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# **Audit of the Administration of Personal Services Contracts in the Department of Education**

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

Report No. 94-27  
December 1994



**THE AUDITOR**  
STATE OF HAWAII

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## The Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawaii 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 and 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.

Hawaii'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 South King Street, Room 500  
Honolulu, Hawaii 96813

# OVERVIEW

THE AUDITOR  
STATE OF HAWAII

## Audit of the Administration of Personal Services Contracts in the Department of Education

### Summary

The Office of the Auditor initiated this audit because of the size of the Department of Education (DOE), the amount it spends on personal services contracts, and the administrative flexibility and autonomy it enjoys.

We found that the DOE has expended millions of dollars for additional personal services from several thousand vendors without knowing whether the expenditures have furthered its educational mission. It does not know how much is being spent, much less for what purposes and with what results. The DOE has not controlled or assessed the need for these services since there is a great deal of variability in their use among schools, districts, and state offices. The DOE is unable to explain how the funds are spent or why they are distributed so unevenly.

We found that the DOE's approach to personal services contracts creates considerable bureaucratic paperwork but still fails to ensure efficiency, economy, fairness, and open competition. It has offered little central guidance. Nowhere is the initiation process described or the individual steps specified. We also found that responsibilities for managing these contracts are unclear and inappropriately assigned; policies and procedures are outdated, cumbersome, and inadequate; and uncertainty and inconsistency surround the several ways in which additional personal services are acquired.

Many of those receiving contracts are also DOE employees. But the department does not know how many fall into this category or whether the contract work conflicts with their regular work. We found that about a quarter of the contracts above \$1000 and 59 percent of the contracts of less than \$1000 went to DOE employees. In a number of instances the work was similar to or extensions of the employees' normal work.

In addition, laws and policies against parceling are being circumvented, especially by the Office of Personnel Services. Virtually no competition exists. Further, we found that the dating and timeliness of personal services contracts need to be greatly improved, and control over small expenditures is excessive while overall control is ineffective.

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## Recommendations and Response

We recommend that the superintendent of education establish a management system for the acquisition of additional personal services. The system should include policies and procedures to ensure the educational effectiveness of the services, fair and open competition, efficiency, economy, and compliance with all laws and rules on procurement. The Office of Personnel Services should be assigned the responsibility of ensuring compliance with all personnel laws, rules, policies, and state ethics laws. The system should also ensure that additional services acquired from DOE employees are appropriate and proper and generate sufficient data to allow for an assessment of the effectiveness, propriety, and efficiency of expenditures. Further, the system should ensure open competition by preventing the practice of parceling and fostering competition for small purchases. The DOE should implement and enforce procedures for accurate dating and timely processing of contracts and establish appropriate levels of control to eliminate unnecessary paperwork and processing.

The DOE responded that it agrees with some of the findings and disagrees with others. It says that it is aware of the issues and most of them have been resolved or are in the process of being resolved.

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Submitted by

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STATE OF HAWAII

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## Foreword

The State Auditor initiated this *Audit of the Administration of Personal Services Contracts in the Department of Education* as part of a broad concern with procurement in Hawaii's state government. The Department of Education has the flexibility and autonomy to expend substantial amounts on a variety of personal services contracts. The audit was conducted pursuant to Section 23-4, Hawaii Revised Statutes, which requires the State Auditor to conduct post audits of all departments, offices, and agencies of the State.

We wish to express our appreciation for the cooperation and assistance extended by officials and staff of the Department of Education.

Marion M. Higa  
State Auditor





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# Chapter 1

## Introduction

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Personal services contracts can constitute a significant expenditure of public funds. Agencies often use these contracts to acquire specialized and temporary services. As part of a broad concern with procurement in Hawaii's state government, the State Auditor initiated this audit of personal services contracts within the Department of Education (DOE). We selected the DOE because it is the largest department within Hawaii state government, and it administers thousands of personal services contracts. The DOE also enjoys a high degree of autonomy in how it manages these contracts.

This audit was performed pursuant to Section 23-4, Hawaii Revised Statutes, which requires the Auditor to conduct postaudits of the transactions, accounts, programs, and performance of state agencies.

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## Background

Unlike most Hawaii state agencies, the DOE enjoys a high degree of autonomy in procuring personal services and administering contracts for those services. Under administrative flexibility legislation initially passed in 1986 (Act 321), the DOE gained full control over such matters as purchasing, preauditing, accounting, and the devising of business and accounting forms. This legislation also transferred from the governor to the Board of Education the authority to waive bid requirements for purchases. With the passage of this legislation, the DOE has been able to determine and control most aspects of its administration of personal services contracts.

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## Activities Included Under Personal Services Contracts

The DOE uses personal services contracts to acquire a wide variety of services. Apart from contracts for the A+ after school care program, and grants, subsidies, and purchases of services authorized under Chapter 42D, HRS, the DOE utilizes personal services contracts for the following:

1. **Staff development/in-service training** for the presentation of various training programs, including workshops, seminars, etc.
2. **Consultant services** for information, analysis, and opinion in either oral or written form, including reports on surveys conducted, studies made, programs evaluated, systems to be installed, and programs to be implemented.

3. **Diagnostic services** to test, examine, diagnose, evaluate, and treat students needing mental health services, speech therapy, physical therapy, occupational therapy, and audio-visual care.
4. **Guidelines and plans development**, such as the design, development, and production of guides and plans, including curriculum guides and improvement plans.
5. **Student instruction** in a private or public setting during school, after school, or on weekends and holidays, including presentations and “hands-on” demonstrations in such areas as art, music, drama, dance, science, and Hawaiiana.
6. **Technical assistance** by professionals, paraprofessionals, and lay personnel to assist staff and students in carrying out educational endeavors, such as providing lighting, sound, and staging assistance in helping students to stage a performing arts program.
7. **Program evaluation** of projects or programs, collecting data for reporting purposes, etc.

The only services automatically excluded from personal services contracts are equipment maintenance services for which the DOE has separate purchasing procedures.

DOE administrators can acquire additional personal services in three different ways: (1) through temporary employment on a full time or part time basis on the department’s payroll, (2) through a personal services contract, and (3) through direct issuance of a purchase order. This means that the services of one person may be acquired in more than one way, resulting in redundant employment, conflicts of interest, and violation of tax and other laws governing employment. Hence, it is important for DOE to have clear policies and procedures that would protect against possible misuse and abuse.

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## Objectives of the Audit

1. Identify and describe the Department of Education’s existing rules, policies, and procedures governing personal services contracts.
2. Evaluate the administration of personal services contracts by the Department of Education.
3. Make recommendations based on the audit’s findings.

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## **Scope and Methodology**

The audit focused upon the DOE's management of personal services contracts issued during FY1992-93 and the first half of FY1993-94. Excluded from the scope of the audit were personal services contracts for (1) grants, subsidies, and purchases of services made pursuant to Chapter 42D, HRS, and (2) agreements made between the DOE and other governmental agencies. Various special conditions apply to these two categories of contracts. Also excluded from the audit were contracts for after school care services under the DOE's "A+ Program." The DOE negotiates these contracts based on the request for and submission of proposals from interested parties.

We reviewed relevant laws, rules, policies, and procedures, and examined contract logs and contract documents. We interviewed DOE officials and personnel at the state office, several of the district offices, and at a limited number of schools.

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



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# Chapter 2

## Management of Personal Services Contracts By the Department of Education

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In this chapter we assess the use of personal services contracts by the Department of Education (DOE). We identify a number of problems relating to the DOE's management of these contracts and make recommendations for changes and improvements.

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### Summary of Findings

1. The DOE has expended millions of dollars for personal services from several thousand vendors without knowing whether the expenditures have furthered its educational mission. It does not know how much is being spent, much less for what purposes and with what results. The DOE has not controlled or assessed the need for these services since there is a great deal of variability in their use among schools, districts, and state offices.
2. The DOE's approach to personal services contracts creates considerable bureaucratic paperwork, but still fails to ensure efficiency, economy, fairness, and open competition. More specifically:
  - a. Responsibilities for managing these contracts are unclear and inappropriately assigned.
  - b. Policies and procedures are outdated, cumbersome, and inadequate.
  - c. Uncertainty and inconsistency surround the several ways in which additional personal services are acquired.
  - d. Laws and policies against parceling are being circumvented, especially by the Office of Personnel Services.
  - e. Despite a strong formal policy favoring competition, virtually no competition exists in the letting of DOE personal services contracts.
  - f. The dating and timeliness of personal services contracts need to be greatly improved.
  - g. Control over small expenditures is excessive while overall control is ineffective.

