
An Audit of Hawaii's Implementation of the New Procurement Law

A Report to the
Governor
and the
Legislature of
the State of
Hawai'i

Report No. 95-8
February 1995



THE AUDITOR
STATE OF HAWAI'I

Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawai'i State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. Financial audits attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.
2. Management audits, which are also referred to as performance audits, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called program audits, when they focus on whether programs are attaining the objectives and results expected of them, and operations audits, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.
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5. Health insurance analyses examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.
6. Analyses of proposed special funds and existing trust and revolving funds determine if proposals to establish these funds are existing funds meet legislative criteria.
7. Procurement compliance audits and other procurement-related monitoring assist the Legislature in overseeing government procurement practices.
8. Fiscal accountability reports analyze expenditures by the state Department of Education in various areas.
9. Special studies respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

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OVERVIEW

THE AUDITOR
STATE OF HAWAII

An Audit of Hawaii's Implementation of the New Procurement Law

Summary

In response to a procurement code that was old, fragmented, and unclear, the 1993 Legislature, in Act 8 of the 1993 Special Session, passed a comprehensive procurement code for the State of Hawaii. The new law, Chapter 103D, HRS, which was based on the framework provided by the American Bar Association's *Model Procurement Code for State and Local Governments*, was enacted to increase competition, ensure fairness, and establish greater uniformity in the purchase of goods and services by the State and counties. The law also established a procurement compliance audit unit in the Office of the Auditor.

We found that the administration has been slow in implementing the procurement code and has not taken the necessary steps to ensure effective implementation. The late start of the Procurement Policy Office without appropriate staff has limited the ability of the policy board to carry out its responsibilities. Furthermore, the late appointment of the interim administrator of the Procurement Office delayed development of an on-going training program, procurement manual, and a periodic review of the procurement process. Because rules were issued late and insufficient attention was paid to interpreting the law and communicating the rules clearly, we found a number of instances of noncompliance and confusion about the law and rules.

We also found that State and county departments and agencies followed questionable practices in three areas. First, small purchase policies vary among agencies. Second, to avoid formal competitive bids required for purchases of goods and services over \$10,000, agencies are improperly breaking up purchases into amounts below \$10,000, commonly known as "parceling." Finally, to avoid use of competitive sealed proposals to procure professional services, agencies are using the alternate list method of selection with questionable justification.

The new procurement organization structure is ineffective with conflicting and unclear roles and responsibilities. The division of responsibility and authority between the administrator and the policy office is not clear in law or practice. Both have a responsibility to audit procurement practices. In addition, we found that the administrator has conflicting roles as the chief procurement officer (CPO) for the Executive Branch and as the individual responsible for reviewing procurement practices of all governmental agencies.

Recommendations and Response

We recommend that the Procurement Policy Board and the Procurement Office be consolidated as a central authority to issue rules, interpret the procurement law and rules, and audit, monitor, and enforce its implementation.



We believe that Chapter 103D, HRS, should be amended to eliminate the designated chief procurement officers, and have the comptroller designate procurement officers for the executive branch and have the heads of the Judiciary, the Legislature, and counties designate their respective chief procurement officers. The statute should also be amended to require the administrator to issue delegations of purchasing authority.

We also recommend that the new Procurement Office establish formal written procedures to follow when clarification and interpretation of the procurement law and rules are required, and immediately develop a procurement training program specifically on the new Hawaii law and rules. The Procurement Office should amend the rules to prohibit the creation of different thresholds within the small purchase limits and specify quotation methods. Finally, the Procurement Office should develop a procurement manual with standardized forms for the source selection methods and investigate noncompliance in procurement practices.

The Procurement Policy Board agrees with our recommendation to consolidate the Policy Board and the Procurement Office. The board believes that standardized forms would conflict with each jurisdiction's unique roles and functions. Also, the board disagrees that it should prohibit the creation of different thresholds within the small purchase limits and specify quotation methods. The board agrees that the new Procurement Office should develop procurement training programs and investigate noncompliance of procurement problems and issues.

The interim administrator agrees that the law's early effective date allowed little time to plan for proper implementation of the law. He agrees on the need for contractual consistency, an expedited training program, and new procurement manuals and vendor guides.

The City and County of Honolulu commented on delegation of purchasing authority, sole source purchases, procurement of professional services, and small purchase requirements.

The Division of Community Hospitals responded that it developed division guidelines with no "lead time" in compliance with the law. The division also says it has implemented training sessions, developed its own policy and procedures manuals, and established communication linkage with facilities. The division is seeking a waiver to Chapter 103D, HRS, for the procurement of pharmaceutical drugs, and other medical supplies.

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Submitted by

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Foreword

This report was prepared in response to Chapter 103D, HRS, which establishes a procurement compliance audit unit within the Office of the Auditor and requires the unit to review the adequacy of procurement under the new code and rules.

We wish to acknowledge the cooperation and assistance extended to us by the officials and staff of the Procurement Policy Office, the State Procurement Office, the Department of Education, the Judiciary, the University of Hawaii, the City and County of Honolulu, the Department of Defense, and the Division of Community Hospitals within the Department of Health.

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Chapter 1

Introduction

With increasing public concern over a procurement code that was old, fragmented, and unclear, the Legislature in Act 8 of the 1993 Special Session passed a new Hawaii Public Procurement Code (codified as Chapter 103D, Hawaii Revised Statutes). The new code is based on the *Model Procurement Code for State and Local Governments* developed by the American Bar Association (ABA). The ABA model code is used as a basis for the procurement laws of numerous other jurisdictions nationwide. In enacting the code, the Legislature sought to increase competition, ensure fairness, and establish greater uniformity in the purchase of goods and services by the State and counties.

Background

To implement procurement policy and practice, the Hawaii Public Procurement Code created a new organizational structure comprised of a Procurement Policy Office and a Procurement Office within the Department of Accounting and General Services (DAGS) and 16 chief procurement officers for various agencies and governmental units within the state. The code also established a Compliance Audit Unit within the Office of the Auditor.

Procurement Policy Office

The policy office is an autonomous unit assigned to DAGS for administrative purposes. The office is primarily responsible for establishing rules to govern the procurement, management, control, and disposal of any goods, services, and construction consistent with Chapter 103D, HRS. The policy office decides on matters of policy. The policy office also has the authority to audit and monitor the implementation of the law and its rules.

The policy office is comprised of five members:

- The comptroller.
- A county employee with significant high-level procurement experience.
- Three persons who are not employees of, or contractors with, the State or any county. At least one shall be a certified professional in procurement, and at least one shall have significant high-level, federal procurement experience.

The chair of the policy office is elected annually by a majority of the members—the comptroller is not eligible to serve as the chair. DAGS must staff the board. It must provide at least one full-time support staff and funding for the policy office.

Procurement Office

The procurement code also established a separate Procurement Office within DAGS with line responsibilities for procurement. The office is headed by an administrator who is also the chief procurement officer for the executive branch except for the University of Hawaii and the Department of Education.

To ensure the independence and technical competence of the administrator, the procurement code sets forth a number of provisions. The governor, with the advice and consent of the Senate, is to appoint the administrator from a list of no less than three and no more than five names submitted by the policy office. The administrator is appointed for a term of four years and may be removed only by the governor with prior notification to the chair of the policy office, the president of the Senate, and the speaker of the House.

The administrator is part of the Office of the Comptroller but operates independently of the comptroller and has final authority over all procurement operations. Finally, the administrator must have five years of experience in public procurement within twelve years preceding the date of appointment. The administrator must also have demonstrated executive and organizational ability.

