit for general building construction. The Construction Reform Task Force had recommended a separate project limit to prevent contractors from relying on trade-specific experience to obtain higher general building construction limits.

In addition to a Certificate of Eligibility, each bidder must submit an Update Statement with its bid on a M.G.L. c. 149 project.¹³ The Update Statement is intended to provide the awarding authority with detailed information on projects completed; changes in the bidder's business organization, financial condition, or bonding references; and judicial or administrative proceedings initiated since the date of the most recent Certificate of Eligibility.

¹³ Any bid submitted without a Certificate of Eligibility and an Update Statement is invalid and must be rejected [M.G.L. c. 149, §44D(1)(a)].

Findings

Finding 1. Recent procedural improvements in the contractor certification system have strengthened safeguards against unqualified contractors.

1a. The Contractor Qualification Statement and Update Statement now require contractors to disclose demands for direct payment filed by their subcontractors.

Contractors that routinely fail to pay their subcontractors jeopardize successful completion of public projects by causing financial hardships for and undermining good working relationships with their subcontractors. Contractor failure to pay subcontractors also imposes substantial administrative burdens on the awarding authorities responsible for processing demands for direct payment from subcontractors.¹⁴ The Office's 1998 review disclosed that Anchor Contractors had consistently failed to pay its subcontractors on projects examined by the Office. The Office recommended that DCAM deny certification to contractors that routinely fail to pay their subcontractors; at that time however, the Contractor Qualification Statements used by DCAM did not solicit information on demands for direct payment filed with awarding authorities by subcontractors. The Construction Reform Task Force also recommended that DCAM deny certification to contractors that routinely fail to pay their subcontractors on time.

The Office's follow-up review found that DCAM revised the Contractor Qualification Statement in May 2000 to require applicants to disclose any previous failures to pay subcontractors and suppliers. The revised Contractor Qualification Statement requires applicants to answer the following three questions:

Has your surety made payment to a materials supplier or other party under your payment bond on any contract?

¹⁴ Under M.G.L. c. 30, §39F, an eligible subcontractor is entitled to demand payment directly from the awarding authority if the general contractor fails to make payment to the subcontractor within 70 days after the subcontractor has completed the subcontracted work.

Has any subcontractor filed a demand for direct payment with an awarding authority on a public project with any of your contracts?

Have any of your subcontractors or suppliers filed litigation to enforce a mechanic's lien against property in connection with work performed or materials supplied under any of your contracts?

If the applicant answers "yes" to any of these three questions, it is required to provide project name(s) and location(s), names of all parties involved, and relevant dates. DCAM added three similar questions to the Update Statement in December 1999. As of October 2000, however, the contractor evaluation form had not been revised to solicit information on demands for direct payment.

DCAM officials reported to the Office that DCAM denies certification to applicants that show a consistent pattern of failing to pay their subcontractors, as evidenced by demands for direct payment on the projects listed in the applicant's Contractor Qualification Statement. DCAM officials also stated that contractors with less serious records of failure to pay their subcontractors are sometimes given six months to demonstrate that they have rectified the problem; if the problem persists, the applicant is denied certification. According to DCAM officials, these determinations are made at the discretion of the contractor certification office. As of October 2000, however, DCAM's written contractor certification procedures did not specify how an applicant's disclosure of demands for direct payment is to be evaluated by the contractor certification office.

1b. The Contractor Qualification Statement and Update Statement now require contractors to disclose family and financial relationships with owners and designers of current and completed projects.

The contractor certification system cannot and should not rely on project owners and designers with family or financial relationships to a contractor for unbiased evaluations of the contractor's performance. Until recently, however, the Contractor Qualification Statement did not require applicants to disclose their family and financial relationships to owners and designers listed by the applicants as references for completed projects. The process by which Anchor Contractors was certified highlights the importance of

requiring this disclosure. The Office's 1998 review revealed that the maximum allowable dollar value of a single project on which Anchor Contractors could bid was increased by 2,150 percent between 1991 and 1997 on the basis of a project reference with undisclosed family and financial ties to Anchor Contractors.

To reduce the risk of DCAM's inadvertent reliance on biased contractor evaluations by project designers and owners, the Office recommended in 1998 that the Contractor Qualification Statement be revised to require disclosure of each applicant's family and financial relationships with owners and designers of all projects listed in the application. The Office also recommended that any applicant failing to make the required disclosures be subject to decertification and, where warranted, debarment.