## **The DOE Has No Clear Rationale for Using Personal Services Contracts**

The DOE has a workforce of almost 18,000 fulltime equivalent positions and a payroll amounting to hundreds of millions of dollars annually, but it also supplements its workforce with a significant amount of personal services acquired through contracts and purchase orders.

Despite the substantial amount spent, the DOE does little to ensure that these expenditures further its educational mission. In fact, no one at DOE knows how much is being spent for additional personal services, for what purposes, and with what results. The need for such services is questionable since they are used unevenly throughout Hawaii's educational system.

### ***Expenditures for extra personal services are significant***

Accurate information on the extent to which DOE acquires personal services is lacking, but available data indicate that the cost of these services may range between \$4 million and \$10 million a year. Partial data for FY1992-93 show the following:

- The DOE processed almost 500 contracts greater than \$1,000 each, totaling more than \$2.5 million.
- The Office of Instructional Services (OIS) handled some 774 short form contracts (used for contracts of less than \$1,000) totaling more than \$320,000.
- The Honolulu District recorded 612 short form contracts amounting to almost \$250,000.
- The Leeward District reported that it had processed 683 short form contracts, but it was unable to provide a dollar total for these contracts. However, for FY1993-94 through the end of March, the Leeward District reported handling 475 short form contracts amounting to almost \$170,000.
- The Windward District for the first nine months of FY1993-94 recorded 150 short form contracts totaling more than \$50,000.

In response to a March 1994 request from the Senate Committee on Ways and Means, the DOE submitted two reports on expenditures from July 1, 1993 on all contracts of \$1,000 and more. Excluding expenditures for the A+ Program, for grants and purchases of services under Chapter 42D, and for agreements with other government agencies, the reports listed expenditures of approximately \$2 million.

These data on personal services contracts are incomplete, but they clearly indicate that the DOE is expending millions of dollars annually on such contracts and is dealing with several thousand vendors in the process. In addition, the DOE is also expending untold amounts for personal services acquired through purchase orders. In short, the DOE's use of additional personal services beyond its regular staffing is significant.

***The DOE lacks data on the use of additional personal services***

The DOE acknowledges that it does not have complete or readily usable information on its use of additional personal services. This was apparent in the DOE's response to the request for information from the Senate Ways and Means Committee during the 1994 legislative session.

By working overtime and receiving additional time to prepare its response, the DOE was finally able to generate the two separate and lengthy listings of personal services contracts. However, the information supplied was cumbersome to use, inconsistent, and incomplete.

The first listing was 87 pages long and showed, by program, prior expenditures and amounts budgeted for personal services contracts of \$1,000 or more for the 1993-95 fiscal biennium. The second listing was 17 pages long with summary data on contractors, contract purposes, contract dates, and contract amounts for all personal services contracts of \$1,000 or more that had been issued to date during FY1993-94.

The two listings were both supposed to be summaries of expenditures for contracts of \$1,000 and more. While the two listings were consistent with regard to most programs, we found inconsistencies affecting ten programs, or almost 10 percent of the total programs listed. In nine cases, the second listing contained information on programs not included in the first listing. In the tenth case, different amounts were shown for the same program. Due to these inconsistencies, the total amounts for the two listings differed by more than \$125,000.

More important, however, were the DOE's disclaimers regarding the completeness of its information. The DOE noted first that compiling information on contracts for less than \$1,000 was "an arduous task" that could not readily be done due to the decentralized nature of the data. Second, it noted that many expenditures coded as "services-on-a-fee basis" are "encumbered by purchase orders without the back up of a personal services contract (many expenditures do not require a personal services contract as back up)." In effect, the DOE was admitting that personal services of an unknown amount and nature are being acquired directly through purchase orders even though its own policies and procedures prohibit the use of purchase orders in lieu of contracts.



***Use of additional personal services is varied***

Available data show that use of additional personal services is quite varied throughout Hawaii's educational system. Some offices, districts, and schools acquire extra personal services to a greater extent than others. The DOE is not in a position to explain or justify such variations. Data on the distribution of contracts is most complete on contracts of \$1,000 and more, limited on contracts of less than \$1,000, and virtually unavailable for personal services acquired directly through purchase orders.

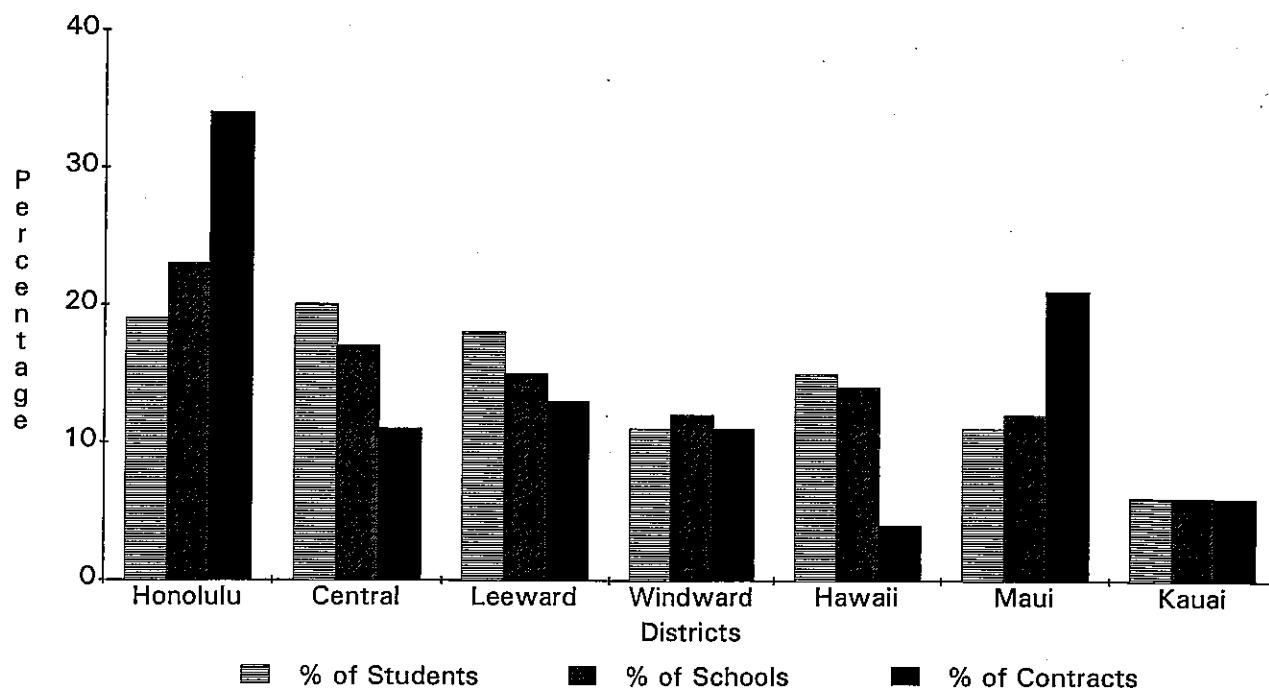
**Unevenness in contracts of \$1,000 and more**

In examining contracts of \$1,000 and more, we found that for FY1993-94 the seven districts spent a total of \$826,130 for 259 personal services contracts. On an enrollment basis of 180,428 students in 239 schools, the distribution of expenditures was quite disparate among the seven districts. Exhibit 2.1 shows the distribution of contracts and expenditures compared to enrollment and number schools.

- Honolulu District had 19 percent (34,764) of the students and 23 percent (56) of the schools, but had 34 percent (87) of the contracts and expended 33 percent (\$275,190) of the funds.
- Hawaii District, with 15 percent (27,023) of the students and 14 percent (33) of the schools, had only 4 percent (10) of the contracts and expended 3 percent (\$26,982) of the funds.
- Kauai District contracts and expenditures were just about proportionate to district size; Maui District was disproportionately high.
- Central and Leeward Districts were disproportionately low.