Chief procurement officers

The chief procurement officers are the central procurement authorities for their respective jurisdictions. They are responsible for implementing procurement in compliance with the law and rules. They procure or supervise procurement for all goods, services, and construction; supervise and control inventories of goods; sell, trade or dispose of surplus goods; and establish programs for inspecting, testing, and accepting goods, services, and construction.

The 16 entities and their respective chief procurement officers are as follows:

- Judiciary—administrative director of the courts
- Senate—president of the Senate
- House of Representatives—speaker of the House
- Office of Hawaiian Affairs—Board of Trustees

- Counties—respective finance directors for the executive branches and respective chairpersons of the councils for the legislative branches.
- University of Hawaii—president of the university
- Department of Education—superintendent of education
- Division of Community Hospitals—deputy director for community hospitals
- Remaining executive agencies and governmental bodies—administrator of the Procurement Office

Compliance Audit Unit

The procurement code also established a Compliance Audit Unit within the Office of the Auditor with responsibilities to:

- Periodically review and audit procurement practices within government for compliance with the law and all applicable rules;
- Advocate competition, fairness, and accountability in the procurement process;
- Review and assess applicable innovations in procurement methods or processes;
- Review statutes and rules to determine whether they promote fairness, efficiency, and accountability in the procurement process;
- Review selected contracts awarded;
- Conduct studies, research, analyses, and make reports and recommendations;
- Establish a procurement library;
- Report to the appropriate agency and chief procurement officer on areas of noncompliance and recommendations for remedial action; and
- Be present at legislative hearings and policy meetings to present the findings of the audit.

This is the first of the compliance audit reports that the Office of the Auditor will be issuing under its responsibilities for reviewing the

adequacy of procurement under the new code and rules. The code took effect on July 1, 1994. In this initial report, we focused on the adequacy with which the Procurement Policy Office and the Procurement Office have initiated implementation of the code. We also sampled procurement practices at three agencies to assess the impact of the new code. Our objectives are specified below.

Objectives of the Audit

1. Determine whether the rules, regulations, requirements, policies, and procedures of the new procurement code, Chapter 103D, HRS, are being adequately and effectively implemented by the Procurement Policy Office, administrator of the Procurement Office, and chief procurement officers.
2. Review and evaluate whether the Division of Community Hospitals within the Department of Health, the Department of Defense, and the City and County of Honolulu are procuring goods and services in compliance with the new procurement law, rules, policies, and procedures.
3. Make recommendations based on the audit's findings.

Scope and Methodology

The audit focused on the adequacy and effectiveness with which the new procurement code is being implemented by components of the new organization for procurement. We interviewed all members of the Procurement Policy Office, the administrator of the Procurement Office, a sample of chief procurement officers, and several fiscal administrators who have been delegated authority for procurement for their respective jurisdictions by their chief procurement officers.

We reviewed laws, rules, minutes of meetings, policies and procedures. We sampled procurement practices at the Division of Community Hospitals of the Department of Health, Department of Defense, and the City and County of Honolulu by reviewing their contract files, expenditure reports, and fiscal documents.

Our work was performed from August through December 1994 in accordance with generally accepted government auditing standards.

Chapter 2

Implementation of the New Procurement Law

In this chapter we assess the adequacy and effectiveness with which the responsible bodies—the Procurement Policy Office, the Procurement Office, and the chief procurement officers (CPOs) — have implemented the Hawaii Public Procurement Code. We find that insufficient attention and support has been given to proper implementation of the code. We also note some ambiguities in the code that warrant correction and make recommendations for changes and improvements.

Summary of Findings

1. The administration has been slow in implementing the procurement code and has not taken the necessary steps to ensure that the code will be implemented effectively.
2. The procurement organizational structure is ineffective with conflicting and unclear roles and responsibilities.
3. State and county departments and agencies are following questionable practices and appear to be violating the procurement law and rules. More specifically:
 - a. Policies and procedures on small purchases are unclear and inadequate.
 - b. Sole source purchases appear to violate law, eliminate competition, and result in added costs.
 - c. Emergency purchases appear to violate law.
 - d. Laws and rules against parceling of purchases are being circumvented.
 - e. Professional services are being procured in apparent violation of the law and rules.

Timely and Effective Steps Were Not Taken to Implement the Procurement Code

The procurement code was signed into law in October 1993, to be effective on July 1, 1994. This left little time to plan for proper implementation of the law. In addition, timely actions were not taken to establish and staff the bodies that would implement the law.

The policy office was established late

The procurement code established a Procurement Policy Office consisting of a five-member policy board. The policy office is primarily responsible for establishing rules to govern the procurement, management, control, and disposal of goods, services, and construction. In addition, it has the power to audit and monitor the implementation of its rules. The chair and members of the board also believe that they have the responsibility to interpret the law for chief procurement officers and to function as a clearing house for problems.

However, the office was established late and has been without appropriate staff. The governor did not appoint members to the policy board until April 1994—just three months before the law became effective. In addition, the board has been working without sufficient staff support from the Department of Accounting and General Services (DAGS). Most of the staff support has been come from existing DAGS staff who have added the duties of the policy office to their other duties and responsibilities. This has limited the ability of the policy board to carry out its responsibilities.

Untimely rules

The procurement law establishes statewide policy. Rules are governing precepts and procedures that prescribe the conditions and manner of implementing the law. Rules should guide departments and agencies in carrying out actual purchasing activities in accordance with the law.

The five-member policy office held its first meeting on May 10, 1994. At that meeting, members of the board organized and discussed the urgent need for interim procurement rules and regulations to meet the July 1, 1994, implementation date of the new law.

The board's late start effectively prevented it from participating actively in developing rules to guide implementation of the new law. The new rules are mostly the work of staff of the DAGS and the Department of the Attorney General. The rules were issued too late to be effectively implemented by July 1, 1994.

The board issued the interim rules on June 16, 1994. With only two weeks to implement a new procurement code that had made significant and comprehensive revisions to the existing law, CPOs were left generally confused and without clear understanding of the requirements of the law and rules. The policy office also had no time to put in place a formal communication system for conferring with CPOs or to respond to their concerns about how to implement the code.

The late issue date of the interim rules also made it difficult for CPOs to amend their individual procurement procedures and manuals in a timely

manner. CPOs are amending their procurement policies and procedures incrementally as they become more familiar with and understand the requirements of the new law. Several CPOs have made only marginal changes in existing policies and procedures, while others have issued entire new manuals. Furthermore, several CPOs have made no changes to any of their policies and procedures while one CPO did not know that interim rules existed.

Poor communications with CPOs

The policy office has been able to dedicate only a single board meeting to discuss with the chief procurement officers the implementation of the new law. This was scheduled on June 28, 1994 — less than a week before the effective start date of the new law. At this meeting, the chairman of the policy office introduced the new interim administrator of the Procurement Office and discussed functional roles and responsibilities. The meeting also covered the implementation of the interim procurement rules and regulations that had just been issued to CPOs.

The policy office is having a difficult time interpreting laws and rules for CPOs. Having had only a single meeting with CPOs, it is receiving a multitude of questions from CPOs and their delegated agents that it cannot respond to in a timely manner. The policy office has no formal and consistent communication system in place for CPOs to query issues, problems and concerns. Confusion, uncertainty, and misunderstanding of the law and rules are occurring and purchasing activities are frequently based on each individual CPO's idea, interpretation, and history.

