Retainage Release for Public Works Projects

2017 Report to the Legislature

September 2017
Table of Contents

Executive Summary ........................................................................................................... 1
Introduction .......................................................................................................................... 2
Information Requested by the Legislature ................................................................. 3
  Improve Timeliness and Reduce Backlog ................................................................. 3
  Reduce Average Approval Time and Size of Backlog .............................................. 3
  Develop a Long-Term Strategy .................................................................................. 6
Conclusion ........................................................................................................................... 7
Figures
  Figure 1: Average days to release retainage ............................................................ 4
  Figure 2: Contract release inventory (backlog) ....................................................... 5
  Figure 3: New contracts received for review ........................................................... 5
  Figure 4: Total contracts reviewed ............................................................................ 6
Appendix A: June 26, 2017 letter .................................................................................... 8
Executive Summary

Introduction

Washington State law requires the Department of Labor & Industries (L&I) and other public agencies to withhold final payment (retainage) on a public works contract until confirmation is received that all taxes and industrial insurance premiums due for the work have been paid. L&I’s review and release of retainage directly supports the workers’ compensation system that covers 2.8 million workers and 177,000 employers by leveling the playing field when public funds are used on improvement projects. During Fiscal Year (FY) 2017, these reviews resulted in 390 compliance actions for misclassified, underreported, or unpaid workers’ compensation premiums, leading to the recovery of $2.2 million thus far.

In a June 26, 2017 letter to L&I Director Joel Sacks (Appendix A), Senator Baumgartner and Representatives Sells and Manweller expressed concerns that L&I’s release of retainage took too long and had too many contracts pending for review. The letter asked L&I to take steps to eliminate this backlog and reduce the average approval timeline for release to 60 days. It also requested that L&I provide a report on three items:

1. Steps the department is taking to improve timeliness and eliminate the backlog.
2. Improvements to date on the average approval time and size of backlog.
3. A long-term strategy to maintain an average approval time of less than 60 days with minimal backlog.

Retainage release improvements, results, and long-term strategy

Over the past 12 months, L&I’s Contract Release program has made technology changes and a staffing adjustment to streamline processes and make it easier for public works customers – awarding agencies, prime contractors, agency staff and the State Auditor’s Office – to work with L&I.

Before L&I made these improvements, average release times were as high as 110 days, and the number of contracts pending review – the backlog – was as high as 1,100 contracts. As a result of the improvements, the average number of days to issue the certificate of retainage release for May and June 2017 was reduced to under 60 days. July’s average days to release was under 45 days. As of July 31, 2017, the current inventory of projects awaiting retainage release was just shy of 300 projects – the lowest number since the program began in 2009.

As part of a long-term strategy, L&I has also identified additional system improvements that would reduce misclassification errors and improve communication tools to quickly resolve compliance issues and maintain a lower number of releases awaiting approval.
Introduction

Since 1992, retainage has been required on all Washington State public improvement contracts to help protect public funds by providing both a financial incentive to complete the project, and readily available funds to pay any defaults on the contractor’s behalf. In 2009, passage of House Bill (HB) 1555 added L&I as a lien priority to the retainage requirements under Chapter 60.28 RCW to protect workers’ compensation funds.

The Department of Labor & Industries (L&I) is pleased to provide this report as requested by Senator Baumgartner and Representatives Sells and Manweller in a June 26, 2017 letter to L&I Director Joel Sacks (Appendix A). The letter addressed concerns regarding L&I’s release of retainage and asked L&I to take steps to eliminate the backlog and reduce the average approval timeline for release to 60 days. It also requested that L&I provide a report on three items:

1. Steps the department is taking to improve timeliness and eliminate the backlog.

2. Improvements to date on the average approval time and size of backlog.

3. A long-term strategy to maintain an average approval time of less than 60 days with minimal backlog.
Information Requested by the Legislature

**IMPROVE TIMELINESS AND REDUCE BACKLOG**

L&I has taken several steps to improve timeliness and reduce the backlog of contracts awaiting review. Over the past 12 months, L&I’s Contract Release program has made technology changes and a staffing adjustment to streamline processes and make it easier for public works customers – including awarding agencies, prime contractors, agency staff and the State Auditor’s Office – to work with L&I.