The Office's follow-up review disclosed that DCAM revised the Contractor Qualification Statement in May 2000 to require applicants to disclose family and financial relationships on current and recently completed projects.¹⁵ DCAM also revised the Update Statement in December 1999 to require disclosure of this information on projects completed since the date of the bidder's most recent Contractor Qualification Statement. As of October 2000, however, the contractor evaluation form had not been revised to solicit information on family and financial ties to the contractor. According to DCAM officials interviewed by the Office, DCAM's current policy is to exclude from consideration any project on which the applicant has disclosed a family or financial relationship with the project architect or owner.

1c. Contractors are now required to sign the Contractor Qualification Statement under the pains and penalties of perjury, as required by M.G.L. c. 149.

M.G.L. c. 149, §44D requires applicants to sign the Contractor Qualification Statement under the pains and penalties of perjury.¹⁶ As of 1998, however, the Contractor

¹⁵ M.G.L. c. 149, §44D(2), as amended by Chapter 159 of the Acts of 2000, requires contractors to disclose family and financial relationships with owners of construction project listed in the Contractor Qualification Statement.

¹⁶ M.G.L. c. 149, §44D(2).

Qualification Statement did not reflect this requirement. The Office's 1998 review found that the Contractor Qualification Statements submitted to DCAM by Anchor Contractors in 1996 and 1997 contained false statements and omissions: for example, a Contractor Qualification Statement submitted to DCAM by Anchor Contractors listed three incomplete projects as completed projects.

To strengthen DCAM's ability to deny certification to and debar contractors who submit false information to DCAM, the Office recommended that DCAM require applicants to sign the Contractor Qualification Statement under the pains and penalties of perjury, as required by M.G.L. c. 149, §44D.

The Office's follow-up review disclosed that DCAM amended the Contractor Qualification Statement in May 2000 by adding an affidavit to be signed by the applicant that reads as follows:

All answers and statements contained in the attached application for Certificate of Eligibility are true and correct. Signed and sworn under the pains and penalties of perjury.

DCAM officials reported to the Office that the new affidavit has encouraged increased reporting of legal and administrative problems by applicants. As noted earlier, M.G.L. c. 149, §44D(2) subjects contractors that submit false statements on the Contractor Qualification Statement or Update Statement to penalties of up to 20 years in prison and fines of up to \$1,000.

1d. DCAM has reportedly instituted safeguards for certification extensions.

When DCAM is unable to process an application for renewal of a contractor's certification in a timely manner, DCAM routinely extends the contractor's certification status for several months beyond the expiration date listed on the contractor's Certification of Eligibility.¹⁷ In 1998, the Office found that the average monthly backlog of certification applications had increased from 211 to 265 between 1996 and 1997.

¹⁷ Under DCAM's regulations, the maximum extension period can be no longer than six months. [810 CMR 4.02(4)]

The Office's 1998 review also disclosed that DCAM granted certification extensions without reviewing the contractor's new application. This practice posed risks in cases such as that of Anchor Contractors, which was allowed to continue bidding on public projects for four months after its 1997 certification had expired. The Office's 1998 report recommended that DCAM institute safeguards for certification extensions, such as requiring an abbreviated review of the contractor's pending application before extending a contractor's certification.

According to DCAM officials interviewed by the Office, the contractor certification office now issues extensions to contractors only after reviewing the information on bonding, financial status, and litigation contained in the applicant's Contractor Qualification Statement. As of October 2000, however, DCAM's written contractor certification procedures did not include the review procedures used by the contractor certification office prior to granting certification extensions, nor did they specify standards for granting certification extensions.

Finding 2. The contractor certification system continues to lack stringent standards for evaluating applicants' financial condition and capacity to undertake public work.

2a. Current standards for assessing each applicant's financial condition continue to be vague and unreliable.