Schools initiated and administered a large number of contracts (159 out of 259) directly. The distribution of contracts and funds among schools also showed wide disparities:

- Only 70 schools, or 29 percent of the total, actually had such contracts;
- Almost 40 percent of the schools in both the Honolulu and Maui Districts had personal services contracts of \$1,000 or more;
- Less than 25 percent of schools in the Central and Kauai Districts had contracts.
- Only 15 percent (5 out of 33) of the schools in the Hawaii District had such contracts.

**Exhibit 2.1****Comparison of Percentage of Personal Services Contracts of \$1,000 or More With Student Enrollment and Schools, FY1993-94**

Schools with contracts of \$1,000 or more varied widely in the number of contracts and dollar amounts. Exhibit 2.2 presents this information for selected schools.

**Exhibit 2.2****Personal Service Contracts at Selected Schools**

District/School	Number of Contracts	Total Expenditures
<b>Central</b>		
Wahiawa Elementary	1	\$ 1,000
Moanalua High School	9	\$ 47,427
<b>Maui</b>		
King Kamehameha III Elementary	1	\$ 1,400
Kihei Elementary	11	\$ 31,520
<b>Honolulu</b>		
Kauluwela Elementary	1	\$ 1,950
Farrington High School	8	\$ 36,650

### **Variations in contracts for under \$1,000**

The statewide distribution of personal services contracts for under \$1,000 is difficult to pinpoint due to the scarcity of information. However, detailed information was available for the Leeward District. For the period from July 1, 1993, to March 30, 1994, we found considerable variation in the distribution of these expenditures among the district's schools. Similar variation probably exists in other districts.

- 9 of the 37 schools in the Leeward District had no contracts;
- 14 schools (about 38 percent) had 5 or fewer contracts;
- 2 schools had between 20 and 30 contracts;
- 3 schools had between 40 and 50 contracts;
- 1 school had 85 contracts.

In terms of dollar amounts, 8 of the schools with contracts expended less than \$500 apiece and another 6 expended less than \$2,000 each. However, 1 school expended \$54,020 and 3 others expended more than \$13,000 each.

The variation in the number of contracts and their amounts appears to have no relationship to the size or type of school. For example, neither the largest nor smallest elementary schools in the Leeward District had contracts. Contract expenditures at elementary schools ranged from \$100 to \$20,466. Intermediate schools showed the least variance. Among 4 intermediate schools, 2 had no contracts, 1 had 1 contract for \$150, and 1 had 11 contracts totaling \$4,396. Among the 5 high schools, the range was from a low of 8 contracts totaling \$3,925 to a high of 85 contracts amounting to \$54,020. Among schools with contracts, the range of expenditures per student was from \$0.15 to \$32.41.

### **No explanation for variation**

No one in the DOE is responsible for assessing or managing how resources are being used to acquire additional personal services. Thus, the DOE is placed in the untenable position of being unable to explain how much is being spent, how the funds are being spent, or why the expenditures are distributed as they are. The DOE is unable to relate these expenditures to its educational mission or otherwise justify its use of these resources. This is an abdication of management responsibility.

***Use of personal services should be based on DOE's educational mission***

Considering the significant effort and resources being devoted to acquiring additional personal services, the DOE should manage these activities to ensure that they are closely related to the department's educational mission.

Proper management would give adequate attention and direction to such matters as: (1) identifying needs for personal services based on educational requirements, (2) assessing the availability of resources within and outside of the DOE to meet identified personal services needs, (3) justifying the use of extra personal services beyond normal staffing, (4) procuring extra personal services in a fair, efficient, and effective manner, (5) monitoring the performance of those providing extra personal services, (6) evaluating the results obtained from the use of extra personal services, and (7) setting overall policies and procedures affecting the use of extra personal services.

In summary, if the DOE is to manage effectively its extensive use of extra personal services, it must first ensure that these services are essential for achieving the educational mission of the department.

***Contract administration is decentralized***

The determination of need for extra personal services, the assessment and allocation of available resources, and the selection of vendors are all highly decentralized. According to DOE officials at the state, district, and school levels, the initiation of personal services contracts (including these various steps) is left almost entirely to individual schools or to units within the different statewide and district offices. Even though decentralized, contract administration practices should be standardized to ensure accountability, effectiveness, efficiency, and fairness throughout the DOE.

The DOE has provided little central guidance. Scattered throughout the DOE's formal policies and procedures are a number of general statements pertaining to various aspects of personal services contracts. Nowhere, however, is the initiation process described, its importance explained, or its individual steps or components specified.

It is often impossible to determine from the contracts such important information as the need for the services, the purpose to be served, and the results expected. To illustrate, one contract simply identified the vendor as a mainland school official, specified a fee of \$700 a day for two days, and described the purpose of the contract as: "Provide training on concept attainment and concept development strategies to certified staff."

The monitoring of vendor performance and evaluation of the results obtained from personal services contracts is also highly decentralized within the DOE. Once contracts are approved, they are returned to the

initiating units for implementation. No one appears to be concerned with or involved in monitoring performance or evaluating results once contracts have been approved.

***Direction must come from the superintendent of education***

In view of the decentralized manner in which personal services are acquired, direction must come from the superintendent of education. The Office of the Superintendent should establish a system of management and control that would ensure that expenditures for additional personal services serve educational purposes. The management system should include a determination of the educational purpose of the service, how the service would fulfill the purpose, the reason why the service cannot be provided by existing staff, why the vendor was selected, and the basis for the fee paid. The system should also address responsibilities for monitoring and evaluating the services provided.

Staff from the Office of the Superintendent, such as those from the Evaluation Branch, should play an important role in making sure that the system focuses on the effectiveness of personal services in helping the DOE achieve its educational objectives.

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**The Use of Additional Personal Services Is Not Well Managed**

The DOE has issued extensive policies and procedures relating to the use of additional personal services. These have not resulted in effective management control over expenditures. Lacking are adequate safeguards against abuse and efforts to enhance efficiency, economy, fairness, and open competition. In the sections that follow we discuss a number of shortcomings in the DOE's use and management of additional personal services. We begin with the inappropriate and unclear assignment of responsibilities in this area.

***Responsibilities are not appropriately assigned***

The acquisition of extra personal services is closely related to both procurement and personnel management. Currently, however, little attention is paid to procurement or personnel management or to interactions between these two functions. The DOE's procurement and personnel management offices are involved in only a limited way while the Budget Branch, with little or no special expertise in either procurement or personnel management, is assigned key responsibilities.

**Office of Business Services (OBS)**

The DOE's handbook on personal services contracts specifically refers to such contracts as a procurement activity and sets forth a general policy in favor of free and open competition and public bidding.

The Office of Business Services (OBS), however, has only limited involvement in the procurement of personal services. The head of OBS, the assistant superintendent for business services, approves waivers from the bidding requirement. The OBS accounting section and vouchering section process purchase orders for personal services, and the procurement and distribution section handles all contracts that go out to bid. However, none of the OBS units plays a significant role in the initiation, review, or approval of most personal services contracts.

It is the program units throughout the DOE that initiate the contracts, the departmental and district level offices that approve contracts under \$1,000, and the Budget Branch that coordinates the review and approval of contracts over \$1,000. It is also the program units that decide whether to use purchase orders or to go through contracts. This means that no one brings a real procurement perspective to the acquisition of additional personal services in terms of being a specialist in procurement and involved in procurement on a regular, on-going basis.

### **Office of Personnel Services (OPS)**

The DOE's Office of Personnel Services (OPS) shares some responsibility for the contracting of personal services. But it plays a relatively minor role even though DOE policies and procedures state that personal service contracts are closely interrelated to departmental personnel administration.

For example, the handbook states that personal services contracts are not to be used if they result in an employer/employee relationship between the DOE and a contractor or otherwise conflict with the DOE's personnel policies. Further, the contract review process set forth in the handbook calls for all contracts to be checked for compliance with applicable personnel laws and policies, such as being properly exempt from state civil service coverage, not being in conflict with the job functions of regular DOE employees, and being consistent with departmentally established fee rates.

Personal services contracts for \$1,000 or more are regularly routed to OPS to verify compliance with state personnel laws and requirements. But the OPS verification appears to be perfunctory since the office almost always grants clearance. OPS has no role in acquiring personal services of less than \$1,000. Thus, no OPS expertise is being applied to the acquisition of many personal services.

