

Sacramento County and Ingentra: A Cautionary Tale

Summary

The grand jury investigated the circumstances leading to Sacramento County owing a \$20M debt to the federal government. This debt arose when a county contractor failed to remit to the Internal Revenue Service (IRS) all money due from the payrolls of special districts within the county. Albert Cipoletti, Chief Executive Officer (CEO) of Ingentra HR Solutions, pled guilty to federal charges of wire fraud, along with the controller of the company. A sentencing hearing was scheduled for April 15, 2011.

Sacramento County is required to process the payrolls for special districts within its boundaries. This function was performed by county employees until 2004. At that time the county's Department of Finance concluded that the computer system used by the county for these payrolls was "obsolete, cumbersome and very costly to maintain" (language from the Sacramento County Board of Supervisors Resolution) and concluded that it could be cheaper to have a private contractor handle the payroll. A Request for Proposal (RFP) was issued, two bidders responded and the contract was awarded to the higher bidder, Ingentra HR Solutions, (at that time called Humanic Solutions). Based primarily on a county-designed demonstration, Ingentra showed it could best fulfill the terms of the contract. The contract was renewed four times after 2004. In the spring of 2010, an IRS agent met with county representatives to point out a discrepancy between the funds due and the funds received from Ingentra. After payment of \$3M, the county still owes \$17M.

The grand jury's investigation involved extensive review of emails and other documents, and interviews with many county employees, both past and present. It was soon apparent that the Ingentra contract was not a routine transaction. It required the processing of payrolls for 47 special districts which varied widely in size, functions, policies and conditions of employment. Moreover, the county had never before contracted for payroll services. While the grand jury found that county employees had followed the usual policies and procedures for contracting out, this was not a usual contract. Safeguards were available that might have reduced the county's risk, but they were not recognized and put in place.

The jury determined that practices that may work quite well for purchasing some goods and services are inadequate for special and unique contracts such as the one involved here. The grand jury recommends alterations to the RFP process that will enable the county to assess risks to the county early in the process, to perform credit and litigation checks on bidders, to require different types of insurance, if needed, and to follow the same processes before renewing a contract. This is particularly important because the county owes the IRS primarily because it failed to employ an effective contract renewal review process. If a check of litigation filed against Ingentra were performed, the county would have learned that Ingentra was being sued for breach of similar contracts.

The grand jury's recommendations apply to "special" contracts. The jury defines a "special" contract as the first of its kind for Sacramento County, a materially significant contract because of the amount of money involved, or a complex contract. While there

are never any safeguards to guarantee that no contractor will embezzle or steal from the county, the grand jury's recommendations will help weed out and deter potential wrongdoing by a contractor. By instituting these recommendations, Sacramento County can turn the tale of Ingentra's fraud from a sad one into a cautionary one from which valuable lessons can be learned.

Foreword

The Ingentra contract was with Sacramento County and is therefore under the jurisdiction of the Sacramento County Grand Jury. The major focus for this investigation was the standard boilerplate process used by the county in purchasing goods and services, the contract process and the lack of review during the contract renewal process. There is no real risk management review of RFPs, contracts and the contract renewal process. The grand jury concluded that this process should be reviewed due to the county's increased outsourcing of services.

Issues

Does the RFP process provide Sacramento County with opportunities to adequately assess risk and to allow the county to learn enough about the potential contractors?

Did the contract with Ingentra contain enough safeguards to protect Sacramento County in the event that Ingentra failed to perform?

Is the contract renewal process adequate to ensure that Sacramento County will be protected against a contractor's failure to perform?

Reason for Investigation

The grand jury undertook an investigation upon the discovery that Sacramento County owes \$17 million to the IRS for payroll taxes. Initially, there was concern as to whether county employees were complicit in the criminal activity engaged in by Ingentra. The jury's investigation revealed no criminal activity on the part of Sacramento County employees. The jury also wanted to ensure that the process by which contracts are awarded adequately safeguards the county against potential damage. The jury seeks to assist the county in determining whether the purchasing process adequately allows the county to assess the risks posed by special contracts.

