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# **Audit of Selected State Agencies’ Procurement of Professional Services Contracts**

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

Report No. 05-05  
May 2005



**THE AUDITOR**  
STATE OF HAWAI‘I

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## Office of the Auditor

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

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

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.
2. *Management audits*, which are also referred to as *performance audits*, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits*, when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits*, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.
3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.
4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.
5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.
6. *Analyses of proposed special funds* and existing *trust and revolving funds* determine if proposals to establish these funds are existing funds meet legislative criteria.
7. *Procurement compliance audits* and other *procurement-related monitoring* assist the Legislature in overseeing government procurement practices.
8. *Fiscal accountability reports* analyze expenditures by the state Department of Education in various areas.
9. *Special studies* respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

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



### THE AUDITOR

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# OVERVIEW

## *Audit of Selected State Agencies' Procurement of Professional Services Contracts*

Report No. 05-05, May 2005

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### Summary

This audit was initiated to assess compliance with the Hawai'i Public Procurement Code and to assess management controls and oversight concerning the procurement of professional services. Specifically, the audit focused on contracts subject to Act 52 of the 2003 Regular Session. Act 52 amended Section 103D-304, Hawai'i Revised Statutes, to allow for independent, impartial, and qualified committees to review and select the most qualified professional service contractors based on published criteria. The audit concentrated on the Departments of Accounting and General Services, Human Services, and Transportation.

We found that the State Procurement Office's lax oversight has contributed to the difficulty all three agencies have experienced with procuring professional services. Although required by law to do so, the State Procurement Office has failed to periodically review the procurement practices of all government bodies. The State Procurement Office has also failed to maintain a procurement manual, as required by statute, that clarifies the laws and administrative rules and provides useful information to individuals responsible for procuring professional services.

In all three audited agencies, we found lack of a common understanding of the process for procuring professional services. All three agencies appeared to have little, if any, oversight or review of the processes they used. Additionally, the agencies lacked documentation to demonstrate the impartiality, independence, and qualifications of the committee members responsible for reviewing and selecting contractors, which clearly disregards the Legislature's changes to the Procurement Code with the passage of Act 52.

More seriously, we found untimely, and at times, questionable professional services procurement practices occurring within the audited agencies. We found contracts that strongly suggest work began prior to contract execution and contracts that were executed without a clearly defined scope of services and fee compensation. We also found different applications of the annual notice requirement and project-specific notices published for reasons other than those allowed by statute. Some of the audited agencies used selection criteria that are not included in the statute and used methods of evaluating submittals including a *consensus* process that appeared subjective. These procurement practices are inefficient and increase the State's liability.

Practices in the Med-QUEST Division of the Department of Human Services have raised the issue of improper employer-employee relationships and issues of conflicts of interest regarding statements of impartiality and independence.

Section 103D-304(i), Hawai'i Revised Statutes, requires professional services contracts for \$5,000 or more to be posted electronically within seven days of the



contract award. However, 49 percent of the contracts we reviewed were not posted within the first 30 days of contract award. Some postings ranged from 94 to 222 calendar days after contract award. Because electronic posting is the main venue for disseminating information regarding the selection process and triggering the time for unsuccessful contractors to request debriefing or to file any protests, the late postings are troubling.

Although mandated by law, the State Procurement Office has failed to provide procurement training to state agencies. Since November 2000, 12 training sessions were conducted for state agencies and only three of these were initiated by the State Procurement Office. Our audit also revealed that very little training is formally provided by the departments nor is formal training requested from the State Procurement Office. We also noted that state agencies must also shoulder the responsibility of providing their staff with appropriate procurement training to enable them to comply with the Procurement Code.

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## Recommendations

We recommended that State Procurement Office take a proactive role in ensuring that agencies process contracts more efficiently and post awards in a timely manner. We also recommended that the State Procurement Office comply with its statutory responsibilities to develop and administer a statewide training program, maintain and distribute a procurement manual, and periodically review the procurement practices of all government bodies.

We recommended that agencies develop, implement, and enforce clearly defined written policies and procedures, and require documentation to support the impartiality and independence of review and selection committee members, as well as individuals authorized to negotiate fees. We also recommended that agencies increase training for employees who procure professional services and request training from the State Procurement Office for the agencies' employees.

Our final recommendation was that the Department of Human Services, Med-QUEST Division, review and make appropriate changes to the status of the medical director and consultants of the Medical Standards Branch.

All three of the audited agencies and the State Procurement Office generally agreed with our recommendations. The Department of Transportation responded that it acknowledges the concerns noted in the draft report and will work with the State Procurement Office to address our concerns. The Department of Human Services welcomed our recommendations and commented that they serve to improve the contracting processes. The Department of Accounting and General Services replied that our report provides an independent evaluation of its policies and procedures and clearly points out the improvements that it needs to pursue. We made some technical revisions that do not affect the substance of the report.

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Submitted by

**THE AUDITOR**  
STATE OF HAWAI'I

Report No. 05-05  
May 2005

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## Foreword

This is a report on our audit of selected agencies' procurement of professional service contracts. This audit was conducted pursuant to Section 23-4, HRS, which requires the Auditor to conduct postaudits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions.

We wish to express our appreciation for the cooperation and assistance extended to us by the Departments of Accounting and General Services, Human Services, and Transportation, and other organizations and individuals whom we contacted during the course of our audit.

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# Chapter 1

## Introduction

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Contractors in Hawai'i have long demanded a transparent procurement process to prevent the appearance of favoritism and to restore public trust in the awarding of government contracts for professional services. For years there was a perceived link between government contracting and political fundraising. In response to these concerns, Act 52 was passed by the Legislature during the 2003 Regular Session. Act 52 amended the Hawai'i Public Procurement Code, Chapter 103D, Hawai'i Revised Statutes (HRS), establishing independent, impartial, and qualified committees to review and select the most qualified contractors based on published criteria. Prior to this change, contractors were selected by department heads, who are political appointees.

To assess compliance with the Hawai'i Public Procurement Code and to assess management controls and oversight concerning the procurement of professional services, the State Auditor initiated this audit, which concentrated on three departments—the Departments of Accounting and General Services, Human Services, and Transportation. The audit was conducted pursuant to Section 23-4, HRS, which authorizes the Auditor to conduct postaudits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions.

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## Background

The Hawai'i Public Procurement Code, Chapter 103D, HRS, is based on the Model Procurement Code for State and Local Governments, drafted under the auspices of the American Bar Association by attorneys and state and local purchasing officials. The procurement code applies to all procurement contracts awarded by governmental bodies of the State of Hawai'i and its counties, whether the consideration for the contract is cash, revenues, realizations, receipts, or earnings, any of which the State receives or is owed; specific types of procurements may be exempt by law or administrative rule. The goals of the code are to provide increased economy in procurement activities and maximize best value to the fullest extent practicable; ensure fair and equitable treatment of all persons who deal with procurement; foster competition; provide safeguards for the maintenance of a procurement system of quality and integrity; and increase public confidence in the procurement process.

Title 3, Subtitle 11, Procurement Policy Board, Chapters 120-132, Hawai'i Administrative Rules (HAR), further promotes the economy, efficiency, and effectiveness in the procurement of goods and services



and the construction of public works for the State. The purposes of administrative rulemaking are to implement legislation and to establish operating procedures for state agencies.

***Professional  
services statute,  
Section 103D-304, HRS***

Hawai'i's procurement code strives to ensure fair competition and economy in all contracting, and the State continuously reviews and updates the code to achieve these goals. Act 52, Session Laws of Hawai'i (SLH) 2003, amended the procurement code, including portions of Section 103D-304, with the intent to increase openness in the award of professional services contracts. Act 52, which was effective as of July 1, 2003, sought to accomplish this by requiring that 1) design professional services be procured only under Section 103D-304, or pursuant to emergency procurement procedures, 2) an independent selection committee rank the applying professional service providers according to relevant criteria, 3) the awarding procurement official negotiate award of the contract with providers in the ranked order set by the committee, and 4) equal distribution of contract awards be ensured where providers hold the same qualifications or ranking.

Act 216, SLH 2004, which took effect on January 1, 2005, made significant changes to Chapter 103D, including repealing statutory exemptions. With regard to the procurement of professional services, Act 216 added language prohibiting the overturn of selection committee recommendations without due cause.