### **The Budget Branch**

The Budget Branch in the Office of the Superintendent is most involved in managing personal services contracts. It has been delegated broad duties in reviewing contract documents, providing advice and guidance,

and ensuring the orderly processing of contract documents. It originated the handbook that sets forth policies and procedures for personal services contracts, it reviews on behalf of the superintendent all personal services contracts for \$1,000 or more, and it is generally looked to as the repository of information on personal services contracts.

Despite its broad responsibilities, the Budget Branch focuses mainly on the technical details of making sure all required documents are present and properly filled out.

The Budget Branch maintains summary and analytical information on most personal services contracts for \$1,000 or more but makes little use of the data. It has no information on contracts for less than \$1,000. It does not prescribe any recordkeeping requirements for those who approve such contracts and makes no effort to monitor activities relating to the issuance of the contracts.

The Budget Branch is almost totally excluded from two important aspects of personal services procurement—the acquisition of personal services directly through purchase orders and the offering of personal services contracts through competitive bidding. Both of these activities are handled almost entirely through OBS.

### **More appropriate assignment of responsibilities**

Communication and coordination among the Budget Branch, OBS, and OPS have been minimal. All three units concede that many DOE employees are receiving personal services contracts, but none is responsible for obtaining information on how many persons fall into this category, who they are, how much they are being paid, or what specific types of services are being acquired in this manner, and whether the contracts are proper.

To properly manage the acquisition of personal services, a clearer and more appropriate assignment of responsibilities is needed. Since the two major aspects of this activity are procurement and personnel management, we believe that OBS and OPS are key. The OBS procurement section should take the lead in bringing a procurement focus to the activity. It should be made responsible for making sure that procurement of these services is done in an effective, fair, and efficient manner.

Under the direction of OBS, the Procurement Section should also be also responsible for developing a new handbook of policies and procedures that would comply with the State's new procurement law and rules. It should be the source of all official policies and procedures that govern this activity. Currently, amendments and supplements to the handbook

on personal services come from various sources within DOE. Even the Budget Branch, which is officially responsible for the current handbook, does not always keep abreast of changes.

The Procurement Section should work closely with the OPS. OPS should be responsible for such matters as reviewing the availability of resources within DOE to meet needs for personal services, the appropriateness of paying DOE employees for these services, and compliance with state and DOE policies and rules on personnel matters. These two offices should also work closely with the Evaluation Section in the Office of the Superintendent to establish a management system that would ensure the educational effectiveness of the personal services acquired.

***Policies and procedures are outdated, cumbersome, and inadequate***

When activities are decentralized, sound policies and procedures are particularly necessary to provide administrators with basic guidelines. It is important that policies be clear, complete, and up to date. However, the DOE's policies and procedures relating to the use of additional personal services are outdated, cumbersome, and inadequate. The DOE recognizes that it has a problem in this area but has not taken sufficient action to remedy the problem.

### **Outdated policies and procedures**

Issued in February 1986, the DOE's handbook, *Special Contracts and Agreements for Personal Services*, antedates both the enactment of the administrative flexibility legislation in 1986 and the Hawaii Public Procurement Code in 1993. The DOE has issued amendatory and supplementary policies and procedures but the 1986 handbook remains the basic guide. The handbook is seriously out-of-date and thus can be confusing.

DOE personnel have to look elsewhere for the correct information. For example, in a number of sections, the handbook refers to other state agencies that used to be part of the review and approval process. The handbook notes that sole source waivers from bidding requirements must be approved by the state comptroller and includes a sample request directed to that official. Until recently, however, the DOE assistant superintendent for business services was the official authorized to approve such waivers.

### **Cumbersome amendment process**

The handbook is a separate bound pamphlet that cannot be amended and updated by simply removing outdated material and inserting new material. Consequently, amendments or supplements are issued as memoranda or other separate communications. These memoranda are



issued by various administrators—the superintendent, assistant superintendents, or other sources within the department. Without a system for issuing, arranging, and identifying amendments and supplements, administrators have no assurance that they are working with complete and up-to-date versions of all applicable policies and procedures.

During our fieldwork on this audit, we were given a stack of documents identified as amendments or supplements to the handbook, but we came across others that were not in the original stack given to us. In one instance, we found a memo from the superintendent of education that was unfamiliar even to the Budget Branch, which is responsible for the policy handbook. We had to supply the Budget Branch with a copy of this document.

### **Unclear and inadequate policies and procedures**

The policies and procedures are unclear and inadequate. They lack clear guidelines relating to: (1) the initiation of projects (including determining need, assessing the availability of resources within and without the department, evaluating vendor qualifications, and arriving at reasonable prices), and (2) the administration of personal services contracts once the contracts have been approved (including monitoring performance and evaluating results).

Also missing are essential criteria and safeguards in such important areas as: (1) determining what constitutes employment with the DOE, (2) allowing the acquisition of additional personal services without the use of personal services contracts, and (3) ensuring compliance with legal and ethical requirements.

### **Insufficient corrective action**

The DOE is well aware that its handbook is outdated. Officials say that a revised draft has been held up pending implementation of the State's new procurement code. They want to see the impact of the new law before issuing any new or revised policies and procedures. This is understandable, but the DOE still needs to move promptly in this area.

The revised draft is still not adequate. It eliminates the out-of-date references to other state agencies, but it still requires a lot of bureaucratic processing from officials without providing adequate guidelines and safeguards. For example, contracts for as little as \$1,000 would still need the superintendent's approval. Also, the revised draft is still in the form of a separate pamphlet that will be difficult to amend and keep up to date.

***Control over  
acquisition process is  
uncertain***

The DOE needs to take a broader approach to its revision efforts by taking into account changing conditions, providing adequate guidelines for all aspects of procuring additional personal services, and strengthening controls in several of the areas discussed in this report. The DOE also needs to make sure that the new handbook has a format that can be readily amended and updated.

Since the DOE's policies, procedures, and practices are inadequate, the DOE is unable to assure that proper control is being exercised or that all legal requirements are being met. Contracts result in redundant employment, conflicts of interest, and violation of tax and other laws governing employment.

**Persons who should be on the DOE payroll**

The DOE's handbook on personal services contracts states that contracts are *not* to be used if the rendering of the services will result in "an employer/employee relationship between the DOE and the contractor." However, the handbook provides no guidelines for determining when an employer/employee relationship might be established. The handbook also fails to provide guidance as to what constitutes or creates such a relationship. In the absence of clear guidance, many persons are being given contracts who should be on the DOE's payroll.

The U.S. Internal Revenue Service (IRS) has been questioning school districts nationwide about their use of personal services contracts. The IRS is concerned because taxes are not withheld from contracts as they would be from employee paychecks. The IRS has established criteria for determining when an employer/employee relationship is created for payroll and tax withholding.

The DOE has formed an internal management committee to develop policies and procedures that would comply with IRS criteria. The committee has a proposed policy for "temporary contract employees" that would place a person temporarily on the DOE payroll without making that person an employee for employee benefit purposes. Members of the committee estimate that this proposal would cover up to 90 percent or more of the persons now receiving personal services contracts. This suggests that, in the past, the vast majority of those personal services contracts created an "employer/employee relationship" in violation of the DOE's handbook on personal services contracts.

**Weak controls over contracts for DOE employees**

Many of those receiving contracts are also regular employees of the DOE. DOE policy allows this if the work or service to be performed is not an extension or continuation of the employees' normal, regular work

and is performed during non-working hours. However, the DOE does not monitor or otherwise control these contracts with DOE employees.

DOE officials readily concede the department contracts with many DOE employees, and that they do not know how many employees fall into this category or whether the employees' contract work relates to their regular work. Current procedures do not require contractors to disclose employment with the DOE or the nature of that employment. Similarly, contractors are not required to affirm that the contract work is not connected to their regular work or does not occur during regular working time.

Administrators say that they rely upon their own familiarity with the DOE staff and upon the honesty of DOE employees. In a system involving thousands of employees and contractors, however, stronger safeguards are needed.

A comparison between names of contractors listed in contract logs and names of DOE staff listed in the DOE's personnel rosters confirm that many DOE employees are receiving contracts:

- In FY1992-93, 111, or 26 percent, of the 430 contracts ranging from \$1,000 to \$4,000 went to 88 DOE employees.
- In FY1993-94, 91, or 22 percent, of the 414 contracts ranging from \$1,000 to \$8,000 went to 79 DOE employees.
- For the nine-month period from July 1, 1993, to March 30, 1994, the Leeward District issued 278, or 59 percent, of its 475 contracts of less than \$1,000 to DOE employees.