M.G.L. c. 149, §44D requires DCAM to evaluate each applicant's financial condition and to use this information in determining the maximum amount of work the applicant is capable of undertaking.¹⁸ In addition, DCAM's contractor certification regulations state:

A Contractor must establish to the satisfaction of [DCAM] that the Contractor is financially sound, based upon such information concerning the Contractor's financial condition as the Commissioner may prescribe.¹⁹

¹⁸ M.G.L. c. 149, §44D(3) states, in part, that criteria upon which DCAM must evaluate contractors include "the maximum amount of work the applicant is capable of undertaking as demonstrated by the applicant's financial condition, bonding capacity, size of previous projects, and present and anticipated work commitments."

¹⁹ 810 CMR 4.05(2).

Thus, DCAM's evaluation of each contractor's financial condition is an essential component of the contractor certification process. The Office's 1998 review revealed that DCAM lacked a reliable method of assessing applicants' financial capability and screening out applicants whose financial instability poses unacceptable risks to awarding authorities.

The Office's follow-up review disclosed no substantive improvement in this area. DCAM's written contractor certification procedures contain only the following vague instructions to DCAM evaluators:

1. The most recent year-ending financial statement²⁰ is reviewed to determine whether the applicant appears to be financially sound (i.e. able to perform its contracts and meet its obligations). Net worth, net income and working capital are noted on the worksheet.

(a) If the current financial statement causes reasonable doubt as to whether the applicant is financially sound, additional financial information may be requested.

(b) If, after considering sufficient financial information, the applicant's financial position is such that it is evident that the applicant is not financially sound, certification will be denied.

DCAM continues to lack clear, reliable standards for identifying contractors that are financially sound. Moreover, some contractors that have the financial capacity to undertake a limited number of projects of limited size may lack the necessary financial capacity to undertake additional or larger projects. However, DCAM has not developed financial benchmarks for using information regarding an applicant's financial condition to determine the maximum amount of work the applicant is capable of undertaking, as required by M.G.L. c. 149, §44D.

²⁰ M.G.L. c. 149, §44D(2) requires each applicant seeking certification to provide DCAM with a statement of financial condition prepared by a certified public accountant. The financial statement must include information on the contractor's current assets and liabilities, including plant and equipment, bank and credit references, and maximum bonding capacity.

2b. Contractor certification limits continue to be excessively generous.

A contractor's Single Project Limit is the highest dollar amount the contractor may bid on any single building project subject to M.G.L. c. 149. A contractor's Aggregate Work Limit is the maximum dollar amount of construction that the contractor may obligate itself to complete at the time that it submits a bid on a building project subject to M.G.L. c. 149. The Single Project Limit may not exceed the contractor's single project bonding capacity, and the Aggregate Work Limit may not exceed the contractor's aggregate bonding capacity.²¹

The Office's 1998 review disclosed that DCAM's methods of computing the Single Project Limit and Aggregate Work Limit provided insufficient protection to awarding authorities. These computation methods have not changed since the Office conducted its 1998 review. To compute a contractor's Single Project Limit, DCAM identifies the dollar value of the largest project completed by the contractor within the past five years, adjusts for inflation, and multiplies the result by either 140 percent or 200 percent, depending upon the average score derived from the contractor evaluations obtained by DCAM for completed projects, regardless of size. Under this procedure, a certified contractor whose average evaluation score has barely met or exceeded the minimum required average score of 70 is awarded a Single Project Limit amounting to 140 percent of the dollar value of the largest project the contractor has completed over the past five years.

Similarly, DCAM computes a contractor's Aggregate Work Limit by identifying the dollar value of the largest volume of construction work completed by the contractor within the past five years, adjusting for inflation, and multiplying the result by either 140 percent or 200 percent, depending upon the contractor's average evaluation score. Under this procedure, a certified contractor whose average score has barely met or exceeded the minimum required average score of 70 is awarded an Aggregate Work Limit amounting

²¹ 810 CMR 4.04(2-4, inclusive).

to 140 percent of the dollar value of the largest volume of construction work project the contractor has completed over the past five years.

Because DCAM has not developed more restrictive methods of calculating certification, the contractor certification system continues to produce excessively generous certification limits for certified contractors. In essence, a contractor's bonding capacity is still the primary litmus test of its capacity to undertake larger projects or additional projects. As the Office noted in 1998, bonding capacity – while an important and appropriate safeguard – may not be sufficient to protect awarding authorities from contractors that are financially overextended, undercapitalized, understaffed, or otherwise ill equipped to take on additional public contracts. Moreover, the experiences of jurisdictions that invoked Anchor Contractors' performance bonds illustrate that this process can be expensive, time-consuming, and difficult.

