
A Review of Hawaii's Procurement Law

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

Report No. 92-29
December 1992



THE AUDITOR
STATE OF HAWAII

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.
3. Sunset evaluations evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.
4. Sunrise analyses are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.
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.

Hawai'i's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.



THE AUDITOR

STATE OF HAWAII

Kekuanao'a Building

465 S. King Street, Room 500

Honolulu, Hawai'i 96813

OVERVIEW

THE AUDITOR
STATE OF HAWAII

A Review of Hawaii's Procurement Law

Summary

In Act 274, Session Laws of Hawaii 1992, the Legislature requested that the State Auditor conduct a study to provide information and recommendations for the enactment of a comprehensive procurement code for the State of Hawaii. Chapter 103, Hawaii Revised Statutes, on Expenditure of Public Money and Public Contracts, governs the procurement of goods and services for the State. Initially enacted in 1909, the statute has been amended over 200 times but still does not provide the legal foundation of a sound public purchasing program.

The current procurement code is old, fragmented, and vague. It no longer meets the needs of the State in a number of respects. Definitions of common terms used throughout the statute are unclear, source selection is limited to one method, and because the statute is vague and silent on many issues, it is open to interpretation. The statute's lack of clarity has led to inconsistencies in purchasing practices among state agencies. Moreover, there is an absence of statewide rules to regulate and guide purchasing policy. Each department is left to develop its own purchasing guidelines, and vendors must respond to differing requirements from one agency to the next. In effect, enormous expenditures for goods and services are being made with little uniform guidance and regulation.

The current procurement code requires significant revisions. Developing a comprehensive and modern procurement code that can satisfy the State's purchasing requirements will be a long-term process. Our proposals are only the first steps. We believe these proposals create the foundation for the basic changes needed to increase competition and fairness and establish greater uniformity in state purchasing.

Recommendations and Response

We recommend that the State of Hawaii begin the process of revising its procurement code based in part on the framework provided by the American Bar Association's *Model Procurement Code for State and Local Governments*. We believe that Chapter 103 should be amended to include a statement of purpose, language detailing the specific scope of the statute, and clearer definitions of commonly used terms. The statute should also provide for additional source selection methods, authorization for cooperative purchasing agreements, and procedures for vendor protests and vendor debarment or suspension.

We also recommend the establishment of a procurement policy office as the central procurement policy authority for the State. The office would be headed by a director with at least ten years of experience in large-scale procurement of goods and services. With the assistance of a procurement advisory committee, the director would issue statewide rules and regulations consistent with the revised procurement code. The procurement advisory committee would be comprised of a small group of public procurement officials and members from the private sector.

The department did not comment on many of our recommendations for revisions to Chapter 103. It did agree that Chapter 103 should be clarified regarding emergency purchases. It also agreed that considerable savings could be obtained through volume purchasing. The department disagreed, however, with our recommendation for the appointment of a director for a new procurement policy office, suggesting instead that the comptroller should continue to be the State's procurement policy officer. We believe that a high level person with extensive experience in procurement is needed to bring policy direction to state procurement.

The department disagreed with many of our findings, particularly those relating to inconsistencies in practice and the lack of guidance given to departments. The department says adequate guidance is given in budget execution policies, administrative directives, comptroller's circulars, and its accounting manual. We do not believe that these are sufficient to give statewide direction for purchases of goods and services. An improved state law and better rules are needed.

Marion M. Higa
State Auditor
State of Hawaii

Office of the Auditor
465 South King Street, Room 500
Honolulu, Hawaii 96813
(808) 587-0800
FAX (808) 587-0830

A Review of Hawaii's Procurement Law

**A Report to the
Governor
and the
Legislature of
the State of
Hawaii**

Submitted by

THE AUDITOR
STATE OF HAWAII

Report No. 92-29
December 1992

Foreword

This report was prepared in response to Act 274, Session Laws of Hawaii 1992, which requested that the State Auditor conduct a study to provide information for the enactment of a comprehensive procurement code for the State of Hawaii.

We wish to acknowledge the cooperation and assistance extended to us by the officials and staff of the Department of Accounting and General Services, particularly the staff of the Purchasing and Supply Division, the University of Hawaii, the Department of Education, the Department of Transportation, the Department of Health, and the members of the State Procurement Study Group. We also wish to acknowledge the assistance provided by the Council of State Governments' Interstate Consulting Service.

Marion M. Higa
State Auditor

Table of Contents

Chapter 1 Introduction

Request for the Audit	1
Objectives of the Audit.....	2
Scope and Methodology	2

Chapter 2 Revision of Hawaii's Procurement Code

Summary of Findings	5
Hawaii's Procurement Code is Inadequate	5
ABA Model Code Provides a Sound Framework for Procurement	8
The State of Hawaii's Procurement Code Needs to be Revised	12
Recommendation	14

Chapter 3 Organization for Procurement

Summary of Findings	15
Uniform Procurement Policy is Needed	15
Procurement Authority	19
Conclusions	19
Recommendations	20

Chapter 4 Source-Selection Methods and Procedural Changes for the Revised Procurement Code

Summary of Findings	21
More Options Are Needed in Source-Selection Methods	21
Larger Quantity Discounts Are Possible	25
Amendments Are Needed for Vendors	27
Conclusion	29
Recommendations	29

Notes	31
-------------	----

Response of the Affected Agency33

Table

Table 2.1: Recommendations Made 10

Chapter 1

Introduction

Chapter 103, Hawaii Revised Statutes on Expenditure of Public Money and Public Contracts, governs the procurement of goods and services for the State. Initially enacted in 1909, the statute has been amended over 200 times. The amendments, however, have not combined to produce a comprehensive procurement statute. Some of the statute's original provisions have remained virtually unchanged and many are open to interpretation.

In 1989, the State of Hawaii hired Lallatin and Associates to analyze Hawaii's procurement programs, policies, procedures, and laws to recommend the most advantageous procurement system for the State.¹ Lallatin and Associates reported that they found minimal vendor competition due to unclear authority and inconsistent policies and procurement practices. This lack of competition potentially results in the State spending too much for its purchases. According to the report, the State of Hawaii's purchasing statute was "without stated purpose, not comprehensive or consolidated and structurally disorganized."² The state comptroller expressed support for the report's principal findings and recommendations, but none of the report's recommendations have been enacted.

The Legislature has also noted specific problems with sole-source or non-bid purchases. For example, in hearings on a GTE Selex phone contract, the Senate Ways and Means Committee found no formal procurement process was used to award this non-bid contract. Testimony to the Legislature noted a need to revise the procurement statute.

Request for the Audit

In Act 274, Session Laws of Hawaii 1992, the Legislature requested that the State Auditor conduct a study to provide information and recommendations for the enactment of a comprehensive procurement code for the State of Hawaii.

The Legislature believes the existing procurement code should be improved to produce economic benefits for the state and to increase competition among government suppliers. The act specifically asked that the study review the American Bar Association's *Model Procurement Code for State and Local Governments*,³ the Council of State Governments' and the National Association of State Purchasing Officials' *State and Local Government Purchasing*,⁴ and the Lallatin and

Associates report. The act also called for the State Auditor to review procurement codes from other states and the federal government and to interview the respective state and federal procurement officials. Finally, the act asked the State Auditor to consult with state agencies to determine circumstances or conditions that might necessitate exemptions to the procurement code.

Objectives of the Audit

1. To identify the implementation of Chapter 103, HRS, by examining the organizational structure, policies, procedures, and processes used by selected executive branch agencies for the purchase of goods and services.
2. To review the American Bar Association's *Model Procurement Code for State and Local Governments*, the Council of State Governments' and the National Association of State Purchasing Officials' *State and Local Government Purchasing*, the Lallatin and Associates report, and the procurement codes of selected states and the federal government to identify possible recommendations for improving Hawaii's procurement code.
3. To formulate appropriate recommendations for the development of a comprehensive procurement code to govern the purchasing practices of the State of Hawaii.

Scope and Methodology

Our study focused on the purchase of goods and services governed by Chapter 103, HRS. We did not examine every aspect of procurement; instead, we concentrated on developing recommendations for a revised procurement statute in the areas of a statement of purpose, applicability of the statute's provisions, better definitions, organizational structure, source-selection methods, vendor protest remedies, and vendor debarment and suspension procedures.