It was impossible to determine from DOE records whether a conflict existed between the employee's regular work and the contract work. In a number of instances, however, descriptions of the contract work to be performed were similar to or extensions of the employee's normal work. For example, a teacher attached to a district office was given a \$3,900 contract to update and revise the district's special services handbook. Another district gave a district office teacher a \$2,894 contract to "provide educational evaluations of students at various school sites." Similarly, a special education teacher in the state level Office of Instructional Services was granted a contract for \$3,800 to conduct educational evaluations of special education students.

The DOE should require, at a minimum, that all contracts to DOE employees contain documentation identifying the employee's employment status with the department and verifying that the contract work does not conflict with the staff member's regular job. The employee should also affirm that no conflict exists.

### **Inconsistent use of purchase orders**

DOE policy prohibits the use of purchase orders for acquiring personal services. The handbook states: "A purchase order (Form C-03) cannot be used in lieu of the contract forms in obtaining personal services." Nevertheless, many administrators ignore this policy and acquire personal services directly through purchase orders.

The use of purchase orders for this purpose seems to be fairly widespread throughout the DOE. In interviews, administrators and staff cited varied reasons for using purchase orders, for example: (1) the supplier was a firm rather than an individual, (2) the supplier was someone who could validly issue an invoice (as distinct from a personal request for payment), (3) the supplier was listed on an approved vendor list, and (4) the extra protection that might be provided by a contract was not needed. They also noted that purchase orders are more efficient than contracts because they avoid the approval process required for contracts.

The policy prohibiting the use of purchase orders to acquire personal services is poor for a number of reasons. It is neither complied with nor enforced. It also results in inconsistent or unfair treatment of suppliers. Some schools and offices use purchase orders while others continue to follow a more complicated and time-consuming process of personal services contracts.

To deal with this situation, the DOE should reconsider its blanket prohibition against the use of purchase orders for personal services. It should modify its policies and procedures by specifying when and how purchase orders can be used. Under the new procurement law, purchases of less than \$10,000 are considered small purchases for which purchase orders may be used. The DOE may set a lower threshold for the use of purchase orders and monitor compliance.

### ***Laws and policies against parceling are being circumvented***

"Parceling" is a prohibited practice of dividing contracts into smaller amounts so as to defeat or evade applicable bidding or approval requirements.

State law and DOE policy clearly prohibit any parceling of contracts. Section 103D-305, HRS specifically prohibits this practice. The DOE's handbook also states that "All offices are cautioned that the dividing or parceling of contracts to circumvent any requirements whether purposely or inadvertently is expressly forbidden by law."

Not all multiple non-bid contracts awarded to a single contractor during a particular period are illegal. Justifiable reasons may exist. However, officials should be alert to the possibility of parceling and ensure that multiple non-bid contracts to the same contractor are indeed justified and do not represent parceling.

It appears that many schools and offices within DOE are using parceling to: (1) evade the statutory requirement for public bidding or waiver on contracts that will exceed a fixed threshold (in 1992-93, this threshold was \$4,000; for 1993-94, it was initially set at \$8,000 and subsequently raised to \$10,000); (2) evade the DOE's internal requirement that all contracts that exceed \$1,000 must go to the superintendent for approval; or (3) evade the statutory provision that prohibits the granting of contracts exceeding \$4,000 to state employees except through public bidding or by the filing of a public and written justification with the State Ethics Commission at least 10 days before the contract is effected.

### **Avoiding the bidding requirement**

We found many instances where parceling appears to have occurred in contracts awarded in FY1992-93 when the bidding threshold was \$4,000. Parceling meant splitting contracts of \$4,000 and over into several contracts for less than \$4,000.

During FY1992-93, the DOE recorded 430 contracts issued to 354 different contractors in amounts ranging from \$1,000 to \$3,999. Of these contractors, 54 received multiple contracts that exceeded \$4,000 in total cost. Of the 54, 42 received 2 contracts, 11 received 3 contracts, and 1 received 4 contracts. All told, these 54 contractors, or 15 percent of all contractors, received 121 contracts, or about 28 percent of all contracts. The 121 contracts totaled \$353,137, or almost 32 percent of the overall total of \$1,106,688 for all 430 contracts. More than half of the contractors (31 out of 54) received multiple contracts from the same initiating units for the same or similar purposes and for time periods that were identical, overlapping, or in close sequence.

For example, one contractor received two contracts for \$1,735 and \$2,465 from the same office for the same one week period to "share thoughts" and to provide in-service training relating to "Whole Language." Another contractor received contracts for \$3,000 and \$3,999 from the same office for the same time period to carry out activities relating to bilingual family care services. Still another received two contracts for \$3,959 each from the same office for successive time periods plus a third contract for \$3,375 from another office for virtually the same time period. All three contracts were for psychological consultation services.

### **Conspicuous use of multiple contracts at the Office of Personnel Services (OPS)**

Apparent parceling at OPS is of particular concern. OPS was conspicuous in issuing multiple contracts to contractors whose combined contracts exceeded the \$4,000 threshold in FY1992-93. The office issued a number of contracts for its Cohort School Leadership Program

and its Hawaii Leadership Academy—two programs that provided in-house training and development for DOE educational and administrative personnel. Those contracted were for the most part current or retired DOE administrators.

During FY1992-93, OPS issued 2 or more contracts to 10 separate individuals that when combined exceeded \$4,000. In most instances, the individual contracts were for periods of work in immediate sequence to one another. The amounts of the contracts were just below the \$4,000 threshold (e.g., \$3,990). Altogether, these 10 contractors received 24 contracts totaling \$79,174. Totals for each contractor ranged from \$5,250 to \$10,980.

OPS continued to issue multiple contracts in FY1993-94 when the contract bidding threshold was raised from \$4,000 to \$8,000. Interestingly enough, with the threshold raised to \$8,000, 7 of the contracts were set just below this new limit—from \$7,000 to \$7,950. Contract prices were raised even though there was no indication that the nature of the work performed under these contracts had changed between FY1992-93 and FY1993-94.

During FY1993-94, OPS issued multiple contracts to 12 individuals (including 9 of those who had received multiple contracts in 1992-93 plus 3 additional persons). It granted 25 contracts to 12 individuals totaling \$117,948. Among these 12 contractors, 5 received total amounts of \$10,000 or more, well in excess of the new \$8,000 threshold. Individual totals ranged from a low of \$5,150 to a high of \$14,950 (received by 3 different individuals).

These OPS practices raise serious questions of inside dealing, cronyism, and favoritism. First of all, the contracts were confined primarily to current and former employees of the DOE. This restricted access, avoided bidding, and kept the procurement process from being open and competitive.

Secondly, as the office responsible for overall personnel management and for reviewing all personal services contracts of \$1,000 or more, OPS should be particularly sensitive to making sure that its personal services contracts are appropriate, proper, and beyond reproach.

Thirdly, these personal service contracts are aimed at providing in-service training and development for those personnel seen as the future leaders of the department. The OPS approach sets a poor example for the future leadership of the DOE.

### **Avoiding the superintendent's approval**

Approval by the superintendent of education is required for all personal services contracts of \$1,000 and more. We reviewed data on short-form contracts (those less than \$1,000) in the Honolulu, Windward, and Leeward district offices and the Office of Instructional Services (OIS) to determine if contracts were being parceled to keep them under \$1,000. We found indications of parceling in three of these four offices.

At the Honolulu District Office, we found one contractor had received 10 contracts ranging from \$700 to \$816 apiece which totaled \$8,024. Several of the contracts were received on the same day and were for workshops to be presented on successive days. Although the contracts were initiated by five different staff in the district, four staff members awarded two or more contracts each to the contractor. One district staff member gave another contractor 2 contracts for \$999.60 each. The contractor in this case was a DOE teacher and the two contracts were submitted at about the same time for work to be performed over closely successive time periods. The same district staff member issued 3 contracts for \$900 each to another contractor for work to be performed between April and June 1993. Still another contractor received 3 contracts in amounts of \$996, \$999, and \$600 for work that was to be performed between January and April 1993. This contractor was the spouse of an educational specialist in the Honolulu District Office.