Resulting noncompliance

Because rules were issued late and insufficient attention was paid to interpreting the law and communicating the rules clearly, we found a number of instances of noncompliance or confusion about the law and rules. For example, we found that:

- The executive branch, City and County of Honolulu, and the Department of Education (DOE) have not completed the written delegation of procurement authority in accordance with the rules.
- The executive branch and the DOE have not developed standard forms to ensure compliance with the law and rules.
- The administrator of the Office of Hawaiian Affairs was unaware that interim rules had been issued.

- The Department of Defense and Maui Memorial Hospital failed to implement requirements for small purchases until several months after the effective date of the law.

Disregarded policy office functions

The late start also delayed implementation of programs for other policy office functions and responsibilities. For example, the policy office has not established policies and procedures to audit and monitor the performance of chief procurement officers. Without policies and procedures, the policy office has no basis for periodically reviewing and overseeing procurement practices at all jurisdictions.

Procurement Office was also set back

The late start of the policy office had a domino effect. Proper establishment of the Procurement Office was also delayed.

Section 103D-204, HRS, established a Procurement Office within DAGS headed by an administrator. The administrator has final authority over all procurement operations and serves as the chief procurement officer for the state executive branch departments except for the University of Hawaii (UH) and the DOE. The administrator is also responsible for periodically reviewing procurement practices, developing and administering procurement orientation and training, and developing a procurement manual for procurement officials. In addition, the administrator is responsible for issuing formal policies and procedures to clarify and interpret the law and rules.

The many responsibilities of the administrator make that appointment key to implementing the new code. However, appointment of an administrator to the Procurement Office was also delayed.

No official administrator

The administrator of the Procurement Office is supposed to be appointed by the governor from a list submitted by the policy office. This was not done. In view of its late start and the impending implementation date of the new law, the policy office decided to name an interim administrator to the Procurement Office. It planned to conduct a thorough recruitment later for a permanent administrator. The policy office recommended an interim administrator to the governor in June 1994, who was officially approved on July 1, 1994—the effective start of the new procurement law.

The late appointment of the interim administrator of the Procurement Office in turn delayed development of an on-going training program, procurement manual, vendor's guide, and a periodic review process. The administrator has had only two informal meetings with the CPOs to discuss problems with implementing the law and rules.

Other neglected functions

In addition, the Procurement Office has not issued policies or procedures or conducted training specifically on the new Hawaii law. Departments and agencies are thus left to interpret the rules and regulations with no authoritative guidance.

CPOs are currently operating without a state procurement manual to explain, define, and clarify the law and rules. This means that rules are being applied in an inconsistent manner. Since no standard or recommended forms have been developed, CPOs are modifying procurement forms on their own to conform with their individual interpretation of the rules. Moreover, CPOs have revised or developed new policies and procedures that have not been reviewed for propriety, consistency, and uniformity by the administrator of the Procurement Office.

The impact of the late start of the policy office, the late appointment of the administrator of the Procurement Office, the late issue of the interim procurement rules, and the failure to carry out other needed functions have all contributed to confusion and lack of understanding of the new law.

Confusion and misunderstanding of the law and rules

The CPOs we interviewed have indicated a need for clear policies and procedures on the interim rules. CPOs frequently contact the Procurement Office administrator and DAGS purchasing staff on an informal basis for clarification and interpretation of the rules; however, no policies and procedures are available that formally clarify or interpret the code and rules. The policy office and the Procurement Office administrator have not established written policies and procedures on how CPOs should request interpretations of the law and rules.

CPOs have addressed problems and questions on the law and rules directly to the policy office, the Procurement Office administrator, DAGS staff, and the attorney general's office using such formats as memorandums, letters, telephone conversations, and meetings. CPOs have complained that there is no communication process in place that establishes the line of authority or the procedures to follow in resolving procurement issues.

Also, no central authority or compilation of decisions is available so that all CPOs are aware of prior determinations by the policy office. Telephone conversations and informal meetings between CPOs and the administrator, the comptroller of the State, and DAGS lack written follow up. The files of the administrator and the CPOs contain no letters, memoranda, or meeting minutes verifying and documenting various interpretations of the procurement law.

When the interim rules were issued in June 1994, the CPOs were instructed to interpret the rules and the new law and apply them to their own situations. In response, several CPOs wrote new policy and procedure manuals, some issued directives, some held training classes, and some are waiting for more direction before making major changes to their procurement procedures and operations. The policy office and the administrator have not reviewed or approved these various interpretations and practices. Currently, agencies are following a variety of policies for small purchases because of individual interpretations by CPOs. In addition, sole source logs from various CPOs indicate significant differences in their interpretations of the “uniqueness” rule that permits agencies to make sole source purchases. These various interpretations result in uneven and inconsistent application of the law.

The administrator of the Procurement Office plans to develop a policy and operations manual. But in the interim, some preliminary guidelines would be very helpful to CPOs in understanding and resolving common procurement problems and issues.

Delays in obtaining decisions

CPOs and their procurement staff need timely answers to their questions on the law and rules. Timely responses would help their agencies to meet their operational and program needs. The lack of a formal method and procedure for processing procurement questions has resulted in agency delays in selecting professional consultants and in the CPOs’ use of questionable procurement source methods. For example, questionable sole source and emergency purchases have been used to purchase drugs and food products while CPOs await interpretations and determinations by the policy office and the administrator.

No training sessions on the law and interim rules

The Procurement Office administrator is also responsible for training CPOs and their staffs. Training sessions are needed to establish and enforce uniform operations in a procurement system.

Procurement functions in agencies operate at numerous locations and levels. For example, at the Division of Community Hospitals, each hospital procures its own goods and services. Procurement at the University of Hawaii is done by approximately 60 fiscal officers located through the university system. Some officers have their own staff.

The Department of Human Resources Development has conducted two procurement seminars since the implementation of the new law. The seminars were conducted by the National Institute of Government Purchasing for all state and county purchasing officers and staff. They

covered general procurement subjects but did not contain relevant training on the specific requirements of the Hawaii law and rules. To ensure uniform and proper procurement, ongoing training is needed on specific policies and procedures of the new law and rules.

Procurement Organization Is Flawed and Ineffective

The intent of the new procurement law was to establish an effective procurement organization that would operate with clear goals and qualified management free from the pressure of special interest groups. To this end, the law created a separate policy office that would be responsible for rules and have the power to audit and monitor their implementation. The law also created a Procurement Office to be headed by an administrator who would operate independently of the comptroller and have the final authority over all procurement operations. The administrator would also be the CPO for the executive branch (except the UH and DOE) and have the authority to review the procurement practices of all governmental bodies. In addition, the law created 16 CPOs who would each be responsible for procurement in their respective jurisdictions. For the procurement organization to be effective, the roles and responsibilities of each component of the organization must be distinct, clear, and not in conflict.

We believe that this is not the case with respect to the relationships of the administrator of the Procurement Office to the policy office and to the CPOs.

Administrator's relationship to policy office is unclear

The division of responsibility and authority between the administrator and the policy office is not clear in law or practice. Both have a responsibility to audit procurement practices. The policy office is empowered to adopt rules and consider and decide on matters of policy. The administrator also is required to perform periodic review of the procurement practices of all governmental bodies and advise and guide them.

In practice the administrator interprets the law and rules on a daily basis since the policy office board meets only once or twice per month to review and rule on interpretations of the law and rules.

We believe that responsibilities would be clearer if the Procurement Policy Office and the Procurement Office were consolidated. The consolidation would improve procurement in a number of ways.

