
Audit of State Contracting for Professional and Technical Services

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

Report No. 95-29
November 1995

THE AUDITOR
STATE OF HAWAII

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Submitted by

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Foreword

This audit of state contracting for professional and technical services 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. The audit was initiated in response to an invitation by the National State Auditors Association (NSAA) to participate in a joint audit project with other states. The agencies selected for this audit were the Airports Division of the Department of Transportation, the Child and Adolescent Mental Health Division of the Department of Health, and the High Technology Development Corporation which is administratively attached to the Department of Business, Economic Development and Tourism.

We wish to express our appreciation for the cooperation and assistance extended by officials and staff of these agencies during the course of our audit.

Marion M. Higa
State Auditor

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Chapter 1

Introduction

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

The Auditor initiated this audit of state contracting for professional and technical services in response to an invitation by the National State Auditors Association (NSAA) to have Hawaii participate in the 1995 NSAA joint audit project. The NSAA coordinates joint audits in the belief that the projects mutually benefit all the participants. The audit issues are designed to be topical, auditable, common to many states, and of significant importance beyond state boundaries.

The choice of agencies included in this audit was based on public concerns, information gathered in previous audits, and the relatively high volume of contracting in which they engage. Those selected were the Airports Division of the Department of Transportation (Airports Division), the Child and Adolescent Mental Health Division of the Department of Health (CAMHD), and the High Technology Development Corporation (HTDC) which is administratively attached to the Department of Business, Economic Development and Tourism (DBEDT).

Background on Airports Division

The Airports Division of the Department of Transportation owns and operates 16 airports throughout the state. The Oahu District manages Honolulu International Airport, the 18th busiest airport in the United States and the 25th busiest in the world; Dillingham Airfield; and a small airstrip at Ford Island which is leased from the federal government for general aviation. The Maui District manages Kahului, Hana, Lanai, Molokai, and Kalaupapa airports along with the 50-acre Kapalua-West Maui Airport. The Kauai District manages Lihue and Princeville airports and a general aviation airport at Port Allen. The Hawaii District manages Hilo International, Keahole-Kona International, Waimea-Kohala, and Upolu airports.

Background on Child and Adolescent Mental Health Division

As part of a major reorganization of the Department of Health in 1989, the Mental Health Division was split into three separate divisions: the Adult Mental Health Division, the Alcohol and Drug Abuse Division, and the Child and Adolescent Mental Health Division (CAMHD). The three divisions were placed under a newly created administration, the

Behavioral Health Administration. CAMHD is to provide social, living, and academic skills for emotionally disturbed children. The division is working to establish public/private partnerships for comprehensive inpatient and transitional care facilities for youth.

Background on High Technology Development Corporation

The High Technology Development Corporation (HTDC) was established pursuant to Act 152 of Session Laws of Hawaii 1983 and was codified under Chapter 206M of the Hawaii Revised Statutes. It was placed within the Department of Business, Economic Development and Tourism for administrative purposes. Its purpose is to facilitate the growth and development of commercial high technology industry in Hawaii. In line with its statutorily defined duties, HTDC has developed several industrial parks including the Manoa Innovation Center (MIC). Among MIC's tenants are the Research Corporation of the University of Hawaii (RCUH) and the Pacific International Center for High Technology Research (PICHTR). HTDC provides support and services to Hawaii-based high technology companies, promotes Hawaii as a site for commercial high technology activity, and provides advice to the Legislature on policy and planning for technology-based economic development.

Objectives of the Audit

The objectives of the audit, as established by the NSAA and the Office of the Auditor, were to:

1. Assess the adequacy of the internal control structure over contractual services.
 2. Assess contractual service evaluation efforts.
 3. Assess compliance with state reporting requirements pertaining to contractual services.
 4. Make recommendations for improvement as appropriate.
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Scope and Methodology

The scope of the audit encompassed only the professional and technical service contracts in force during the audit period of the Airports Division of the Department of Transportation, the Child and Adolescent Mental Health Division of the Department of Health, and the High Technology Development Corporation. In accordance with the time frame established by NSAA, the audit covered the two year period of FY1992-93 and FY1993-94.

Fieldwork included interviews with management and officials of the affected departments or offices. We also reviewed laws, policy and procedure manuals, and previous audits as appropriate.

We reviewed a sample of contracts and their related contract administration files to determine whether the contracts were awarded as prescribed by law and/or policy, whether there was documentary evidence of on-going monitoring of the contractor during the term of the contract, and whether there was documentary evidence of the agency's evaluation of the outcome of the contract and of the contractor.

One of the main objectives of the audit was to assess the adequacy of the internal control structure over contractual services. Accordingly, we assessed the procedures used by the agency in determining when a contract for services is necessary. We assessed whether the contract award process is the most effective process in protecting assets while ensuring operational efficiency. We also assessed whether an on-going contract monitoring process was in place and whether it was adequately documented. Lastly, we assessed controls over contract payments.

Our work was performed from April 1995 through August 1995 in accordance with generally accepted government auditing standards.

Chapter 2

Airports Division Contracts: Findings and Recommendations

This chapter examines the internal control structure of the Airports Division of the Department of Transportation (Airports Division) over the acquisition of professional and technical services. We also examine the Airports Division's efforts to evaluate or monitor those services.

Summary of Findings

1. The Airports Division's internal control structure has failed to safeguard public assets. As implemented, it has not ensured competition in the contractor selection process and has failed to require adequate planning for contracted work.
2. The Airports Division's management has failed to adequately monitor contracts. The monitoring efforts of project managers have been ineffective and the project managers themselves have not been monitored.

Internal Control Structure Has Failed to Safeguard Public Assets

Management has a duty to develop and maintain a structure of internal controls. The structure as a whole includes all measures and procedures that enable an agency to operate in accordance with management's plans and policies. A primary purpose of an internal control structure is to protect resources against waste, fraud, or inefficient use. This is often called safeguarding assets. Proper planning on the use of resources and a competitive selection process for contractors are recognized as effective methods of safeguarding assets. The Airports Division has failed to maintain adequate competition in the selection of its contractors. In addition, it has also failed to properly plan the efficient use of public funds entrusted to it. The result is a deplorable waste of public moneys.

Lack of competition in the contractor selection process

Maintaining competition in the selection of a contractor is widely recognized as an effective method of protecting resources from waste, fraud, and inefficient use. Business practice and government procurement laws attest to that. We found that the selection of contractors at the Airports Division during the period under audit was often an arbitrary decision made by the then Director of Transportation.

The department has established procedures for the selection of contractors. The division advertises once a year to announce what projects it is anticipating to begin that year. In that advertisement, the division requests that firms interested in pursuing contracts with the division in relation to these projects submit statements of qualifications. The division examines the statements of qualifications received and develops a list of contractors that it believes qualify for proposed projects. This is a preliminary pre-screening step. Once the division decides to start a project, a review committee, consisting of the project manager and/or other staff members assigned by the division chief, assists the director in the selection of consultant firms for specific projects. The review committee reviews the list of qualified contractors and chooses four or five to be on the "short list." The committee then evaluates, in detail, the qualifications of the firms on the short list. For critical contracts, it may interview these firms or have them make presentations on their qualifications. The committee then selects what it considers to be the three best contractors and ranks them in order of preference. The committee submits this list to the director for a final decision. After the contractor has been selected, the division negotiates with the contractor to establish the scope and cost of the work to be done.

While this process attempts to maintain some competition in the selection of the contractor, the process has the flaw of scope and cost playing no role in the selection process. Unfortunately, even this flawed attempt to maintain competition is voided when the director can arbitrarily select a contractor other than one of those recommended by the committee. For example, in April 1991 the director chose Pacific Planning & Engineering to be the prime consultant for the "Automated People Mover" project even though that firm was not one of the firms recommended by the selection committee. Overriding established procedures violates the principles of having an internal control structure and results in no competition at all.

All contracts in our sample contained the statement, "the services to be rendered hereunder are technical and professional in nature and, accordingly, do not admit of competition." However, the selection process cited above indicates that usually three or more firms were qualified to do the work. This would indicate that competition is possible and that the contracts could have been competitively awarded. We recognize that the law under which these contracts were awarded, Chapter 103-22, HRS, was ill-suited to the contracting needs of the Airports Division. The law established sealed bidding as the only means of competition in awarding public works contracts. Competitive negotiation is the type of award process best suited to the needs of the Airports Division. The procedures of competitive negotiation are currently reflected in the new procurement law, Chapter 103D, HRS, which took effect on July 1, 1994.