In addition, we examined the organizational structure, policies, practices, and processes of a sample of executive branch departments. Act 274 specifically asked us to consult with the University of Hawaii, the Department of Education, and the Department of Accounting and General Services. We added the Department of Health and the Department of Transportation because of the large amount they spend for procurement. We interviewed procurement supervisors and purchasing employees at these departments, examined their policies and procedures, and we reviewed a selection of their procurement files. As required by Act 274, we also contacted the Department of the Attorney General.

To obtain a more comprehensive view of the procurement process in the State, we interviewed the 15 members of the State Procurement Study Group, comprised of representatives of various state and county procurement offices⁵. We also examined the minutes of the study group's meetings and the proposals developed by its members.

As requested in Act 274, we reviewed and analyzed the American Bar Association's *Model Procurement Code for State and Local Governments*, the Council of State Governments' and the National Association of State Purchasing Officials' *State and Local Government Purchasing*, and the Lallatin and Associates report. We contracted with the Council of State Governments' Interstate Consulting Service (ICS) for technical assistance in reviewing these models and the procurement codes of selected states and the federal government.⁶

We did not review procurement for the State's capital improvement projects (including architectural and engineering services), construction, and purchases of service governed by Chapter 42D, HRS. Since Act 274 did not require us to audit the procurement practices of state agencies, we did not assess legal compliance or internal controls for any of the agencies we contacted.

Except that we did not assess internal controls or legal compliance, our work was conducted from May 1992 through November 1992 in accordance with generally accepted government auditing standards.

This page intentionally left blank.

Chapter 2

Revision of Hawaii's Procurement Code

In this chapter we examine Hawaii's procurement law, Chapter 103, HRS. We review its overall adequacy for meeting the procurement needs of the State and recent initiatives to improve the statute.

Summary of Findings

1. Hawaii's procurement system is inefficient and costly because the law is out of date, incomplete, open to interpretation, and unable to meet the State's purchasing requirements.
2. State purchasing officials recognize the need for a new procurement code but have reached no consensus on the specifics of such a code. The framework provided by the American Bar Association's (ABA) *Model Procurement Code for State and Local Governments* offers the best approach.

Hawaii's Procurement Code Is Inadequate

The current procurement code is old, fragmented, and vague. It no longer meets the needs of the State in a number of respects. Definitions are unclear, source selection is limited to one method, and the authority of departments to make purchases is vague. The statute's lack of clarity has led to inconsistencies in purchasing practices among state agencies.

We estimate that the State spent over \$800 million in FY1991-1992 just for supplies, printing, advertising, and fee services (consultants)¹. These enormous expenditures are made with very little guidance.

Key provisions governing purchases of goods and services

Chapter 103 covers various aspects of procurement, ranging from general provisions on types of expenditures to qualifications of bidders to contract procedures to the purchase of particular products. Some key provisions that will be discussed further in this report include Sections 103-22, 103-23, and 103-26 on advertisements for bids, and Section 103-11 on the comptroller's authority to issue rules.

Sections 103-22 and 103-23 state that excluding specific exemptions, no expenditure over \$8,000 shall be made except under contract let after public advertisement for sealed tenders. Expenditures between \$4,000 and \$8,000 may be made after a call for informal bids that is advertised at least once in a newspaper of general circulation published within the State. Among the exemptions from this requirement are purchases for purposes which do not admit of competition. The law prohibits dividing expenditures to evade these requirements.

Another section relevant to this report is Section 103-26 which requires advertisement for bids to appear not less than three times in a newspaper of general circulation published within the State; no more than one advertisement may be made on any one day or on two consecutive days. And finally, Section 103-11 allows the comptroller to adopt rules controlling and regulating the expenditure of state funds.

Some specific deficiencies in the procurement code

Act 62, Session Laws of Hawaii 1909, established the regulation of the State's expenditure of public money. Chapter 103 retains many of the original provisions. It has been amended over 200 times but still does not provide the legal foundation of a sound public purchasing program. Some of what the law requires is restrictive. More important is what the law omits. It does not contain an overall statement of purpose or provisions that clearly delineate which expenditures are subject to its requirements. The statute lacks specific definitions, and it offers little flexibility in purchasing procedures.

Inadequate definitions

Common terms used throughout the statute are not defined. For example, no definition is given of the term "expenditures." Purchasing officials we interviewed defined it in at least four ways. In deciding what constitutes an expenditure over \$4,000, some purchasing officials say it is the amount per item. Others say it can be more than one item. Others say it is the amount to be paid to a single vendor. Still others say that it is the amount paid to a single vendor for a single year.

In addition, ambiguous phrases are not defined. For example, Section 103-22 says that expenditures for "purposes which do not admit of competition" are exempt from competitive bidding requirements, but the phrase "purposes which do not admit of competition" is not defined.

Limited methods of purchasing

The statute specifies only competitive sealed bidding as a purchasing method and requires the State to take the lowest responsible bid. This is not always in the State's best interest. The lowest responsible bidder may not give the best service or be the most cost-effective choice in the long run. Purchasing officials say they need more flexibility in how they go about making purchases by having the statute authorize more source-selection methods. This flexibility would promote vendor competition and allow purchasing decisions to be based on other important criteria such as quality, performance, or timeliness.

Open to interpretation

Because the statute is vague and silent on so many issues, it is open to interpretation. One purchasing official noted that departments interpret the statute according to their own needs. For example, some state agencies use a request for proposal (RFP) method to purchase even though this method is not authorized by Chapter 103.² Since the statute does not specifically prohibit the RFP, some agencies solicit proposals for a purchase and then evaluate the proposals based on their own criteria. Once the agency makes a selection, it requests approval from the comptroller for an exemption from the statutory bidding requirements. The comptroller usually approves the request.

The statute is silent on the issue of vendor-protest procedures. Individual departments have developed their own procedures to resolve vendor protests. Some departments have written guidelines, others use more informal procedures.

Departments need the authority to debar or suspend vendors from bidding for state contracts when merchandise or service is inferior. In 1992 the Legislature amended Chapter 103 to allow departments to ban contractors who provide substandard work from receiving any state contracts for two years. But terms such as “contractor” and “work” were not defined leaving the scope of this legislation open to interpretation. We were informed that the Department of the Attorney General has stated verbally that the legislation could be used to suspend a vendor for any type of procurement. It would be useful for this provision to be more clearly defined in the statute.

Unclear purchasing authority

Chapter 103 is silent on the authority of individual departments to purchase goods and services. Section 26-6 authorizes the Department of Accounting and General Services (DAGS) to manage the centralized purchasing programs of the State. What is meant by “the centralized purchasing programs of the State” is not defined.

Currently, state agencies are not required to make purchases of goods and services through DAGS. DAGS will, however, provide purchasing assistance to any agency that requests it.

Inconsistent purchasing practices

The effect of the inadequate procurement code is inconsistent practices among the agencies. The statute offers little guidance to agencies, and

there are no statewide rules to fill the gap. A common complaint from purchasing officials we interviewed concerned the lack of uniformity in state purchasing practices. They said vendors complain about having to follow different practices for different agencies.

Section 103-11 authorizes the comptroller to adopt rules to control and regulate the expenditure of state moneys but does not require the comptroller to do so. So far the comptroller has not adopted rules. The only statewide instructions are circulars and memoranda issued by the comptroller and administrative directives and budget execution policies issued by the governor. These are not sufficient to give statewide direction for purchases of goods and services.

Each department is left to develop its own purchasing guidelines. In reviewing state practices, we found that DAGS-Purchasing and Supply Division has its own series of memos and directives to guide its purchasing decisions. The Judiciary, the Legislature, and some executive branch agencies, including the Department of Education, the University of Hawaii, the Department of Human Services, and the Department of Transportation, have independently developed written guidelines to govern their purchasing. Other departments such as the Department of Health and the Department of Budget and Finance have not developed guidelines but use information provided by DAGS for their purchasing practices. The Community Hospitals Division and the Department of Public Safety are in the process of developing purchasing guidelines.

In effect, enormous expenditures for goods and services are being made with little guidance and regulation. In fact, no one keeps track of how money is being spent. The State does not keep a break down of how much money is spent on purchasing each commodity. In addition, no readily available information exists to describe expenditures for specific purchases. This type of information would be useful if the State were managing procurement economically. The State needs to know how much is being spent and what is being purchased to plan for greater bulk buying.