Consolidation would result in a single Procurement Office that would be staffed by an administrator who reports to a procurement board—the current policy office board. The board would retain responsibilities to

recommend a candidate for administrator to the governor. The office through the administrator would also be responsible for auditing and monitoring the procurement activities of all governmental units. This would remove the duplication between the responsibility of the policy office to audit and that of the Procurement Office to review. The consolidation would also eliminate confusion among CPOs as to whom to consult and who is the authority for interpretations of the law and rules.

Consolidating the two offices would also be in line with the intent of the model code of the American Bar Association—the basis for Hawaii’s new code. Procurement organization in the model code embodies two basic concepts. First, it centralizes procurement authority and second, it separates the operational function from the policy-making function. The model code creates an independent procurement policy office to promulgate rules, audit, and monitor procurement activities. It creates a chief procurement officer who delegates procurement authority to user agencies.

Administrator has conflicting responsibilities

The administrator of the Procurement Office is the CPO for the Executive Branch. The administrator is also responsible for reviewing the practices of all governmental bodies. The two roles conflict. Management principles of separation of duties and responsibilities require that the administrator not be responsible for reviewing his own decisions as CPO of the executive branch.

The administrator is also responsible for reviewing the activities of all other CPOs. This again is a conflict since the administrator must also review, advise, and interpret the law and rules for all CPOs. This places the administrator in the untenable position of having to oversee the procurement practices of CPOs and their staff that the administrator advises and assists.

Weak enforcement authority

Finally, the law is weak in terms of enforcement. Section 103D-106, HRS, makes violations of law a misdemeanor but does not specify who has the power to impose penalties. Section 103D-207, HRS, empowers CPOs with all procurement authority. The rules assign CPOs the power to impose penalties. This results in the administrator having no direct authority over CPOs to improve their procurement practices and enforce compliance with the rules and code. It is also unlikely that CPOs would impose penalties on their own staff who they are responsible for supervising. We believe that the power to penalize should be associated with the power to audit and monitor. The new consolidated procurement office and its administrator should be given this power by law.

Current delegations are inappropriate

The CPOs by law are generally the director and chief executive officer of their respective government jurisdiction or agency. Their procurement qualifications, education, and experience are not specified in the law or administrative rules. Their lack of procurement experience and their primary responsibilities as head of a department may require them to delegate their procurement responsibilities to staff.

Although the delegated procurement staffs report to their respective CPO, much of their operational directions and guidance come from the administrator of the Procurement Office and the policy office. This conflicting and unclear authority structure creates ineffective and inefficient operations where problems result in noncompliance or circumvention of the law.

The procurement structure recommended by the American Bar Association's Model Procurement Code is to have the administrator of a state procurement office decide on and delegate purchasing authority to procurement officers in government agencies and jurisdictions. This delegation would insure that the highest level official responsible for procurement would receive the necessary delegated procurement authority for the official's respective jurisdiction, agency, or department.

Instead of designating CPOs in the law, the law should be amended to allow the comptroller to designate chief procurement officers in the executive branch and have the heads of the Judiciary, the Legislature, and each of the counties designate their own chief procurement officers. These procurement officers would then have the necessary authority to make knowledgeable decisions without delay and would bring their procurement needs directly to the attention of the administrator of the Procurement Office. This method would have the added advantage of flexibility and allow the administrator to rescind the authority from those procurement officers who do not effectively comply with the law.

As the following section demonstrates, clearer authority over procurement practices and enforcement of the law is badly needed.

State and County Departments and Agencies Follow Questionable Practices

Our review of the procurement files of several agencies revealed inconsistent practices and a general lack of compliance with the new procurement law in three areas. First, small purchase policies vary among agencies. Second, to avoid formal competitive bids required for purchases of goods and services over \$10,000, agencies are improperly breaking up purchases into amounts below \$10,000, commonly known as "parceling." Finally, to avoid competitive sealed proposals in procuring professional services, agencies are using the alternate list method of selection on questionable grounds.

Small purchase policies and procedures vary among departments and agencies

We reviewed policies and procedures for small purchases at seven agencies and found them to be inconsistent. All agencies recognize the small purchase limits of \$10,000 for goods and services and \$25,000 for construction, but their thresholds within these purchase limits and specified quotation requirements varied significantly.

Significance of small purchase policy and threshold

Small purchase policies and procedures can be effective in minimizing administrative expenses and excessive management controls over small dollar purchases. Rules and procedures should not require formal competition but should preserve competition to the extent possible. They should also insure openness to any prospective vendor interested in doing business with government by affording them an equal opportunity to provide a quote on goods and services. The rules and procedures should at a minimum make explicit the principles governing evaluation of quotations for the different threshold levels within the \$10,000 ceiling.

Policies and practices vary among agencies

Section 103D-305, HRS, sets the small purchase limits of \$10,000 for goods and services, and \$25,000 for construction. Sections 3-122-75 and 3-122-76, HAR, require no quotation for less than \$1,000 purchase for goods and services, and \$4,000 purchase for construction. The sections require three quotations for the purchase between \$1,000 and \$10,000 for goods and services, and between \$4,000 and \$25,000 for construction. The rules do not specify any quotation method.

Exhibit 2.1 compares the small purchase policies of some of the agencies examined in our audit. They show threshold levels varying from under \$500 to under \$1000 for no quotes, thresholds of \$500 to \$4000 for oral quotes, and thresholds of up to \$10,000 for three quotes without specifying whether it should be oral or written.

Actual practices vary and have not been fully in compliance with the law. We found that the Department of Defense (DOD) and the Division of Community Hospitals failed to implement the three quotation small purchase requirement on a timely basis. The DOD delayed the implementation until late September 1994, while the Division of Community Hospitals introduced the small purchase requirements and standard reporting forms at a training session on August 15, 1994. We also found small purchases of construction materials were almost automatically exempted from the three quotation requirement at the DOD. The department justified not obtaining three quotations due to short notice in 13 out of 14 small construction purchases.

Exhibit 2.1
Comparison of Small Purchase Policies

Department/Agency	Goods & Services		Construction	
	\$ Threshold	Quotation Requirement	\$ Threshold	Quotation Requirement
Executive Branch	Under \$1,000	No Quotes	Under \$4,000	No Quotes
	\$1,000 - \$10,000	3 Quotes	\$4,000 - \$25,000	3 Quotes
Department of Education	Under \$1,000	No Quotes	Under \$4,000	No Quotes
	\$1,000 - \$10,000	3 Quotes	\$4,000 - \$25,000	3 Quotes
Judiciary	Under \$500	No Quotes	Under \$500	No Quotes
	\$500 - \$4,000	3 Written or Oral Quotes	\$500 - \$4,000	3 Written or Oral Quotes
	\$4,000 - \$10,000	3 Written Quotes	\$4,000 - \$25,000	3 Written Quotes
University of Hawaii	Under \$500	No Quotes	Under \$4,000	3 Quotes
	\$500 - \$4,000	3 Quotes	\$4,000 - \$25,000	3 Written Quotes
	\$4,000 - \$10,000	3 Written Quotes		
City and County of Honolulu	Under \$1,000	No Quotes	Under \$2,000	No Quotes
	\$1,000 - \$2,000	3 Quotes	\$2,000 - \$25,000	3 Quotes
	\$2,000 - \$10,000	3 Quotes		
Community Hospitals - DOH	Under \$1,000	No Quotes	Under \$4,000	No Quotes
	\$1,000 - \$4,000	3 Written or Oral Quotes	\$4,000 - \$25,000	3 Written Quotes
	\$4,000 - \$10,000	3 Written Quotes		

At the City and County of Honolulu, only 40 percent of the items selected for testing met the three quotation requirement. A small and limited market was the reason provided for not obtaining three quotes as required in their procurement rules and regulations.