The major difference between the contractor selection process established by the Airports Division and that of competitive negotiation is that the latter requires the negotiation of scope *and cost* as an integral part of the contractor selection process. Competition in cost helps protect public funds from waste and inefficient use.

There is no way to measure the waste, fraud, or inefficient use of public resources that may have occurred due to the failure to consider costs and maintain competition in the awarding of the Airports Division's contracts. However, we firmly believe that adherence to a competitive negotiation process, as required under the new Hawaii Public Procurement Code, is the best way to safeguard assets with respect to the contract award process.

Inadequate planning for contracted work

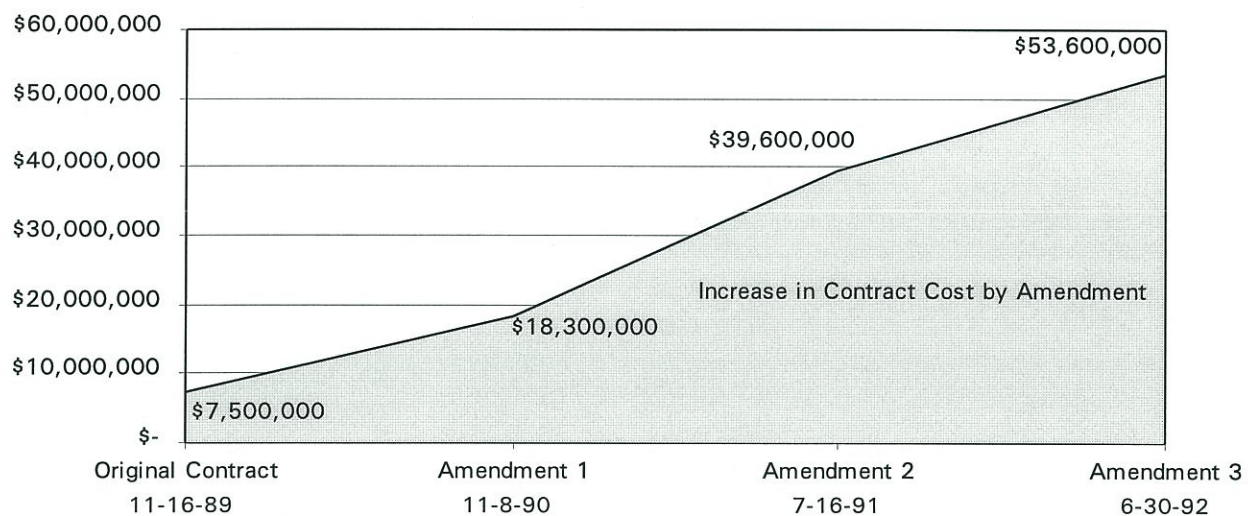
While the maintenance of competition in the awarding of contracts plays a vital role in safeguarding assets, proper planning is perhaps even more important. The definition of an internal control structure implies that management plans for the proper use of resources. This would include assessing the need for a particular project as well as determining the wherewithal to pay for it. It would also require that the scope, outcome, and compensation of a contract be determined at the outset.

The type of contracts most frequently entered into by the Airports Division are well suited to competitive negotiation. Thus, it is appropriate for the scope and compensation to remain less than fully defined until contract negotiations are complete. However, because the scope of work and related terms of service delivery are the point of reference for resolving problems throughout the contract term, it is essential that the scope of work be clearly defined before work begins. Proper procurement standards require that when a government agency decides to prepare the negotiated scope of work for the final contract document, it must be as detailed as possible. The procedure for preparing the scope of work exhibit for a contract is the same as that used to prepare the scope of work for a competitive sealed bid: identify and describe each phase, stage, or task separately; specify the date for the completion of each; identify how and when contract deliverables will be presented to the contract manager; and summarize the review and evaluation procedures the agency will use.

Our audit reveals that the Airports Division failed to properly define the scope of contracts before they were executed. We examined a sample of eight contracts which was equal to more than 25 percent of the total dollar amount of contractual service commitments during the audit period. Five of the eight contracts we reviewed had amendments which drastically increased the compensation of the contractors. Increases in compensation, as called for by these amendments, ranged from 120 to 1600 percent. For example, as displayed in Exhibit 2.1, a contract to develop a new international terminal at the Honolulu International Airport started with a

cost of \$7.5 million and, after three successive amendments over a span of less than 32 months, increased to a total of \$53.6 million. When we asked the consultant in charge of managing this contract why compensation had risen so dramatically, he stated that neither the scope of work nor outcomes were defined when the original contract was written. The scope of the contract was developed as the contract progressed. When the scope of work was fully defined and estimated costs became available, costs were much more than originally expected. Since the contractor's compensation is based on the total of both direct and indirect costs, compensation increased accordingly.

Exhibit 2.1
Design Cost of New HIA International Terminal

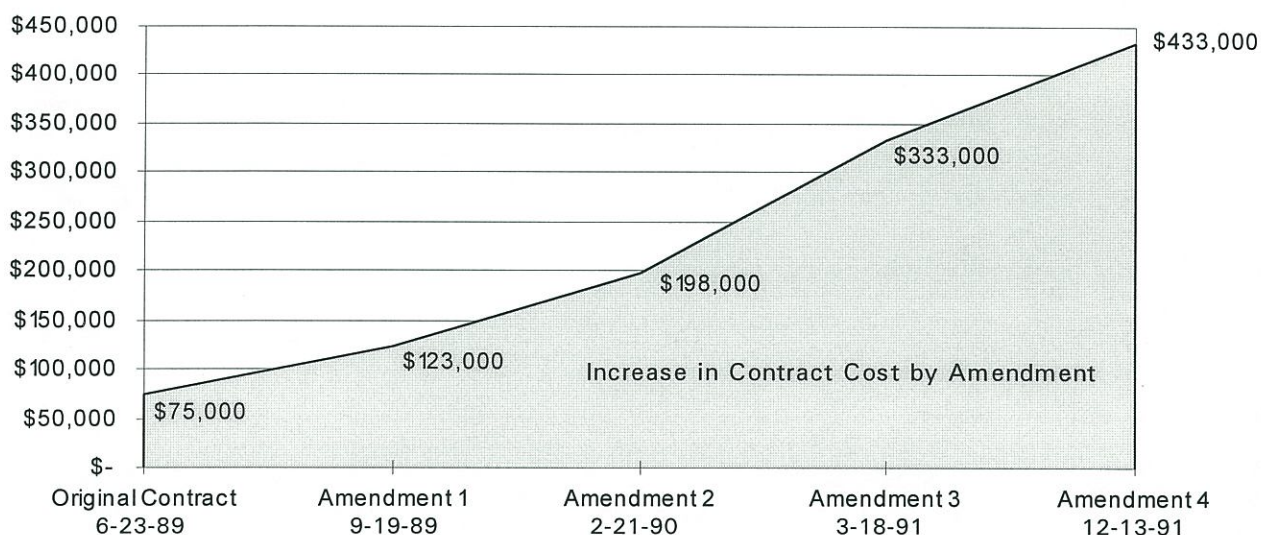


In another example, a contract for bilateral negotiation services was entered into at a cost of \$75,000. Bilateral negotiations are negotiations between other nations and the U.S. Departments of State and Transportation. These negotiations determine the number of flights another country will be allowed to make to the U.S. and where they will land. The contractor was hired to influence the negotiators into sending as many Japanese flights to Hawaii as possible. Twenty-seven days after the contract was signed, an amendment was requested adding \$48,000 to the contractor's compensation. Within two months of the first amendment, another amendment was sought and finalized within eight months of the signing of the original contract. This amendment added another \$75,000 in compensation. A third amendment, costing \$135,000, followed only thirteen months later. Nine months after that, a fourth

amendment added another \$100,000 to the cost of this contract. In the end, a contract which had begun at a cost of \$75,000 rose to a total of \$433,000 in two and one half years. (See Exhibit 2.2.)