ABA Model Code Provides a Sound Framework for Procurement

To remedy the inadequacies in Hawaii's procurement statute, the State should look to the American Bar Association's *Model Procurement Code for State and Local Governments*. The ABA model code offers a flexible and efficient approach. It has 12 articles containing the following: principles and policy guidance for managing and controlling the procurement of supplies, services, and construction for public purposes; administrative and judicial remedies for the resolution of contract controversies; and a set of ethical standards.

The model code is based on the premise of a short statute containing the basic requirements of a good procurement system and the use of rules and regulations to implement the provisions of the statute. Instead of a uniform procurement code, the ABA model is one that state and local governments can adapt to their own needs. Fourteen states have developed procurement codes based on it.

Past reviews of the State's procurement system by Lallatin and Associates, the State Procurement Study Group, and the Legislature have all suggested using the ABA model as a guideline to revise the procurement code. Our consultant, the Interstate Consulting Service of the Council of State Governments, also recommends that the State adopt a modified version of the ABA model code. Table 2.1 highlights some of the recommendations made by the three groups that we believe the State should adopt.

The Lallatin and Associates Report

In 1989, because of concern about the statute, the State contracted with Lallatin and Associates to examine purchasing activity in the State; to survey laws, policies, and procedures; and to recommend the best procurement system. Lallatin and Associates presented its report to the comptroller in the spring of 1990.

Lallatin and Associates found that vendor competition is minimal in Hawaii because of unclear authority and policy and inconsistent procurement procedures. The consultant also found that the purchasing law lacked a comprehensive scope, a stated purpose, and provisions for certain innovations in purchasing. Although some sections were detailed and restrictive, others did not provide enough guidance. For example, Chapter 103 specifies competitive sealed bidding but has no criteria for sole-source purchases or for purchases under the bid threshold.

The report said that in fiscal year 1988, the State spent \$29 million for individual purchases below the bidding threshold and \$25 million on 368 sole-source purchases. The report suggested that the State could have saved approximately \$1.25 million if it established sole-source criteria and reduced such procurement by 25 percent. The report also commented that procurement officials use competitive sealed proposals through a RFP process even though Chapter 103 has no provision for such a procurement method. Neither does the statute have provisions for vendors to protest procurement decisions.

Lallatin and Associates made numerous recommendations, including revising the procurement code using the ABA model code as a guide; adding source-selection methods such as multi-step sealed bidding, multiple-award contracts, competitive sealed proposals, and sole-source procurement; and developing statewide rules, regulations, and

Table 2.1

RECOMMENDATIONS MADE

<u>LALLATIN</u>	<u>STUDY GROUP</u>	<u>COUNCIL OF STATE GOVERNMENTS</u>
Use ABA model as guide	Adopt ABA model	Adopt modified ABA model
Include statement of purpose	Develop statement of purpose	
Apply provisions to all expenditures		Apply code broadly
Establish procurement policy authority		
Add source-selection methods	Add source-selection methods	Add source-selection methods
Establish vendor protest procedures	Include vendor protest and debarment	Formalize bid-protest procedures
Authorize cooperative purchasing	Authorize cooperative purchasing	Authorize cooperative purchasing
Increase bid threshold to \$10,000	Increase bid threshold	
Develop statewide rules		
Expand state price lists	Mandate state price lists	
Allow optional bonding		
Create compliance unit		
Specify application to political subdivisions		
	Reduce number of ads	

procedures for purchasing. The comptroller expressed support for the report's principal recommendations and findings, but to date, none of the recommendations made by Lallatin and Associates have been enacted.

The State Procurement Study Group

In an effort to build consensus on a new procurement code, the comptroller organized a State Procurement Study Group to review the Lallatin and Associates recommendations, decide which of the recommendations should be implemented, and draft the necessary legislation. The study group is comprised of 15 purchasing officials representing 10 executive branch departments or agencies, the Judiciary, the Legislature, and the county governments.

The study group did not meet its goal of drafting legislation, but its members did develop some recommendations. They include: developing a statement of purpose and language detailing the scope of the procurement statute based on the ABA model code; accepting the recommendations made by Lallatin and Associates on competitive sealed bidding, multi-step bidding, and competitive sealed proposals; and providing for small purchases, emergency purchases, and purchases that do not admit of competition.

We found that a majority of the members of the State Procurement Study Group supported developing a procurement code based on the ABA model code. Study group members who were familiar with the Lallatin and Associates report were in general agreement with its recommendations except the recommendation for a centralized procurement system. A majority of the members also supported establishing a central policy office to issue statewide rules and regulations to guide procurement practices throughout the State.

The Council of State Governments' Interstate Consulting Service (ICS)

As a part of our study, we contracted with ICS to review the procurement codes of selected states and the federal government. ICS examined the experiences of 14 states that have procurement codes based on the ABA model code. It also examined relevant portions of the federal procurement code. ICS reviewed the appropriateness of applying to Hawaii the principles expressed by the National Association of State Purchasing Officials in *State and Local Government Purchasing* and the approach of the model code. Based on its review, ICS made the following recommendations for Hawaii:

- Adopt a modified version of the model code.
- Apply broadly the provisions of the model code and allow for administrative exemptions or exceptions to full competition, if necessary.

- Establish DAGS as the centralized procurement authority for the State with the responsibility for all procurement.
- Include the source-selection methods described in the model code.
- Formalize statutory bid-protest procedures.
- Authorize cooperative purchasing agreements.
- Establish bidder lists.

Legislative revisions

During its 1992 session, the Legislature passed HB 2571 which included provisions from the model code and recommendations made by the Lallatin and Associates report. The Legislature stated its belief that the current procurement code is obsolete and commented that HB 2571 was the first step in a long range plan to overhaul the procurement system.

The bill was vetoed by the governor who cited his opposition to specific provisions.³ In his veto message, however, the governor expressed support for the overall objective of the bill and commented that a comprehensive revision of the procurement system was long overdue.

The State of Hawaii's Procurement Code Needs to be Revised

The current procurement code requires significant revisions. Developing a comprehensive and modern procurement code that can satisfy state purchasing requirements will be a long-term process. We believe that accepting the ABA model code as a framework for making the needed revisions is an important first step in that process.

Some parts of Chapter 103 should be amended. Certain provisions based on the ABA model code should be added to fill some gaps. Other parts of Chapter 103 should remain intact until progress is made in implementing the revised procurement code. The following is an overview of our proposals for amendments and additions to Chapter 103. We will discuss some of these further in the next two chapters. Because our review was limited, we wish to emphasize that these proposals are only the first steps in what will be a continuing process of improving the State's procurement code. Other important purchasing activities such as selecting architectural and engineering services and capital improvement projects were not part of our review and are not included in our recommendations.

**Amendments to
Chapter 103**

Section 103-11 gives the comptroller the authority to adopt rules to control the expenditure of state money. We propose amending it to establish a procurement policy office headed by a director who will have the authority to adopt rules governing the procurement of goods and services.

Sections 103-22 and 103-23 detail which purchases must be made by competitive sealed bidding and which can be exempt from the competitive bidding requirement. Amendments are needed to authorize additional source-selection methods. The bid threshold should be raised to \$10,000 and the informal bid threshold should be eliminated.

Section 103-26 requires a call for tenders to be advertised not less than three times in a newspaper of general circulation with no more than one of these publications made on any one or two consecutive days. Procurement officials say this requirement has been costly. It should be changed from three advertised calls for tenders to one with the requirement that all agencies issuing bids post all calls for bids in an accessible public area.

Sections 103-28 and 103-34 require bid security deposits or bonds for all purchases over the formal bid threshold. Such bonds should not be mandatory for all instances of procurement. In the next chapter we recommend establishing a procurement advisory committee to make recommendations on various matters including the requirements for bid bonds and performance bonds.

**Additions to Chapter
103 based on the
model procurement
code**

Adding a statement of purpose and provisions detailing the scope would clarify the intent of the statute and the extent to which it would apply. For example, the model code includes consistency, fair and equitable treatment, and effective broad-based competition among its purposes. This addition would also clarify whether the law applies to all agencies, to both state and county agencies, and to all branches of government, or whether it is limited in its applicability. Definitions of commonly used terms, such as "expenditure," "services," "contract," and so on, should also be added. Such provisions are included in the model code.