The Windward District Office issued two contracts for \$924 apiece to the same contractor who had received 10 contracts from the Honolulu District Office. The two contracts were for workshops separated by a month and half, but they were held at the same school and on the same subject matter. This office also gave 3 contracts to one contractor in amounts of \$950, \$500, and \$500. Some intervals separated the three workshops, but all three involved teacher training in the same subject matter.

The Office of Instructional Services (OIS) gave 2 contracts for \$915 each to a contractor for lecture/demonstrations for two closely related programs covering the exact same time period. Two other contractors each received a \$845 contract one month to develop a framework for a program and then each received a \$819 contract the next month to develop a curriculum for the same program. Finally, another contractor received 6 contracts totaling \$3,692 to provide services in the same subject area from January to May 1993.

We found no indications of parceling at the Leeward District Office. The administrator of this office made a point of monitoring closely for possible parceling by maintaining a computerized log on personal services contracts. Thus, it is possible under the present system to prevent parceling.

### **Avoiding ethics disclosure requirements**

Section 84-15, HRS requires a written justification to be filed with the State Ethics Commission 10 days before a non-bid contract of \$4,000 or more is to be awarded to a state employee. Parceling to keep contracts below \$4,000 would thereby avoid having to file written justifications with the State Ethics Commission.

We found no ethics disclosure letters for those employees whose combined contracts exceeded \$4,000 in FY1992-93. This appears to be a clear circumvention of the intent, if not the letter, of the law. The DOE should make sure that it complies fully with the ethics disclosure requirement.

### **Better controls needed to prevent parceling**

The DOE's handbook contains a strong admonition against parceling, but the department's controls for enforcing this policy are weak and need to be strengthened. For example, the DOE has no procedures to ensure that initiators and reviewers are fully aware of multiple non-bid contracts or have specifically evaluated whether or not parceling may be a problem. Control over parceling is particularly difficult since hundreds of contracts flow through the system, and many administrators are still relying on manual, rather than computerized, recordkeeping systems.

The DOE should require supervisory approval of any additional non-bid contracts awarded to a contractor. The DOE needs to pay greater attention to the problem of parceling and install stronger administrative safeguards against potential abuse.

### ***Personal services contracts are awarded with virtually no competition***

Despite a strong policy supporting open and free competition, personal services contracts are let with virtually no competition. The DOE's handbook states that "insofar as practicable, and except as otherwise provided for, . . . all personal services contracts should be based on competitive bids, awarded at the lowest possible cost consistent with specified standards of quality work performance, experience, etc., and... made without regard to favoritism."

In actual practice, little competition occurs. As noted earlier, large numbers of contracts are awarded to DOE employees and parceling appears to be prevalent. Sole source purchases and a blanket exemption are also used to avoid competition.



### **Excessive use of sole source**

The DOE uses sole source justifications to waive bidding requirements. During FY1992-93, the DOE processed 63 sole source personal services contracts for amounts of \$4,000 or more for a total of \$1,462,011. Individual contracts ranged from \$4,200 to \$217,656. In FY1993-94, with a higher threshold for bidding, the DOE approved 55 sole source personal services for amounts of \$8,000 or more totaling \$1,342,510. Individual contracts ranged from \$8,116 to \$176,400.

DOE officials obtained waivers from the bidding requirement on the grounds that the contractors were sole source providers of the needed services. The DOE assistant superintendent for business services is authorized to grant such waivers. Some of the sole source purchasing appears justified. For example, the Hawaii Academy of Sciences is probably the only party that can successfully stage the annual science fair for students. In other cases, however, sole source purchasing appeared questionable. For example, several contractors offer drama related services, but each is granted sole source status. Under the new procurement law, use of sole source will have to be more fully justified.

### **Blanket exemption of contracts for special education services**

Contracts for diagnostic and treatment services for special education students receive a blanket exemption from the bidding requirement. Instead of obtaining a sole source waiver, the DOE attaches to each contract a copy of a memorandum from the superintendent of education dated August 30, 1991.

The memorandum exempts these services from the bidding requirement on the grounds that the services are necessary to: (1) meet federal and state mandates, (2) cope with a pending lawsuit, and (3) overcome the inability of the Department of Health to provide the needed services. The memorandum further states that there is a limited pool of private contractors who are willing to provide the required services on a fee basis.

The blanket exemption from the bidding requirement has been applied since August 1991 to all personal services contracts for special education services. Such a practice is not covered in the DOE's policies and procedures.

During FY1992-93, the DOE used the blanket exemption to grant 44 contracts to 33 contractors at a total cost of \$932,860. With a higher bid threshold in 1993-94, the department awarded 34 contracts to 22 contractors for a total amount of \$865,918. DOE personnel have informed us that at least one of these contractors is a former employee of the department. This particular contractor received 2 contracts totaling \$71,400 in 1992-93 and 3 contracts totaling \$93,840 in 1993-94.

The assumption underlying this blanket exemption that a non-competitive situation existed in August 1991 and will continue indefinitely has never been tested. A more competitive approach, such as advertising for bids or calling for proposals, might result in increased vendor interest, lower costs, and better services.

### **Successful use of bidding for personal services**

In a couple of recent instances, the department did use competitive bidding successfully. In early 1993, the DOE called for proposals to help in developing an evaluation plan for its school/community based management (SCBM) efforts. The winning bid for this contract was almost \$60,000 less than the other bid that was received. In early 1994, the DOE called for sealed bid proposals to provide adult education services. According to DOE officials, bidding in this area is required for federal funding.

These efforts at competition are limited, but they show that competition can be applied to the acquisition of personal services. The DOE should do everything possible to expand the use of competitive bidding and involve both program and procurement personnel in the process. The new procurement law and rules will require the DOE to revamp its policies and procedures to ensure compliance with competitive bidding requirements. In developing new procedures, the DOE should adopt thresholds and procedures for small purchases under \$10,000 that will foster competition. It should develop a pool of qualified vendors from which a variety of services could be purchased.

### ***Timeliness of contracts needs to be improved***

To properly protect all affected parties, contracts should be entered into and approved before work is actually initiated or obligations incurred. Otherwise, questions of liability arise. In addition, disputes may arise over work that is not officially authorized and payments for such work. We found some serious problems with regard to the dating and timeliness of the DOE's personal services contracts. These problems are discussed below.

### **Confusing dating of contracts**

The way the DOE dates its personal services contracts is confusing and contradictory. The standardized forms which the DOE uses for its personal services contracts provide for a date to be inserted at the beginning of the contracts. According to the DOE handbook on personal services contracts, this date should be the same as the date when the contractor signs the contract. Most of the contracts also provide for the insertion of the dates when the contractor and the superintendent sign the contracts. Contracts are also supposed to indicate when work is to start and to be completed. Under DOE policy, work is not supposed to commence until after the superintendent gives his approval.

However, under current procedures, contractors usually sign the contracts much sooner than the superintendent signs them. Sometimes the interval between the two signings can extend over several months. Thus, most contracts appear to take effect much sooner than they are actually approved by the superintendent. As a result, the contracts may also provide for work to begin before the superintendent actually signs the contracts. They may even allow for the specified work *completion* dates to precede the dates when the superintendent approves the contracts. This not only is confusing but also renders largely meaningless the superintendent's approval. It can also lead to serious disagreements and problems of liability.

For many of the contracts we examined in detail, work appears to have started before final approval was received. This is inconsistent with official policy. In 43 out of the 105 contracts we reviewed, the final approval dates came *after* the work start dates. In one case, the approval was dated 182 days later, and in another case it was 119 days later.

The governor has criticized the DOE for allowing work to start before submitting a contract to him for approval. In a number of instances, payments were made to the contractor less than 30 days after the contracts were approved. This means that payments were authorized almost immediately after the contracts were approved based upon work that had already been performed. Such actions clearly violate official policy.

In 8 of the 105 contracts, work *completion* dates were actually earlier than the final approval dates. In another instance, the two dates were the same. For another 19 contracts, the intervals between the two dates were less than 30 days. These practices reduce contract approval to a mere formality. The DOE should clarify and strengthen the way it dates personal services contracts.

### **Delays in processing**

The DOE's handbook tells administrators to allow 30 days for processing contracts. We found, however, that a number of contracts (16 out of 105) took more than 30 days from the date the contractor signed the contract to the date the contract was submitted to the superintendent's office for approval. In one case, it took 154 days and in three cases it took more than 125 days.