The primary function of the certification limits should be to ensure that contractors are capable of undertaking the public contracts on which they are bidding, not to ensure that contractors are allowed to expand their public work by 140 percent to 200 percent each year. A more restrictive approach to calculating contractor certification limits continues to be warranted.

Finding 3. The Commonwealth's investment of resources has been inadequate to ensure an effective contractor certification system.

3a. DCAM's contractor certification function continues to lack sufficient staff resources to process the certification workload.

The Office's 1998 review disclosed that DCAM's contractor certification office lacked sufficient staffing to process its workload in a timely manner and to institute needed reforms to the contractor certification system. DCAM's average monthly backlog of Contractor Qualification Statements and requests for certification changes had climbed from 211 to 265 over the prior year. The DCAM Commissioner's response to the Office's 1998 report acknowledged that additional staff and other resources would be

required to process the high volume of applications and to address many of the Office's recommendations for administrative changes.

As of June 2000, no full-time, permanent staff had been added to the contractor certification office since the Office's 1998 review, although DCAM had recently hired two temporary workers to provide assistance with application processing, data entry, and administrative work. DCAM's average monthly backlog had climbed to 283, and the total number of certification extensions granted to contractors with expired certifications had climbed from 591 in 1998 to 648 in 1999, and had already reached 403 in the first six months of 2000. Table 1 shows the growth in the average monthly certification backlog and the total certification extensions granted over the four and one-half year period between January 1996 and June 2000. DCAM continues to need additional staff with the necessary training and experience to conduct thorough, reliable, informed evaluations of contractors' eligibility for certification to bid on public building projects.

Table 1.
Contractor Certification Backlog and Extensions

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>First six months of 2000</u>
Average monthly backlog	211	265	264	260	283
Total extensions for year	552	728	591	648	403

Source: DCAM contractor certification office

3b. DCAM continues to lack sufficient resources to provide awarding authorities with computerized access to important contractor certification information.

The inadequacy of the Commonwealth's investment in contractor certification has created impediments to awarding authorities. Although DCAM has made its standard forms, certification procedures, and a continually updated list of certified contractors available to download from the Internet, awarding authorities continue to lack electronic access to the contractor evaluations filed with DCAM. Awarding authorities may review

a contractor's certification file only by traveling to DCAM's Boston office,²² a process that can be time-consuming and inconvenient.

In 1998, the Office and the Construction Reform Task Force recommended that contractor evaluations be computerized for ready access by awarding authorities. Without the necessary investment in computer expertise, awarding authorities will continue to lack ready access to the information they need to determine whether bidders on their building projects are responsible contractors.

²² 810 CMR 4.10.

Conclusion and Recommendations

Thousands of state and local agencies and governments across Massachusetts rely on the Commonwealth to prequalify their contractors for public building contracts. The success of building construction projects to provide essential public facilities such as public safety buildings, schools, libraries, and prisons depends heavily on DCAM's ability to screen out unqualified contractors and to certify qualified contractors in a timely manner.

In recent months, DCAM has instituted changes to the contractor certification system that will strengthen DCAM's capacity to reject applicants and reduce the vulnerability of the contractor certification system to inaccuracy, bias, and fraud. In addition, legislative reforms enacted in 2000 have strengthened contractor certification safeguards by, for example, providing legal protection for awarding authorities preparing written contractor evaluations. These improvements are evidence of progress toward an effective contractor certification system.

However, other needed reforms to the contractor certification system have not been instituted. Although both the Inspector General and the Administration's Construction Reform Task Force called for more stringent contractor eligibility standards in 1998, DCAM's financial eligibility standards continue to be inadequate. Contractors that are financially unstable, undercapitalized, or overextended pose substantial risks to Massachusetts awarding authorities in the form of project delays, corrective construction work, and legal fees. According to a national Dun & Bradstreet study, the business failures of more than 80,000 construction contractors between 1990 and 1997 left \$21 billion in unfinished work on public projects.²³ The Commonwealth has an obligation to protect Massachusetts awarding authorities by raising eligibility standards in this area.

²³ Ryan, Jessica. "Surety's Role in Public Construction." *American City and County*, February 1999, vol. 114, p. 8.