Source-selection methods suggested in the model code should be added to Chapter 103. Some of these should be modified as appropriate for Hawaii's situation. These will be discussed in the final chapter.

Authorization for cooperative purchasing agreements between state and county agencies should be added to Chapter 103.

Vendor-protest procedures are needed along the lines of the administrative procedure suggested by the model code.

Vendor suspension and debarment procedures are needed to authorize the suspension or debarment of vendors in specific situations. Chapter 103 was recently amended to allow for the suspension of contractors who do substandard work but the scope of the legislation is not entirely clear.

Other changes to Chapter 103

State requirements contracts (price lists) as recommended by Lallatin and Associates should be expanded and all state agencies required to use them. In addition, the statute should authorize multiple-source contracting for these contracts.

A procurement policy office should be established to be the central procurement policy authority for the State. This office would develop a procurement orientation program and a procurement manual, conduct spot compliance checks, and serve as a resource for employees with questions about purchasing. The model code recommends total centralization of the procurement system, but we advise centralization of only the policy function at this time. This will be discussed further in the next chapter.

A procurement advisory committee would assist the procurement policy office in developing statewide rules. The advisory committee we propose would have more substantive responsibilities than the one in the model code.

Issuance of procurement rules would be the responsibility of the director of the proposed procurement policy office.

Procurement authority of individual agencies will have to be defined. We are not recommending a centralized purchasing system, but we believe that Chapter 103 should clarify the respective authority of the various agencies for purchasing. We recommend the comptroller, after consultation with the procurement advisory committee and the director of the procurement policy office, issue determinations regarding departmental purchasing authority.

Recommendation

The State of Hawaii should begin the process of revising its procurement code based in part on the framework provided by the American Bar Association's *Model Procurement Code for State and Local Governments* and the recommendations in this report.

Chapter 3

Organization for Procurement

A procurement code establishes statewide policy. The policy is clarified and delineated through rules that prescribe the conditions and manner for implementing the statute. Rules are then translated into procedures that guide agencies in actual purchasing activities. This chapter examines the organization for carrying out policy and practice.

Summary of Findings

1. State procurement is highly decentralized for both policy and practice. No central authority has issued rules for procurement or managed state procurement.
2. Centralization of the procurement policy function is important for ensuring consistent and fair competitive practices, but centralization of procurement operations is not essential or feasible at this time.

Uniform Procurement Policy Is Needed

Purchasing officials interviewed during the course of our study commented that the primary problem with the current purchasing system is the lack of uniformity among state agencies and the different interpretations they use.

The lack of purchasing uniformity among state agencies can be attributed not only to the inadequacies of Chapter 103, but also to the absence of statewide rules to regulate and guide purchasing activities. The comptroller is authorized to issue rules governing procurement but has not done so. As a result, state agencies vary in the ways they manage procurement. Some agencies have their own policies and procedures while others have none. The University of Hawaii, for example, has a *Systemwide Administrative Procedures Manual*. Even so, without more definitive state rules, as legal and regulatory matters arise, the university must rely on the Department of the Attorney General for clarification of the statute.

During our interviews, purchasing officials commented that advice from the attorney general varied depending on which deputy attorney general offered it. Any vendor attempting to do business with more than one state agency experiences a variety of procurement requirements and procedures.

Purchasing activities are highly decentralized. No department or agency is required to make its purchases through the Department of Accounting and General Services (DAGS). In addition, some agencies give their individual units latitude to handle all their purchases under the bid

threshold. Executive branch agencies are only under the control of the comptroller if they request purchasing services from DAGS or submit a request for a waiver from competitive bidding requirements.

Purchasing officials, including the comptroller, commented that one advantage to decentralization is greater flexibility to make timely purchases. Efficient turnaround on goods and services is seen as benefitting program operations. But effective policy and management controls could ensure overall consistency and cohesion and promote effective and efficient procurement without sacrificing timeliness. To develop a healthy level of competition for state business, it is binding on government to have a unified, clear, and understandable process.

Distinguish policy from procurement

The issue of whether procurement should be centralized is controversial. Members of the State Procurement Study Group have expressed concern that this would result in an added layer of bureaucracy, delay purchasing, and reduce their flexibility. We believe that authority for policy and rule-making can be centralized while purchasing operations remain decentralized.

The Lallatin and Associates report states that Hawaii should establish a central purchasing authority that would also have the authority to formulate procurement policy. Our consultant, the Interstate Consulting Service, (ICS) also supports a centralized procurement authority whose director would adopt rules to govern purchasing. ICS comments that all of the 14 states that have adopted some form of the model code had a centralized procurement organization.

ICS recommends that DAGS be the centralized procurement authority for the State with authority for all procurement, including policy, to insure that the best interests of the State are protected. The ICS review of states that had adopted the American Bar Association's model code found that procurement worked best where there was more centralized authority. Where there was greater decentralization and a large number of exemptions, the process was unmanageable. ICS did note, however, that Hawaii's procurement system is much less centralized than any of the other 49 states; therefore changing to a strong centralized procurement system would be a more dramatic move for Hawaii than for other states that have adopted a form of the model code.

The model code recommends a centralized purchasing system, but provides for a separation between policymaking and the operations. It suggests the establishment of a procurement policy office as an independent procurement policy body. This policy body would be responsible for issuing rules and regulations to govern the implementation and monitoring of the procurement statute.

A majority of the procurement officials we interviewed opposed a centralized procurement system for the State of Hawaii. Those opposed to centralization believe that it would be impractical for the State and slow down the purchasing process. DAGS simply does not have the resources to take on centralized procurement. Procurement officials also maintained that a central authority would not have the same purchasing priorities as the individual departments. A majority of the purchasing officials, however, did support the concept of establishing a central policy authority to issue statewide rules and regulations.

Given Hawaii's decentralized procurement system and its current level of purchasing staff and resources, we believe that centralization of the procurement system is impractical. We do, however, support centralizing procurement policymaking authority and believe that this is an important starting point for revising the purchasing system.

A procurement policy office would centralize policymaking

The purchasing officials we interviewed stated that to properly implement any procurement statute, statewide rules should be adopted to promote consistency in the public procurement system. An independent, centralized, full-time policy office would give visibility to policymaking. In *State and Local Government Purchasing*, the National Association of State Purchasing Officials cautioned that purchasing law and policy in many jurisdictions, particularly the states, have become fragmented, contradictory, and confusing. The association states that effectiveness and consistency demand that procurement policy be unified. A policy office specializing in procurement would bring together state and county government officials and give direction to purchasing policy and practices, to legal or government regulation, and to activities on the part of bidders and suppliers.

The State should establish a procurement policy office with a full-time staff, exempt from Chapters 76 and 77, headed by a qualified individual with expertise in procurement. The director of the new office should be appointed by the governor from a list of three candidates recommended by a procurement advisory committee. To protect the office from political influence, the director should be given a term of six years and removed from office by the governor only for cause. The director should be eligible for reappointment. To maintain independence, the procurement policy office should be attached to DAGS for administrative purposes only.

We believe the professional competence of the director of the proposed office is crucial. This individual should have at least 10 years of experience in large-scale procurement of goods and services, preferably as a state or county procurement official, and have demonstrated executive and organizational ability. Certification as a Certified Public Procurement Officer (CPPO) would be desirable.

The specific duties of the procurement policy office would be to:

- Issue rules and regulations consistent with the revised procurement statute.
- Provide administrative support to a procurement advisory committee.
- Perform spot compliance checks.
- Assist and guide agencies in procurement matters.
- Develop and administer a statewide procurement orientation program.
- Develop, distribute, and maintain a statewide purchasing manual.
- Develop, distribute, and maintain a statewide guide for vendors.
- Draft future legislation relating to procurement matters.

Procurement advisory committee

A procurement advisory committee should be established to assist in developing statewide rules for the revised procurement statute. Our consultant, ICS, does not support this concept, but we believe that a procurement advisory committee is the best alternative for the State at this time. The advisory committee could give much needed input on how best to implement a revised procurement statute.