The following summary of Section 103D-304, includes the changes effected by Act 52 and Act 216 and reflects the current law on procuring professional services using lists of qualified persons:

- a) Contracts for professional services shall be awarded on the basis of demonstrated competence and qualification for the type of services required, at fair and reasonable prices;
- b) At a minimum, before the beginning of each fiscal year, the head of each purchasing agency shall publish a notice inviting persons engaged in providing professional services that the agency anticipates needing in the next fiscal year, to submit current statements of qualifications and expressions of interest to the agency;
- c) The head of the purchasing agency shall designate a review committee consisting of a minimum of three persons with sufficient education, training, and licenses or credentials for each type of professional service that may be required. In designating committee members, the head of the purchasing agency shall ensure their impartiality and independence. Names of the

members shall be placed in the contract file. The committee shall review and evaluate all submissions and other pertinent information and prepare a list of qualified persons to provide these services;

- d) Whenever during the course of the year the agency needs a particular professional service, the head of the purchasing agency shall designate a selection committee to evaluate the statements of qualification and performance data of those persons on the list of qualified persons. The selection committee shall comprise a minimum of three persons with sufficient education, training, and licenses or credentials in the area of the services required. In designating the selection committee members, the head of the purchasing agency shall ensure their impartiality and independence. Names of the members shall be placed in the contract file;
- e) Selection criteria employed in descending order of importance shall be 1) relevant experience and professional qualifications, 2) past performance on similar projects, 3) capacity to accomplish the work in the required time, and 4) any additional criteria determined in writing by the selection committee to be relevant to the purchasing agency's needs or necessary to ensure full, open, and fair competition;
- f) The selection committee shall evaluate, against the selection criteria, the submissions of persons on the list of qualified persons and any other pertinent information available to the agency. The committee may conduct confidential discussions with any persons included on the list of qualified persons regarding the services that are required and the services they are able to provide. In conducting discussions, there shall be no disclosure of any information derived from the competing professional service offerors;
- g) The selection committee shall rank a minimum of three persons based on the selection criteria and send the ranking to the head of the purchasing agency. The contract file shall contain a copy of the summary of qualifications for the ranking of each of the persons provided to the head of the purchasing agency for contract negotiations. If more than one person holds the same qualifications, the selection committee shall rank the persons in a manner that ensures equal distribution of contracts among the persons holding the same qualifications. The recommendations of the selection committee shall not be overturned without due cause;

- h) The head of the purchasing agency shall negotiate a contract with the first ranked person. If a satisfactory contract cannot be negotiated with the first ranked person, negotiations with that person shall be formally terminated and negotiations with the next ranked person on the list shall commence. The contract file shall include documentation from the head of the purchasing agency to support the selection of other than the first ranked or next ranked person. If a contract at a fair and reasonable price cannot be negotiated, the selection committee may be asked to submit a minimum of three additional persons for the head of the purchasing agency to resume negotiations;
- i) Contracts awarded for \$5,000 or more shall be posted electronically within seven days of the contract award by the chief procurement officer and shall remain posted for at least one year;
- j) Contracts of less than \$25,000 (small purchase requirements, Section 103D-305), may be negotiated by the head of the purchasing agency, or designee, with at least any two persons on the list of qualified persons. Negotiations shall be conducted in the manner set forth in section (h) above, with ranking based on the selection criteria described in section (e) above, as determined by the head of the agency; and
- k) Non-selected professional service providers may submit a written request for debriefing to the chief procurement officer or designee within three working days after the posting of the award of the contract.

### ***Organizational structure for procurement***

For the most part, public procurement in Hawai'i is decentralized. The procurement function is carried out by 18 chief procurement officers. The chief procurement officers are located throughout the State, serving the executive, legislative, and judicial branches of government, including county governments, the Department of Education, the University of Hawai'i, and the Office of Hawaiian Affairs. Subject to the rules of the policy board, each chief procurement officer may delegate any authority or duty conferred upon the chief procurement officer to designees or to any department, agency, or official within their respective jurisdictions.

A seven-member autonomous State Procurement Policy Board serves as the rule making body for all procurement law. Although there is no direct reporting or oversight relationship between the Procurement Policy Board and the chief procurement officers, the board does have broad-based oversight over procurement policy and implementation.

The State Procurement Office is administratively attached to the Department of Accounting and General Services. The administrator of the office is responsible for assisting and advising governmental bodies in matters relating to the procurement process. The State Procurement Office serves as the central point for the distribution of procurement circulars, guidance, and directives to all jurisdictions. The office and the administrator provide support to the Procurement Policy Board. The administrator also serves as one of the chief procurement officers with responsibility for all executive branch procurements, except for the Department of Education and the Office of Hawaiian Affairs.

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## Prior Audits

While only one audit conducted by the Office of the Auditor focused solely on professional services, the subject has been mentioned in several financial and management audits that included or focused on divisions within the Department of Transportation. To our knowledge, no relevant procurement audits were conducted on the Departments of Accounting and General Services and Human Services. Following is a brief summary of prior audit findings and recommendations applicable to the current audit.

We initiated the *Audit of State Contracting for Professional and Technical Services*, Report No. 95-29, in response to an invitation by the National State Auditors Association. Three agencies were selected for the audit: 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. With respect to the Airports Division, we found in our prior audit that: 1) the internal control structure failed to safeguard public assets and, as implemented, did not ensure competition in the contractor selection process and failed to adequately plan for contracted work; and 2) the division failed to adequately monitor contracts. The monitoring efforts of project managers were ineffective and the project managers themselves were not monitored.

We recommended that the Airports Division: 1) follow a competitive negotiation process in selecting its contractors; 2) develop and enforce an internal control structure requiring that 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 that contracts include clearly defined outcomes, outcome measurements, scope, and contractor compensation; and 3) develop and implement internal control procedures designed to adequately monitor the effectiveness of project managers.

In our *Financial Audit of the Highways Division of the Department of Transportation*, Report No. 98-9, we found that the Highways Division failed to comply fully with the Hawai'i Public Procurement Code and the administrative rules relating to a sole source contract. To include a second phase, the division amended a sole source contract with a certified public accounting firm to develop and install a comprehensive system of accounting, reporting, and internal control. The amendment covered payment of \$1.5 million to the contractor and was neither submitted to the chief procurement officer for approval nor posted in a public area. As a result, other vendors were not afforded the opportunity to determine if they were qualified to perform the services and if so, to object to the sole source amendment. We recommended that the director of transportation ensure compliance with the provisions of the Hawai'i Public Procurement Code.

We found in our *Financial Audit of the Airports Division of the Department of Transportation*, Report No. 99-8, that there were significant deficiencies in the Airports Division's procurement process, including failure to ensure competition in the contractor selection process for a new multi-million dollar Airports Management Information System. We also found that one of the contracts to develop and implement this computer system may have been improperly procured as a sole source contract, that the division did not properly plan for the contracted work relating to this system, and that contract files for this project were not properly maintained. We recommended that the division maintain competition in the selection of contractors, adhere to the Hawai'i Public Procurement Code and related administrative rules, adequately plan for contracted work, and maintain an adequate filing system.

We noted in the *Management Audit of the Highways Division of the Department of Transportation*, Report No. 00-09, that procurement code violations have been a serious recurring problem for the division. We found that the division continued to award contracts without ensuring adequate competition. The division also ignored procurement record retention requirements, which resulted in its inability to justify the selection of many of the design consultants in the audit's sample. Division staff failed to adequately review the work of design consultants and construction contractors and avoided the contract change order review and authorization process.

We recommended that the State Procurement Office consider imposing procurement violation sanctions against the department. We also recommended that, at a minimum, the administrator of the State Procurement Office should review the division's procurement and training procedures and make recommendations for improvement, including progressive disciplinary action as warranted. In response to our recommendations, the State Procurement Office reported that some

of the department's procurement staff may not have a clear understanding of the State's procurement code and rules, and requested a response from the department regarding the audit findings and the department's procurement practices.

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## Objectives

1. Assess the extent to which the Departments of Accounting and General Services, Human Services, and Transportation comply with the statutory provisions for the procurement of professional services.
  2. Assess management controls and oversight for the procurement of professional services.
  3. Make recommendations as appropriate.
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## Scope and Methodology

In November 2004, we conducted telephone interviews with all executive agencies regarding policies and procedures for the procurement of professional services. As a follow-up, we requested that the executive agencies provide written confirmation about the information we obtained during the interviews. Based on their written confirmation, we found that three agencies had written policies and procedures, three agencies did not procure professional services, and 11 agencies did not have written policies and procedures for the procurement of professional services.

In addition to the procurement of professional services method under Section 103D-304, the procurement code provides other methods of source selection for professional services including competitive sealed bidding, competitive sealed proposals, small purchases, sole source procurements, and emergency procurements. We chose to review the current process used by the three executive agencies for procuring professional services under Section 103D-304. We selected the Departments of Accounting and General Services and Transportation for this audit because, among all executive agencies, they had the largest value and volume of awards for professional service contracts. We also included the Department of Human Services since it is one of the executive agencies having no written procedures for procuring professional services. Services are procured at the division level and the monetary value of awards is high.

We conducted interviews and reviewed documents to determine whether procurement practices complied with the Hawai'i Public Procurement Code, administrative rules, and each agency's policies and procedures. We reviewed public procurement notices to ensure completeness and

accuracy, and assessed specific professional services procurement activities to determine whether they met prescribed law and policy.

We reviewed a total of 46 contracts subject to Act 52: 12 from the Department of Accounting and General Services, 14 from the Department of Transportation, and 20 from the Department of Human Services. For our contract review, we selected professional service contracts based on the dollar amount of the award. We looked at awards of high dollar totals and also those under \$25,000, the current threshold for small purchase procedures, to ensure that the agencies were not engaged in parceling. Finally, we assessed whether the system for procuring professional services is efficiently and effectively managed and whether there is documentary evidence of ongoing performance monitoring.

Our audit work was conducted from January 2005 through March 2005 according to generally accepted government auditing standards.

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# Chapter 2

## **The Departments of Accounting and General Services, Human Services, and Transportation Have Experienced Difficulties With Procuring Professional Services**

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Employees in the three departments we audited must deal with a complex procurement code, few, if any, agency policies and procedures, and lack of training and oversight to procure professional services properly. Therefore, it is not surprising that we found several instances of non-compliance including the use of additional notices and selection criteria that differ from those contained in the statute; inaccurate and untimely electronic posting of awards, with some awards posted weeks and even months after the fact; and selection committee members who lacked independence and impartiality. In addition, we found many problematic practices within the departments, including lack of documentation, contract files that were disorganized and difficult to locate, work starting before contracts were executed, limited competition, conflicts of interest, and the appearance of biased awards.