One goal of the new law was to simplify procurement requirements for vendors. These differing thresholds and quotation methods for small purchases unnecessarily confuse and frustrate vendors. The law required the policy office to issue rules that would ensure administrative simplicity and practicable competition. So far, the rules offer no guidance on the need for additional threshold levels within the small purchase ceiling. The rules call for “three quotations” but it does not define what this requires. More guidance is needed on whether quotes can be verbal, written, or faxed. Lack of a common and mandatory written quotation form and definition results in inconsistent and inefficient small purchase practices by CPOs.

Questionable sole source purchases may be violating the law

During our audit, we noted several questionable purchases awarded as sole source in possible violation of the law. Sole source purchases that circumvent the law can result in excessive costs to the State and counties since they avoid the competitive bidding process. Use of the sole source method to circumvent the bidding process can result in increased cost.

Our audit found several questionable purchases and contracts as follows:

- City and County of Honolulu used the sole source method to award service contracts to the Hawaiian Humane Society to operate the city’s animal shelter and the spay and neuter program. The annual contracts totaled \$1,156,000 and \$527,000, respectively. Without formally bidding out the contracts, it is not known whether other veterinarian groups could have provided similar services at a more competitive price.
- The City and County of Honolulu also awarded two maintenance contracts totaling \$78,150 on a sole source basis to the Digital company for maintaining its computer equipment. The Digital company manufactures the equipment but is not the only source for maintenance services for such equipment. Other vendors could have been found to compete for maintenance service contracts.
- Maui Memorial Hospital used the sole source method in July 1994, to purchase pharmaceutical drugs totaling \$106,000 from a vendor even though it was aware that other vendors were available.

- DOE regularly uses the sole source method to acquire professional and technical services without reviewing the need for doing so. DOE processed 38 sole source contracts for June through September 1994, ranging in price from \$10,000 to \$734,000.

The new code allows sole source procurement only after a CPO makes a written determination that only a single source exists for the required good, service, or construction. Since the sole source method allows no competition, it should be restricted to circumstances that are sufficiently justified and necessary to meet the unique nature of the requirement, the supplier, or market conditions. CPOs must avoid making sole-source determinations without assessing whether competition exists. To ensure the most advantageous price, all agencies should solicit competitive bids whenever they are unsure of the sole source nature of a product or service.

Emergency purchases appear to violate law and rules

During our audit, we noted two examples where the Division of Community Hospitals made questionable emergency purchases in apparent violation of the law.

The law provides for emergency purchases when an urgent need is involved. Section 103D-307, HRS, authorizes the head of a purchasing agency to obtain a good, service, or construction essential to meet an emergency. The emergency procurement must be made with such competition as is practicable, and approval from the CPO should be obtained prior to the procurement when practicable.

The Division of Community Hospitals used the emergency procurement method to purchase routine pharmaceutical drugs for Maui Memorial Hospital without competition in August and September 1994. The purchases, which cost \$123,000 and \$150,000, respectively, were for normal, routine monthly pharmaceutical needs and not an emergency, unplanned condition.

Laws and rules against parceling are being circumvented

Procurement of goods and services above \$10,000 require competitive formal bids in accordance with the law. In our review, we found agencies circumvent this requirement by parceling large purchases into several smaller units of less than \$10,000. Parceling can reduce or eliminate competition for goods and services since it evades the formal, open, competitive bidding requirements of the law and rule. Section 103D-305, HRS, specifically prohibits this practice. The following are examples:

- Department of Defense parceled engineering services from a consulting engineer by processing payments for services totaling \$54,602 as small purchases below \$10,000. DOD had entered into a sole source, open-ended, informal agreement with the firm for professional services. Since the agreement was not a formal contract, the department made payments for partial services that were parceled as \$9,033.00 in small purchases.
- Division of Community Hospitals parceled physical therapy services. The purchase order log for Maui Memorial Hospital revealed that it hired a physical therapist for patient services through an open-ended agreement dated February 2, 1994. Based on this agreement, the hospital has made six payments totaling \$17,428 to one individual since July 1, 1994. Since this agreement was not a prior year contract exempt from the law, the hospital parceled the payments to avoid formal bidding requirements. For example, three purchase orders, all dated November 1, 1994, were issued in amounts totaling \$3,040, \$3,344, and \$3,648. These three purchase orders collectively totaled \$10,032 and exceeded the \$10,000 ceiling. As three purchase orders, each qualified as a small purchase under the law.
- Maui Memorial Hospital parceled purchases of drugs. Maui Memorial Hospital purchases over 90 percent of its medical drugs from one supplier. It has no formal contract with this supplier, only a three-year letter of agreement. Its drug purchases will exceed \$2,000,000 this fiscal year. Its current practice of procuring drugs in lots below \$10,000 from this supplier is parceling and circumvents the bidding requirements in the new law.
- Maui Memorial Hospital parcels purchases of food products. The hospital will purchase over \$300,000 worth of food using a Request For Quotes system. This informal quotation method uses the lowest price quote for a food item from a supplier as the basis for a small purchase award. Since the total amount purchased from most suppliers will exceed \$10,000 each year, the hospital must purchase these food items through formal advertised bids.

Professional services are not being procured in accordance with law and rules

The old procurement law permitted non-competitive selection of professional services under a “does not admit of competitive bidding” clause. Professional services were considered unique and special and therefore competition was not necessary. This lack of competition, however, had created a public perception of favoritism and cronyism — that professional services were being exchanged for political contributions.

The new procurement code requires professional services in excess of \$10,000 to be selected through a competitive process. The law recommends competitive sealed proposals as the source selection method, especially when price is neither the sole nor the most important evaluation criterion. The competitive sealed proposal method allows for flexibility. For example, in addition to price, it permits proposals to be evaluated on such judgmental criteria as professional experience, competency, and quality.

The Department of Education, the University of Hawaii, and other agencies continue to routinely use the sole source method to procure professional services with the rationale that services are “unique.” While we generally agree that noted speakers may be unique and justified for sole source procurement, we disagree with the use of sole source procurement by the DOE to hire educational specialists to conduct training for teachers.

We also found a number of other contracts that appear to circumvent the requirements for procuring professional services.

- The Department of Defense issued a letter of intent to a professional consultant on November 19, 1993, that promised to hire the firm as planner and designer for unspecified projects between July 1, 1993, and June 30, 1995. The total fees are not to exceed \$300,000. Since this letter is not a formal contract, its continued use as the basis for selecting this firm for professional services violates the requirements of the law.
- The Division of Community Hospitals on July 1, 1994, entered into a “does not admit of competitive bidding” contract for \$2,490,098 with a radiology consultant in questionable violation of the law and rules.

Use of alternate list method can circumvent the intent of the law

Agencies are attempting to use an alternate method that is not competitive. In addition to the competitive sealed proposal method, under certain circumstances, the law permits an alternate method—a pre-qualified list—to be used for selecting for professional services. CPOs must approve use of this alternate method and only after the department or agency has demonstrated the following:

- The purchasing agency has an adequate number of persons on the professional list from which to make selections.
- Negotiation would result in more advantageous prices for the State.

- The scope of work is not sufficiently defined to permit accurate price proposals.
- A claim of urgency is in fact justified.

The University of Hawaii recently advertised for professional services (mainly architects and engineers) in an attempt to develop a prequalified list for procuring professional services following the alternate list method in the rules. It received 174 applications. The process of reviewing, qualifying, approving, and ranking this large number of applicants is a daunting and time-consuming task.