For purposes of efficiency, the committee should be comprised of a small group of public procurement officials and members from the private sector with the comptroller as an ex-officio voting member. The public sector members should represent all branches of state and county government who are involved in the day-to-day procurement of goods and services. The Judiciary, the Legislature, and the counties would nominate their respective representatives and the comptroller would select representatives of three or four executive branch departments. The private sector members would be appointed by the governor from recommendations made by the Chamber of Commerce, various trade associations, or small business associations. Pending the appointment of the director of the procurement policy office, the advisory committee should be chaired by the comptroller. Once appointed, the director of the procurement policy office would chair the committee.

The duties of the procurement advisory committee should include:

- Assisting in developing statewide rules and regulations to be issued by the director of the procurement policy office for implementation of the revised procurement statute.
- Making recommendations to the procurement policy office regarding legislation to reform or improve the procurement statute.
- Preparing and submitting a list of eligible candidates to the governor to fill the position of director of the procurement policy office.
- Assisting the director of the procurement policy office in evaluating, developing, and maintaining a comprehensive and statewide procurement system.

Currently the comptroller has the authority to adopt rules controlling the expenditure of state money, but the comptroller has never asserted that authority. We, therefore, recommend that Section 103-11 be amended to give the director of the procurement policy office the authority to adopt rules for the procurement of goods and services. The authority to adopt rules governing other expenditures shall remain with the comptroller.

Procurement Authority

Chapter 103 is silent on the authority of individual departments to purchase goods and services. We believe that centralization of purchasing is currently impractical. The statute, however, should include language that defines the purchasing authority of the individual state departments and agencies. In addition, the statute should identify the conditions and procedures for delegating procurement authority.

The statute should include language requiring the comptroller, after consultation with the procurement advisory committee and the director of the procurement policy office, to issue determinations regarding departmental purchasing authority.

Conclusions

Statewide rules and procedures are key to improving the procurement system. Rules would facilitate understanding, administration, and proper use of the State's procurement system. The establishment of a procurement advisory committee and a procurement policy office would help insure the issuance of such rules, regulations, and procedures. A centralized and fully staffed procurement policy office would provide the needed expertise to develop a statewide procurement orientation program

and purchasing manual. These two resources would address the concerns raised by many purchasing officials. Through its compliance function, the office would also instill greater confidence among the public. The centralization of procurement policy authority would be a vital step forward in the long term process of revising the State's procurement system.

Recommendations

1. The Legislature should establish an independent procurement policy office to issue rules, administer procurement policy, develop a procurement manual, and develop a procurement orientation program for state employees. The procurement policy office should be administratively attached to the Department of Accounting and General Services.
2. The Legislature should establish a procurement advisory committee to help the procurement policy office to develop statewide rules and regulations consistent with the revised procurement statute.
3. Section 103-11, HRS, should be amended to transfer the authority to adopt rules on the procurement of goods and services to the director of the procurement policy office.
4. Chapter 103, HRS, should be amended to require the comptroller, after consultation with the procurement advisory committee and the director of the procurement policy office, to issue determinations regarding departmental purchasing authority.

Chapter 4

Source-Selection Methods and Procedural Changes for the Revised Procurement Code

In this chapter, we discuss changes that are needed to give greater flexibility and guidance to purchasing officials. We also propose changes that could result in cost savings to the State.

Summary of Findings

1. Chapter 103, HRS, lacks flexibility in source-selection methods and other procedural steps that could simplify state procurement.
2. Greater use of cooperative purchasing and price lists could result in cost savings.
3. Provisions relating to vendors should be added to ensure fair play, and changes should be made in bonding requirements to increase competition.

More Options Are Needed in Source-Selection Methods

Chapter 103 requires all purchases over \$4000, except in specific instances, to be made through competitive bidding. Competitive sealed bidding is deemed to be the most impartial method of acquiring goods and services through fair and open competition. Chapter 103 authorizes no other source-selection method.

Since 1909, all purchases over the bid threshold have been required to be made through competitive bidding. State purchasing, however, has become much more complex. The State requires diverse goods and services which must be purchased from a variety of marketplaces. Procurement officials need the flexibility to use a variety of purchasing methods to obtain the most economical price and ensure fair and open competition. A majority of the state purchasing officials we interviewed commented that the procurement statute needs to be revised to authorize the use of source-selection methods in addition to competitive sealed bidding.

According to literature in the procurement field, competitive sealed bidding is the most commonly used method for acquiring goods and services. It should be the standard for the issuance of contracts. But it is also recognized that competitive sealed bidding is not always the best method for purchasing specific goods and services. Our consultant

reports that almost all of the 14 states that have adopted procurement codes based on the model code have also adopted the source-selection methods recommended in the model code. These methods include competitive sealed bidding, multi-step sealed bidding, competitive sealed proposals, emergency procurement, and sole-source procurement, as well as procedures for making small purchases.

Chapter 103 should be amended to authorize the use of these other source-selection methods, but competitive sealed bidding should remain the preferred method. A written explanation of the reasons why competitive sealed bidding is not practical should be required prior to the use of an alternative source-selection method.

Multi-step sealed bidding

Multi-step sealed bidding, an alternate version of competitive sealed bidding, is used for complex procurement acquisitions. The first step is to solicit unpriced offers to meet specific requirements through an invitation to bid. Bidders whose offers are determined to be qualified under criteria in the invitation to bid are then asked for sealed bids. DAGS-Purchasing and Supply Division uses this process even though it is not authorized by Chapter 103. Multi-step sealed bidding should be an option for procurement officials, and it should be authorized by statute.

Competitive sealed proposals

The use of competitive sealed proposals is appropriate when judgment must be exercised regarding the quality of the competing offers. The criteria for evaluating the bid must be contained in the request for proposal (RFP). The award is made to the responsible bidder whose offer is most advantageous to the State. Unlike competitive sealed bidding, the award need not go to the lowest responsible and responsive bidder. The bidder and the contracting officer may discuss and alter the proposal so long as all bidders are treated alike. The Lallatin and Associates report states that competitive sealed proposals are usually used in procuring professional services and technical equipment.

Some state agencies already use the RFP process. According to the administrator of DAGS-Purchasing and Supply Division, agencies solicit proposals, evaluate them using their own criteria, and select a vendor. Agencies then request an exemption from competitive sealed bidding from the comptroller.

All procurement literature we reviewed supported the use of competitive sealed proposals. Adding this method to Chapter 103 should result in more competitive procurement of goods and services and should offer purchasing officials an alternative that allows them to make decisions on factors other than price.

In competitive sealed proposals as well as in competitive sealed bidding and multi-step bidding, the statute should delineate the steps to be followed in opening the bid and awarding the contract. The model code recommends that this be done to ensure uniform and appropriate practices among all agencies.

Sole-source procurement

Chapter 103 provides no standards for allowing purchases to be made without competition. Currently, these purchases are made under the “purposes which do not admit of competition” exception in Section 103-22. The governor’s administrative directive 92-01 permits a sole-source purchase when a particular good or service may be obtained only from one source. The directive requires agencies to justify sole-source purchases and to receive approval from the comptroller for an exemption from the bidding requirements before making the purchase.

Sole-source procurement is needed. A required good or service may be available only from one source. The procurement statute should specifically authorize sole-source purchases. But such purchases should be allowed only when it is determined in writing prior to the purchase that the required good or service is available from only one source and is necessary to meet the State’s purchasing requirements. Additionally, the statute should require the comptroller’s approval of the bid-exemption request prior to purchase and full documentation of all sole source purchases. At the same time, the comptroller should have some flexibility to waive this requirement for justifiable, documented reasons. Statutory provisions and specific requirements for sole-source procurement should reduce the use of the “purposes which do not admit of competition” clause.

Emergency procurement

Authority for emergency procurement is intended to allow for unexpected purchases of goods or services when a situation is so urgent that the required item must be purchased immediately. Emergencies will occur and procurement statutes should recognize this. Chapter 103 provides for emergency purchases but does not specify who has the authority to make such purchases or when they may be made.

Section 103-5 states that “no expenditure shall be made under any general appropriation for emergencies except for urgent causes arising when the legislature is not in session, or without the approval of the governor.” The statute should be clarified to authorize emergency procurements in specific situations such as when there exists an immediate threat to public health, welfare, or safety or when there is a need for emergency replacement of medical diagnostic and therapeutic equipment for community hospitals. Purchasing officials may be authorized to make emergency procurements on a case-by-case basis, but

these must be made with as much competition as possible and with written documentation of the basis for the emergency and the reasons why the particular contractor was chosen.