Exhibit 2.2

Cost of Bilateral Negotiation Services Contract



We were told that the contractor was awarded this contract because his firm was uniquely qualified for this project. What made the firm uniquely qualified was that a staff member who would be assigned to this project had vast experience in bilateral agreements. We fail to understand why this expertise could not be used in determining the scope of services before contract execution. The frequency and dollar magnitude of the amendments of this contract clearly indicate a lack of proper planning on the part of the Airports Division.

Another indication of inadequate planning is the Airports Division's suspension of numerous contracts after millions of dollars had been spent for services. Management has a responsibility to assess the need for a particular project as well as determine the wherewithal to pay for it. The Airports Division failed in these responsibilities. Our sample contained four contracts that were suspended before completion. The stated reason was, "The Airports Division has begun a comprehensive review of the Airports System Capital Improvement program with the objective of reducing program costs." The fact that the work was suspended leads one to question whether it was really necessary and/or whether the wherewithal to pay for it had been given adequate consideration. In either case, the failure to properly plan these projects resulted in the payment of more than \$102 million in public funds to contractors with no apparent benefit to the public.

The lack of planning by the Airports Division on the use of resources indicates management's failure to give cost considerations high priority. The cost of neglecting to fully define the scope of contracts, resulting in high-priced amendments, and the suspension of numerous contracts before benefits are realized, appears to have received insufficient attention. In light of the division's fiduciary duty to manage public funds in an efficient and prudent manner, eliminating unnecessary costs through proper planning must be given top priority.

Failure to Adequately Monitor Contracts

A primary purpose of an internal control structure is to protect resources against waste, fraud, or inefficient use. The proper monitoring of contracts is essential to accomplishing that purpose. We found that the Airports Division failed to adequately monitor its contracts. This resulted in overpayments to contractors and appears to have been caused by management's lack of concern for protecting resources.

Ineffective monitoring efforts by project managers

The Airports Division assigned a project manager to monitor each contract. For most large contracts, these project managers were consultants who were themselves under contract with the Airports Division. But whether they were state employees or consultants, project managers were ineffective in safeguarding public resources. For example, an internal audit in January 1992 by the Airports Division's Fiscal Office Audit Section found that a subcontractor working on the automated people mover project was billing for non-reimbursable lodging and travel expenses as well as using a multiplier higher than that allowed. A multiplier is a percentage of direct labor cost which the contractor uses in determining chargeable costs. Using a higher multiplier would result in higher payments. The allowable multiplier was established by department policy and was agreed to by the prime consultant in an amendment to the original contract. The general terms and conditions of the contract hold the contractor responsible for fulfilling the terms of the contract whether or not it uses a subcontractor.

The tone of the internal report was one of total frustration. The internal auditors stated that they had discovered these types of findings in the past and had made recommendations to correct them. They said, "However, to our knowledge, nothing has been implemented." They concluded that, "No Consultant should be given the freedom to apply for such reimbursements" and "We strongly feel that we must take action on this situation before other consultants begin to understand the leniency of the Airports Division." At the time of this internal audit report, the contract was being monitored directly by division personnel.

In response to this January 1992 report, the division finally did notify the contractor of the excessively high multiplier. The contractor argued that the higher multiplier had “been in use since October 1990 and accepted by the State without question until recently.” Although the audit report did not quantify any past overpayments, the contractor’s reply indicates prior invoices probably resulted in overpayments to the contractor.

In another internal audit of a contract monitored by a consultant project manager, the DOT’s auditors found that the State was overbilled almost \$56,000. The internal auditors attributed the overbilling to “weaknesses in the billing preparation and review procedures.”

Whether a division employee or a consultant, the project manager is responsible for reviewing billings and the work of the contractor. But when the project manager is a consultant, its motivation to exercise tight control over contractors is at risk. This is especially so when there is a lack of independence between consultant project managers and the contractors they are intended to monitor. For example, a consultant project manager, M & E Pacific, Inc. (M&E), was hired to monitor Pacific Planning & Engineering, Inc.’s (PPE) contract to design plans and specifications for the construction of the automated people mover. However, PPE was authorized to incorporate into its design concept drawings that had been prepared by M&E. Additionally, PPE was later assigned to replace M&E as project manager over its own contract. Such a lack of independence equates to no monitoring at all and public resources are exposed to considerable risk.

Failure to monitor project managers

Given the vital role that project managers are intended to play in safeguarding assets, it seems reasonable to expect the Airports Division to endeavor to monitor and evaluate their efforts. Yet when a project manager’s efforts were known to be failing, such as indicated in the January 1992 internal audit, management failed to take corrective action. Although internal auditors repeatedly pointed out to management that contractors were making improper reimbursement requests and using excessive multipliers, we saw no evidence that management took action to see why the project manager was allowing this. We also found no evaluations performed on the state employees who were assigned to monitor contracts.

Evaluations of consultant project managers are supposed to be done every year regardless of the degree of completion of the work. The evaluation form consists of a single, two-sided sheet of paper. In reviewing the June 1992 evaluation of one consultant project manager, we found that the Airports Division had been dissatisfied with the project manager’s performance since it had first been hired in August 1989. Yet this consultant’s contract had been amended three times with compensation

rising from \$1.1 million to \$18.7 million. This is a clear indication that the evaluation process as exercised fails to safeguard public assets.

Conclusion

The Airports Division's internal control structure over contractual services is clearly inadequate. The division has failed to maintain competition in the contractor selection process. It has failed to adequately plan the desired outcome, scope, and funding of projects. Additionally, the Airports Division has neglected to adequately monitor the efforts of its project managers. This has resulted in the waste and inefficient use of public funds.

Recommendations

1. The Airports Division should follow a competitive negotiation process in selecting its contractors.
2. The Airports Division should develop and enforce an internal control structure which requires that:
 - a. A thorough evaluation of the need for and the availability of resources to pay for a project be documented before contracts are entered into, and
 - b. Contracts include clearly defined outcomes, outcome measurements, scope, and contractor compensation before they are executed.
3. The Airports Division should develop and implement internal control procedures designed to adequately monitor the effectiveness of project managers.

Chapter 3

CAMHD Contracts: Findings and Recommendations

This chapter examines the internal control structure of the Child and Adolescent Mental Health Division of the Department of Health (CAMHD) over the acquisition of professional and technical services. We also examine CAMHD's efforts to evaluate or monitor those services. Additionally, we assess CAMHD's compliance with statutory reporting requirements.

Summary of Findings

1. The Child and Adolescent Mental Health Division does not exercise sufficient and appropriate administrative controls over its contracts for services, putting the state and providers at risk.
2. CAMHD's monitoring and evaluation efforts need improvement. The division does not properly plan or carry out monitoring efforts over its contracts nor does it evaluate contract outcomes.
3. CAMHD failed to comply with the reporting requirements of Chapter 42D, HRS.

Administrative Controls Are Inadequate

The Child and Adolescent Mental Health Division administered professional and technical contracts totaling \$42 million during our audit period. It, like all management, has a duty to develop and maintain a system of administrative controls to promote operational efficiency. We found, however, that the division is deficient in exercising administrative controls in these ways: (1) failure to control contract file access and accountability, (2) failure to prescribe file contents and organization, (3) a lack of clear payment authorization procedures, (4) allowing providers to render services without a contract at all, and (5) allowing contractors to begin work before the execution of contracts.

These deficiencies result in confusion and frustration among contractors and staff, the possibility of questionable costs going undetected, and the possibility of placing the State and the providers in jeopardy should any legal problems arise.

Poor controls over files

We examined thirteen of CAMHD's contracts, which totaled about 50 percent of the \$42 million administered during our audit period. Our review found that management has not implemented administrative

controls and procedures over contract files, including access, accountability, and file maintenance. Although the program specialist IV's job description requires her to establish and maintain a log of all contracts processed and their status, this has not been done. We observed a note taped to the filing cabinet requiring those removing files from the cabinet to put a Post-it™ on the cabinet stating that the file had been pulled and by whom. We observed that this too was not being done. Consequently, contracts could not be readily located in filing cabinets. For example, the division took three days to locate one of the contracts we asked to examine.