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### **Summary of Findings**

1. The State Procurement Office's lax oversight has resulted in cumbersome, untimely, and, at times, questionable professional services procurement practices by the audited state agencies.
2. The State Procurement Office and audited state agencies have failed to provide formal training for personnel responsible for procuring professional services.



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## **Lax Oversight Has Led to Some Unacceptable Procurement Practices**

### ***The administrator of the State Procurement Office is required by law to perform specific duties***

While each agency should provide oversight of its own procurement activities, the administrator of the State Procurement Office is also tasked with performing periodic reviews of the procurement practices of all governmental bodies. Based on our review of three executive agencies there is little, if any, oversight of the procurement of professional services either by these three agencies or by the State Procurement Office. As a result, there are issues of non-compliance, inefficiency, and ineffectiveness.

The State Procurement Office has not been meeting all of its statutory obligations. In addition to being the chief procurement officer for executive branch agencies, the administrator of the State Procurement Office is charged by Section 103D-206, to perform periodic reviews of the procurement practices of all governmental bodies; assist, advise, and guide governmental bodies in matters relating to procurement; develop and administer a statewide procurement orientation and training program; and develop, distribute, and maintain a procurement manual for all state procurement officials. If each of these duties were carried out, agency employees who procure professional services would benefit significantly, primarily because procurement is not their main responsibility—sometimes it is not even in their job description.

### **Periodic review of procurement practices of all governmental bodies is lacking**

The State Procurement Office has not been periodically reviewing the procurement practices of all governmental bodies. In the past, the office has contracted with certified public accounting firms to conduct audits of procurement practices, including an audit of the county councils in 1998 and procurement reviews of small purchases by five state departments in 2002 and 2003. The only other audit was conducted by purchasing specialists of the procurement office; they examined the procurement practices of the agency's own branches including the surplus property and inventory management branches. According to the State Procurement Office, more reviews and audits have not been conducted due to budgetary and staffing constraints.

Periodic reviews by the State Procurement Office would identify those areas in which procuring employees could benefit from training or more information. These reviews could also uncover practices that do not comply with statutory or rule requirements, such as those we found in our review of the three executive agencies.

We found, for example, inconsistent use of statements of qualifications and expressions of interest received in response to annual notices for

qualified persons. We also noted a variety of reasons, other than those permitted by the procurement code, for publishing additional notices.

We also found, among the three agencies audited, that not all agencies use review committees and that some agencies combine the review and selection committee into a single committee. Occasionally a short-list committee is formed, for which the procurement code makes no provision. A short-list committee, as used by the Department of Transportation, is comprised of lower level staff. It is used to shorten the list of qualified persons provided to the selection committee for ranking. Although a state agency has the option of procuring professional services via several methods, when the professional services method is selected the agency is required to comply with all sections of the statute relating to this method—not just the sections it chooses to comply with.

Additionally, the agencies do not consistently use the selection criteria, or apply them in their order of importance, as provided under the code. Furthermore, selection committees use varying methods of ranking submissions of potentially qualified persons; we noted quantitative scoring in some cases and ranking by consensus in others. We could not determine the objectivity of some ranking methods because of the lack of documentation. In addition, without written documentation, we could not determine whether the head of the purchasing agency had indeed ensured the qualifications, independence, and impartiality of review and selection committee members, as required by the code.

We also noted that the agencies do not consistently comply with the requirement to electronically post awards. The failure to post awards may negatively impact (nonselected) professional service providers, who may lose the opportunity to request a debriefing or to protest the award, as the code allows.

Developing ad hoc processes may be an agency's attempt to meet statutory and rule requirements in a manner most expedient for its procurement needs. By periodically reviewing agencies, the State Procurement Office would be informed of their practices, both appropriate and idiosyncratic. These reviews would be an integral step in the fulfillment of the office's other statutory duties—namely, to assist, advise, and guide agencies on procurement matters and to develop and administer a statewide procurement orientation and training program.

### **A procurement manual for use by state employees has not been maintained**

Before February 23, 2005, the State Procurement Office offered a Public Procurement Manual at its website; the manual was dated June 1998. The State Procurement Office had confirmed earlier, in January 2005,

that this manual was the only version of a procurement manual it had issued. In a foreword to the manual, a former State Procurement Office administrator explained, *“My goal was to simplify and clarify the State’s procurement system while ensuring fair and open competition with proper documentation of all purchasing actions.”* Based on our review of the agencies, this is exactly what is needed so that employees tasked with procurement have the knowledge to efficiently and effectively expend public funds. Unfortunately, the procurement manual was never updated to incorporate changes to the statutes and administrative rules, therefore anyone who used it as a point of reference risked using outdated information and not complying with current statutes and rules. In fact, we found instances where staff have followed outdated and inaccurate information.

During an interview on February 18, 2005, with the former administrator of the State Procurement Office we inquired as to why the 1998 procurement manual was still on the website. The former administrator explained that the office did not have the resources to maintain the manual and that it was difficult to update the website and apprise everyone of procurement requirements. On February 23, 2005, the procurement manual was removed from the website and replaced with links to various sources of information including the Hawai‘i Procurement Code and procurement administrative rules, circulars, and directives. These links are preceded by this statement: *“Due to the numerous statutory changes that occur, and thereafter, Hawaii Administrative Rule changes that follow to implement the statutes, the Procurement Manual is not available at this time.”*

Referring employees to the very statutes, rules, circulars, and directives that they find complex and difficult to understand, instead of providing an updated and accurate procurement manual that explains and simplifies the procurement process, does nothing to solve the many problems that persist in procurement.

***Staff within each agency lack a common understanding of the process***

The process to procure professional services in the agencies we reviewed is carried out by program specialists, engineers, or other employees who are not procurement specialists. As a result, written procurement policies and procedures that are current and tailored to each agency, combined with continual training, is especially critical. When these key elements are missing, employees tasked with procurement lack a common understanding of the procurement process and problems are inevitable.

### **Department-level staff responsible for procurement are unsure of their responsibilities under the law**

In the Department of Human Services, the administrator of the Administrative Appeals Office welcomed our review of the agency's contracts and sought assurance that she is correctly applying the requirements to procure professional services. We found several areas of concern that suggest staff of other departments similarly are unsure of their responsibilities relating to the procurement of professional services.

Section 103D-304(e), clearly specifies the selection criteria and the order of their importance in the selection committee's evaluation of submissions received in response to a notice for professional service providers. In spite of this statutory requirement, 18 (or 39 percent) of the 46 contracts we reviewed in the Departments of Accounting and General Services, Human Services, and Transportation either used criteria not specified in the statute or used the criteria but in a different order of importance.

The procurement code does not dictate a particular scoring method when evaluating submissions using the professional services method of procurement as it does when the competitive sealed proposals method is used. However, the methods used by some agencies are troublesome. In the contracts reviewed, we found that most selection committees used a quantitative method of scoring to evaluate submittals. Use of a numeric-based system, such as a quantitative method, to determine ranking helps remove subjectivity from the selection process.

However, all of the selection committees of the Department of Accounting and General Services relied on consensus among its members to rank consultants. The minutes of each selection committee set forth the selection criteria used and the ranking of consultants reached by consensus among committee members, but do not contain explanations of the basis on which consensus was reached. Without documented explanations, selection committee decisions cannot overcome the appearance of subjectivity. In fact, a section head in the design branch commented that the consensus process is subjective and added that sometimes the committee makes its selections via e-mail, instead of holding meetings. The consensus method, as applied by the department, can hardly withstand scrutiny if a debriefing request were received.

The Med-QUEST Division of the Department of Human Services also departed from statutory requirements regarding selection criteria. The agency failed to use criteria required by statute. Moreover, it used a "met/not met" system to score submittals it received from potential professional service providers and did not rank the submittals as required

by statute. Instead, all respondents who met the criteria received contracts, except one who could not provide a tax clearance certificate.

Overall, we found a lack of documentation to demonstrate that review and selection committee members are qualified, independent, and impartial. Sections 103D-304(c) and (d), require the head of each purchasing agency to designate a minimum of three persons with sufficient education, training, and licenses or credentials in the area of the services required to serve on the committees. The head of a purchasing agency is also required to ensure the impartiality and independence of committee members. Of all contracts we reviewed, 87 percent contained no documentation to show that committee members were qualified. Further, in 91 percent of the contracts examined, we could not determine how the heads of the purchasing agencies ensured that committee members were impartial and independent. While the statute does not call for these requirements to be in writing, without documentation, we question how someone reviewing contract files can determine that the requirements were met.

There is also considerable confusion regarding information that contractors must submit. When entering into a contract, contractors are required to provide certain forms. These forms include a tax clearance certificate, a certificate of compliance, and a certificate of good standing. Despite attempts by the State Procurement Office to clarify the requirements, 52 percent of the contracts we reviewed did not contain applicable forms or contained forms that were outdated.

### **Silo effects characterize departmental approaches**

Each of the three departments we assessed designates a position to administer procurement activities; however, the designated employee appears to focus mainly on processing the contract once it is received from the division, branch, or program. There appears to be no oversight or review of the process used to procure professional services, with each division, branch, or program following the process that best fits its needs.

The Department of Transportation's contracts engineer, in addition to other responsibilities, reviews professional services contracts, which are prepared by the divisions, for sufficiency as to substance and for compliance with applicable statutes and federal regulations. She is also responsible for writing memos on contract matters. Although her job description does not include training others, she trains division employees regarding procurement as needed. The training is informal and unofficial, attendance and dates are not documented, and records of training sessions are not kept. Division employees informed us that they rely heavily on the contracts engineer for guidance, updates, and training on the procurement of professional services, yet her role in the process seemed unclear to the divisions.