Competition among qualified contractors is the key to best value construction. To date, the Administration has not devoted the necessary resources to institute meaningful reform of the contractor certification system. The following recommendations, many of which were first recommended by the Office of the Inspector General in 1998, are aimed at addressing the remaining areas of vulnerability through systemic improvements. Implementing these recommendations will require the commitment of additional resources and expertise to ensure that the contractor certification system serves its intended purpose: to screen and prequalify contractors for public building projects. Such an investment is long overdue. Massachusetts awarding authorities and citizens deserve an efficient, effective contractor certification system.

The Inspector General's specific recommendations are as follows:

1. DCAM should develop clear, reliable standards for assessing each contractor's financial capability.

M.G.L. c. 149, §44D requires DCAM to evaluate a contractor's financial capacity and factor this information into the certification limits established for each certified contractor. DCAM should develop clear, reliable standards for assessing each contractor's financial capability. While a detailed financial analysis of each applicant's financial statements would be impractical, DCAM should obtain the necessary expertise, on a consultant basis if necessary, to develop financial ratios that will enable a reasonable assessment of each construction contractor's financial condition and benchmarks linking financial capacity to the size of the public projects the contractor will be certified to undertake.

2. DCAM should develop more restrictive methods for calculating contractor certification limits.

DCAM should ensure that the methods used to calculate the Single Project Limit and Aggregate Work Limit for each certified contractor minimize the likelihood that otherwise competent contractors will become financially or technically overextended. The contractor certification limits should allow room for modest growth in the dollar value of public contracts undertaken by financially stable contractors with strong

performance records. Higher-risk contractors should not be permitted the same expansion. For example, rather than basing the limits on the dollar value of the largest project the contractor has completed or the largest volume of construction work completed by the contractor over the past five years, DCAM should devise a calculation method that takes into account the average dollar value of projects completed in the most recent year or years as well as the dollar value of the largest projects. DCAM should consider according more weight to larger projects when computing the average numerical rating used to certify contractors. Finally, DCAM should consider adopting a more conservative approach to increasing contractors' single project and aggregate work limits by reducing the 140 percent and 200 percent multipliers currently used in calculating these limits.

3. DCAM should revise the contractor evaluation form to solicit information on contractor failure to pay subcontractors and to identify biased references.

The contractor evaluation form is central to the contractor certification system. In addition to yielding numerical scores, the evaluations submitted by awarding authorities provide an important cross-check to the information supplied by contractors in the Contractor Qualification Statement and the Update Statement. Accordingly, the evaluation form should solicit information on direct payment claims filed by subcontractors on projects undertaken by the contractor. It should also require references to disclose any family or financial relationships with the contractor, thereby enabling DCAM to omit biased references from consideration in the certification process. These disclosures will also assist DCAM in assessing the accuracy of the information provided by applicants for certification. Moreover, if contractor evaluations report relevant information that was not disclosed by the applicant as required by the Contractor Qualification Statement and Update Statement, DCAM may determine that the applicant has provided false or inaccurate information and take appropriate action.

To encourage accurate contractor evaluations, the revised contractor evaluation form should advise awarding authorities that M.G.L. c. 149, §44D provides qualified immunity to those filling out contractor evaluations on behalf of awarding authorities.

It should also state that under M.G.L. c. 149, §44D, awarding authorities must complete contractor evaluation forms in order to be eligible for state funding of subsequent construction projects.

4. DCAM should revise the written contractor certification procedures to include specific protocols governing all significant decisions affecting the evaluation process.

DCAM's written contractor certification procedures do not reflect the practices of the contractor certification office in some key areas. Written procedures formalize practices and help ensure that rules are uniformly applied and consistent with an agency's regulations and applicable law. DCAM should revise the contractor certification procedures to specify the protocols currently used by DCAM's contractor certification office regarding each of the following issues:

Certification extensions. The contractor certification procedures should specify the abbreviated application review that must be completed before extending a contractor's expired certification.

Family and financial relationships. The contractor certification procedures should explicitly require DCAM evaluators to exclude from consideration references provided by individuals with family or financial relationships to the contractor and the completed projects owned or overseen by such individuals.

Failure to pay subcontractors. The contractor certification procedures should specify that DCAM will deny certification to contractors whose completed projects exhibit a consistent pattern of demands for direct payment filed by subcontractors.