Small purchases

As indicated in the Lallatin and Associates report, the State of Hawaii spent \$29 million in fiscal year 1988 for purchases below its bidding threshold. Chapter 103 has no criteria for making these purchases. Under the State's current decentralized purchasing system, some individual programs have complete discretion to make these purchases as they wish. Although purchases under the bid threshold may not justify the time and expense of competitive sealed bidding, such purchases should be controlled through policy and regulation that ensure adequate competition.

Chapter 103 should be revised to include language mandating the use of "small-purchase procedures" for purchases under the bidding threshold. The proposed procurement policy office should adopt rules guiding these purchases. We recommend that purchases below \$500 require procedures adequate and reasonable to provide competition; purchases between \$500 and \$2,499 require at least three telephone quotations; and purchases from \$2,500 to \$9,999 require at least three written quotations. Written documentation of the purchase and the contractor chosen are also essential. The small-purchase levels are based on the following discussion which recommends an increase in the State's bid threshold.

Increase in the bidding threshold

The bid threshold is very important. Purchases under the bid threshold require less time and effort because formal bidding is not required. But they may result in less competition and fewer public safeguards. The Lallatin and Associates report states that "a balance must be achieved between the time and effort necessary and the level of desirable competition."

Currently, the State operates under a two-tier bid threshold of \$4,000 and \$8,000. All purchases over \$4,000 require competitive bidding; stricter requirements exist for expenditures over \$8,000. For example, expenditures over \$8,000 require a contract rather than a purchase order, and the bidder chosen must provide a performance bond equal to 50 percent of the contract price. A majority of the purchasing officials we interviewed said that the bid threshold should be increased. Their suggestions for bid thresholds ranged from \$8,000 to \$50,000 with the majority recommending an increase to around \$8,000 or \$10,000. The Lallatin report also recommends increasing the bid threshold to \$10,000 for supplies and services.

We recommend that there be a single bid threshold of \$10,000. All purchases over this limit should be made using one of the recommended source-selection methods. All purchases under this new limit should be governed by the small-purchase procedures discussed earlier. The combination of small-purchase procedures and the increased bid limit should address the concerns of purchasing officials about the length of time procurement takes because more purchases would be made using the small-purchase procedures. This combination should provide the necessary competition and allow purchasing officials to concentrate their efforts on higher dollar purchases.

Advertisements

Chapter 103 requires all purchases over \$4,000 but less than \$8,000 to be advertised in a newspaper of general circulation at least once and those over \$8,000 at least three times on non-consecutive days. Adequate public notice of all competitive or sole-source purchases over the bid threshold is necessary. We believe, however, that the number of advertisements could be reduced from three to one without sacrificing competitiveness. This is consistent with the views expressed by the Lallatin and Associates report and the State Procurement Study Group. Agencies making expenditures over the bidding threshold should also be required to post all bids in an accessible public area. We also suggest that the State work with local newspapers to group bid advertisements to make it easier to identify notices.

Larger Quantity Discounts Are Possible

The State could save money through quantity discounts if the procurement statute were to authorize cooperative purchasing agreements and mandate the use of state requirements contracts.

Cooperative purchasing agreements

Cooperative purchasing is the combining of requirements of two or more political entities to obtain the advantages of volume purchasing, reduction in administrative costs, and other benefits. A proposal from the State Procurement Study Group defines cooperative purchasing as “procurement by, or on behalf of, more than one state, county, city, or other governmental agency or any governmental unit outside the State.”

Cooperative purchasing agreements are voluntary, self-initiated arrangements and need statutory authorization because these agreements cross jurisdictional lines. Procurement literature supports the authorization of cooperative purchasing agreements. Such agreements enable governmental entities to achieve lower prices through increased quantity discounts, to reduce duplication of effort, and to facilitate the sharing of information.

Chapter 103 should be amended to authorize cooperative purchasing agreements. The members of the State Procurement Study Group developed a proposal regarding cooperative purchasing agreements based on the model code.

State requirements contracts

Annual requirements contracts, also called “price lists,” are used to consolidate volume purchasing needs. Vendors are asked to bid to supply the specified item needed in volume. Agencies are generally required to purchase that item from the successful bidder. In return, the successful bidder is obligated to furnish the item.

Both the Lallatin and Associates report and *State and Local Government Purchasing* comment that excellent benefits are derived through the use of annual requirements contracts because they provide volume discounts and they reduce the administrative costs of bidding the same item several times a year. Requirements contracts should also result in more timely acquisition because the vendor and the price of the item have already been determined. Vendors are also benefitted because they are guaranteed a large volume of business for a specified length of time. All state and local governments use these types of contracts; some to a greater extent than others.¹

Chapter 103 does not require the use of state requirements contracts or state price lists as they are known in Hawaii. However, the governor’s budget execution policy mandates all agencies make purchases in accordance with state price lists. The University of Hawaii and the Department of Education are excepted. Agencies may request a waiver from the comptroller if the item on the price list does not suit their needs.

The Lallatin and Associates report found that agencies have had problems with price lists and that more than one-half of the agencies sometimes do not purchase required items from the price lists. The report also noted that the number of items on price lists were limited. Purchasing officials we interviewed cited numerous problems with the items on price lists including poor quality items, items which did not meet their needs, outdated items, items which could be purchased at a lower price from other suppliers, and delays in item delivery. They complain that they have had no input on which items or vendors are chosen for price lists.

The statute should be amended to require the use of state price lists. They are a valuable resource and their use should be encouraged. We agree with the Lallatin and Associates recommendation that the use of requirements contracts should be expanded to cover additional commonly used items or commodities. Their report maintains that the

State purchases only about 5 percent of the commonly used items from these contracts and increasing this to 75 percent could save the State millions of dollars annually².

The price lists could be made more useful if DAGS-Purchasing and Supply Division and the Department of Budget and Finance (which handles requirements contracts for telecommunication equipment) are required to solicit the input of user agencies when developing or negotiating these contracts. Such input could alleviate many of the problems agencies say they have with the current price lists. The Community Hospitals Division currently has a purchasing committee that works with DAGS-Purchasing and Supply Division to insure that price list items meet the needs of the hospitals. This process should be expanded to other state agencies.

We also support the Lallatin and Associates report recommendation to authorize multiple-source contracting for requirements contracts. Multiple-source contracting is the award of a requirements contract for similar items or services to more than one vendor. They are appropriate when a single supplier cannot provide the necessary item on a day-to-day basis to a large number of widely dispersed user agencies. DAGS-Purchasing and Supply Division also advocates the use of multiple-award contracting. The procurement policy office should adopt rules to govern the use of these contracts to avoid abuses.

Amendments Are Needed For Vendors

Vendors must have confidence in the State's procurement process. The State could establish better relationships with vendors and increase competition if the law provided for vendor-protest procedures. Procedures for the suspension or debarment of vendors should also be included in the statute. These would identify the rights and responsibilities of those involved. In addition, competition among vendors would be increased by reducing the bond requirement.

Vendor-protest procedures

The purchasing process is subject to complaints, protests, and controversies because bidders will not always agree with procurement decisions. Chapter 103 does not include vendor-protest procedures, leaving procurement officials to develop their own methods for resolving protests. Some departments have written guidelines, others use more informal procedures. For example, the Department of Transportation requires that protests be acknowledged within two weeks and a response be sent to the vendor by the director. The Department of Public Safety weighs the merits of the protest and then contacts the Department of the Attorney General for advice. The Department of Budget and Finance forwards all protests directly to the Department of the Attorney General.

It is imperative that bidders and contractors have confidence in the bidding process. This is best assured by establishing a process for aggrieved persons to protest procurement decisions. *State and Local Government Purchasing* recommends that, if at all possible, vendor protests be resolved through informal discussions. If the protests cannot be resolved, the model code contains an administrative procedure for resolving timely protests and allows the vendor to appeal the decision directly to the court. The State Procurement Study Group made a proposal on protest procedures that contains these provisions.