Although the department has promulgated written procedures for the professional services selection process, the Highways Division has developed its own written procedures. The Airports Division also has its own system, called “project development and tracking” or PDT. The PDT system contains updates to the law and sample forms for use by division employees in various situations and is intended to supplement the training provided by the contracts engineer. The contracts engineer signs contracts on behalf of the director, yet does not require the divisions to submit supporting documentation with the contracts. She relies on the divisions to comply with the department’s written procedures and applicable statutes and rules. However, since two of the divisions have developed their own procedures, we question how compliance can be verified without supporting documentation.

The Department of Accounting and General Services also has a contracts engineer position within the Staff Services Branch of the Division of Public Works. This contracts engineer processes the contracts for funding approval and execution, but does not provide training as in the Department of Transportation. Again, documentation supporting the professional services award process is not submitted with the contracts and there is no verification of compliance with statutes and rules.

The Department of Human Services’ procurement and supply specialist might be regarded as fulfilling a comparable function. She provides guidance and training, distributes updates to the statutes and rules, and processes professional service contracts in addition to her other duties. Each division does its own procurement of professional services, and supporting documentation on the process used by each division is not submitted with contracts. There are no department procedures for the procurement of professional services; each division operates independently and each has its own way of procuring professional services. We question how compliance with statutes and rules can be verified without supporting documentation.

We also found that the Department of Human Services’ Fiscal Management Office is not as familiar with the professional services procurement process as it is with the process to procure other goods and services. Accordingly, guidance and training on procuring professional services is limited. In addition, the divisions do not communicate their knowledge of the professional services process with one another.

For example, the Vocational Rehabilitation Division and the Administrative Appeals Office procure professional services using lists of qualified persons. In fact, they share the submittals received in response to a published notice for attorneys, which lists requirements for both entities. The Vocational Rehabilitation Division issues mediator service contracts for a term of two years, while its attorney service contracts



are for one-year terms. Despite receiving support from the Fiscal Management Office, the Administrative Appeals Office struggles for six months each year to go through its procurement process. Yet it issues attorney service contracts for one-year terms only. The Administrative Appeals Office appears to be unaware that it can enter into contracts longer than a year, provided the published notice so states. A better understanding of the professional services procurement method by the Fiscal Management Office and communication between the divisions would enable the Administrative Appeals Office, and perhaps other divisions in the department, to operate more efficiently and effectively.

Until departments establish policies and procedures and provide guidance, training, and oversight, resources will continue to be misused. In addition, departments as a whole could benefit from improved communication among its divisions, branches, and programs.

### **Agencies blindly attempt to follow the law without determining effectiveness and efficiency**

Agencies do not question whether changes to the law and analysis of the available methods of source selection might enable them to procure professional services more effectively and efficiently. Instead, they blindly attempt to follow the existing law and they also use the method of source selection most familiar to them.

The Department of Human Services provides an example of failure to analyze the various methods of source selection available to it. We requested a list of all its awards for professional services. We noted that these services were procured with the competitive sealed proposals, otherwise known as request for proposals (RFP), and small purchase methods, in addition to the method that uses lists of qualified persons. The department's Fiscal Management Office explained that because the professional services method is a new process, most of the department's offices continue to use the more familiar RFP process. When there is no guidance or training on the different methods, the best approach for a program may not be given consideration.

Other examples of following the law for the sole purpose of compliance involve the application of the annual notice requirement in Section 103D-304(b). The statute provides that the head of each purchasing agency shall, at a minimum, publish a notice before the beginning of each fiscal year inviting persons engaged in providing professional services that the agency anticipates needing in the next fiscal year, to submit current statements of qualifications and expressions of interest to the agency.

The Department of Accounting and General Services publishes an annual notice containing a list of the projects for which professional services are anticipated and actually uses the responses it receives. All submittals are evaluated by a review committee and those who qualify are entered into a database. When a particular professional service is needed for a project, a list of qualified parties who expressed interest in the project is given to the selection committee. If there are not enough qualified parties for a specific project, all persons qualified for the particular discipline involved in the project are added to the list. This practice appears to comply with the intended use of the annual notice under the statute. The division does not need to publish additional notices during a fiscal year.

The Department of Human Services also publishes an annual notice; however, the divisions differ in their use of the responses and in the review and selection committee process. Some divisions use a review committee to qualify interested parties and provide a list of qualified persons to the selection committee. Other divisions combine the review and selection committees into one committee that both qualifies and ranks the interested parties. Still other divisions combine the committees to qualify and score the respondents, although they do not rank them, as required by law.

While the Department of Transportation meets the minimum requirement of the statute by publishing an annual notice, the notice does not list the projects for which services will be needed during the next fiscal year. Nothing is done with the responses. Instead, as the need for each project arises, additional notices are published—approximately five to ten notices per month. As a result, in order to be considered for selection, professional service providers must continually check the website listed in the department’s annual notice and submit their proposals according to the individual advertisements. This process does not meet the criteria for publishing additional notices of Section 103D-304(b). Although not in compliance with the law, the department believes that publishing project-specific notices is a more efficient way to receive and evaluate the responses received. The department should conduct an analysis to determine whether the law should be changed if the requirement for an annual notice is not beneficial to the department. Consideration should be given to whether competition would be limited and to the additional efforts required of the potential service providers.

### **Lack of documentation in contract files hampers staff review**

During our audit, we experienced difficulty reviewing contract files. None of the agencies we audited had a single location for their contract files. In addition, we did not find complete contract files—files that contained all applicable documents ending with close out paperwork. When all contract-related documents are not in one file, internal or external reviewers cannot obtain a complete picture of the contract.



The Audit Division of the Department of Accounting and General Services came closest to having complete files in one place. However, when the division procures audit services for another state agency, the relevant contract is missing from the Audit Division file. These contracts are prepared by the audited agencies and are not retained by the Audit Division. In addition, documentation supporting the qualifications of review and selection committee members was not in the contract files; it was filed elsewhere in the Audit Division. Furthermore, written documentation of committee members' impartiality and independence did not exist.

In the three agencies we reviewed, paperwork related to the review and selection committee process, including scoring sheets and consultant submittals, was not always filed with the contract. Evidence of fee negotiations was seldom found in the contract files and, in fact, was nonexistent in many cases. We were told that fee negotiations are not always documented and they are oftentimes only verbal discussions between the agency and the consultant. Fee negotiation is an important part of the process and calls for documentation to prevent future problems, especially for large contracts. Copies of department memoranda designating review and selection committee members were usually not placed in the contract files but were filed elsewhere in the departments.

In some agencies, procuring employees considered a contract file "complete" once a contract was awarded. The contract implementation documents, invoices and payment records, correspondence after award, deliverables, change orders or supplements, record of final payment, and contractor evaluation became another file located at the project site or in another section of the agency. In order to evaluate the effectiveness of a project, the contract file must contain everything related to the contract. The agencies should develop written procedures to standardize what is included in contract files and how contracts are administered.

### **Agencies do not have formal, documented procedures**

Agencies have a fiduciary responsibility to effectively and efficiently manage public resources. Without formal, written policies and procedures, this responsibility becomes difficult, if not impossible, to fulfill. Additionally, if policies and procedures are available but not enforced, they are useless.

The Department of Transportation has written procedures for procuring professional services, although there is nothing in the procedures requiring documentation of impartiality and independence of review and selection committee members.

The Department of Accounting and General Services, Public Works Division, provided us copies of procedures relating to professional services contracts; however, the dates on the procedures ranged from 1981 to 1999, with the most current dated December 1, 1999.

The Department of Human Services does not have written procedures for the procurement of professional services. The Med-QUEST Division said that it uses the administrative rules and circulars from its Fiscal Management Office and the State Procurement Office as guides. The division conceded that it does not have a method for evaluating its contractors.

In fact, in our survey of all executive agencies, 11 agencies responded that they do not have written policies and procedures and that they simply follow statutes, rules, or procurement directives regarding the purchase of professional services. Several of these 11 agencies indicated that they do not see the need for developing written policies and procedures because: 1) written policies and procedures are not required; 2) the rules provide inherent checks and balances; and 3) the statutes, rules, and various directives are specific and detailed, thus augmenting them would serve no purpose.

While the statutes, rules, directives, and circulars regarding procurement are a good start in understanding requirements, their application should be tailored to each agency's needs. In the three agencies under review, the employees who procure professional services are not procurement specialists; purchasing is just a small portion of their responsibilities. As a result, they need clear, concise, and easy-to-understand procedures to enable them to do their job and comply with the law.

***Procurements of professional services have been untimely***

Although the procurement code does not stress the value of proper planning and timeliness, best practices developed by the National State Auditors Association support and emphasize their importance when contracting for services. The association sees proper planning as providing the foundation for the awarding and monitoring of contracts. Timely planning is critical and helps an agency to identify the types of services required and when they are needed. Consequently, the three departments under review are within the letter of the law. However, they have, at times, disregarded the importance of proper planning, negatively affecting the timeliness of services to be provided and calling into question the necessity of contracts, the openness and transparency of government, and public confidence in the procurement processes. Often, to accommodate the time constraints of an end user, work may proceed without an executed contract, increasing the State's liability.

### **Contracts are meant to protect all parties involved**

Before entering into any legal agreement, prudence dictates that safeguards be instituted and precautions be taken. According to the National State Auditors Association's best practices, contracts must be formal, written documents that should: 1) protect agency interests; 2) identify responsibilities of the contracting parties; 3) define deliverables; and 4) document the mutual agreement, the substance, and parameters of the agreement. A well written contract that includes a defined scope and fee benefits all parties to the contract by clarifying everyone's expectations and responsibilities.