Even contractors themselves complain. After being requested to submit insurance certificates to the division, one contractor replied that this was the *third* time he had done so and that either the division or the department's Administrative Services Office (ASO) keeps misplacing them. The normal procedure would have been for the secretaries to open the mail and put the certificates in the box of the program specialist who is responsible for filing them. However, no one could determine whether the loss occurred at the hands of the secretaries, at the hands of the program specialist, or at the hands of someone who may have removed the certificates from the filing cabinet. The absence of administrative controls over contract files results in operational inefficiencies, promotes confusion and frustration, and impedes effective contract administration.

***Incomplete and
unorganized contract
files***

The contents of CAMHD's contract files are non-standardized, insufficient, and generally haphazard. The division has not developed check-off lists enumerating required documents, their order of presentation, or the monitoring and evaluation duties to be performed. Correspondence was loose and unorganized. Contract history forms, which could have been used for contract monitoring purposes, were either left blank or missing from the files altogether. Several contract files did not even contain finalized copies of supplemental contracts. Furthermore, we found no documentation of the rationale to support contract amendments. Consequently, we could not determine if amendments were valid or reasonable.

Documentation of the contractor selection process was also not included in the contract files. The documentation that was available was filed haphazardly in separate binders. Documents were not organized by contract or relevant request for proposal (RFP) numbers. Using these binders, we were able to find only four RFPs for the thirteen contracts we reviewed. Since two of the remaining nine contracts were with the Department of Education, we determined that they could justifiably be considered sole source and overlooked the lack of documentation. However, the remaining seven contracts had no documentation available

for our review concerning the contractor selection process. With no audit trail for more than 50 percent of our sample, it was impossible to form an opinion on that process.

We believe the major cause of these conditions is that staff responsible for contract management and related information are neither qualified nor experienced. Although the job description for the program specialist IV states that she is responsible for contract development and processing, she has not established what is to be included in a contract file and in what order. In view of the program specialist's lack of experience, a clinical psychologist informally assumed the major role in contract administration. The job related to contract administration appears overwhelming to her as well—understandably so when her job description did not include contract administration and her performance evaluation did not cover her work on contract administration. This clinical psychologist and the program specialist are the two employees primarily involved in contract administration. Neither is qualified, experienced, knowledgeable or properly trained in contract administration duties.

Another reason for the problems noted is the division's failure to develop a manual to guide the staff in their duties. No official manual of established policies and procedures on procurement and contracting existed during our audit period. There was one binder located in the division which was referred to as a manual. It was an unorganized collection of applicable statutes, executive memoranda, rules and regulations promulgated by the Department of Accounting and General Services (DAGS) or by the Department of Budget and Finance (B&F), and memoranda from DOH's ASO. CAMHD claims to be in the process of publishing a "Policy and Procedures Manual." We examined the draft copy—currently only a two-page document. This document indicates that the division intends to continue to use the aforementioned binder as its primary reference.

No clear policies and procedures over contractor payment authorization

Clear authorization policies and procedures over payments to contractors help ensure operational efficiency by reducing the risk of losing resources through waste, fraud, and inefficient use. CAMHD's division chief has not established clear authorization policies and procedures over payments to contractors. We found that the payments are authorized by non-supervisory staff "because they are most familiar with the contract." Yet there is no documentation that the payment approval process is linked to satisfactory performance by the contractor. For example, quarterly reports that CAMHD received from contractors, often the only monitoring document, showed no evidence of review—not even a check mark and certainly no initials or signatures of a state employee.

Staff involved in payment authorization are not adequately trained. Even the clinical psychologist in charge of contract administration didn't know who had approved payments and what documents she had signed for approval. As stated earlier, this is due in part to CAMHD's lack of a suitable manual to guide staff in their duties. It is also due to a lack of guidance from the division chief.

Under these circumstances, questionable costs could go undetected. In order to alleviate this problem, CAMHD needs to establish clear payment policies and procedures. These policies and procedures should require that the division monitor contractors' invoices to ensure that they are accurate, relevant to the contract, and represent proper use of public funds.

Not all purchases of service are under contract

It is essential that contracts be properly executed before any services are provided. Without the benefit of a contract, there is no assurance that services being provided are those that are necessary or intended by the Legislature.

Our review found that not all of CAMHD's purchases of professional and technical services were under written contract. For example, CAMHD had no contract with Nursefinders of Hawaii, Inc. or Interim Health Care. They are service providers to the WrapAround Program. An internal memo from the division to the department's ASO indicated that the purchase of services from these two providers was in violation of the bidding law. The memo also stated that potential lawsuits by these providers were likely due to CAMHD's inability to pay them.

A 1994 internal audit report conducted by an inquiry team appointed by the health director found that CAMHD had a problem with outstanding payments to these two providers. The ASO could not process their invoices because there were no approved contracts and no DAGS approval pursuant to Chapter 103, HRS. As a result, the ASO fiscal officer directed the public health administrative officer to separate the requisitions into less than \$10,000 increments. The internal audit found 24 purchase orders totaling \$85,650 paid to Nursefinders for FY1993-94. This appears to be a violation of the "no parceling" provisions of the procurement law.

In early September 1994, a deputy attorney general advised CAMHD and the ASO to stop processing payments to Nursefinders. Twenty eight requisitions or purchase orders, totaling nearly \$270,000, were still on hand. In October 1994, the administrator of Nursefinders told the internal audit team that the division owed the provider over \$400,000.

From the evidence presented in the internal audit report, it is apparent that the departmental ASO had made an effort to oversee the division's expenditures. A memo from the ASO chief to the deputy director of the Behavioral Health Services Administration, dated September 1992, expressed extreme concern over CAMHD's neglected contract administration duties. It pointed out the division's negligence in obtaining governor's approvals, the lack of bids, and the failure to let contracts prior to the rendering of services.

The ASO had also identified and reported some unusual, "highly questionable" expenditures as the WrapAround program grew. When the ASO became aware of the increased level of expenditures, she requested that CAMHD prepare an RFP. However, the division did not comply. In March 1994, the health director ordered the division to cease and desist the questionable expenditures. The failure to fully execute contracts with these unpaid providers prior to allowing them to provide services put the State in jeopardy from potential lawsuits.

Work allowed before contract execution

In addition to allowing some providers to render services without benefit of contracts, CAMHD allowed other providers to begin work prior to the execution of contracts with them. This is not in the best interests of the State, the contractor, or the public. Properly executed contracts are essential to ensure that (1) the type and scope of services to be provided have been agreed upon, (2) the services are those for which the Legislature appropriated funding, and (3) the roles and responsibilities of the division and service providers are clearly delineated to avoid confusion or misunderstandings.

Providing services without contractually defined roles and responsibilities puts both the State and the providers in jeopardy should any legal problems arise. Lack of direction from the division chief and open disregard for state procurement policies and department policies encouraged this poor practice.

Contract Monitoring and Evaluation Is Inadequate

Monitoring is the routine, ongoing review of the contractor's performance. It should compare performance against the scope of services specified in the contract, review expenditures, and ensure compliance with contract requirements. Evaluation efforts at the conclusion of a contract allow management to measure contract outcomes. Outcome measures should assess some aspect of the effect, result, or quality of a service. CAMHD does not have an adequate monitoring and outcome evaluation system. Based on her job description, it appears that the responsibility for developing such a system falls on the untrained and inexperienced program specialist IV. Inadequate monitoring and evaluating practices could result in fraud, waste, and inefficient use of public resources.

Poorly planned monitoring approach

Effective contract monitoring includes three functions:

1. Fiscal monitoring—assures adherence to laws, ordinances, regulations, codes, and other requirements regarding the expenditure of funds.
2. Program monitoring—reviews how well services were provided to the target population, whether services achieved the desired outcomes.
3. Compliance monitoring—reviews and documents whether the provider operates in accordance with laws and regulations governing program organization, administration, personnel policies, client records, and facilities.

With the exception that a contractor may be required to submit reports upon CAMHD's request, CAMHD's contracts themselves did not document planned monitoring approaches. We found no evidence of intensive monitoring in the first 30 days of the contract. This would be the appropriate time to help assure that contractors got started on the right path. Quarterly progress reports were not consistently included in the contract files. As stated earlier, quarterly reports, often the only monitoring document, showed no evidence of division review. Furthermore, quarterly reports are silent on essential monitoring information such as "does the work meet the contract requirements," "is the contractor on schedule," and "are payments contingent upon the successful completion of defined stages of work." It is questionable whether the quarterly progress reports are an adequate monitoring device to ensure fulfillment of the required scope of services or to provide a proper audit trail.