Method of Investigation

Interviews were held with personnel from the Department of Finance, Department of General Services and persons on the evaluation team. The following items were reviewed:

- The Sacramento County Contracts Manual
- The RFP for special district payroll services
- The two submitted bids
- The contract extensions

- Numerous emails among evaluation team members and Sacramento County personnel.

Background and Facts

Contract Development--the Request for Proposal Process

This is the first time Sacramento County outsourced payroll processing for the special districts. While it is not unusual for a company or governmental agency to outsource payroll processing, this particular situation was unique. The 47 special districts served by the Ingentra contract varied in type from fire districts to park districts to water districts to cemetery districts. The payroll processing for these districts is very complicated because each of the districts is a separate entity operating under its own policies and procedures. They had differing pay dates, differing retirement systems, differing health and/or dental care plans, and differing policies on vacation, sick leave, and personal time. The districts had as few as two employees to as many as several hundred. Some of the districts hired temporary and seasonal help requiring payroll processing to be flexible. The payroll processing contractor would be receiving payroll information from 47 different sources in a variety of formats. One of the districts did not use computers.

The contract was awarded to Ingentra through the use of Sacramento County's standard purchasing procedures. The Contracts and Purchasing Services Division administered the RFP process in which potential contractors were invited to bid for the contract based on specifications contained within the RFP. The Purchasing Division provided the standard boilerplate specifications, including required insurance policies, which have been used for years. The numerous and complicated technical specifications for the RFP were created by a committee of people with expertise in the various aspects of payroll processing. The committee was appointed and headed up by Department of Finance personnel.

The RFP was sent to numerous payroll providers and published on Sacramento County's website. Only two companies responded. Ingentra was a small company operating from a New York office. The other bidder was a large, nationally known firm.

The bids were analyzed by an evaluation team made up of people who were part of the committee that created the technical specifications for the RFP. The team developed an evaluation form which gave varying weights to the different aspects of the proposal and the required demonstration of services. The specifications of the RFP were compared with the contents of the bids. An important provision of this RFP process required the bidders to come to Sacramento to demonstrate their services by following a script created by the evaluation team. The script required the bidders to produce a sample payroll run, showing that they could accurately calculate all payments and deductions. During the evaluation the bidders were also required to show that they could adapt to unanticipated changes in the payroll process and that the various special districts could easily transmit information to the successful bidder.

Finally, the evaluation team contacted references identified by the bidders. The references responded to a list of questions prepared by the evaluation team. Beyond

asking for the opinions of Ingentra customers, there were no checks on the past or current performance of the bidders.

Ultimately, the higher of two bidders, Ingentra, was selected by the evaluation team. The award was based on the strength of the company's performance during a demonstration of its services. The other bidder, in the unanimous determination of the team that evaluated the bids, did not perform nearly as well. The Sacramento County Board of Supervisors approved the award of the contract to Ingentra for an initial term of 20 months and included a provision for up to four 15 month extensions. The contract was renewed four times. The final extension was for more than the allowed 15 months without board review or reauthorization.

Problems with the Request for Proposal Process

The grand jury observed several problems with the RFP process followed in this case, all resulting from a singular focus on the mechanics of the payroll and not recognizing the larger question of contractor accountability. In the effort to handle the intricacies of this particular payroll situation, no one identified a fundamental problem, the potential theft of money entrusted to the contractor. The purchasing department and evaluation team were doing their jobs in performing the functions of purchasing. Too often the people who conceive and execute an idea are short sighted because they are caught up in the details of the idea and because they already believe it is an idea worth pursuing. That appears to be what happened here.