Work should not begin before a contract is executed—that is, agreed upon and signed by all parties to the contract. Doing so may, among other issues, increase the State's liability and jeopardize the scope of the services to be provided. The Design Branch in the Division of Public Works of the Department of Accounting and General Services admits that to meet project deadlines, contractors have started work before executing a contract. Subsequently, the contractor bills the State for work completed prior to contract execution. Furthermore, there have even been times that a project is completed before a contract is executed. Although intentions may be admirable as state agencies attempt to increase efficiency, allowing work to proceed without an executed contract is not advisable and should not be condoned. If the law or process is inefficient, then the law or process needs to be re-examined accordingly.

### **Work has begun before contracts have been formally executed**

We found two contracts originating with the Division of Public Works of the Department of Accounting and General Services that strongly suggest work began prior to contract execution. The first involves a December 2, 2004, letter from the division administrator addressed to the contractor authorizing work to proceed:

Due to the need to complete this project in a timely manner, it has become necessary to issue you this Notice to Proceed prior to the final execution of your contract. Accordingly, you are authorized to proceed with the work.

The contract was executed more than three weeks later on December 28, 2004, in the amount of \$158,190. Despite the risks posed to the State, and therefore the public, the division defends the practice:

In order to accomplish our mission and meet the demands of users/clients, we cannot wait for a fully executed contract to be completed before we start. If we were to wait for an executed contract, we would loose [sic] approximately two months of time where no work is being

done and would require us and the consultant to “remobilize” after the waiting period. This is very inefficient...it is fairly uncommon that we can afford the time to wait for a fully executed contract before starting the design consultant work. This is not illegal as we do have funds available. If funds were not available (allotted), it would be illegal.

A second contract, issued by the Department of Accounting and General Services, was executed on October 18, 2004, in the amount of \$1,031,496. A *consensus* selection process was influenced by the Department of Education’s request to select a particular contractor because of the contractor’s familiarity with the project. Change orders and contract amendments totaling \$420,238 increased the contract amount to \$1,451,734. In the contract file, we found documentation that \$1,006,496, out of the initial \$1,031,496, was billed on October 31, 2004 only 13 calendar days after the contract was executed. According to the division, work on the project proceeded before the contract was executed. When questioned, the division reiterated the need for work to proceed to accommodate time constraints placed upon the project by the end users, even without an executed contract. To minimize liability exposure for all stakeholders, the department should take appropriate measures to ensure work does not proceed prior to contract execution.

### **Contracts were executed without clearly defining the scope of services to be provided**

We found two contracts originating at the Harbors Division in the Department of Transportation that were executed without clearly defined scopes of services. The first contract, for a price not to exceed \$500,000, was executed on December 13, 2004. As of February 24, 2005, the notice to proceed was still pending. According to the division’s design engineer, negotiations involving a detailed scope of work and fee compensation have not yet been completed. He added that upon completion of the negotiations, the notice to proceed would be issued and a work order executed.

In this case, there are two interrelated problems: 1) the scope of services to be provided by the contractor was not clearly defined; and 2) the fee compensation due to the contractor has not been finalized. Instead, the amount of the contract was set at an amount *not to exceed* \$500,000, based on services that had not been agreed upon and remain uncertain. Entering into a contract without clearly defining the scope of services to be provided is ill-advised and may result in unnecessary cost and liability. According to the National State Auditors Association’s best practices, the contract should not only clearly state and define the scope of work, but the procedures for any changes as well.

The second contract, in the amount of \$1,990,000, was executed on June 30, 2004 to avoid lapsing funds. However, as of February 24, 2005,

the notice to proceed was, similar to the first contract, still pending. According to the division's design engineer,

A notice to proceed has not been issued due to ongoing negotiations of detailed scope of work and fee compensation. When successful negotiations are completed, a notice to proceed will be issued. Should the not to exceed amount be deemed insufficient...additional funds for amending the contract would be requested. The contract was written in this manner to allow for contract execution and resulting encumbrance of funds into this contract, on or prior to June 30, 2004, at which time the appropriation lapses.

Ironically, in a January 24, 2005, interview, the same design engineer informed us that it is common for appropriations to be made for up to two to three years before a project begins. He maintained that if a contract is not executed within that timeframe, the project should be re-evaluated to determine whether funding should be requested again or the project should be canceled. Had the division heeded its own advice, it could have re-evaluated the need for the project and determined whether the encumbered funds might have been better spent elsewhere. Instead, close to eight months after the contract was executed, the department has a project for which a notice to proceed is still pending.

### **Departments take weeks to electronically post contract awards that are sometimes inaccurate**

We found that the audited departments take weeks to post awards; moreover, the information posted is, at times, inaccurate. Section 103D-304(i), requires professional services contracts for \$5,000 or more to be posted electronically within seven days of the contract award. Information to be posted includes, but is not limited to, the names of persons ranked and submitted by a selection committee to the purchasing agency's head, the name of the person to whom the contract was awarded, the dollar amount of the contract, the name of the agency official making the selection, and any relationship of the awardee's principals to the official making the award.

Although the statute does not specify whether working or calendar days apply, most of the 46 contracts we reviewed clearly are not in compliance. Act 52, and Section 103D-304(i), applied to 39 of the contracts we reviewed. Seven contracts were less than \$5,000 in value and were not required to be electronically posted. Nineteen out of 39 contracts (49 percent) were not posted within the first 30 calendar days after the award date and 9 (23 percent) were not posted within the first 90 calendar days. In fact, three of the nine contracts, which were issued by the Department of Transportation, were not posted until 94 to 187 calendar days after the contracts were awarded. The remaining six, which were from the Department of Human Services, were posted from

120 to 222 calendar days after the award of the contracts. Electronic posting is the main venue for disseminating information regarding the selection process and triggering the time for unsuccessful contractors to request debriefing or to file any protests.

We also found that one of the three departments under review posted the same award multiple times on the State Procurement Office website. Due to changes in responsibilities and personnel, the Department of Accounting and General Services, Division of Public Works had five different awards listed repetitively on three separate dates: September 10, 2004, September 21, 2004, and October 4, 2004. The department assures it has taken measures to ensure that multiple listings do not recur.

The electronic postings on the State Procurement Office website should communicate useful information to (nonselected) contractors and the public. Although not specified by law, a listing of competitors in alphabetical order is not as informative as a listing in the order ranked by an agency's selection committee. Procurement Circular 2000-04, Amendment 1, dated July 7, 2000, issued by the State Procurement Office advised state agencies to post contractor names submitted for selection in alphabetical order. But, to achieve transparency of the procurement process, unsuccessful contractors and the public would be better served if the ranking of contractors were revealed instead. The State Procurement Office should reconsider its 2000 circular and advise agencies to disclose information allowing for a meaningful comparison of contractors.

### **Departments have not received any formal requests for debriefings regarding the selection process**

During interviews with each department's personnel involved in the procurement of professional services, we learned that no contractor has ever formally requested a debriefing. According to Section 3-122-70(a)(1): "The purpose of a debriefing is to inform providers of professional services of the basis for nonselection. A written request for a debriefing shall be made within three working days after the posting of the award of the contract."

Instead, nonselected contractors have inquired verbally about their qualifications. This informal method appears to be the preferred way for nonselected contractors to question a department's selection process without compromising their chances for future awards.



***The Department of Human Services grapples with several issues***

Unlike the other agencies audited, the Department of Human Services finds itself in the midst of several other issues. Its major problems include: 1) improper employer-employee relationships due in part to complying with the federal Health Insurance Portability and Accountability Act of 1996 (HIPAA); 2) conflicts of interest as statements of impartiality and independence are compromised; 3) unfairly limited competition through the use of outdated fee schedules; and 4) inappropriate use of selection criteria and processes.

**The Department of Human Services faces questions of improper employer-employee relationships**

The Med-QUEST Division of the Department of Human Services is addressing claims of improper employer-employee relationships. The division procures the services of medical consultants in accordance with Section 103D-304, under one-year contracts. The medical consultants conduct various reviews that, according to the division, can be performed only by physicians. Included in the contracts are duties, responsibilities, and requirements that each medical consultant is required to fulfill. The medical consultants are supervised by another contracted physician, the medical director.

According to the division's procurement personnel, the position of medical director was held by a state employee until about 1996. Thereafter, the position was contracted out and filled through the procurement of professional services. The current medical director, who has been in place since 1999, is not only responsible for supervising the other contracted medical consultants, but also state employees within the division. Additionally, the medical director position appears on the division's organizational chart, further raising questions of improper employer-employee relationships.

When we consulted with the State's attorney general, we were advised that an employer-employee relationship is not based solely on the wording in a contract, but also on how a contract is carried out. For example, HIPAA seeks to protect the privacy of a person's health information by placing physical and procedural guidelines on organizations that handle health care information. To comply with HIPAA by restricting access to case files, the division provides office space, on its premises, to medical consultants for case file reviews. The ambiguous working relationship between the division and its contracted medical consultants leads to questions about the status of those consultants. Determining whether they are employees of the division or independent contractors is based on: 1) the division providing office space for its medical consultants to conduct work that must be completed on-site; 2) the extent of control the division exercises over the duties and responsibilities of its medical consultants; 3) the number of hours,

controlled by the division, that each medical consultant may work per week; 4) the duration of the relationship between the division and its medical consultants; and 5) the contractual responsibilities of the medical consultants, which may have the effect of restricting other gainful work. In hopes of resolving the employer-employee relationship issue, the division has issued an RFP to allow the division to contract with a management company that will provide the medical consultants.