Moreover, during our fieldwork we came upon four contracts with amendments still in process that attempt to adjust the scope of services and/or compensation amounts retroactively. These unexecuted amendments appear to be last minute or even "after-the-fact" attempts to adjust the contracts to reflect what actually took place during the contract term. Three of the four contracts were about to expire at the time of our fieldwork and the other one had already expired. This situation indicates complete neglect of the monitoring process. Needed services may not have been provided and funds may have been allowed to lapse. Effective and timely monitoring could have allowed management to assist the contractors in meeting their scope requirements. Alternatively, management could have terminated the contracts with non-performing contractors and sought contractors who could perform; or, management could have re-allocated resources to other programs. Such actions might have minimized any waste or inefficient use of public resources.

No staff at CAMHD are trained in prescribing, monitoring, and evaluating the work of contractors. An individual called a “program monitor” is assigned to each contract. However, the program monitor mainly monitors the progress of children and/or adolescents participating in a clinical program and not the contractor’s performance of services as prescribed by the contract.

Again, we believe these problems to be due in part to the lack of training and experience on the part of the program specialist and her failure to establish and enforce monitoring policies and procedures. The lack of a useful manual to guide staff in the performance of their monitoring duties also contributes to the problems.

In our 1992 *Financial Audit of the Department of Health*, Report No. 92-30, we found that the department lacked contract monitoring guidelines for its divisions. The report pointed out different contract monitoring practices at divisions. We recommended then that the department develop for its divisions written contract monitoring standards as guidelines on how contracts should be monitored and how monitoring activities should be documented. Our 1995 follow-up audit, Report No. 95-13, found that the department failed to act on our recommendation.

***CAMHD does not
evaluate contract
outcomes***

Evaluation of the outcomes of a contractor’s services may identify fraud, waste or inefficient use of public resources, and inform management of projects or contractors to be avoided in the future.

Our review indicated that CAMHD does not perform any evaluation of contract outcomes. The contracts did not clearly define expected outcomes nor describe outcome measurements. Instead, the “outcome objectives” included in the contracts usually reflected outputs—that is, quantitative rather than qualitative results. Output measurements might reveal the number of clients served, but they fail to determine whether the clients were actually helped by those services. The degree to which a client is helped is an outcome. Regardless of how many clients were served, if they derived no benefit from the service, then the public’s resources were wasted.

The officials informed us that the division has not devised or implemented any substantive method of evaluating final outcomes because the nature of services performed make such measurements difficult. However, the division was unable to explain *why* the nature of the services performed made evaluation difficult.

A review of a contract by one of the division’s own clinical psychologists supports our finding. He criticizes the ambiguous scope of services and program objectives, the lack of methods to measure the degree to which the objectives are attained, and the lack of outcome measurements.

The division has unofficial guidelines which require that new contracts be evaluated twice a year and old contracts evaluated once a year. However, the clinical psychologist in charge of contract administration is doubtful whether the contracts are evaluated as required. Ten out of the thirteen contracts we sampled had no program monitoring reports. The program monitoring report is to be completed by the program monitoring team after each site visit. Had the reports been completed, they would have documented the provider's efforts to serve the target population as specified in the contract, whether or not the provider carried out program activities as proposed, and documented the provider's ability to accomplish program objectives and implement contract requirements as agreed.

Five of the contracts had reached their completion dates at the time of our fieldwork, however, no final evaluation reports were placed in the contract files. As a result, the division is unable to ascertain whether the contracts provided any benefit to the State or taxpayers.

We found a form to be used in writing an Annual POS Program Report in the "Monitoring Packet" published in April 1995. The report is to be completed by a program evaluation specialist.

Among other areas covered, the report asks:

- whether clients received the most appropriate services,
- whether the provider had a system for measuring client progress, and
- whether services were based on appropriate assessments.

The report appears to be a good tool in evaluating outcomes should it ever be used.

The lack of a substantive evaluation process is due to weak administrative controls. These include poorly trained staff, and no suitable manual to guide the staff in their evaluation duties. Without proper contract evaluation, there is no assurance that the division uses public funds effectively, prudently, or responsibly.

CAMHD Failed to Comply With the Reporting Requirements of Chapter 42D, HRS

Most of CAMHD's contracts are subject to Chapter 42D, HRS, which pertains to subsidies, grants, and purchases of service.

Section 42D-25, HRS, requires contractors to submit quarterly progress reports and requires CAMHD to write an annual report for each contract describing progress, compliance, and corrective action required of the

contractor. These annual reports are to be completed within 30 days of the required annual on-site visit.

As stated earlier, quarterly progress reports were not consistently included in the contract files. The clinical psychologist in charge of contract administration confirmed that this reporting is not done 100 percent. It does not appear that any special consideration has ever been given to this reporting requirement.

In only four out of the thirteen contracts we reviewed were the annual written reports mailed to contractors after yearly site-visits were conducted. And one report was completed and mailed to the provider more than five months after the on-site visit. This violates the 30 day time limit stipulated in the law. Moreover, this report, which pointed out an unfulfilled part of the contract, could have allowed the contractor to take corrective action in the second year of the contract had it been issued on time.

Another contract involved a therapeutic foster care program for seriously emotionally disturbed children. CAMHD concluded there was almost 100 percent compliance with contract standards. But the division later received a complaint from the Department of Human Services (DHS) concerning the contractor. DHS stated that foster parents' responsibilities were over-extended by the insufficient support of the contractor's social workers. DHS also pointed out that no quarterly reports had been submitted to it regarding status of clients.

The failure to issue annual reports on nine out of thirteen contracts, the issuance of a report five months late, and the fact that a report failed to properly assess the contractor's performance is evidence of CAMHD's non-compliance with Section 42D-25, HRS.

Conclusion

CAMHD's poor administrative controls, failure to monitor contractor performance or evaluate contract outcomes, and failure to comply with statutory reporting requirements seriously undermine the division's ability to manage resources in the public's best interests.

Recommendations

1. The division chief should establish controls and procedures over filing contracts, as well as clear payment policies and procedures.
2. The division chief should see that the program specialist is properly qualified and trained to:

- a. establish and enforce a policy ensuring complete and organized contract files;
 - b. establish and enforce monitoring and evaluation policies and procedures; and
 - c. formulate a manual to guide staff in the performance of their contract administration duties.
3. Staff should be properly trained in the performance of their contract monitoring and evaluation duties.
4. Contractors should be prohibited from providing services until a fully executed contract is in place.

Chapter 4

HTDC Contracts: Findings and Recommendations

This chapter examines the internal control structure of the High Technology Development Corporation (HTDC) over the acquisition of professional and technical services. We also examine HTDC's efforts to evaluate or monitor those services.

Summary of Findings

1. HTDC has developed and implemented a sound internal control structure. It has a trained and qualified staff, clearly written and detailed contracts, and generally maintains competition in the contractor selection process.
2. HTDC has also been diligent in its contractual service evaluation efforts. It follows an effective monitoring approach during the course of the contract and appropriately evaluates contract outcomes.

Sound Internal Control Structure

Management has a duty to develop and maintain a system of internal controls. A primary purpose of an internal control structure is to protect resources against waste, fraud, or inefficient use. This is often referred to as safeguarding assets. Since a governmental agency also has a fiduciary duty to the public, its duty to safeguard assets is compounded. HTDC has developed an internal control structure which is well suited to achieving the objective of safeguarding assets. The attributes of this internal control structure include trained and qualified staff, clearly written and detailed contracts, and the maintenance of competition in the selection of contractors.

Trained and qualified staff

HTDC has a staff possessing the technical capability to prescribe, monitor, and evaluate the work of contractors. The overall responsibility of contract management and related information has been assigned to two contract administrators who are well trained and have years of experience specifically in contract administration. Their contract administrative duties are included in their job descriptions and a system has been implemented in which they are evaluated on their performance of those duties. Support personnel involved in contract administration are also experienced and trained in those duties. Most possessed these attributes when they were hired and they continue to sharpen their skills by attending seminars in contract administration offered by the State.