First, no part of the RFP process requires a county official or department to look at a potential contract and ask, "What is the worst thing that can go wrong? What steps can be taken to prevent this? Is there insurance or another form of protection that can compensate the county? Is outsourcing this service the best solution for the county?" In this case, both payroll worth millions of dollars and the payment of state and federal taxes were turned over to a contractor. Although the county purchasing agency should be able to address such issues, the agency got caught up in performing the routine functions of purchasing, rather than shopping and evaluation. Raising such questions should be done by an official or department that is not and will not be directly involved in the resulting contract.

Another problem with this process arose from a lack of flexibility in analyzing bids. The people evaluating the bids seemed to have no mechanism to use to amend the specifications. During the evaluation process bidders may file "exceptions" to the specifications in the RFP. The bidder files an exception if a provision varies from the specifications requested. Exceptions can be the inclusion of extras not required, as it was in this case. In this RFP, the losing bidder filed exceptions. One of the exceptions was the inclusion of insurance for employee dishonesty and computer crime coverage for losses arising out of or in connection with any fraudulent or dishonest acts committed by employees. Another exception included errors and omissions coverage. These types of insurance were not required under the RFP which contained standard specifications for general comprehensive liability, auto liability, and workers' compensation coverage. No one on the evaluation team or in the purchasing services department remarked on this exception. The words "dishonesty" and "crime" were not noticed as red flags signaling a potential problem. The insurance mentioned in the exception offered a possible source of

protection. When asked about this exception, one interviewee's only response was to note that the insurances were beyond the scope of the RFP and could not be used in the evaluation for awarding the contract to the one who carried that insurance. Other interviewees simply did not notice this red flag.

It is true that in Ingentra's case, where the CEO of the company was engaged in fraud, the employee dishonesty insurance would not apply. However, had only Ingentra's employees engaged in the fraud, the insurance might apply. The county should require that it be named as an additional insured in such a policy.

Reference checking consisted only of asking a series of questions to clients identified by the bidders. A section of the RFP asks the bidders if they have been sued for breach of a contract with a public entity. This was a cursory check, at best. The RFP should ask about suits for breach of any similar type contract with both public and private parties. There should be a litigation search to determine if the bidders, or its principals, are named in lawsuits in any jurisdiction in which the company does business.

Further, the RFP process should require closer examination of potential contractors. Credit checks of the bidders, both the company itself and, if the company is essentially a sole proprietorship as Ingentra was, the principals of the company. A credit check can reveal a company in financial distress, a sign that the company is not a good candidate for handling the contract. The same is true of an asset check. A company with few assets would not be a good candidate. Should a company with few or no assets fail to perform, any lawsuit filed by the county for breach of contract or indemnification would be futile because the company could lack assets or be indebted enough to seek bankruptcy. These checks must be done to give the county a clear view of the potential contractors.

There was no referral to risk management until after the contract was awarded. That, in itself, was a problem. There was no input into possible types of insurance to require in the RFP. The only provision examined by risk management after the award was an indemnity clause proposed by Ingentra which purported to indemnify Sacramento County in the event of gross negligence on the part of Ingentra. This clause was changed at the request of risk management to require indemnification for ordinary negligence. Risk management questioned whether the standard insurances (workers' compensation, auto and comprehensive liability) were in place. It appears that risk management's job is only to review and suggest appropriate insurance. Risk management should always be consulted before an RFP is sent out for bid.

Contract Administration

There was a significant problem with the way this contract was monitored. There was no follow up with the IRS or any California taxing authority to determine if payment was actually made by Ingentra. The contract required use of the Electronic Federal Tax Payment System (EFTPS) for payment of all federal tax. Witnesses testified they were under the impression that only the entity transmitting money in this way was entitled to view the information. That entity was Ingentra. At the time nobody challenged this assumption; in fact Sacramento County could have checked these payments electronically. County personnel saw the quarterly returns prepared by Ingentra and sent to Sacramento County, but did not see the quarterly returns Ingentra actually filed with

the IRS. This is significant because the lack of verification permitted Ingentra to understate and underpay the employee withholding tax to the IRS without the county knowing that it occurred.