The questionable employer-employee relationship, however, remains unresolved indefinitely as other state agencies, including the State Procurement Office and the Departments of Accounting and General Services, Human Resource Development, and Labor and Industrial Relations, continue to address the issue. According to the Department of the Attorney General, department personnel will soon begin training to identify and analyze future employer-employee relationship situations; but the attorney general concedes that the issue is not easily resolved.

### **Conflicts of interest surround the Med-QUEST Division's contracted medical consultants and their statements of impartiality and independence**

We found notarized affidavits of impartiality and independence signed by the medical consultants and medical director who participated on the review and selection committees for fellow medical consultants. The affidavits state that the signers have: “no personal, business, or any other relationship that would influence his/her decision in the review or selection process...”

On its face, this statement appears to comply with Sections 103D-304(c) and (d), which direct the head of a purchasing agency to ensure the impartiality and independence of review and selection committee members. However, during contract review, we discovered that the medical director sat on the review and selection committee for medical consultants she now supervises. Conversely, a medical consultant sat on the review and selection committee for her supervisor, the medical director. Furthermore, a medical consultant lists the medical director as a reference on her resume. This situation clearly demonstrates that the division is violating Sections 103D-304(c) and (d).

### **The Department of Human Services sets compensation too low**

The Department of Human Services compensates contractors below current comparable rates. As a result, it may be limiting competition. For example, the Med-QUEST Division uses outdated fee schedules to compensate its medical consultants. According to the division's procurement personnel, the division used to consult with other departments and benchmarked with other states to determine the fee



schedules for medical consultants. However, this practice ended about five years ago, and the division continues to use outdated fee schedules for current contracts. The division's finance officer noted that its contractors were underpaid in comparison to those employed by the Department of Health. Consequently, it is not surprising to find low turnover as the same medical consultants reapply annually while potential competing candidates may be discouraged.

Another example of purposely low compensation is the contract for attorney services used by the department's Administrative Appeals Office. The office's administrator said she intentionally sets the not-to-exceed amount of her contracts at \$24,000. She does this to avoid requirements and complexities, which she believes would exist, for procuring a contract that would not qualify as a small purchase. However, she rationalizes that she is able to generate more contracts for smaller amounts, thus spreading the work among more attorneys.

### **The Vocational Rehabilitation Division utilizes its own selection criteria and processes**

The Vocational Rehabilitation Division of the Department of Human Services uses its own criteria in the selection process for procuring mediators and attorneys. Although the division's contracts do not exceed the small purchases ceiling of \$25,000, the division is still required by law to follow the State's procurement code. We judgmentally sampled and reviewed seven contracts originating from the division and found that: 1) all seven contracts appeared to follow the process of procuring professional services from a list of qualified persons, but were executed using the small purchases contract form instead of the more appropriate contract for professional services form; 2) all seven contracts were awarded without ranking the qualified contractors; and 3) each contractor received exactly the same score from each of the selection committee members. For example, out of a maximum score of 100, the three selection committee members each scored one contractor a 40, and another contractor a 59. In addition, the scoring on one of the rating forms appeared to have been changed so that the total points on that form equaled those on each of the other three rating forms.

Because the division uses the professional services method for procuring attorney and mediator services, Section 103D-304, applies. The division did not use the specific selection criteria mandated by the statute, nor did the selection committee rank the submittals in the manner required by statute. The head of the purchasing agency is obligated to ensure the independence and impartiality of the selection committee members. However, by their identical scorings, committee members appear to have compromised their independence and impartiality. Finally, although the value of the contract is below the small purchase threshold of \$25,000,

the contract forms should correspond to the method of source selection used—the professional services method—not to the dollar amount of the award.

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## **The State Procurement Office and Audited State Agencies Have Failed To Provide Formal Training for Personnel Responsible for Procuring Professional Services**

### ***The State Procurement Office is required by law to provide training***

Although mandated by law, the State Procurement Office has failed to provide state agencies with training on the procurement of professional services. Instead, the procurement office issues circulars, and the Procurement Policy Board issues directives that attempt to explain the details of the procurement code, rules, and any amendments. In turn, state agencies have not provided their staff with the training and guidance necessary to supplement the circulars and directives for compliance with procurement law. We emphasize that ultimate responsibility for compliance with procurement laws resides with the procuring agency; however, training and guidance from the State Procurement Office would greatly increase the effectiveness of the professional services procurement process across all agencies and reduce the likelihood of non-compliance.

The State Procurement Office has not fulfilled its statutory mandate to provide training to state agencies on the procurement of professional services. Section 103D-206(3), directs the administrator of the State Procurement Office to develop and administer a statewide procurement orientation and training program.

This statutory responsibility is expanded upon in the State Procurement Office's functional statement, which says that the orientation and training program should be available for purchasing personnel, provider organizations, and all other interested parties. The responsibility to provide training appears in the position descriptions for the administrator and assistant administrator of the State Procurement Office. To date, a statewide procurement orientation and training program does not exist.

The law does not place the same responsibility on state agencies. However, according to the U.S. Government Accountability Office, a state agency is defined by its personnel and their capacity to perform. In order to perform, an agency must affirmatively shoulder the responsibility to train its personnel on the duties, requirements, and responsibilities entailed in carrying out business in an efficient, timely, and legal manner. Unfortunately, through reviews of written policies and procedures and interviews with procurement personnel of the three departments, our audit revealed that very little training is formally provided by the departments, nor is formal training requested of the State Procurement Office. Instead, agency personnel involved with

the procurement of professional services continue to rely on: 1) the law and their own reading of the administrative rules; 2) each other; 3) informal inquiries and meetings with the State Procurement Office; and 4) the State Procurement Office's circulars and website and policy board directives.

### **Training conducted by the State Procurement Office does not cover professional services procurement**

The State Procurement Office has conducted a total of 12 training sessions in the past 52 months (since November 2000). Of these 12, only three were initiated by the State Procurement Office. The remaining nine training sessions were requested by agencies, which determined the subjects covered. The training, narrow in scope, was attended only by personnel of the requesting agencies. For example, 33 percent (four out of 12) of the training sessions were held exclusively for a joint audience: the Department of Human Services and Housing Community Development Corporation of Hawai'i. The only training relating to the procurement of professional services was a review of Act 52 conducted in November 2003.

Understandably, agency personnel have difficulty recalling the last time they received formal training on the procurement of professional services given by the procurement office. A staff member of the Audit Division at the Department of Accounting and General Services, who has been with the division for about 18 years, stated succinctly that the State Procurement Office does not currently offer training. Instead, departments train themselves by relying on the State Procurement Office's website. This sentiment was echoed by other procurement personnel.

### **Procurement circulars and directives are not substitutes for training**

Instead of establishing a formal procurement training program, the State Procurement Office believes its statutory obligation is met by issuing circulars and directives to state agencies to communicate amendments to the procurement law. The effectiveness of circulars and directives as substitutes for training does not bear out, considering the confusion and dubious practices of the agencies we audited. Furthermore, how informed any state agency may be on procurement matters relies too heavily on the initiative of individual employees. For example, since 1999, in attempts to make updates to the law easier to understand, a procurement and supply specialist in the Financial Management Office of the Department of Human Services has taken it upon herself to interpret the contents of procurement circulars and directives and issue additional circulars to internal personnel, as needed. She also

encourages department personnel to call her for assistance if they are unsure about procurement procedures. The department's reliance on this individual employee's initiative reflects the State Procurement Office's ineffectiveness in communicating and providing guidance on a complex procurement code and related administrative rules. Without systematic dissemination of information, through training and responsive guidance, the State Procurement Office leaves statutory and administrative compliance to the chance that an agency has employees willing to go the extra mile—a situation that may raise legal issues and undermine a transparent and fair procurement process.

***The Hawai'i State Procurement Code's complexity requires better training of procurement staff***

The Hawai'i State Procurement Code is complex and difficult to understand. Due to frequent amendments to the law, training is vital to keep procurement employees up-to-date and to ensure compliance with and understanding of the code. Instead, agencies are reduced to relying on telephone calls to procurement office staff, procurement circulars and directives, and each other for advice and guidance regarding the complexities of procurement law.

The State's procurement process is decentralized. However, we found that two of the three departments we audited did not have internal written policies or procedures for staff to follow to supplement procurement statutes, rules, circulars, and directives. The National State Auditors Association's best practices recommends that a state agency know the State's bidding and contract laws as well as any other procedures that it is obligated to follow. Combined with little guidance from the State's authority on procurement, additional responsibilities, such as interpreting procurement law, are added to the workload of staff whose primary duties lie elsewhere.

**Procurement is usually not the primary responsibility of staff who procure professional services**

With decentralization of the State's procurement process, agencies' staff find themselves responsible for unfamiliar processes and requirements that undergo frequent change. Without the assistance or guidance of written policies and procedures, procurement personnel are left to fend for themselves to procure professional services.

Few individual state employees have the expertise in procurement to be sources of guidance. For example, at the Division of Public Works of the Department of Accounting and General Services, personnel relied on a staff member for his knowledge of the processes to procure professional services. This dependence persisted despite the employee's transfer, effective July 1, 2004, from the Quality Control Branch to the Planning Branch, where he was assigned duties and responsibilities associated

with his new position. If he had abruptly discontinued employment, his expertise and knowledge of procurement processes would have been lost to the division. Almost one year later, although the problem is being addressed, the division has not completely trained a replacement.