Clearly written and detailed contracts

We examined seven contracts equaling about 97 percent of the \$4 million in contracts for professional and technical services in force during our audit period. All contracts reviewed were very detailed regarding the contractor's work assignment and the responsibilities of both the contractor and the agency. They explicitly defined expected outcomes and clearly described how those outcomes would be measured. The contracts used standardized language and included terms to expressly protect the interests of the State. Only three of the seven contracts we reviewed had amendments and there were only four amendments in total. Each amendment appeared reasonable and justified and only one resulted in increased compensation. This indicates that adequate planning was exercised before contracts were entered into.

Adequate contract award process

Chapter 206M, HRS, exempts HTDC from the requirement of competitive bidding. In addition, an Attorney General's opinion dated August 2, 1990, states, "we believe that HTDC's exemption from competitive bidding applies to any and all of its agreements or other expenditures of public funds." However, even though exempt, HTDC encouraged competition by making requests for proposals in about half of the contracts reviewed. In others, sole source was justifiable and in only one did we conclude that the award was not competitive when it could have been.

Our audit reveals that HTDC did allow contractors to begin services prior to the execution of the contracts. Except for this, we believe the internal control structure over contractual services to be more than adequate. With respect to this exception, we noted that HTDC has started moving the effective dates of its more recent contracts back to August to allow processing and execution of the contracts before work begins.

Diligent Contractual Service Evaluation Efforts

Safeguarding assets would also involve evaluating the services of contractors. Evaluation efforts can be divided into two areas: evaluation of the services being provided during the course of the contract term and evaluation of the outcomes of the contract. Evaluation of the services being performed during the course of the contract term, or contract monitoring, is important to assure that the contractor is performing as the scope of the contract requires. This can reveal any waste, fraud, or inefficient use of public funds at its earliest stages, thus preventing further loss of assets. Evaluation of outcomes allows managers to determine whether the State "got what it paid for." Managers can then use this information to allocate resources to projects which accomplish the most good. HTDC's efforts to monitor contractor performance and contract outcomes are commendable.

Laudable monitoring efforts

HTDC was involved in continual monitoring and evaluation of the services for which it had contracted. More than half of the contracts used contract checklists and contract summary sheets to document the successful completion of steps in both the pre-contract and on-going phases of the contracts. Where appropriate, there was evidence of intensive monitoring in the first 30 days of the contract. This start-up period is recognized as the best time to help the contractor get on the right path to a successful outcome.

The contracts themselves documented planned monitoring approaches. These ranged from requiring monthly status reports from the contractors and monthly project meetings to discuss accomplishments and plans, to detailing “milestones” to be achieved before compensation installments would be paid. Monitoring plans, as set out in the contracts, covered such things as determining whether the work met the contract requirements, determining whether the contractor was on schedule, and linking payments to the successful completion of defined stages of work. When work was determined to be unacceptable, appropriate action was taken as planned, such as withholding further payments until satisfactory corrections were made.

In addition to these monitoring efforts, when specialized knowledge was required which was not possessed by the HTDC staff, HTDC would contract with a specialist to aid in monitoring the work of other contractors. In our sample, a resource teacher was contracted to monitor three other contractors. We found it important to note that she was totally independent of the contractors she was assigned to monitor.

Appropriate outcome evaluation efforts

In addition to finding HTDC’s monitoring efforts laudable, we found its outcome evaluation efforts appropriate. All of the contracts reviewed fell into one of two categories: contracts with the Maui Economic Development Board (MEDB) and contracts relating to the Multimedia Industry Development for Academic Software project (MIDAS).

Two of the three MEDB contracts were for the operation of the Maui Research and Technology Center. Since these services are on-going and long-range, choosing a point to measure outcome is difficult. However, in February 1994, HTDC hired Coopers & Lybrand LLP, a certified public accounting firm, to conduct an agreed-upon procedures review of MEDB to ascertain whether MEDB had complied with the contract provisions and to assist HTDC in evaluating contract performance. The report did result in some reportable conditions which led to MEDB’s having to develop a plan for corrective actions. HTDC used Coopers & Lybrand’s review in determining whether to renew the contract with MEDB. The third MEDB contract was for the development of a plan for the

acquisition and operation of a mini-super computer. This contract had not reached completion by the time we finished our fieldwork and therefore outcome evaluation did not yet apply.

Additionally, none of the MIDAS contracts had reached their completion dates at the time of our fieldwork. However, the contracts clearly state that the end products must satisfy both the HTDC project manager and a resource teacher. The resource teacher was under contract to aid in the monitoring of the other MIDAS contractors and to evaluate the results of their work. Her contract states that she is required to submit reports documenting her evaluations “prior to the conclusion of this agreement.”

Conclusion

HTDC should be used as a model by other administrative agencies of the executive branch. Its efforts to establish a sound internal control structure and contract monitoring and outcome evaluation process are worthy of emulation. We believe that its success can also be attributed to the high priority given by management to seeking qualified and well trained staff to oversee the administration of contract services for the agency.

The results of our audit indicate that there is inconsistency in the adequacy of internal control structures over contractual services within the State. As Chapters 2 and 3 demonstrate, the internal controls of the Airports Division and CAMHD are insufficient to protect public assets from waste, fraud, and inefficient use. However, as Chapter 4 illustrates, HTDC has developed and implemented an internal control structure that is sound.

The efforts of the three agencies in monitoring or evaluating contractual services are also inconsistent. The efforts of the Airports Division and CAMHD are clearly inadequate whereas the efforts of HTDC are noteworthy.

State reporting requirements vary depending upon the statute authorizing the contract under review. All of the Airports Division contracts reviewed were awarded pursuant to Chapter 103, HRS, which establishes no reporting requirements at the division level. All of the CAMHD contracts reviewed appeared to be awarded under Chapter 42D, HRS, which has specific reporting requirements. As presented in Chapter 3 of this report, we found that CAMHD failed to comply with those reporting requirements. The contracts we reviewed at HTDC were awarded pursuant to Chapter 206M, HRS, and were not subject to reporting requirements.

Recommendations

We recommend that HTDC continue to exercise its effective contract administration controls. In addition, we recommend that HTDC insure that all providers of services be under a fully executed contract before work is allowed and that competitive bidding be further encouraged to insure the best price and product for the State.

Responses of the Affected Agencies

Comments on Agency Responses

We transmitted a draft of this report to the Department of Transportation, the Department of Health, and the High Technology Development Corporation on October 27, 1995. A copy of the transmittal letter to the Department of Transportation is included as Attachment 1. Similar letters were sent to the Department of Health and the High Technology Development Corporation. The responses of the Department of Transportation and the Department of Health are included as Attachment 2 and Attachment 3 respectively. The High Technology Development Corporation chose not to respond.

Airports Division of the Department of Transportation

While our request to the agency was to comment on our tentative audit recommendations, the department chose instead to criticize our audit report. The department alleged that we failed to recognize that 1) controls over the contracting process extend far beyond the Airports Division, 2) the Airports Division exercised prudence in reducing the scope of its program and its contracts when it became apparent that passenger traffic and financial projections were not being realized due to changing economic conditions, and 3) the Airports Division had implemented corrective actions and procedures. The department further claims that our report contains inaccuracies, misstatement of facts and glaring omissions. The department also challenged our finding on the failure to monitor contracts adequately, alleging our lack of compliance with generally accepted government auditing standards (GAGAS).

We are disappointed with the department's response since it fails to recognize the scope and objectives of our audit. As we had communicated to the department prior to the start of the audit, the primary focus of the audit was to assess the adequacy of the internal control structure over contractual services at the Airports Division. The purpose of an internal control structure is to insure that adequate checks and balances are in place within an organization to ensure that the State gets the best product or value for the dollar expended. As our findings indicate, the internal control structure over contractual services at the Airports Division is clearly inadequate. The division fails to maintain competition in the contractor selection process and fails to adequately plan the desired outcome, scope, and funding of projects. In addition, the division neglects to monitor adequately the efforts of its project managers. This has resulted in the deplorable waste and inefficient use of public funds, such as the more than \$102 million in payments to contractors for canceled projects. It is unfortunate that the response by the department does not focus on the appropriateness of our recommendations and what steps, if

any, have been taken to improve the internal control structure itself. It is not sufficient to make corrections of overpayments, for example; it is necessary to make structural changes to prevent overpayment from occurring in the first place.