Similarly, the Department of Waste Water Management, City and County of Honolulu, also advertised for professional engineering services in order to develop a prequalified list of professionals. It received many letters of interest for each of its 22 pending construction projects. The department is holding these 22 construction projects in abeyance because professional consultants have not been selected. Instead of issuing requests for proposals (RFPs) for these projects, the Wastewater Department received approval from its CPO to use the alternate list method of selecting a single professional for each project. We believe that the department's actions indicate general non-compliance with the intent of the rules regarding use of the alternate prequalified method.

In the first three months of FY1994-95, the executive branch CPO approved approximately 30 requests for using the alternate list method. The reasons stated on the requests were the urgency of the need and the difficulty in defining the professional services. Some of these were questionable.

The alternate list method of procuring professional services does not meet the objectives of open competition since the agency selects one professional from the list to negotiate each job or project. This appears to circumvent the open competitive process for procuring professional services. The use of this method should be limited to only emergency or urgent situations or conditions.

Moreover, our review indicates that this method may circumvent competition if the person or group making the selection does not maintain "an arm's length" distance in the process.

Advantages of competitive sealed proposals

We found that the CPOs we interviewed have generally been reluctant to use the competitive sealed proposal method because they lack experience and understanding of the process. They believe the process takes longer to complete and fear complaints and protests from vendors on the selection criteria used to evaluate and award winning proposals.

The competitive sealed proposal method of source selection has a number of advantages. First, the scoring, interview, and negotiation process permits an in-depth analysis of every candidate's qualification and capabilities to do the job. Second, the scope of work or specifications may be negotiated to meet the organization's requirements. Finally, if the original prices are too high, negotiation can be continued after the bids are opened to bring the cost within budget. The ability to negotiate a price after bids are opened is an extremely effective management technique especially in a market environment where competition is very limited.

The Procurement Office needs to educate procurement officials on the advantages of using competitive sealed proposals and familiarize them on how it should be done.

Conclusion

The new procurement code has made significant and much needed changes to promote fairness, increase competition, and establish greater uniformity in the purchase of goods and services. However, its benefits have yet to be realized because of poor implementation by government and the lack of clarity in the roles and responsibilities of components of the procurement organization.

A central procurement authority with no line responsibilities would be able to exercise independent professional judgment in dealing with appropriate procurement officials, provide timely and quality services to educate staff, and interpret the law and rules while protecting the interests of the public. This central authority should have the sole discretion and responsibility for delegating procurement authority and accountability to the highest "hands on" procurement official in a department, agency, municipality, or branch of government. It should also be responsible for auditing, monitoring, and enforcing the new code.

Recommendations

1. We recommend that the Procurement Policy Board and the Procurement Office be consolidated as a central authority to issue rules, interpret the procurement law and rules, and audit, monitor, and enforce its implementation.
2. The Legislature should amend Chapter 103D, HRS, to:
 - a. Eliminate the designated chief procurement officers and require the administrator of the Procurement Office to issue delegations of purchasing authority.

- b. Have the comptroller designate chief procurement officers for the executive branch and have the heads of the Judiciary, Legislature, and counties designate their respective chief procurement officers.
3. The new Procurement Office should:
- a. Establish formal written procedures for procurement officials to follow when clarification and interpretation of the procurement law and rules are required.
 - b. Immediately develop a procurement orientation and training program specifically on the new law and rules for state and county officials.
 - c. Develop a procurement manual with standardized forms and instructions on the use and application of the source selection methods.
 - d. Amend sections 3-122-75 and 3-122-76, HAR, to prohibit the creation of different thresholds within the small purchase limits and specify quotation methods.
 - e. Investigate noncompliance of procurement problems and issues, recommend measures for improvement, and when necessary, apply sanctions for violators as provided under the law.

Responses of the Affected Agencies

Comments on Agency Responses

We transmitted a draft of this report on January 26, 1995 to the Procurement Policy Office, the interim administrator of the Procurement Office, the City and County of Honolulu, and the Division of Community Hospitals within the Department of Health. A copy of the transmittal letter to the Procurement Policy Office is included as Attachment 1. Similar letters were sent to the Procurement Office, the City and County of Honolulu, and the Division of Community Hospitals. The responses of the Procurement Policy Board, the interim administrator of the Procurement Office, the City and County of Honolulu, and the Division of Community Hospitals are included as Attachments 2, 3, 4, and 5, respectively.

The Procurement Policy Board agreed with our recommendation to consolidate the Policy Board and the Procurement Office. The board did not believe that developing a procurement manual with standardized forms and instructions is a good idea since each jurisdiction may have unique roles, functions, and procedures. Also, the board disagreed with our recommendation to amend the interim rules to prohibit the creation of different thresholds within the small purchase limits and to specify quotation methods. The board commented that the rules were written to permit each CPO the flexibility to establish its own small purchase threshold levels and quotation methods within the law. Finally, the board agreed that the new Procurement Office should develop procurement training programs and investigate noncompliance on procurement problems and issues.

The interim administrator of the Procurement Office generally agreed with our findings and recommendations. He agreed that a training program must be developed and implemented quickly and procurement manuals and vendor guides must also be created.

The City and County of Honolulu made many comments and clarifications on our findings concerning delegation of purchasing authority, sole source purchases, procurement of professional services, and small purchase requirements. We incorporated some of the clarifications into the report.

The Division of Community Hospitals says it complied with the code and developed division guidelines with no lead time. The division also says it has developed and implemented training sessions, developed its

own policy and procedures manuals, and established communication linkage with facilities. The division is seeking legislation for a waiver to Chapter 103D, HRS, for the procurement of pharmaceutical drugs, medical supplies, and medical equipment.

STATE OF HAWAII
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917



MARION M. HIGA
State Auditor

(808) 587-0800
FAX: (808) 587-0830

January 26, 1995

COPY

Mr. Haruo Shigezawa
Chairperson, Procurement Policy Office
Kalanimoku Building
1151 Punchbowl Street, Room 412
Honolulu, Hawaii 96813

Dear Mr. Shigezawa:

Enclosed for your information are three copies, numbered 9 to 11 of our draft report, *An Audit of Hawaii's Implementation of the New Procurement Law*. We ask that you telephone us by Tuesday, January 31, 1995, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Monday, February 6, 1995.

The State Procurement Office, the Division of Community Hospitals, the City and County of Honolulu, the Governor, and presiding officers of the two houses of the Legislature have also been provided copies of this draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

Marion M. Higa
State Auditor

Enclosures

BENJAMIN J. CAYETANO

~~XXXXXXXXXX~~
GOVERNOR



EUGENE S. IMAI

~~XXXXXXXXXX~~
COMPTROLLER

MARY PATRICIA WATERHOUSE
~~XXXXXXXXXX~~
DEPUTY COMPTROLLER

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING
AND GENERAL SERVICES

P.O. BOX 119
HONOLULU, HAWAII 96810-0119

February 6, 1995

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FEB 6 3 53 PM '95

OFF. OF THE AUDITOR
STATE OF HAWAII

Ms. Marion M. Higa
State Auditor
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917

Dear Ms. Higa:

Thank you for the opportunity to comment on the findings and recommendations found in the draft report of An Audit of Hawaii's Implementation of the New Procurement Law. Copies of the draft report were forwarded to the Procurement Policy Board members for review and comments.

In the main, the Board feels that the tone of the audit report may convey the wrong perception that chaos and confusion prevail in State and County procurement agencies. As far as we know, the level of service has remained high as agencies switch over to implementing the new law. Of course, it is to be expected that some agencies may have greater adjustments to make than others and may require greater efforts and time to adjust to the changes. The Board felt that the audit may have been done too early (August-December, 1994) and caught the CPO's in a transition period where full compliance under the new law could not be achieved within the time available.