The contract with Ingentra did not require any audits. Witnesses testified that they assumed and/or knew that SAS 70 computer audits would be performed. A SAS 70 audit examines the controls over information technology and related processes. It does not include an audit of the financial statements, an examination of the internal controls over financial reporting, or any tests of payments to third parties such as the IRS. The county never asked for, and did not receive, copies of financial statement audits from Ingentra nor did the county determine whether audits were performed. Furthermore, the performance of the contract was never subject to a pre-award, interim, or post-award audit. An audit based on information provided by the contractor would not necessarily find embezzlement like that committed by Ingentra, but it could deter a casual embezzler in the way that a locked car door deters a not very serious car thief.

Money was wire transferred to an Ingentra bank account each month to be used for the payroll and employee withholding taxes, but apparently the county had no way to monitor what went into and out of the account. The contract contained no provisions to permit Sacramento County to monitor transactions conducted by Ingentra on the county's behalf.

Contract Renewal Process

The Ingentra contract offered a potential of four 15 month contract renewals. There were two problems with the way the contract renewal was handled. First, there was no effective process for determining if the contract should be renewed. Second, the final renewal was for a time period in excess of the 15 month term allotted by the Board of Supervisors' authorizing resolution.

It appears that there is no effective process for renewal established or followed. The decision to renew is usually up to the "using agency", in this case the Department of Finance. The decision to renew was based on lack of complaints about the contractor. No one was upset about anything Ingentra did. Payrolls were met. There was a problem reported by one special district when its laid off employees were not listed as employees for the purpose of claiming unemployment benefits from the Employment Development Department. This problem was corrected. The county lost no money as a result, though unfortunately, the employees did not receive benefits as quickly as they should have. Aside from that, no one reported any problems with the operation and administration of the contract. The payroll processing simply went on as before through four contract renewals.

Unfortunately, Sacramento County missed vital opportunities to learn about Ingentra and its principal Albert Cipoletti's business conduct. No formal audit was performed. No searching for litigation occurred. The terms and price of the contract were not reviewed. Because no litigation check was performed before the July 2007 renewal, Sacramento County did not learn that Mr. Cipoletti and Ingentra were sued by a law firm in federal court in New York in 2006. The lawsuit alleged that Ingentra did not pay the IRS and

other taxing authorities as it promised to do in a payroll processing service contract.¹ Also, because there was no litigation check, Sacramento County did not learn that Ingentra, Mr. Cipoletti, or Ingentra's predecessor company Total Times Solutions were named as defendants in lawsuits in New York, New Jersey, and Pennsylvania during 2006-2007.

Had someone entered Albert Cipoletti's name in an Internet search engine, it is likely that a *Newsday* article written in September 2006 would have turned up. It describes the bankruptcy proceedings of a company called Total Time Solutions which was owned by Mr. Cipoletti. The creditors claimed that Total Time deducted money from their accounts but failed to pay federal and state taxes.

Litigation searches must check for all litigation involving contracts like that in which Sacramento County was involved, not just for litigation arising from contracts with public agencies. The search should examine all the jurisdictions in which the company operates. When the contract is with a small business, like Ingentra, it is equally important to look for litigation involving the conduct of the company's principals.

Conclusion

After investigating the award and renewal of the special district payroll processing contract to Ingentra, the grand jury concludes that current Sacramento County contracting practices must be improved, both before a contract is initiated and before any contract is renewed. The county must amend purchasing practices to enable it to assess risks to the county early in the process, to perform credit checks, asset checks, and litigation searches on bidders, and to be flexible in the types of insurance required.

Of utmost importance is the need for reforming the way in which contracts are renewed. Before contracts are renewed, the contractor must undergo a litigation check, credit check and performance audit, if appropriate. These changes cannot guarantee that a contractor will not embezzle or steal from the county, but they will help weed out potential contractors that are at risk of failing to perform and deter potential wrongdoing.