Other procedural issues. DCAM should also review and, where necessary, amend the contractor certification procedures to ensure that they comport with statutory requirements, current policies, and the practices of the contractor certification office.

5. The Administration should invest sufficient resources to ensure an effective contractor certification system.

First, the staffing needs of DCAM's contractor certification function should be assessed. DCAM officials interviewed by the Office estimated that three additional full-time, permanent staff could be required to enable timely, thorough contractor certification reviews, with no significant backlog. The target staffing level should enable DCAM to process applications for recertification without granting extensions except in rare circumstances.

DCAM should also invest in a computer consultant to design and periodically update a secure, web-based application that enables authorized public officials to access contractor evaluations.²⁴ Creating a secure website would enable awarding authorities to review contractor evaluations from their own public offices. An effective system of sharing contractor evaluations would supply awarding authorities with an essential tool to ensure that only qualified contractors receive public construction contracts.

²⁴ Under M.G.L. c. 149, §44D(2) contractor applications and evaluations are not public records and are not open to public inspection.

This page intentionally left blank.

Appendix A: DCAM's Response

The attached response* of the Commissioner of DCAM to a confidential draft of this report acknowledges the importance of reforming the contractor certification system and indicates that DCAM is taking steps to implement improvements recommended by the Inspector General. DCAM's constructive response is encouraging news for the Massachusetts awarding authorities that rely on the contractor certification system to prequalify contractors on public building projects.

However, the Office of the Inspector General disagrees with the DCAM's suggestion that its approach is sufficient to generate reliable assessments of applicants' financial capability. Because DCAM has not instituted clear, stringent financial eligibility standards, the contractor certification system does not reliably screen out applicants whose financial instability poses unacceptable risks to awarding authorities. Moreover, DCAM continues to lack financial benchmarks for using information regarding each applicant's financial condition to determine the maximum amount of work the applicant is capable of undertaking, as required by M.G.L. c. 149, §44D.

Based on DCAM's response, the draft report was amended to clarify that DCAM expects to issue the designer evaluation form required by M.G.L. c. 7, §38E in November 2000.

* The response letter has been scanned for electronic publication. The text has not been changed.

This page intentionally left blank.



The Commonwealth of Massachusetts

Executive Office for Administration and Finance

Division of Capital Asset Management

One Ashburton Place

Boston, Massachusetts 02108

Tel (617) 727-1050

Fax (617) 727-5363

ARDEO PAUL CELLUCCI
GOVERNOR

JANE SWIFT
LEUTENANT GOVERNOR

STEPHEN R. CROSSBY
SECRETARY, ADMINISTRATION
& FINANCE

DAVID B. PERINI
COMMISSIONER

October 26, 2000

BY HAND DELIVERY

Robert A. Cerasoli
Inspector General
Office of the Inspector General
One Ashburton Place, Room 1311
Boston, MA 02108

Re: Confidential Draft Report on Contractor Certification Dated October 12, 2000

Dear Inspector General Cerasoli:

Thank you for sending me the above-referenced confidential draft report (the "Draft Report") concerning the Commonwealth's certification process for contractors on public building construction projects. This letter provides the Division of Capital Asset Management's response to the Draft Report.

I have reviewed the recommendations you made in the Draft Report. Your Draft Report acknowledges that several of the previously recommended changes made in your August 1998 report have been implemented by the Division of Capital Asset Management. Specifically the Division of Capital Asset Management has completely revised the Application for Certificate of Eligibility as well as the Update Statement. Currently, the Division is participating in a Division of Capital Asset Management initiated Certification Task Force with representatives of our agency and the construction and bonding industries. The Task Force is actively working on providing input to the Division of Capital Asset Management on certification related issues, including revisions to a new Standard Contractor Evaluation Form. Many of the issues raised in your Draft Report have already been discussed by the Task Force and will be addressed in a number of ways including a revised evaluation form. This new Evaluation Form and revised Certification Guidelines and Procedures will be available by the end of the year.

In your discussion of contractor evaluations, the Draft Report states that DCAM has not yet developed a Designer Evaluation Form as required by recent legislation. In fact, DCAM has developed a Designer Evaluation form and it has been under review by our programming, construction and legal offices. It will be advertised in the Central Register within the next month.