With regard to some of the specific issues raised by the Department of Transportation in its response letter, we respond as follows:

- The department says that the audit failed to accomplish its objective of assessing the internal control structure because it did not analyze or report on the control structure that extends to the highest levels of government. We respond that the scope of an audit defines what the objectives of the audit apply to. The scope of our audit, as clearly communicated to the department, applied to the service contracts of the division and not to state contracting as a whole.
- The department says that the audit recognizes that contractor selection decisions were arbitrarily made by the then Director of Transportation but fails to reach any conclusions or recommendations on this practice. On the contrary, we clearly stated our conclusion: "Overriding established procedures violates the principles of having an internal control structure and results in no competition at all."
- The department says that decisions to terminate work do not indicate a failure to assess the need for projects but are necessary when changing economic conditions become apparent. The department claims its decisions showed prudence. We hold that canceling contracts when changing economic conditions "become apparent" indicates poor planning, not prudence. It is also poor planning to expand the scope of the projects to the extent that the division did, as reflected by the numerous contract amendments.
- The department provided updated statistical information on the airports system and we have changed our report accordingly. The information as originally presented was taken directly from the *Airports Division Annual Report 1993*.
- The department recommends that some of our findings under the section "Failure to Adequately Monitor Contracts" be modified or omitted since corrective actions have been taken. It also states that failures should be considered findings only if they have not been corrected. The division misses the point. The objective of the audit was to assess the internal control structure. Taking steps to correct deficiencies resulting from a weak internal control structure does not address the root problem.

***Child and Adolescent
Mental Health
Division of the
Department of Health***

- The department complains that our report does not consider whether the compensation paid contractors was reasonable. By the objectives of our audit, the point is not whether a contractor was properly compensated, but whether the compensation and scope were properly determined at the outset of the contract. It's an issue of proper planning, not one of appropriate payment.

The response from the Department of Health recognizes the deficiencies cited in our report and claims that many of them have been addressed. However, such claims are not substantiated by our fieldwork evidence and we stand by our report findings. For example, the department says that a contract tracking log had been developed and was in use prior to our staff's visit. However during fieldwork, our analysts actually accompanied the clinical psychologist in her attempts to locate contract files for review. This included her questioning the program specialist about their whereabouts. The fact that the files could not be readily located proved that no effective contract tracking log system was in place.

The department says that it does not understand our comment that the contract selection process was not included in the contract file since the request for proposal (RFP) is part of the contract. Including the RFP and the proposal of the selected contractor as part of the contract does not answer pertinent questions about the selection process such as how many proposals were received and how the selected contractor was chosen from among them.

Other comments by the department in its response give some explanation for the deficiencies but fail to convince us that deficiencies have been substantially addressed.

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

October 26, 1995

COPY

The Honorable Kazu Hayashida, Director
Department of Transportation
Aliiaimoku Hale
869 Punchbowl Street
Honolulu, Hawaii 96813

Dear Mr. Hayashida:

Enclosed for your information are three copies, numbered 6 to 8 of our draft report, *Audit of State Contracting for Professional and Technical Services*. We ask that you telephone us by Monday, October 30, 1995, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Thursday, November 9, 1995.

The Department of Health, High Technology Development Corporation, 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



STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION
869 PUNCHBOWL STREET
HONOLULU, HAWAII 96813-5097

ATTACHMENT 2

KAZU HAYASHIDA
DIRECTOR

DEPUTY DIRECTORS
JERRY M. MATSUDA
GLENN M. OKIMOTO

IN REPLY REFER TO:

AIR 95.309

November 7, 1995

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

RECEIVED
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OFC. OF THE AUDITOR
STATE OF HAWAII

Dear Ms. Higa:

This is in reference to the report of the State Auditor on the contracting for professional and technical services by the Airports Division and two other State agencies.

We find the audit report is lacking in its failure to recognize that:

1. Controls over the contracting process extend far beyond the Airports Division.
2. The Airports Division exercised prudence in reducing the scope of its program and its contracts when it became apparent that passenger traffic and financial projections were not being realized due to changing economic conditions.
3. The Airports Division had implemented corrective actions and procedures to address weaknesses identified in its management of contracts and projects.

Existing practices in State government are such that the internal control structure over contractual services extend far beyond the Airports Division. If the stated objective of the audit was to assess the adequacy of such controls, the audit failed to accomplish this because it did not analyze or report on the control structure that extends to the highest levels of government.

The audit fails to recognize that the consultant selection process is not dictated nor made by the Airports Division. The process described on page 6 of the audit is not an Airports

Division procedure. Procedures followed by the Airports Division are prescribed by the Department of Transportation for all three divisions of the Department. We do not agree that the Airports Division can be faulted for the selection process when deviations from the prescribed procedure are made outside the division. The audit recognizes that decisions were arbitrarily made by the then Director of Transportation but fails to reach any conclusions or recommendations on this practice.

In theory, the Department of Transportation's procedure for consultant selection does provide for competition since the initial selection does not require the Airports Division to award a contract to the selected consultant. If negotiations on the scope and amount of the contract fail to reach an agreement between the parties, the Division is free to negotiate with another consultant. Although cost is not considered in the original selection, it is a factor in the final decision to award the contract.

Decisions to terminate work do not indicate a failure to assess the needs for a project. The audit report fails to examine the reasons for reducing the cost of the airport construction program and ignores that events beyond the control of the Airports Division resulted in a rapid change in the volume of passengers, declining tourism levels, declining airline profitability and reduction in duty free revenues. The Airports Division took drastic steps to reduce its program and subsequent costs well in advance of the steps currently being undertaken by the State in light of declining general fund revenues.

The audit report contains inaccuracies and misstatements of facts. The statewide airports system consists of sixteen, not fifteen airports. For 1994, HIA is ranked as the 18th busiest airport in the United States and 25th in the world.

More important are the glaring omission of certain information to the reader. The report cited overpayments relating to large contracts during the period under audit. What the report fails to mention is that the overpayments have been corrected through cost audits performed by the division's auditors. Due to concern over excessive multipliers, audits are being requested on large contracts in which the multiplier exceeds 2.88 along with lowering the profit margin from 15% to 10% as a result of the State's economy.

The report also cites an internal audit prepared on a contract involved in the automated people mover project and states that a high multiplier was used. Our auditors had conducted a spot

check in January 1992 and noticed that a multiplier of 2.95 was being implemented to the direct labor charges. In February 1992, the multiplier was adjusted to 2.88. An overhead audit was issued on April 8, 1993 which substantiated a 2.95 multiplier. The billings were therefore readjusted. To our knowledge, this is the only contract in which a multiplier exceeding 2.88 was paid upon without the Director of Transportation's prior approval.

The audit cites the division's failure to monitor project managers and again, refers to the automated people mover project with the 2.95 multiplier and says "we saw no evidence that management took action to see why the project manager was allowing this." This is a false statement since corrective actions were made. Actions were taken to also limit travel expenses to a per diem allowance as well as performing an overhead audit. According to generally accepted government auditing standards (GAGAS), a fieldwork standard for performance audits is to obtain evidence to afford a reasonable basis for the auditor's findings and conclusions. In our opinion, some of the findings stated under the section "Failure to Adequately Monitor Contracts" should be modified or omitted since corrective actions have been taken on the "sampled" contracts which were within the audit period. The corrective actions would have been detected through further investigation of documentary and testimonial evidence which could have been obtained through audit folders and interviews with the Airports Division's Audit Section.

In the second paragraph of page 7 of the audit, it is stated that, "There is no way to measure the waste, fraud, or inefficient use of public resources that may have occurred due to the failure to consider costs and maintain competition in awarding of the Airports Division's contracts." In spite of this, the audit reaches the conclusion that there has been "a deplorable waste of public moneys" without specifically stating how much was wasted.

In the last paragraph of page 7, the audit points to "amendments which drastically increased the compensation of the contractors." It is further stated that increases "ranged from 120 to 1600 percent." The audit fails to examine what the compensation was paid for and to provide an opinion whether the amount finally paid to the contractor was a reasonable compensation for the work performed. We are not aware of any State law that prohibits the use of contracts that provide for payment based on the actual costs incurred by the contractor.