A number of contracts (12 out of 105) took more than 30 days to receive approval from the superintendent's office. In one case, it took 119 days and in another, it was 111 days. Both of these apparently got bogged down by having to go to the Board of Education and the governor for approval. The DOE handbook recognizes that such contracts take longer to process, but it allows an expected time lapse of 60 days for this purpose—just about half the time required for these two contracts.

### **Policy on timeliness is not being enforced**

The DOE knows that it has a problem with respect to allowing work to proceed before contracts are approved. On July 7, 1989, the superintendent of education sent a memorandum to DOE administrators noting that some personal services contracts were submitted for approval after services had already been started or completed. He reminded the administrators that this was not acceptable and instructed them to submit their requests for approval on a timely basis.

On July 12, 1993, the superintendent issued another memorandum to DOE administrators. He again noted that some contracts were submitted for approval after work had already begun or had been completed. He cautioned administrators against this practice and explained the need to plan ahead and allow sufficient time for the review and approval process. He warned that violations of regulations would subject administrators to liabilities and possible penalties and reemphasized that no contractor should be allowed to start work without a fully authorized contract.

Despite these repeated admonitions, timeliness in submitting personal services contracts remains a problem. Numerous contracts continue to be received in the superintendent's office less than 30 days before their start dates. In at least one case in early 1994, the work start date had already passed before the affected contract was received in the superintendent's office.

The DOE needs to take stronger corrective actions to ensure that contracts are processed on a timely basis. It also needs to enforce its policy against allowing work to proceed under a contract until the contract is approved and fully in force.

### **Controls over small expenditures are excessive**

Management controls should be appropriate to the level of expenditures being controlled—that is, relatively simple controls may be sufficient for small expenditures whereas stronger and more stringent controls are appropriate for large expenditures. Controls should be geared toward providing the level of protection needed. The DOE is exercising control over many small expenditures that is both excessive and ineffective.

### **No minimum threshold for contracts**

The DOE has set no minimum dollar amount for personal services that would require a contract and approval by the assistant/district superintendent level. As a result, expenditures as low as a few dollars require the same documentation and extended administrative processing as expenditures that range up to \$999.

At the same time, schools and other expending units can spend thousands of dollars for other types of acquisitions without having to go through such an elaborate procedure. They simply issue purchase orders for what they want and enter the information into the computerized accounting system. If sufficient funds are available, then the acquisitions can proceed.

The DOE is annually issuing thousands of short form contracts (that is, contracts for less than \$1,000). Many of these contracts are for \$100 or less and a large majority of them are for \$500 or less. Exhibit 2.3 presents contract data for the Office of Instructional Services and three districts.

**Exhibit 2.3**  
**DOE Short-Form Contracts\***

District/Office	Number of Contracts			
	Total Contracts	\$1- \$100	\$101- \$500	\$501- \$999
Office of Instructional Services	744 (100%)	91 (12%)	389 (52%)	264 (35%)
Honolulu District	597 (100%)	127 (21%)	291 (49%)	180 (31%)
Windward District	150 (100%)	33 (22%)	84 (56%)	33 (22%)
Leeward District	475 (100%)	152 (32%)	160 (34%)	163 (35%)

Source: DOE records.

\*The data for the Office of Instructional Services and the Honolulu District are for fiscal year 1992-93, the data for the other two districts are for the first nine months of fiscal year 1993-94.

From the foregoing, it can be concluded that some of the short form contracts are for very small amounts and that about two-thirds of them are for amounts of \$500 or less.

**Focus on technicalities**

It appears that those in the DOE hierarchy who review and approve personal services contracts focus primarily upon the technical aspects of making sure that all required forms are included and properly filled out. As a consequence, current controls afford little protection against such serious problems as inappropriate extra employment of DOE staff

members, parceling of contracts, and allowing work to proceed under contracts before the contracts are approved. In addition, the controls over personal services contracts that do exist can apparently be circumvented altogether simply by acquiring services directly through purchase orders without using personal services contracts.

In view of the workload involved in the current processing of personal services contracts and the general ineffectiveness of existing controls, the DOE should shift from its emphasis on detailed controls to more effective controls.

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## Conclusion

The DOE expends considerable sums on personal services contracts. DOE officials mechanically process multitudinous forms for relatively small dollar amounts up and down the organizational chain. To better manage this process, the DOE should develop basic guidelines for acquiring personal services. The guidelines should deal with such important matters as determining need, assessing available resources, promoting competition, monitoring performance, and evaluating results. The guidelines should also be sufficiently comprehensive and clear to be readily understood and usable by administrators at the operating or expending level. The DOE should train these administrators on the guidelines and then give them fairly wide discretion to apply them, subject to overall surveillance and internal auditing by the department. The DOE needs to rethink its whole approach to controlling the acquisition of extra personal services. This is especially true as it moves more actively toward decentralization and school/community based management.

The DOE must develop its guidelines to ensure compliance with the new procurement law and rules. It must set about acquiring any needed resources in an effective, fair, and efficient manner, taking into account the advantages and disadvantages of regular full time employment, temporary contract employment, and personal services contracts let through competitive bidding and negotiation. Finally, it must provide for appropriate monitoring of performance and evaluation of results.

Such an approach calls for close coordination and cooperation among the DOE's educational program managers, its personnel managers in OPS, and its procurement managers in OBS.

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## Recommendations

1. We recommend that the superintendent of education establish a management system for the acquisition of additional personal services. The management system should include:

- a. A requirement that staff from the Planning and Evaluation Branch of the Office of the Superintendent develop policies and procedures to ensure the educational effectiveness of such services;
  - b. The designation of the Procurement and Distribution Section in the Office of Business Services as the lead office to develop, coordinate, and issue up-to-date policies and procedures for the acquisition of additional personal services that would ensure fair and open competition, efficiency, economy, and compliance with all laws and rules on procurement; and
  - c. The assignment of responsibilities to the Office of Personnel Services to ensure compliance with all personnel laws, rules, policies, and state ethics laws.
2. The management system for the acquisition of personal services should:
  - a. Ensure that additional services acquired from DOE employees are appropriate and proper;
  - b. Generate sufficient data to allow for an assessment of the effectiveness, propriety, and efficiency of expenditures;
  - c. Ensure open competition by preventing the practice of parceling (particularly at the Office of Personnel Services), eliminating the blanket exemption for special education services contracts, and establishing policies and procedures for small purchases that foster competition;
  - d. Implement and enforce procedures for accurate dating and timely processing of contracts; and
  - e. Establish controls that are appropriate to the level of control needed and eliminate all unnecessary paperwork and processing.

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## Response of the Affected Agency

### Comments on Agency Response

We transmitted a draft of this report to the Department of Education (DOE) on December 12, 1994. A copy of the transmittal letter to the department is included as Attachment 1. The department's response is included as Attachment 2.

The DOE responded that overall it agrees with some of the findings that there is room for improvement. It says that it is aware of the issues and most of them have been resolved or are in the process of being resolved. The superintendent has appointed a task force to revamp the administration of personal services contracts and plans that by June 1995, all areas will be resolved as needed changes are made to the system.

The department says it disagrees with some findings. It states that our finding that the department lacks central review and evaluation of personal services contracts conflicts with our finding that the DOE exercises too much control over school expenditures. DOE says, "Central review means central control." This is a misreading of our report. Our findings were that the DOE had not controlled or assessed the need for personal services contracts and whether they contribute towards accomplishing the DOE's mission. We also said that it exercised excessive and ineffective control over small expenditures. These findings do not conflict with each other. In fact, our recommendation was that the level of control should be appropriate to the level of expenditures being controlled.

The DOE also assumed that "the auditor questions the need for such [personal] services," since we pointed to the uneven use of these contracts throughout the school system. We noted that the department was not in a position to explain or justify the uneven use of contracts. It has no system in place to assure that the personal services contracted for are essential to the DOE's mission, or that they are obtained efficiently and economically.

The DOE argues that parceling of contracts is not defined in law. It intends to disseminate an improved definition of parceling and reduce the varied interpretations that have existed.



ATTACHMENT 1

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 12, 1994

**COPY**

The Honorable Herman M. Aizawa  
Superintendent of Education  
Department of Education  
Queen Liliuokalani Building  
1390 Miller Street  
Honolulu, Hawaii 96813

Dear Dr. Aizawa:

Enclosed for your information are three copies, numbered 6 to 8 of our draft report, *Audit of the Administration of Personal Services Contracts in the Department of Education*. We ask that you telephone us by Wednesday, December 14, 1994, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Thursday, December 22, 1994.