Our consultant (ICS) believes that formalizing bid-protest procedures is valuable and creates a greater sense of fairness. Most of the 14 states it reviewed had adopted formal protest procedures that provide for an administrative resolution of bid protests. All of the 14 states allow an appeal to the judicial system after administrative remedies are exhausted. Our consultant recommends formal procedures with court review after completion of the administrative process. Our consultant also notes that an automatic stay, as recommended by the model code, may hinder the procurement process.

We recommend that Chapter 103 be amended to include provisions establishing formal vendor-protest procedures. Emphasis should be placed on handling vendor protests through an administrative procedure to insure fairness.

Suspension and debarment of vendors

The procurement statute should also authorize the debarment or suspension of vendors. The model code provides for a vendor to be debarred or suspended if convicted of fraud, embezzlement, theft, forgery, a criminal offense involving a public or a private contract, violation of contract provisions, or violation of ethical standards, or for any other cause the head of a purchasing agency deems to be serious or compelling. Debarment or suspension should only take place after reasonable notice to the vendor and an opportunity for the vendor to be heard. The debarment or suspension is effective for specific periods of time and the vendor may appeal the decision to the Judiciary. The State Procurement Study Group has a proposal for debarment and suspension based on the provisions of the model code.

Although Chapter 103 was recently amended to allow departments to suspend for two years contractors whose work is deemed substandard, the language in the statute is of limited value because it is open to interpretation. We recommend that more precise provisions and procedures for the debarment or suspension of vendors be added to Chapter 103.

Bonding requirements

Bid security and performance bonds are designed to protect the interest of the State against bad faith or failure on the part of the bidder to complete the provisions of the contract. About 90 percent of the states, however, provide some discretion in bonding because the cost of bonding is passed on to the purchaser and can be detrimental to the State.³ The literature we examined shows that bonds are usually a requirement for construction contracts but are optional for the purchase of goods and services.

Section 103-28 allows the comptroller to determine which bids require a bid deposit. The Comptroller's Circular 1992-3 states that all bids \$8,000 or more must be accompanied by a bid deposit. Public works and repair and maintenance projects require bid deposits when expenditures exceed \$15,000. Additionally, the statute requires a performance bond equal to 50 percent of the contract amount for all competitively-bid expenditures over \$8,000. Purchasing officials raised concerns that current bonding requirements limit competition because many smaller businesses cannot meet them. Moreover, bonding may not be an effective means of providing assurance to the State because legal issues may render the bond inaccessible.

We believe that Chapter 103 should be amended so that bid bonds and performance bonds are not mandatory for all instances of procurement. This is consistent with the recommendations contained in the Lallatin and Associates report and the provisions of the model code. Specific circumstances requiring bonds should be decided by individuals with procurement experience. The procurement advisory committee through the director of the proposed procurement policy office should make recommendations to the Legislature detailing the requirements for the bid bond and performance bond.

Conclusion

The changes suggested in this report should provide needed flexibility to purchasing officials while continuing to insure adequate competition. Including the recommended provisions in the procurement statute should give vendors and the public more confidence in the purchasing system and would save the State millions of dollars annually.

Recommendations

1. Chapter 103, HRS, should be amended to authorize additional source-selection methods including multi-step sealed bidding, competitive sealed proposals, sole-source procurement, and emergency procurement, as well as procedures for small purchases. Competitive sealed bidding should remain the standard.

2. The bid threshold for the State should be increased to \$10,000 and the informal bidding limit should be discontinued.
3. Chapter 103, HRS, should be amended to recognize that bid bonds and performance bonds need not be required in all instances of procurement. The proposed procurement advisory committee through the director of the proposed procurement policy office should make recommendations to the Legislature detailing bid bond and performance bond requirements.
4. Public notification of all purchases over the bid threshold should be announced through advertisements in a newspaper of general circulation at least once and by public posting of all bids by state agencies.
5. Chapter 103, HRS, should be amended to authorize the establishment of cooperative purchasing agreements.
6. Chapter 103, HRS, should be amended to include provisions for vendor-protest procedures and vendor-debarment or suspension procedures based on the proposal developed by the State Procurement Study Group.
7. Chapter 103, HRS, should be amended to include language mandating the use of state requirements contracts or price lists.
8. Requirements contracts or price lists should be expanded to cover additional commonly used items and commodities.
9. The Department of Accounting and General Services-Purchasing and Supply Division and the Department of Budget and Finance should be required to consult other state agencies when developing or negotiating requirements contracts or price lists.
10. Chapter 103, HRS, should authorize the use of multiple-source contracting for requirements contracts or price lists.

Notes

Chapter 1

1. Lallatin and Associates is a consultant from New York that the State of Hawaii hired in 1989 to analyze the current procurement system and make recommendations to improve it. Their study focused on the executive branch, excepting the Department of Education and the University of Hawaii, and used data collected for the period July 1, 1987 through June 30, 1988. They presented their recommendations to the state comptroller in the spring of 1990.
2. Lallatin and Associates report, 1990, p. II-1.
3. The American Bar Association's *Model Procurement Code for State and Local Governments* is composed of 12 articles that provide the following: statutory principles for managing and controlling the procurement of supplies, services, and construction for public purposes; administrative and judicial remedies for the resolution of contract controversies; and a set of ethical standards. It was approved by the American Bar Association's House of Delegates in February 1979.
4. *State and Local Government Purchasing* (third edition) was published by the Council of State Governments (CSG) and the National Association of State Purchasing Officials (NASPO) in 1988. It contains information regarding procurement practices for both the public and private sector.
5. The State Procurement Study Group, created by the state comptroller, is comprised of 15 purchasing individuals representing 10 executive branch departments and agencies — the Judiciary, the Legislature, and the county governments. Established in 1989, its duty was to review the Lallatin and Associates recommendations, decide which ones to implement, and draft the necessary legislation.
6. The Council of State Governments' Interstate Consulting Service (ICS) was established in the early 1970s as a mechanism to offer states the expert experience of state officials.

Chapter 2

1. Figures extracted from Department of Accounting and General Services' Financial Accounting and Management Information System Report, Annual Expenditure by Major Object Code, August 4, 1992.

2. The request for proposal (RFP) is a source-selection procedure that permits negotiation of proposals and prices. It allows changes to be made after proposals are opened and contemplates that the nature of the proposals and/or price offered will be negotiated prior to award. Council of State Governments, *State and Local Government Purchasing*, Lexington, Kentucky, 1988, p. 225.
3. Governor John Waihee vetoed HB 2571 because of reservations regarding provisions that required the attorney general to review every procurement of the executive branch and because of imposition of criminal sanctions for violations of state procurement laws. Governor's veto message on HB 2571, June 19, 1992.

Chapter 4

1. Council of State Governments, *State and Local Government Purchasing*, Lexington, Kentucky, 1988, p. 40.
2. Lallatin and Associates report, 1990, p. V-8.
3. Council of State Governments, *State and Local Government Purchasing*, Lexington, Kentucky, 1988, p. 56.

Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this study to the Department of Accounting and General Services on December 3, 1992. A copy of the transmittal letter to the State Comptroller is included as Attachment 1. The comptroller's response is included as Attachment 2.

The department did not comment on many of our recommendations for revisions to Chapter 103. It did agree with our recommendation to clarify Chapter 103 regarding emergency purchases, and it also agreed that considerable savings could be obtained through volume purchasing.

The department disagreed with our recommendation for the appointment of a director for the proposed procurement policy office and instead suggested that the comptroller continue as the State's procurement policy officer. We recommend that the director have at least 10 years of experience in large-scale procurement of goods and services, preferably as a state or county procurement official, because we believe the state needs high-level professional competence to bring policy direction to state procurement. The policy office would also handle a variety of procurement-related duties in addition to the issuance of rules.

The department disagreed with our findings that state agencies are inconsistent in their purchasing practices and that enormous expenditures are being made with very little guidance. The department says that budget execution policies, administrative directives, comptroller's circulars, and its accounting manual guide purchasing. We do not believe that these are sufficient to give statewide direction for purchases of goods and services or take the place of a sound purchasing law and rules.

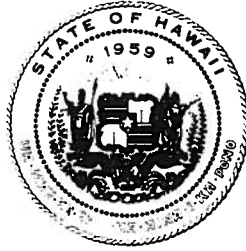
The department also said that the State Procurement Study Group had supported a procurement organization that had policy resting with the comptroller. We note that a draft proposing this had not been circulated to, reviewed by, or voted on by all the members of the study group.