In January 2017, L&I temporarily moved one full-time staff member to assist with reducing release times and minimizing the backlog. In May 2017, with the help of FY 2017 supplemental funding, the new Retainage Overview Analysis and Release (ROAR) system was implemented, along with other improvements to streamline the review and release of retainage on public works projects. ROAR enabled electronic entry of contracts into L&I’s system, eliminating 90 percent of hand entry. This allowed L&I to focus more staff time on reviewing and releasing contracts. ROAR also created a more efficient system for contract review by integrating all the needed information for review into one place.

As a result of these efforts, the average number of days to retainage release for May and June 2017 was reduced to under 60 days from as high as 110 days, as described in the next section. July’s average days to release was under 45 days. As of July 31, 2017, the current inventory of projects awaiting retainage release was just shy of 300 projects – the lowest number since the program began in 2009.

L&I is confident that, with these improvements, release times will continue to be less than 60 days.

**REDUCE AVERAGE APPROVAL TIME AND SIZE OF BACKLOG**

Customers and stakeholders are already beginning to see the results of L&I’s efforts to reduce average approve time and number of contracts needing review.

**Average number of days to release retainage**

The average number of days to release retainage has ranged from as low as 44 days to as high as 110 days over the last two fiscal years. The large disparity in these numbers is due to several factors, including the construction cycle, staff turnover, and the number of contractor accounts to be reviewed on a project – which can range from one to over 150. It is important to note that the reported average number of days to release is an overall average. The monthly average can sometimes become inflated if older contracts requiring an audit due to compliance issues are subsequently appealed, which can delay release by as much as 600 to 800 days.
As shown in Figure 1, the addition of a full-time equivalent (FTE) position and the implementation of the new ROAR system have been yielding positive results, with the average number of days to release below 60 days for both May and June 2017. Though not shown in the graph, in July 2017 the average number of days to release was below 45 days.

In addition to enabling electronic entry of contracts and creating a more efficient system for contract review, the new ROAR system will now allow L&I to report median number of days as well as average number of days. This will help the agency track and monitor contracts with compliance issues versus those without issues, and provide more detailed data on the number of days to release.

**Figure 1: Average days to release retainage**

![Figure 1: Average days to release retainage](image)

Source: L&I LINIIS and ROAR Data

Although there was only a small increase in the number of contracts L&I received during FY 2017, the value of the contracts needing review increased significantly. In FY 2016, the three-person Contract Release program reviewed just under 4,000 contracts with a total contract value of $4.9 billion; in FY 2017, the four-person program (3.5 FTEs on average for the year) reviewed 4,220 contracts with a total contract value of $7.6 billion.

**Backlog (inventory of contracts awaiting review and approval for release)**

The Contract Release program’s inventory of contracts awaiting review and approval for release fluctuates along with the cycle of construction activity; backlog decreases during the summer months while public works projects are underway, and increases as projects are completed and payment is sought in the winter and at the end of the year.

Figure 2 compares the number of contracts awaiting release during FY 2016 and FY 2017. In FY 2016, backlog increased steadily from a low of 338 contracts to a high in March of over 1,100 contracts. In FY 2017, backlog decreased from a high of over 1,400 in December to 419 in June. L&I’s improvement efforts dramatically decreased inventory by 68 percent between January and June of 2017, and the downward trend continues.
Figures 3 and 4 show comparisons for FY 2016 and FY 2017 regarding the number of contracts received, the value of contracts reviewed, and the additional Industrial Insurance premiums identified and collected during L&I’s reviews. All three increased, with the value of the contracts nearly doubling. As a result, workload, as measured in contract dollar value and number of contracts reviewed, also continues to increase. However, with the addition of one full-time staff member, the department is confident release times will continue to be less than 60 days.

Source: L&I LINIIS and ROAR Data
Figure 4: Total contracts reviewed

<table>
<thead>
<tr>
<th></th>
<th>Total Contract Value</th>
<th>Contracts Reviewed</th>
<th>$ Collected to Date*</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 2016</td>
<td>$4.9 Billion</td>
<td>3,967</td>
<td>$1.2 Million</td>
</tr>
<tr>
<td>FY 2017</td>
<td>$7.6 Billion</td>
<td>4,220</td>
<td>$2.2 Million</td>
</tr>
</tbody>
</table>

Source: L&I LINIS and ROAR Data

*Note: Dollars collected for Industrial Insurance premium audits, balances due, and penalties continue to increase as identified dollars owing are collected.