The Governor and presiding officers of the two houses of the Legislature have also been provided copies of this draft report.

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

Sincerely,

Marion M. Higa  
State Auditor

Enclosures

BENJAMIN J. CAYETANO  
GOVERNOR



HERMAN M. AIZAWA, Ph.D.  
SUPERINTENDENT

STATE OF HAWAII  
DEPARTMENT OF EDUCATION

P.O. BOX 2360  
HONOLULU, HAWAII 96804

OFFICE OF THE SUPERINTENDENT

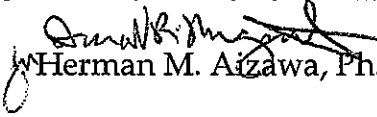
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OFFICE OF THE AUDITOR  
STATE OF HAWAII

MEMO TO: Honorable Marion M. Higa, State Auditor

FROM:  Herman M. Aizawa, Ph.D., Superintendent of Education

SUBJECT : Audit of the Administration of Personal Services Contracts in the  
Department of Education

Thank you for the opportunity to review and comment on the audit report. The audit covers a wide spectrum of concerns related to the review, processing, approval and implementation of personal services contracts within DOE.

Overall, we agree with some of the findings that there is room for improvement and disagree with others. We are aware of the issues and concerns. Most of them have either been resolved, or are in the process of being resolved. We believe that the report contains some conflicting findings and recommendations. For example, the report criticizes DOE for the lack of central review and evaluation of personal services contracts. At the same time, it criticizes DOE for exercising too much control over school expenditures for personal services contracts. Central review means central control. If you want more central review, you cannot at the same time ask for more decentralized control. You can have one or the other, but not both. Another example of such conflicting criticism is the charge that DOE needs to streamline procedures and reduce bureaucratic delays in the processing of personal services contracts. At the same time, it also criticizes DOE for lack of open bidding, which takes more time, and for the lack of assessments of: (1) the effectiveness of expenditures, (2) the propriety of expenditures, and (3) the efficiency of expenditures. If program managers are required to prepare all of these reports, do all of these pre-audit and post-audit checks as part of the requirements to expend funds for personal services contracts, the delays and paperwork will not decrease, it will increase dramatically. It is difficult to reduce paperwork and delays if you are going to demand more information and reviews. In short, you can do one or the other, but not both.

We also note that personal services contracts are not as easy to administer as other types of expenditures. Every agency in state government has been struggling to understand exactly what is a personal services contract and how such contracts should be processed administratively. With the advent of the new internal revenue services code which requires employers to separate contracts where there are employee-employer relationship, from contracts with business entities, the management problem has become more complicated. Everyone is also struggling with the processing of these types of expenditures, whether to use the purchase order or the more formal contract. Our own feeling is that the PO is a simple contract instrument and appropriate for certain types of expenditures such as goods and simple services purchased from a corporation like the maintenance of office machines. But when purchasing personal services from a person, more often than not, the PO is not satisfactory, and a more formal contract with terms and conditions is more appropriate. A contract can include many conditions and requirements such as causes for termination, liabilities, indemnification, bonding, description of specific services, schedules, penalties for default or unsatisfactory services, etc.

There are three other concerns cited in the audit that we want to comment on, and these are: (1) rationale and use of personal services within DOE, (2) parceling and (3) the management of personal services contracts.

(1) **Rationale and use of personal services.** Since personal services are used so unevenly throughout the school system, the auditor questions the need for such services. We disagree with this finding. All schools are different, with different needs, different students, different staffs, different administrative styles, different communities, etc. Because of such differences, we expect schools to be different. We would be surprised if they were all the same, with the same expenditure patterns. It is a fact that some schools may hire more part-time teachers and buy more personal services through contracts than other schools. That is their prerogative. Now that we have SCBM, decentralized authority, lumpsum budgeting, and student centered schools, those differences will amplify over time. Furthermore, in the coming years, we expect more personal services will be contracted out. It seems that more and more, the schools prefer to purchase personal services through contracts, rather than the traditional method of creating and filling positions. Personal services contracts give the schools more flexibility and does not result in long-term commitment of funds to specific programs and positions. The ultimate in contracting personal services is privatization. This is where we contract out the entire school with an outside business entity. At this stage, we are only one short step from privatization. It must be remembered that education is a personal services enterprise. This is evidenced by the fact that 85 percent of DOE's operating budget is for personal services. And between the two ways of buying personal services, through positions or contracts, we believe the contract route will grow.

(2) **Parceling.** The law forbids parceling, but does not define it. It leaves the definition of parceling to the administration. The standard definition of parceling is: "the practice of dividing contracts into smaller amounts to evade applicable bidding requirements". This definition, which is still somewhat ambiguous, is the one that is in use now. To improve the definition, at a recent meeting of chief procurement officers, parceling was defined "as the intent to divide purchases into smaller amounts during any 12-month period to evade applicable bidding requirements". Although this definition is an improvement over the current one, it is still difficult to administer. Under this new definition, there must first be an **awareness of the total need for such services during the 12-month period, and then an intent to evade the bidding requirement.** The key word is "intent". The auditor seems to imply that if there are multiple contracts with the same person during one year, then it is parceling. We agree that on the surface, and without a thorough check, it may look like parceling. But a closer scrutiny will reveal that these are actually separate contracts for different purposes. Concept such as "intent to evade" is not so easy to translate into operational procedures. The confusion, misunderstandings, and misinterpretations about parceling extends from the lack of a clear working definition of parceling. For example, three different educational specialists, using three different allotments, may each process separate contracts with the same person for similar professional services in different program areas. Is this parceling? We do not think so. Or one program manager may contract with the same person for three different professional services at three different times of the year. Is this parceling? We do not think so. To further clarify this point, let us take two specific examples of parceling that were cited by the auditor. Here are the schools' versions of what happened:

"The original contract was to inservice teachers in grades K-3. But because the inservice was so successful, the teachers in grades 4-6 asked for the same workshop also. A second contract was subsequently written. There was no intent to parcel and this was a different project."

"A person was contracted to help the teachers in writing the curriculum for language arts. Because of the exceptional skills of the person, two months later, the same person was contracted to help with the writing of the social studies curriculum and to inservice the teachers. There was no attempt at duplicity or intent to parcel the contracts."

As stated earlier, the lack of a clear and precise operational definition of parceling is the primary reason for this discrepancy in interpretations. To correct this situation, we intend to disseminate an improved definition of parceling and reduce the varied interpretations that have existed.

(3) **Management of personal services contracts.** The report cites several problems with the administration of personal services contracts. It states that DOE needs to improve various aspects of the overall management of personal services contracts such as:

1. Review
2. Assessment for effectiveness, propriety, and efficiency
3. Allowance for greater open competition
4. Control
5. Reducing the paperwork and streamlining the processing
6. Clarifying the roles and responsibilities of the various offices that should be involved in the review and processing of personal services contracts.

Nine months ago, the superintendent appointed a task force, made up of representatives from the budget branch, office of personnel services, and office of business services, to examine the overall administration of personnel services contracts. The charge was to revamp the existing management system and bring it in line with the requirements of the new state procurement law and the new federal IRS code. Since then, the task force has been working diligently to make the necessary revisions. Improvements are being implemented as we move along. For example, the auditor cites as a problem the blanket exemption of contracts for special education services. We do not believe this is a problem. The blanket exemption was issued because there were not enough providers, and the time frame for obtaining services was so short. Going the bidding route would have taken too long. We could not have complied with the legal time limits, and since there were not sufficient bidders to meet the enormous demand for services, the price would not have been better. The blanket exemption allowed the schools to comply with the law and meet their needs in the most expeditious manner. In any event, the new procurement law has changed everything. Today, the blanket exemption has been dropped and we have changed the way we secure personal services for special education. These services now fall into the category of "professional services" with its own set of procedures. Another example is where the auditor cites DOE for the "excessive use of sole source providers". While we do not agree that there is excessive use, nevertheless, the new procurement law and the new IRS code have changed the procedures and reduced the number of sole source providers.

The plan is that by the end of this fiscal year (June 1995), all the areas related to personal services will be resolved. Meanwhile, between now and June 1995, we will continue to implement needed changes as we proceed through our review.

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