### **Agency staff have difficulty interpreting the laws, rules, circulars, and directives**

State agencies rely internally on individuals to gather and disseminate information to the appropriate personnel or use the information when personally involved in the procurement process. However, many struggle with interpreting the law and rely heavily on the procurement office for guidance. Unfortunately, the procurement circulars and directives are often mere regurgitations of the law and rules, and the information on the State Procurement Office website may not be current.

For example, at the Administrative Appeals Office of the Department of Human Services, attorney services are procured annually by a staff member who spends up to six months, struggling to interpret the law, rules, and any applicable changes. In 2004, she used the information from the June 1998 procurement manual, issued by the procurement office and previously found on its website, as a guide. After starting the procurement process, she realized the manual was outdated, resulting in additional work to correct the errors caused by following the manual.

Additionally, we learned that the department's Financial Management Office advises its personnel to use the June 1998 manual as a supplement to the procurement law, rules, circulars, and directives. It is problematic that the department's Financial Management Office, which is responsible for internal procurement training, continues to rely on a procurement manual that is over six years old and has outlived amendments to the law it was created to explain.

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## **Conclusion**

Section 103D-304, governs the procurement of professional services. Prior to July 1, 2003, professional service providers were selected by politically appointed department heads—giving the perception of favoritism and resulting in the lack of public trust in the awarding of professional service contracts.

With the passage of Act 52, SLH 2003, the problem of department heads selecting professional service contractors appears to have been resolved. However, other non-compliance issues remain in the Departments of Accounting and General Services, Human Services, and Transportation. In addition to developing written policies and procedures, the departments and the State Procurement Office need to work together to

develop a useful and effective training program so that the employees tasked with the procurement of professional services know what is required of them.

Public trust in the procurement of professional services will not be restored until state employees understand the law, receive continual training, and have workable procedures to help them effectively and efficiently procure professional services in compliance with the law.

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## Recommendations

1. The State Procurement Office should:
  - a. Take a proactive role in ensuring that agencies process contracts more efficiently and post awards in a timely manner;
  - b. Comply with its statutory responsibility to develop and administer a statewide training program;
  - c. Maintain and distribute a procurement manual; and
  - d. Periodically review the procurement practices of all governmental bodies.
2. Agencies should:
  - a. Develop, implement, and enforce clearly defined written policies and procedures that ensure consistent and systematic compliance with procurement statutes and rules;
  - b. Require documentation to support the impartiality and independence of review and selection committee members, as well as individuals authorized to negotiate fees;
  - c. Increase training for employees who procure professional services to ensure compliance with Section 103D, HRS and Title 3, Chapters 120-132, HAR; and
  - d. Request that the State Procurement Office provide formal training to agency staff who are directly involved with procurement. This training should provide practical and easy-to-understand guidance for implementation of procurement statutes and rules.
3. The Department of Human Services, Med-QUEST Division, should review and make appropriate changes to the status of the medical director and consultants of the Medical Standards Branch.

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## Responses of the Affected Agencies

### Comments on Agency Responses

We transmitted drafts of this report to the Departments of Accounting and General Services, Human Services, and Transportation on May 12, 2005. A copy of the transmittal letter to the Department of Accounting and General Services is included as Attachment 1. Similar letters were sent to the other two agencies. The responses from the Departments of Accounting and General Services, Human Services, and Transportation are included as Attachments 2, 3, and 4, respectively. Based on the responses received, we have made some technical revisions which do not affect the substance of the report.

The Department of Transportation responded that it acknowledges the concerns noted in our draft report with respect to the annual notice requirement and will work with the State Procurement Office to address our concerns. While the statute does not require that the annual notice contain a list of specific projects, we feel such a list is important so that contractors are aware of upcoming projects and can submit statements of interest accordingly. While the department provided explanations for entering into contracts without a clearly defined scope of services, we reiterate that the scope should be developed prior to contract execution to prevent risk to the State. We commend the department for implementing new procedures to resolve its electronic posting problems.

The Department of Human Services welcomed our recommendations that serve to improve its contracting processes by ensuring fair competition and economy as well as enhancing the efficiency and effectiveness of its programs. The department felt that its reliance on statutes, rules, and its internal fiscal circulars and memoranda provided sufficient guidance in the area of procurement; however, the department did note that the statutes and rules may not provide unequivocal guidance in all professional services procurement situations. Based on our interviews with employees in the department who are tasked with the procurement of professional services, the current written procedures are not sufficient.

The Department of Human Services also noted that it felt that the employee-employer relationship concerns detailed in our report had already been identified and addressed. We note, however, that although the Med-QUEST Division has entered into a contract which it believes resolves the issues detailed in our report, we were not able to confirm this assertion. Additionally, as of May 11, 2005 the contract had not been executed. Therefore, the contractor has been working since April 1, 2005 without an executed contract.



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The Department of Accounting and General Services replied that our report provides an independent evaluation of its policies and procedures and clearly points out improvements that it needs to pursue. It will require prioritizing and performing work more efficiently so that resources necessary to address and implement the recommendations can be freed up without additional staffing and budgetary resources. The department agreed with, and plans to, implement most of our recommendations.

The department asserted that we failed to note a most recent update to procedures that were provided to us by the Public Works Division. While we did receive a copy of the *Revisions to the Policies and Procedures Governing Design Consultant Contract* issued in March 2004 from the department that updates the 1981 version, this document does not address procedures for the procuring professional services. It covers such areas as asbestos, lead, toxic products, schematic plans and documents, but not the procurement process.

We acknowledge that selection committees in the Public Works Division in the department follow the statutory criteria and their order of importance, but the criteria used by the Audit Division do not. With regard to the consensus method of ranking consultants used by the Public Works Division, we stand by our statement that the contract file should contain documentation as to how consensus is reached to avoid the appearance of subjectivity.

The department's explanation of its form letter authorizing contractors to proceed with work prior to an executed contract is flawed. When the professional services method of source selection is used there is no solicitation and the contractor does not submit a bid. Instead the scope and fee are negotiated with the first ranked contractor. Therefore, the contractor has not agreed to the terms and conditions of the solicitation and the contract cannot incorporate the solicitation as none exists. The interests of the State are not met and protected by using this letter when the professional services method of source selection is used. Furthermore, the department has not addressed the larger issue of why work is allowed to begin prior to contract execution.

We also note that the figures in our report regarding the second of two contracts, issued by the department and executed on October 18, 2004, are correct. Based on documentation we obtained from the contract file, the initial contract total was increased by \$420,238. For clarification, we will note in the report that change orders and other contract amendments led to this increase in the total.

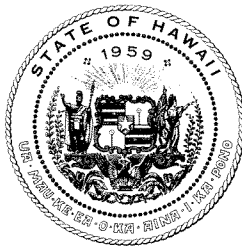
The State Procurement Office replied that it has not routinely performed periodic reviews of procurement files and practices of government

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agencies. The office stated that numerous significant concerns and issues have had a bearing on its actions; however it has laid out steps to implement our recommendations. While the office is required by statute to provide formal procurement training, we agree that ultimately each agency is responsible to ensure that its employees comply with the relevant procurement statutes and rules.

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

May 12, 2005

**COPY**

The Honorable Russ K. Saito  
State Comptroller  
Department of Accounting and General Services  
Kalanimoku Building  
1151 Punchbowl Street  
Honolulu, Hawai'i 96813

Dear Mr. Saito:

Enclosed for your information are three copies, numbered 6 to 8, of our confidential draft report, *Audit of Selected State Agencies' Procurement of Professional Services Contracts*. We ask that you telephone us by Monday, May 16, 2005, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Monday, May 23, 2005.

The Department of Human Services, Department of Transportation Governor, and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

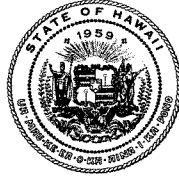
Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

Marion M. Higa  
State Auditor

Enclosures

LINDA LINGLE  
GOVERNOR



**STATE OF HAWAII**  
**DEPARTMENT OF ACCOUNTING**  
**AND GENERAL SERVICES**  
P.O. BOX 119  
HONOLULU, HAWAII 96810-0119

Russ K. Saito  
Comptroller

Katherine H. Thomason  
Deputy Comptroller

May 23, 2005

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OFF. OF THE AUDITOR  
STATE OF HAWAII

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

Subject: Department's Response to the Report on the Audit of Selected State Agencies'  
Procurement of Professional Services Contracts

Dear Ms. Higa:

We appreciate the opportunity to comment on the report, "Audit of Selected State Agencies' Procurement of Professional Services" (the Report).

The Report provides an independent evaluation of our policies and procedures and clearly points out improvements which we need to pursue. It will require that we prioritize and perform our work more efficiently so that we can free up the resources necessary to address and implement the Report recommendations without additional staffing and budgetary resources.

We have included in our response, those areas which address the State Procurement Office (SPO). The SPO response in detail is also attached for your information.