DEVELOP A LONG-TERM STRATEGY

Legislators also requested that L&I identify “a long-term strategy to maintain an average approval time of less than 60 days with minimal backlog.” Adding a staff person helped meet the immediate need to release retainage more quickly. Systematic changes have also helped reduce both the backlog and the length of time for retainage release. Additional systematic changes would continue to maintain these improvements.

Supplemental funding L&I received in FY 2016 and 2017 laid the groundwork for the new ROAR system and allowed its implementation. Through development of this system and process studies, the agency has identified additional process improvements that, if funded and fully implemented, would help sustain an average retainage release time of less than 60 days, while also maintaining a low inventory of projects. Process studies showed that, often, when a contractor ends up in an audit situation that delays release of retainage, it is because they were paying their workers’ compensation in the wrong risk class. L&I may request funding to develop an information technology tool to help contractors ensure they are paying their workers’ compensation insurance in the correct risk class at the beginning of their project – thus preventing retainage release delays at the end of the project because they paid the incorrect insurance rate. The tool, if approved by the Governor and legislature and fully funded and implemented, would correlate a contractor’s identified scopes of work for a project with all of the potential associated insurance risk classes, and issue an alert if the needed risk class were not included on the account.

L&I recommends continuing process studies to explore further technology improvement strategies to reduce misclassification errors and improve communication tools. Further technology improvements would help the agency more quickly resolve compliance issues, which will continue to reduce the average number of days to release retainage and make it easier to do business with L&I.

L&I may also request Governor approval to seek funding from the legislature to provide dedicated, targeted resources to educate awarding agencies and contractors about their rights, responsibilities, and liabilities when participating on public works projects. This education would include a demonstration of new tools that allow both awarding agencies and contractors to monitor their performance during a project, enabling them to immediately identify and minimize issues that can stall the timely release of retainage during closeout of the project.
Conclusion

Senator Baumgartner and Representatives Sells and Manweller asked L&I to take steps to eliminate the retainage release backlog and reduce the average approval timeline for release to 60 days. Over the past 12 months, L&I’s Contract Release program has made technology changes and a staffing adjustment to streamline processes and make it easier for public works customers – awarding agencies, prime contractors, agency staff and the State Auditor’s Office – to work with L&I. This has resulted in a reduction in the average number of days to release retainage from more than 110 to less than 60 days, with a low of 45 days. In addition, the backlog of contracts has been reduced from a high of 1,100 to just short of 300.

As part of a long-term strategy, L&I has identified and may pursue additional system improvements that will help sustain an average retainage release time of less than 60 days, while also maintaining a low inventory of projects. The agency has also performed process studies, which have identified ways to assist contractors at the beginning of their public works projects to prevent retainage release delays at the end of the project.

L&I is confident that these improvements will result in more timely release of retainage and reduced backlog of contracts. Additional changes, as part of a longer-term strategy, will help sustain an average retainage release time of less than 60 days, while also maintaining a low inventory of projects.
June 26th, 2017

Director Sacks,

As you know, for public works projects costing $35,000 or more, state law requires public agencies to withhold 5% of the contract amount until it is demonstrated that all contractors on the project have paid the appropriate prevailing wages and state taxes, including workers’ compensation and unemployment insurance premiums.

RCW 60.28.011(3)(b) states, “Sixty days after completion of all contract work the public body must release and pay in full the amounts retained during the performance of the contract subject to the provisions of chapters 39.12 and 60.28 RCW.” Thus, the public body has an obligation to release retainage 60 days after contract completion, but in order to meet this obligation it requires timely approval for the release of retainage from the state Department of Revenue (DOR), Employment Security Department (ESD) and Department of Labor and Industries (L&I).

It has been brought to our attention that L&I historically has taken more than 90 days on average to approve and release retainage and has had a backlog of as many as 1000 retainage release requests to be processed. We request that the Department take steps to eliminate this backlog and reduce the average approval timeline to 60 days. We further request that the Department report to us by September 31, 2017: 1) the steps it is taking to improve the timeliness of retainage release approvals and the elimination of the backlog, 2) the improvements to date of the average approval time and the size of the backlog, and 3) its long-term strategy for maintaining an average approval timeline of 60 days with a minimal backlog.

Thank you for your attention to this matter.

Mike Sells, State Representative 38th Legislative District

Michael Baumgartner, State Senator 6th Legislative District
Matt Menwell, State Representative
13th Legislative District