The department also suggested that legislation be drafted to develop an interim Chapter 103A following the ABA model code format. Existing statutes that remain would be moved into the new parts of Chapter 103A while the "A" would be deleted once the entire code is completed.

We believe that this would be confusing. Our recommendations are a first step in what will be a long-term process of developing a modern and

comprehensive procurement code. We, therefore, recommend that Chapter 103 be amended in some fundamental areas while other parts of Chapter 103 should remain intact until further progress is made in implementing the revised procurement code.

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

December 3, 1992

The Honorable Robert Takushi, Comptroller
Department of Accounting and General Services
Kalanimoku Building
1151 Punchbowl Street, Room 412
Honolulu, Hawaii 96813

Dear Mr. Takushi:

Enclosed are three copies, numbered 6 through 8, of our draft report, *A Review of Hawaii's Procurement Law*. We ask that you telephone us by Tuesday, December 8, 1992, on whether 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, December 14, 1992.

The Governor, the presiding officers of the two houses of the Legislature, and the Director of the Legislative Reference Bureau 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

JOHN WAIHEE
GOVERNOR



ROBERT P. TAKUSHI
COMPTROLLER
LLOYD I. UNEBASAMI
DEPUTY COMPTROLLER

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING
AND GENERAL SERVICES

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

PS-93-335.2

December 11, 1992

RECEIVED

DEC 14 11 44 AM '92

OFF. OF THE AUDITOR
STATE OF HAWAII

MEMORANDUM

TO: Ms. Marion M. Higa, State Auditor
Office of the Auditor

FROM: Robert P. Takushi, State Comptroller *RPT*

SUBJECT: A Review of Hawaii's Procurement Law - A Report to the
Governor and the Legislature of the State of Hawaii

I would like to express my appreciation for providing the opportunity to comment on your draft report A Review of Hawaii's Procurement Law. To begin, I wish to commend you and your staff for performing the comprehensive study of the procurement policies and practices of the State and for formulating recommendations for the enactment of a new procurement code. The following are our comments and recommendations regarding your report.

COMMENTS

Page 5, Hawaii's Procurement Code is Inadequate

The report states that Hawaii spent over \$800 million in FY 1991-1992 just for supplies, printing, advertising, and fee services (consultants) and that these expenditures were made with very little guidance. It is unclear how this information was obtained, but DAGS, through legal ads and contract awards issues mandatory price lists for various types of supplies and services. Printing is addressed in Sections 103-51 and 354-3 of the HRS, and the hiring of consultants or personal service contractors comes under the direction of the Governor's Budget Execution Policy through either the bid process or by requesting bid exemption approval from the Comptroller, as stated in Administrative Directive 92-01.

Page 6, Inadequate Definitions

The report states that no definition is given for the term "expenditures" and that purchasing officials defined it in at least four ways. When you are required to bid and what is an expenditure are two different things. The definition of expenditures is found in the State of Hawaii Accounting Manual.

Page 8, Inconsistent Purchasing Practices

The report states that no one keeps track of how money is being spent. We believe this to be a very broad statement that is not true. The State has departments, agencies, and programs whose mission is to keep track of how money is being spent. The State also has financial accounting reports that lists by major object codes, how much money is spent on a variety of commodities. Individual departments can break the major object codes into minor object codes to describe the expenditures into further detail. The DAGS Inventory Management branch also has inventory reports that lists purchases by item classes.

Page 9, The Lallatin and Associates Report

The report states that as per the Lallatin report, the State could have saved approximately \$1.25 million if it established sole-source criteria and reduced such procurement by 25 percent. Sole-source criteria was established in Comptroller's Circular 1977-3 and recently in Administrative Directive 92-01. Also, the Comptroller only approves/disapproves bid exemption requests based on whether the purchase is non-competitive. It is the Department of Budget and Finance and the Legislature that approves departmental budget requests for the specific expenditures. We are unable to validate any savings at this point.

Page 11, The State Procurement Study Group

The report states that a majority of the State Procurement Study Group supported establishing a central policy office. However, the final draft of the state procurement organization had matters of policy for the executive department (except DOE and UH) resting with the State Comptroller and not a policy office. A copy of the final draft organization dated June 24, 1992 was provided to the Office of the Auditor.

Page 12, The State of Hawaii's Procurement Code Needs to be Revised

Act 274, 1992, SLH tasks the Office of the Auditor to continue to develop recommendations for procurement legislation. It is not clear if the Office of the Auditor intends to pursue that endeavor.

Page 16, Uniform Procurement Policy is Needed

The report states that executive branch agencies are only under the control of the comptroller if they request purchasing services from DAGS or submit a request for waiver from competitive bidding. However, the budget execution policy mandates that executive branch agencies shall purchase items from DAGS price lists and all vehicle purchases and leasing contracts shall be made through DAGS.

Page 21, Summary of Findings

The report states that Chapter 103, HRS lacks flexibility in source selection methods and other procedural steps that could simplify state procurement. Although there are no statutory provisions that allow other than competitive sealed bidding, under Chapter 103, case notes of court opinions permit the use of the federal two-step when appropriate.

Page 22, Competitive Sealed Proposals

The report states that some agencies already use the RFP process and that according to the administrator of DAGS, Purchasing and Supply Division, agencies solicit proposals, evaluate them, select a vendor, and then request an exemption from bidding.

The manner in which it is stated, sounds as though that procedure is a normal, accepted method. The Comptroller, when appropriate, has requested agencies to complete the process and issue an invitation for bids (IFB) to make an award.

Page 23, Emergency Procurement

The reports states that Chapter 103-5 should be clarified to authorize emergency procurement in specific situations.

Per our deputy AG, Section 103-5, HRS is not intended to be an alternate means for statutory bidding and does not address waiver of bidding. Section 103-5, HRS deals with the use of appropriated funds for emergencies which were not specifically budgeted for that purpose and allows the Governor to approve specific changes to the use of those funds. Section 128-10(10) has been used as the authority to waive bidding for emergencies; however, we agree that a clear Chapter 103 provision for emergency procurement is needed.

Page 27, State Requirements Contracts

The report states that the Office of the Auditor agrees with the Lallatin and Associates recommendation that Hawaii should purchase 75 percent of the commonly used items from State price lists, rather than just 5 percent.

This statement needs to be placed in better perspective. The Lallatin Study was addressing total state purchasing volume of all agencies. For example in DAGS, Purchasing and Supply Division contracts for about \$50 million annually, of which approximately 50 percent (\$25 million) is for supplies and services awarded through price lists. We agree that considerable savings can be obtained through volume purchasing and have increased the number of price list contracts since the Lallatin study.

RECOMMENDATIONS

The following recommendation is directed to the section entitled A Procurement Policy Office Would Centralize Policymaking on page 17. It is our recommendation that it is not required for the Governor to appoint a director of the Procurement Policy Office for a six year term, when the State Comptroller (who is already an appointed official) can serve as the Policy Officer. A staff of three civil service employees as a minimum should be provided to develop the rules, and perform compliance checks.

To create another appointed position will only add to the State's already tight budget situation. Once the rules are written, what will be the primary task of the procurement policy office? There really will not be any need for another full-time appointed official. Also to establish an advisory committee made up of various members of state and county government and private sector members will only create a situation similar to that of the procurement study group. With their normal job duties, members will be hard pressed to hold frequent meetings and develop procurement rules. All we need are a minimum three full-time workers that can contact the various key state, county, and private sector officials and concentrating full-time on drafting the necessary rules. Once the rules have been adopted, these workers will concentrate on checking compliance to the rules and developing new rules or statutes as needed.

In addition, it is extremely important that changes to our state procurement code be done in clear and well planned legislation. To amend Chapter 103 without an overall HRS Chapter organization will give us a law that would be difficult to implement. Therefore, we recommend that legislation be drafted to develop an interim Chapter 103A following the ABA Model Code. For example, Part I of Chapter 103A would be the General Provisions, Part II would be the State Procurement Organization, Part III would be Source Selection and Contract Formation, etc. Existing statutes that remain can then be moved into the new parts of Chapter 103A. Eventually, the "A" can be deleted once the entire code has been completed.