With respect to the contract for bilateral services, the audit report states the contract was for bilateral negotiations. Professional services to assist the State in bilateral negotiations were only part of the service provided and included assistance in both aviation and transit issues faced by the Department of Transportation. It is incorrect to state that the firm was hired only for the services of one person on the staff. There were others on the staff with special skills sought by the State for various transportation issues in Washington, D.C. We are not aware of any State law that prohibits the use of contracts retaining a specific firm specializing in certain skills not available within State personnel and for which compensation is made on a time and materials basis. The report fails to note the Airports Division was not involved in the selection process nor in the negotiation of the contract for the consultant. In our opinion, it is impractical to contract a firm on a project by project basis in bilateral negotiations and other critical issues in Washington, D.C. The audit report fails to describe fully and accurately the nature of the scope of the work required of the consultant.

The audit report implies competitively bid contracts are the only type of acceptable government contract, except for services designated by the Procurement Officer to be available by a single source. If the state is to be limited by this type of contracting, it will continue to obtain mediocre services and products. There are numerous examples in all levels of government where urgently needed services and projects are hampered by the bureaucratic process and result in hidden first and future costs that are not recognized in the low bid.

The audit report fails to provide the reader with a complete analysis of contracting procedures and simply leaves the impression that the amounts cited in their report as being wasteful without citing what was accomplished with the funds expended. We believe a properly conducted audit can serve as a useful management tool to identify weaknesses in processes and procedures as well as applicable management improvements. While the report focuses on our "failures", it does not reveal that corrective actions and procedures were implemented by the Airports Division. "Failures" should only be considered a finding if the "failures" have not been corrected. As such, we do not consider the audit presented a fair and balanced presentation of the situation.

According to GAGAS, "When the comments oppose the report's findings, conclusions, or recommendations, and are not, in the auditor's opinion, valid, the auditors may choose to state their

Ms. Marion M. Higa
Page 5
November 7, 1995

AIR 95.309

reasons for rejecting them. Conversely, the auditors should modify their report if they find the comments valid." Therefore, should further review reveal that the comments are valid, we request that the audit report be modified accordingly.

We appreciate the opportunity for this advance review of your findings and conclusions.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Kazu Hayashida".

KAZU HAYASHIDA
Director of Transportation

BENJAMIN J. CAYETANO
GOVERNOR OF HAWAII



LAWRENCE MIIKE
DIRECTOR OF HEALTH

STATE OF HAWAII
DEPARTMENT OF HEALTH

P. O. BOX 3378
HONOLULU, HAWAII 96801

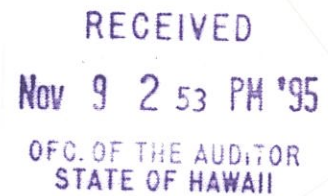
In reply, please refer to:
File:

November 9, 1995

TO: Marion M. Higa
State Auditor

FROM: *Lawrence Miike*
Lawrence Miike
Director of Health

SUBJECT: AUDIT OF CAMHD CONTRACTS



I am responding to your memorandum of October 26, 1995, and draft report of an audit of the Child and Adolescent Mental Health Division (CAMHD) in the Department of Health. While the CAMHD agrees with some of the conclusions of the Legislative Auditor's report for the FY 92-93 and FY 93-94 period, I would like to recommend that the following information be included in the Auditor's Report and that a follow-up visit be made by the auditor before the report is released.

1. Many of the deficiencies noted in the report have now been corrected. The correction process had been initiated prior to the auditor's survey.
2. Rapid turnover in CAMHD administrative staff occurred during the audit period: There were two permanent and one Acting Division Chiefs and four Public Health Administrative Officers, two of whom, although otherwise capable, had no experience with the state system. The Program Specialist who had assumed primary contracting responsibility resigned in early 1993.
3. The staff currently in charge of contracting had no role in that process during FY 92-93, and a limited role in FY 93-94.

When the former Program Specialist resigned, CAMHD was unable to recruit an experienced worker for that position. The psychologist currently involved with contracting added contract coordination including the coordination of contract monitoring to her existing duties in March, 1993. A qualified, but inexperienced individual was hired into the Program Specialist position. Her duties during the audit period were limited to the clerical aspects of contract processing. This constituted more than full-time work.

4. The number of POS contracts increased by one-third from FY 92-93 to FY 93-94 and the dollar value of the contracts doubled from five million to ten million dollars with no corresponding increase in staff dedicated to contracting. Repeated requests for additional support were made. As a comparison, Alcohol and Drug Abuse Division has fewer contracts and six Program Specialists. Two additional Program Specialists positions were recently authorized for CAMHD.
5. Neither formal training nor a training manual addressing contract issues was available. Administrative Services Office staff, primarily the contract specialist, assisted CAMHD with informal consultation and solutions to specific problems.

As stated above, many of the deficiencies cited in the Auditor's Report have been addressed.

The Program Specialist's duties have been expanded from the contract processing role she performed during the latter part of the audit period. She now regularly distributes several types of lists of providers/services, with all pertinent information needed for Division staff. Contract files are all organized and in order, there is a complete file drawer devoted to RFP and contracting procedures in chronological order. Another drawer holds monitoring files and procedures, although these need more development. We have a quarterly report status list, reminder calls and mailings are made as needed. All program staff are now required to document any contract activity in the contract file. We have a list of children served by organization. All contracting forms and types of letters of request are on file with examples for reference.

Adequate controls have been established over the contract files. Contractors have been instructed to send their insurance certificates to ASO and a copy is sent to CAMHD.

Contrary to what is stated in the auditor's report, a contract tracking log had been developed and was in use prior to the auditor's visit.

The Program Specialist states that the Auditor did not discuss any of these issues with her. Had that been done, this information could have been included in the report.

Several specifics of the report should also be clarified:

Page 14, Paragraph 3

"Several contracts did not contain finalized copies of supplemental contracts." The draft copies referred to should have been removed; the intent of these supplemental contract drafts was to replace Block Grant funds in several contracts with General Funds so that the Block Grant funds could be used for training purposes. Ultimately, CAMHD was unable to do this, due to a shortage of General Funds so the contracts were not finalized.

Page 14, Paragraph 4

"Documentation of the contractor selection process was not included in the contract files...we were able to find only four RFP's for the thirteen contracts we reviewed." Since the RFP is part of the contract except in the case of MOA's, the Division does not understand this comment. The exception would be the contract with Castle Medical Center (92-305) for which sole source approval seems to have been granted. The Director's Approval letter was supplied to the auditor.

Page 16, Paragraph 1

"Staff involved in payment authorization are not adequately trained." For much of the audit period, there was no PHAO control over the payment process. There was no accountant on staff; had the account clerk not received extensive support from ASO, no bills could have been paid. With an accountant and a PHAO now committed to working with CAMHD, the payment process has been rectified.

Page 18, Final Paragraph

"...four contracts with amendments still in process that attempt to adjust the scope of services and/or compensation amounts retroactively." Three of the four are foster/group home contracts. CAMHD continues to need increased numbers of foster homes. All contractors have had and continue to have difficulty in recruiting foster parents in adequate numbers, despite active recruiting campaigns and despite CAMHD's insistence that salaries be raised. This does not lessen the need for these services. Some of the funds in these contracts did revert to the General Fund. Others were re-allocated to alternate services for the youth in CAMHD's target population.

Page 19, Paragraph 6

"The Division was unable to explain why the nature of the services performed made evaluation difficult." CAMHD staff believe the major point made in this discussion was that because youth are frequently receiving multiple services, it is difficult to attribute change to a particular service. Also, small changes that do occur, although significant, may be captured only through very specific testing, such as Goal Attainment Scaling.

Page 21, Paragraph 4

"The Division received a complaint from DHS concerning the contractor." This was not a formal DHS complaint but rather a concern expressed by an individual worker in a telephone call. The outcome appears to be that CAMHD urged the contractor to raise salaries to facilitate staff retention.

Again, CAMHD does not dispute some of the conclusions, but does request that the problems be placed in historical perspective, that it be acknowledged that many of the required changes have been instituted and that specific examples be clarified.