I would like to comment on the Construction Reform Task Force's finding in their May 1998 report cited in your 2000 draft report, that "[m]ost contractors who seek prequalification get it – only a handful (less than 5%) are rejected." This statistic is misleading. This percentage does not take into consideration the significant number of contractors which contact our office, visit our website, or receive our application but decide not to apply prior to submitting a formal application due to their inability to meet our stringent requirements for contractor certification.



With respect to the Draft Report, I would also like to point out that the Division of Capital Asset Management had revised its Application and Update Statement prior to the recent statutory changes made to M.G.L. c. 149, §44D, to include disclosure of financial or family relationships with any of the construction project owners. The Division of Capital Asset Management's process of evaluating and revising its existing forms has progressed in a sensible manner. It began with modifications to the Application, then proceeded to the Update Statement. As mentioned above, we are now working on the Evaluation form and will then address the Guidelines and Procedures to ensure they are consistent with all of the revised forms. Please note that it has never been the Division of Capital Asset Management's practice to knowingly accept evaluations from construction project owners having a financial or family relationship to the contractor. The disclosure requirements will help dissuade those who would otherwise be inclined to provide such evaluations.

Questions addressing the existence of demands for direct payment, as noted in the Draft Report's *Finding 1 a*, will be included in the new contractor evaluation form. In the event that a contractor's application reveals an excessive history of direct payment claims, the Certification Office in conjunction with the Legal Office will make a determination on whether to deny certification. This practice will be delineated in our revised Guidelines & Procedures.

To clarify your comment on certification extensions, the Division of Capital Asset Management has always done and continues to do an abbreviated review of certification applications prior to granting any extension necessary to allow time for the Division to conclude its complete review. This abbreviated review encompasses an examination of the application, bonding status, and financial condition. Any issue that potentially affects a contractor's ability to perform public construction is reviewed by the Certification Office in conjunction with the Legal Office to determine whether certification is justified. This practice will also be included in the revised Guidelines and Procedures.

The Draft Report makes recommendations regarding certification limits. The Certification Task Force is currently discussing and evaluating proposed changes to the rating and multiplier structure. Based upon the Draft Report and the Task Force recommendations, the Division of Capital Asset Management is working toward making changes to that structure.

The Draft Report also discusses the increase in the average monthly backlog of applications from 1996 through the first six months of 2000. As a result of the robust construction market, there has been a significant increase in certification applications. It is important to note that an inordinately large increase in certification applications received by the Division of Capital Asset Management this year has greatly contributed to the current backlog. More specifically, the Certification Office has seen an increase of over 10% in the amount of applications received through September 2000 as compared to the total amount of applications received in 1999. The Division of Capital Asset Management is reviewing its current staffing situation in view of the increased volume.

Robert A. Cerasoli
October 26, 2000
Page 3

In addition, the Draft Report states that DCAM “lacks clear and reliable standards for identifying contractors that are financially sound.” If you are referring to a rigid financial template, we agree. However, I do not believe that it is desirable to devise rigid standards, thereby precluding the agency from considering contractors who do not meet the standards, but who demonstrate strong abilities to perform public construction work. Although we do not employ a rigid template, we do look at key financial information, such as working capital, stockholders’ equity, net income, and gross revenues, before certifying an applicant. If these figures raise flags as to the financial soundness of the firm, the Certification Office will consult with the Legal Office in making a determination whether to grant certification. If necessary, we will obtain additional information from the contractor’s CPA in making a proper determination. This process will also be included in our revisions to the Guidelines and Procedures. However, we will continue to evaluate the need for a more rigid framework in reviewing financial statements.

Finally, with respect to the issue of computerized access to certification records, the Office of Administration and Finance, in conjunction with the Division of Capital Asset Management, has formed a technology committee. This group will address the ability to make certification files available on line to awarding authorities and their representatives while maintaining the security and confidentiality of this information required pursuant to M.G.L. c. 149, §44D (2).

Thank you for your thoughtful report. The Division of Capital Asset Management will take your recommendations into account as part of its ongoing work to improve the contractor certification process.

Very truly yours,

David B. Perini
Commissioner

Cc: George M. Matthews, Associate General Counsel
Natasha M. Bizanos, Manager of Contractor Certification