As far as the audit report's comments pertaining to the Policy Office and Administrator are concerned, the Board felt that the report lacked balance in being too critical and in not recognizing the extraordinary efforts put forth by all concerned in promulgating the Interim Rules and in the effort expended in the selection of the Administrator. The readers of the audit need to be given a broader perspective of what went on during the hectic six months that comprised the audit period.

Granted, the Board was appointed very late and had no staff of its own. However, these are realities that the Board, DAGS, and the Office of the Attorney General accepted, coped with, and made adjustments to, in order to meet the mandates of the law.

Ms. Marion M. Higa
February 6, 1995
Page 2

No credit is given to the Comptroller, Mr. Robert Takushi, for assigning to his deputy, Mr. Lloyd Unebasami, the additional duties of interim administrator and CPO of the Executive Branch so that the Board could receive staff support. No laudatory credit was given to the Purchasing and Supply and Public Works Divisions of DAGS for preparing drafts after drafts of the Interim Rules for the Policy Board to review and tear apart until a satisfactory set of rules could be approved and fielded. The Board met five times in May and June, 1994, to review and revise the Interim Rules.

No mention was made in the audit of the considerable effort expended by the Policy Office during this period in preparing the job description, selection criteria, questionnaire, and then advertising the position of Administrator and Chief Procurement Officer for interested applicants. The Board reviewed 55 applications and interviewed five semi-finalists and finally recommended three finalists to the Governor.

As far as the audit's recommendations are concerned, our comments are as follows:

1. Consolidate Policy Board and Procurement Office. This would probably be a good idea provided that proper staffing and funding are authorized.
2. Amend Chapter 103D, HRS, to Change Present Designation of CPO's. Board has no strong feelings for or against recommendation except that it may be contrary to the legislative intent of holding top elected or appointed officials accountable for procurement.
3. New Procurement Office Should:
 - a. Establish formal written procedures when clarification and interpretation of procurement law and rules are required.

This can be accomplished if really desired by CPO's. However, downside is that it may be time consuming and may be viewed as too rigid where fast verbal answer is all that is required. The Board's minutes of June 28, 1994 meeting with the CPO's indicated that the CPO's only mentioned the establishment of a clearinghouse by the Policy Office for all legal opinions issued by the Office of the Attorney General and the various county Corporation Counsels.

- b. Develop procurement orientation and training programs.

Board concurs, however, staffing this requirement is a problem. Meanwhile, CPO's should "grab bull by the horn" and have their own procurement expert conduct orientation and training for staff.

- c. Develop a procurement manual with standardized forms and instructions.

This is not a good idea. Each jurisdiction should develop their own manual since different jurisdictions may have unique roles, functions, and procedures. Also, standardized forms, say for quotes, may not be a good idea since different industries such as automotive repair and others that use and train estimators may insist on using their own forms to the point of declining to quote. When time permits, however, the Policy Office should work toward standardizing general terms and conditions for different types of contracts.

- d. Amend sections 3-122-75 and 3-122-76, HAR, to prohibit the creation of different thresholds within the small purchase limits and specify quotation methods.

The Board disagrees with this recommendation. The purpose of the small purchase law was to eliminate paperwork and expedite small purchases. The Board deliberately left it up to each CPO to establish their own agency's comfort level in regard to additional ceilings for telephone quotes and written quotes between \$1,000 and \$10,000 for goods and services and \$4,000 and \$25,000 for construction. Also, the Board left it up to the CPO's as to the type of quotes received as long as the quotes were properly recorded and filed and reasonable competition solicited. However, if the CPO's would like the Board to establish uniform ceilings in the Rules, then this could be accomplished. This would be a good item for discussion at our next meeting with the CPO's.

Ms. Marion M. Higa
February 6, 1995
Page 4

- e. Investigate non-compliance of procurement problems and issues.

Agree, however, staffing will be required.

As to the audit report's finding on the reluctance of the CPO's to use the RFP type source selection for professional services, we are recommending to the legislature that the law be changed to make RFP's optional rather than mandatory. The CPO's have a real problem with the added workload and lengthy time required to process each RFP. For example, the City and County of Honolulu has over 200 architect and engineer types of consultant contracts to process and award annually. Added staffing would be required to handle the workload created by the need to process 200-plus RFP's. Also, the architects and engineers will be faced with the costly and time consuming problem of preparing and presenting formal proposals for each project. This cost will be passed on and added to the total project cost.

Again, thank you for the opportunity to comment on your audit. We firmly believe the new law and implementing rules are steps in the right direction. However, the State and counties need time to adjust and react to the new requirements.

In conclusion, the Board feels that under the circumstances, considering the constraints of time and in this period of austere government spending, the efforts rendered by all involved in implementing the new procurement law was outstanding.

Sincerely,



Haruo Shigezawa, Chairman
Procurement Policy Board

BENJAMIN J. CAYETANO

~~XXXXXXXXXX~~
GOVERNOR



EUGENE S. IMAI

~~XXXXXXXXXX~~
COMPTROLLER

MARY PATRICIA WATERHOUSE
~~XXXXXXXXXX~~
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STATE OF HAWAII
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P.O. BOX 119
HONOLULU, HAWAII 96810-0119

February 6, 1995

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OFF. OF THE AUDITOR
STATE OF HAWAII

Ms. Marion M. Higa
State Auditor
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917

Dear Ms. Higa:

Thank you for the opportunity to review your draft report on implementation of the new Hawaii Public Procurement Code. Your report addresses many issues of great concern to our office as we work towards the successful implementation of this important legislation.

Over the past six months, the State Procurement Office has been engaged in the challenging work of coordinating the sweeping changes mandated by the new law. During this time we have put in place many of the tools which provide for state agencies to be both more effective and more accountable in the procurement of goods and services for the public. However, while recognizing these successes we also acknowledge that the bulk of our work lies ahead.

As the interim administrator for the State Procurement Office since July 1, 1994, I do concur with your finding that the law's early effective date allowed "little time to plan for proper implementation of the law." This aggressive schedule forced our office to focus its limited resources on achieving goals that address the most pressing procurement issues at hand.

Our primary objective has been to produce rules that supplement the new law. And it is my expectation that once the rules are in good form, I will be able to proceed with establishing the programs necessary to carry through all aspects of the procurement code's purpose.

A training program must be developed and implemented quickly, as there are many requests from all areas of government for this. Contractual consistency needs to be established through uniform policies, procedures, terms and conditions.

Ms. Marion M. Higa
February 6, 1995
Page 2

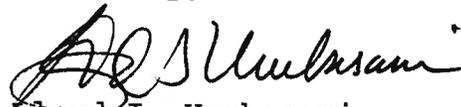
Vendor guides must be created. Employee procurement manuals must be developed. To these goals I am wholly and completely committed.

As you are aware, our state code is essentially a procedural law providing for a system of guidelines and responsibilities. It affords agencies procurement alternatives which they have not previously enjoyed, and which have already paid dividends to the state in terms of proper procurement practices.

In coordination with the state's Procurement Policy Board, it is my goal to foster an environment where state procurement maximizes these advantages and inspires public trust. Pending revisions to the code will delay the rule making process which is critical to implementing procurement standards. However, improvements to the code may be the ultimate result of proposed amendments to the law.

In closing, your report clearly indicates that sufficient time and resources have not been allocated to the on-going implementation effort. The complexity and far-reaching effects of this code warrant only the highest attention to detail, and my office stands ready to focus its resources completely towards achieving this end. If I can be of any assistance to you as your office finalizes its report, please contact me at 587-4700.