¹ Spear Wilderman, PC v. TTS Payrolls, Inc (individually and/or as a wholly owned subsidiary of Ingentra), Ingentra HR Services, Inc. & Albert Cipoletti, US District Court, Eastern District New York

Findings and Recommendations

Finding 1.1 There was no evidence of criminal activity by Sacramento County employees or undue influence held by Ingentra over Sacramento County employees.

Finding 2.1 There was no comprehensive assessment or worst case analysis of the financial risk the county could incur with the proposed contract during the Request for Proposal (RFP) process.

Recommendation 2.1 Involve risk management and the County Counsel while developing the RFP specifications for “special” contracts. A “special” contract is one that is the first of its kind for Sacramento County, a materially significant contract because of the amount of money involved in the transaction, or a complex contract.

Recommendation 2.2 In the case of “special” contracts, before an RFP is finalized and sent to potential bidders, assign responsibility to an appropriate individual or committee to perform a comprehensive risk assessment and to determine the advisability of the county entering into such a contract.

Finding 3.1 There was no mechanism for recognizing the significance of exceptions to or from the specifications offered by bidders.

Recommendation 3.1 Bid evaluators should be instructed to bring any exception or variance from the established specifications to the attention of the purchasing department. The “purchasing department” refers to the purchasing department in whichever county agency originates the RFP process, not just the Purchasing Department contained within the Department of General Services.

Recommendation 3.2 The purchasing department should examine the exception or variance and determine if the RFP should be amended or if a new RFP should be created.

Finding 4.1 The RFP process did not adequately check the backgrounds and reliability of bidders in special contracts, as defined in Recommendation 2.1, or when the bidder is a small corporation or business like Ingentra.

Recommendation 4.1 Reference checking should include credit and asset checks of the bidders plus litigation searches to look for lawsuits against the bidder and/or bidders’ principals in jurisdictions in which the bidder has done or is doing business.

Finding 5.1 There was no requirement that the bidders carry employee dishonesty and computer fraud insurance.

Recommendation 5.1 Require employee dishonesty and computer fraud insurance in all cases in which the contractor handles public funds and makes payments to third parties. Require Sacramento County to be named an additional insured in the policies.

Finding 6.1 Sacramento County used no mechanism to determine if the IRS or the California taxing agencies actually received the proper amount of withheld payroll taxes.

Recommendation 6.1 For any payroll services contract, or any contract involving a third party payee, the user departments or agencies should verify receipt of payment directly from any applicable third party payee.

Finding 7.1 The contract with Ingentra did not require any financial or performance audit.

Recommendation 7.1 Special contracts should be subject to performance audits and the contractor should be required to have a financial statement audit in addition to standard computer audits.

Finding 8.1 The contract renewal process was inadequate.

Recommendation 8.1 Before any “special” contract, as defined in Recommendation 2.1, is renewed, Sacramento County should assess the contractor’s performance and pursue credit, asset and litigation searches to make sure that the contractor remains a reliable provider of services.

Finding 9.1 The final Ingentra contract renewal was for a term longer than that authorized by the Sacramento County Board of Supervisors.

Recommendation 9.1 Any proposed extension of a contract that exceeds the term authorized by the Sacramento County Board of Supervisors must be specifically approved by the Board.

Response Requirements

Penal Code sections 933 and 933.05 require that specific responses to indicated findings and recommendations contained in this report be submitted to the Presiding Judge of the Sacramento County Superior Court by August 1, 2011, from:

- **The Sacramento County Board of Supervisors**
- **The Sacramento County Executive**
- **The Sacramento County Director of Internal Services Agency**
- **The Sacramento County Director of General Services**
- **The Sacramento County Office of County Counsel**
- **The Sacramento County Department of Personnel, Risk Management Office**
- **The Sacramento County Department of Finance**

Mail or hand-deliver a hard copy of the response to:

**Hon. Steve White, Presiding Judge
Sacramento County Superior Court
720 9th Street, Dept. 47
Sacramento, CA 95814**

In addition, email the response to Becky Castaneda, Grand Jury Coordinator, at castanb@saccourt.com