Sincerely,



Lloyd I. Unebasami
Administrator

DEPARTMENT OF FINANCE
CITY AND COUNTY OF HONOLULU

HONOLULU, HAWAII 96813

JEREMY HARRIS
MAYOR



RUSSELL W. MIYAKE
DIRECTOR

VICTOR D. GUILLERMO, JR.
DEPUTY DIRECTOR

February 3, 1995

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OFFICE OF THE AUDITOR
STATE OF HAWAII

Ms. Marion M. Higa
State of Hawaii
Office of the Auditor
465 S. King Street, Room 500
Honolulu, HI 96813-2917

Dear Ms. Higa:

Subject: Comments to An Audit of Hawaii's Implementation of the
New Procurement Law

This is in response to the findings of the draft report of "An Audit of Hawaii's Implementation of the New Procurement Law". The City's comments will primarily address those findings concerning the City and County.

Audit finding: (page 7) It was found that the City and County had not completed the written delegation of procurement authority in accordance with the requirement of the HAR.

Comment: This was due to the fact that the Rules were issued only two weeks before the implementation date causing confusion as to interpreting the law and communicating the rules clearly. We are actively pursuing completion of all delegation of authority.

Audit finding: (page 16) The City and County used the sole source method to award service contracts to the Hawaiian Humane Society to operate the City's animal shelter and the spay and neuter program.

Comment: The animal shelter contract is sole source as authorized by the Revised Ordinance of Honolulu, Chapter 3, Article 5.

Before the spay/neuter contract expires, strong consideration will be given to compete the program. Veterinary groups will be canvassed to determine if they are interested and capable of operating and managing a program of this magnitude.

Audit finding: (page 20) The Department of Wastewater Management, City and County of Honolulu, also advertised for professional

Ms. Marion M. Higa
February 3, 1995
Page 2

engineering services in order to develop a pre-qualified list of professional. It received many letters of interest for each of the 22 pending construction projects. The department is holding these 22 construction projects in abeyance because professional consultants have not been selected. Instead of issuing requests for proposals, the Wastewater Department received approval from its CPO to use the alternate list method of selecting a single professional for each project. We believe that the department's actions indicate general non-compliance with the intent of the rules regarding use of the alternate pre-qualified method.

Comment: The advertisement for qualified consultants for these construction projects was made before the new procurement code became effective. In the spirit of complying with the code which was not a requirement during the transitional period, the Department of Wastewater Management elected to comply with it. The code and the rules authorize procurement of professional services either by the competitive sealed proposal method or by the pre-qualified list method. Every project was justified in accordance with HAR 3-122-66 and approved by the CPO. Additionally, the Mayor formed an oversight panel to oversee the selection process to ensure that selections from the pre-qualified list were made on a fair and equitable basis. The oversight panel is composed of individuals from the ethics commission and from various professional associations and have the power to file protests when there is suspected impropriety in the selection process.

Audit finding: (page 16) The City and County of Honolulu also awarded four maintenance contracts totaling \$470,000 on a sole source basis to the Digital company for maintaining its computer equipment. The Digital company manufactures the equipment but is not the only source for maintenance services for such equipment. Other vendors could have been found to compete for maintenance service contracts.

Comment: The City and County of Honolulu awarded two, not four, maintenance contracts to Digital Equipment Corporation (DEC) totaling \$78,150.00 on a sole source basis. One of the two maintenance contracts was awarded for maintenance of computer software. Software maintenance is inherently proprietary because it includes the furnishing of technical information, software updates and enhancements that can only be furnished by the developer and licensor of the software, DEC. The second maintenance contract awarded to DEC was for computer hardware maintenance totaling \$57,650. The

Ms. Marion M. Higa
February 3, 1995
Page 3

draft report states that other vendors could have been found to compete for the computer maintenance service contracts. The Board of Water Supply, the requesting agency, required that the highest level of maintenance services be obtained for its mainframe computer. Maintenance by the manufacturer, DEC, was necessary to insure the best possible service, equipment reliability, technical support, and replacement parts availability. Purchase of maintenance from sources other than DEC is fraught with the risk of unsatisfactory performance. The manufacturer is the only source with direct avenues to lines of supply, first hand access to current technical support information, and service technicians who have received up-to-date training. The procurement rules do not require that service requirements and operational effectiveness be sacrificed especially when highly specialized and critical equipment is involved.

Audit finding: (page 16) At the City and County of Honolulu, only 40 percent of the items selected for testing met the three quotation requirement. A small and limited market was the reason provided for not obtaining three quotes as required in their procurement rules and regulations.

Comments: The procurement rules under §3-122-75 (a) (1), state: "Insofar as it is practical and based on the agency's specifications, adequate and reasonable competition of no less than three quotations shall be solicited;" Hence, the rules require solicitation of 3 quotations; however, obtaining 3 quotations may not be practical based on the experience of the Division's Procurement and Specification Specialists who purchase these commodities on a regular basis and who know that the marketplace is small and limited and obtaining 3 quotations could not be attained. The procurement files are documented in accordance with HAR 3-122-77 to reflect the basis of competition.

Thank you for the opportunity to comment on your draft report.

Sincerely,


RUSSELL W. MIYAKE
Director of Finance

RWM:jf

BENJAMIN J. CAYETANO
GOVERNOR OF HAWAII



STATE OF HAWAII
DEPARTMENT OF HEALTH

P. O. BOX 3378
HONOLULU, HAWAII 96801

February 6, 1995

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LAWRENCE MILIK
DIRECTOR OF HEALTH

OFFICE OF THE AUDITOR
STATE OF HAWAII

In reply, please refer to:
File:

FH-28

Ms. Marion M. Higa, State Auditor
465 South King Street, Room 500
Honolulu, Hawai'i 96813-2917

Dear Ms. Higa:

This letter is in response to your recommendations contained in the report, *An Audit of Hawai'i's Implementation of the New Procurement Law*.

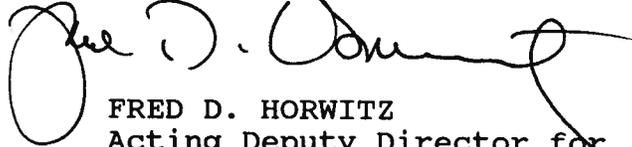
The Division of Community Hospitals' has independently developed and implemented several training sessions for hospital personnel, developed its own Policy and Procedures manual, and established communication linkage with facilities for timely flow of procurement information. It should be noted that we have complied with the Procurement Code and developed division guidelines with no "lead time" following approval of the Bill, no previous guidelines or tested methodology, and a "Bill" that is still in a state of flux.

The mission of the Community Hospitals is to provide the highest quality of care to the citizens of Hawai'i. The health of the patient is of paramount consideration and, at times, has created difficulties in justifying the purchase and administration of the lowest quoted item. There is quite a variation in quality and consistency in generic pharmaceutical drugs. Physicians are trained and skilled on specific apparatus, and to substitute a cheaper piece of equipment could jeopardize the welfare of the patient. The Division of Community Hospitals is seeking legislation for a waiver to 103D, HRS, for the procurement of pharmaceutical drugs, medical supplies, and medical equipment.

Ms. Marion Higa, State Auditor
February 6, 1995
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It is our opinion that this would be of great benefit to the citizens of Hawai'i.

Sincerely,

A handwritten signature in black ink, appearing to read "Fred D. Horwitz", written in a cursive style. The signature is positioned above the typed name and title.

FRED D. HORWITZ
Acting Deputy Director for
Community Hospitals