Our specific responses (italics) to the Report's recommendations (bolded) are as follows:

**1. The State Procurement Office should;**

- a. Take a proactive role in ensuring state agencies process contracts more efficiently and post awards in a timely manner:**

*The SPO will develop a comprehensive plan and timetable which encompasses a statewide training program, updating and posting of an on-line procurement manual, and periodic reviews of procurement practices of governmental bodies. Included in*

*this plan will be success criteria and evaluation steps to ensure that objectives are met and refinements in the plan can be made.*

**b. Comply with its statutory responsibility to develop and administer a statewide training program;**

*The SPO will develop and implement a plan and timetable for a statewide training program.*

*The SPO has, and will continue to leverage its resources by employing the concept of 'train the trainer'. This involves the SPO providing the initial and any follow-up or update training, and thereby enable the departments to train their own purchasing staffs. This training method allows the SPO to multiply the effects of its limited staff.*

**c. Maintain and distribute a procurement manual; and**

*An on-line website procurement manual will be maintained to provide purchasing personnel with an accessible up-to-date manual.*

**d. Periodically review the procurement practices of all governmental bodies.**

*The SPO will develop and implement a plan and timetable to conduct periodic reviews of the procurement practices of governmental bodies. On this effort, the SPO would also propose that the Office of the Auditor (OA) provide the SPO with copies of any audit findings pertaining to procurement that come out of their audits. The SPO could then pursue further review, training, and/or monitoring for compliance with procurement rules and statutes with the affected agency without duplicating work already done by the OA.*

**2. Agencies should:**

**a. Develop, implement, and enforce clearly defined written policies and procedures that ensure consistent and systematic compliance with procurement statutes and rules;**

*A plan will be developed and implemented to revise the policies and procedures for the procurement of professional services in light of the Report findings and recommendations. The plan will encompass training requirements for employees who*

*procure professional services and will include defined objectives to ensure successful implementation.*

- b. Require documentation to support the impartiality and independence of review and selection committee members, as well as individuals authorized to negotiate fees;**

*The Department of Accounting and General Services (DAGS) will implement procedures and forms to document the impartiality and independence of review and selections committee members, as well as individuals authorized to negotiate fees.*

- c. Increase training for employees who procure professional services to ensure compliance with Section 103D, HRS and Title 3, Chapters 123-132, HAR; and**

*Training of employees who procure professional services to ensure compliance with Section 103D, HRS, and Title 3, Chapters 123-132, HAR will be included in the policies and procedures of the DAGS. Emphasis will be placed on those who serve on review and selection committees including any non-DAGS employees. Also refer to response for 2.a.*

- d. Request that the SPO provide formal training to agency staff who are directly involved with procurement. This training should provide practical and easy-to-understand guidance for implementation of procurement statutes and rules.**

*Request will be made to the SPO for formal training. The SPO will also be consulted on an as needed basis to evaluate DAGS initiated training on procurement .*

There are several findings (bolded) and clarifications (italics) we would like to highlight.

- 1. Page 9: The SPO's lax oversight has resulted in cumbersome, untimely, and at times, questionable professional services procurement practices by the audited state agencies.**

*The SPO has not routinely performed periodic reviews of procurement files and practices of government agencies. It has, however, diligently addressed legislative statutory amendments and changes to the procurement code, responded to procurement service requests from departments, and implemented electronic initiatives such as the purchasing card and Hawaii electronic Procurement System (HePS).*

- 2. Page 9: The SPO and audited state agencies failed to provide formal training for personnel responsible for procuring professional services.**

*While we agree that formal training by the SPO is an important tool in ensuring proper procurement practices, it is ultimately the agency's responsibility to understand the process and to ensure that procurement files are thoroughly completed and contains all the necessary documentation.*

*Training and educational information is available on SPO webages, as are formal procurement guidance. The SPO also provides consultation by telephone or e-mails to the agencies and vendors. The SPO responds to requests for assistance in writing or provides on-site training subject to availability of staff resources. The SPO has, and continues to accommodate all requests for information, assistance, and training from purchasing agencies to the interested public.*

- 3. Page 13: In spite of this statutory requirement (Section 103D-304(e)), 18 (or 39 percent) of the 46 contracts reviewed in the Department of Accounting and General Services, Human Services, and Transportation either used criteria not specified in the statute or used the criteria in a different order of importance.**

*The DAGS follows the statutory criteria in the order of their importance when making selections/rankings.*

- 4. Page 13: The procurement code does not dictate a particular scoring method when evaluating submissions the using professional services method of procurement as it does when the competitive sealed proposals method is used. However, the methods used by some agencies are troublesome. In the contracts reviewed, we found most selection committees used a quantitative method of scoring to evaluate submittals. Use of a numeric based system, such as a quantitative method, to determine ranking helps remove subjectivity from the selection process.**

*The DAGS relies on consensus among the selection committee members to rank consultants. This method allows members to evaluate and discuss the qualification and ranking of the consultants based on statutory and other criteria. For qualifications based selections, most evaluations are subjective. Applying numeric based systems to professional services selections requires an individual to use subjective judgment in applying a numeric value.*

- 5. Page 16: Agencies blindly attempt to follow the law without determining effectiveness and efficiency.**



*The DAGS uses procurement methods which ensure compliance with the procurement code while maximizing effectiveness and efficiency. In procuring design professional services furnished by licensees under Chapter 464, DAGS' Public Works Division (PWD) is required by law to use only Section 103D-304 professional services procurement process and Section 103D-307 emergency procurement.*

- 6. Page 17: During our audit, we experienced difficulty reviewing contract files. None of the agencies we audited had a single location for their contract files. In addition, we did not find complete contract files – files that contained all applicable documents ending with close out paperwork.**

*The DAGS PWD does not have a single location for its contract files when the contracts are active (in progress). The contract file will reside with the group that has control of the project at any point in time. The contract file will be in a central location for all completed contracts.*

*In the instance of the DAGS PWD audit, none of the contract files audited were for completed projects, and therefore, did not include close out paperwork. On completed projects, the contract file includes a final acceptance letter to the consultant stating that their contract requirements have been satisfactorily completed and indicates when the final payment was processed.*

- 7. Page 19: The DAGS, PWD, provided us copies of procedures relating to professional services contracts; however, the dates on the procedures ranged from 1981 to 1999, with the most current dated December 1, 1999.**

*There was a document dated 1981; however that does not mean that it was not updated since 1981. The document in question was updated by the "Revisions to the Policies and Procedures Governing Design Consultant Contracts" issued in March 2004.*

- 8. Page 20 and 21: Related to commencement of work by a contractor prior to the execution of a contract.**

**We found two contracts originating with the PWD of the DAGS that strongly suggest work began prior to contract execution. The first involves a December 2, 2004 letter from the division administrator addressed to the contractor authorizing work to proceed.**

**“Due to the need to complete this project in a timely manner, it has become necessary to issue you this Notice to Proceed prior to the execution of your contract. Accordingly, you are authorized to proceed with the work.”**

*The quote is from a form letter which should be reviewed in its entirety. The text of this form letter follows:*

Your fee of \$ \_\_\_\_\_ for the subject project has been approved. Due to the need to complete this project in a timely manner, it has become necessary to issue you this Notice to Proceed prior to the final execution of your contract. (\*) Accordingly, you are authorized to proceed with the work. By commencing performance, you are agreeing to the following conditions.

- 1 Progress payments cannot and will not be made until your contract has been fully executed and processed.
- 2 During this interim period (from your receipt of this Notice to Proceed until your receipt of the fully executed contract), except for those provisions impacted by the above limitation on progress payments, the remaining provisions of your contract, now being processed, will apply, and your company will be subject to those provisions.
- 3 The scope of work shall be as agreed upon

If you have any questions, please call \_\_\_\_\_ of our Project Management Branch, at 586-\_\_\_\_\_.

*(\*) In the standard form letter previously given to the Auditor, there was a sentence here that stated: “We have received the Governor’s approval, and the funds allotted for this project have become available.” This sentence has since been removed because it appears to confuse the issue.*

*By submitting its bid, the contractor has agreed to all of the terms and conditions of the solicitation. The formal contract does not add any new terms, but incorporates the solicitation. The above letter satisfies the basic function of the contract, memorializes the acceptance of the bid, and describes the procedures to take place prior to the full execution of the contract. This letter also serves as an interim agreement between the parties while the contract is being executed, identifying the basic elements of the*

The Honorable Marion M. Higa  
May 23, 2005  
Page 7

*contract, the scope of work and fee, and incorporating the terms and conditions of the solicitation and contract that have already been agreed to by both parties.*

*By using this letter (interim agreement), the interests of the State are met and protected, that is, the terms of the solicitation and contract apply, including the terms for progress payments, but in any event, no payment shall be made until the contract is fully executed and processed. Our Deputy Attorney General has reviewed this letter and agrees that this is an acceptable form, given the fact the determination has been made that the project must commence prior to the execution of the contract.*

**A second contract, issued by the DAGS was executed on October 18, 2004 in the amount of \$1,031,496 ... Change orders totaling \$420, 238 increased the contract amount to \$1,451,734."**

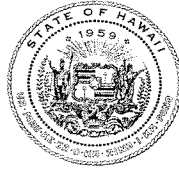
*The contract executed was for \$1,235,000 on October 18, 2004. Of this amount, \$1,031,496 was encumbered. The contract amount was not encumbered because the full amount required had not been allotted. To date, the total amount of change orders on this contract is \$103,434 and not \$420,238.*

If you have any questions or require further details on our response, please call me at 586-0400, or have your staff call Kerry Yoneshige of the Administrative Services Office at 586-0696.

Sincerely,



RUSS K. SAITO  
State Comptroller




ADMINISTRATOR

STATE OF HAWAII  
STATE PROCUREMENT OFFICE

SPO 05-0360

May 23, 2005

TO: The Honorable Russ K. Saito, Comptroller

FROM: Ruth E. Yamaguchi, Acting Administrator  
State Procurement Office 

SUBJECT: Comments on Draft Report on the Audit of Selected State Agencies'  
Procurement of Professional Services Contracts

The following are the State Procurement Office responses to the Report's Summary of Findings and Recommendations.

**Summary of Findings (page 9)**

- 1. The State Procurement Office's lax oversight has resulted in cumbersome, untimely, and, at times, questionable professional services procurement practices by the audited state agencies.*

The State Procurement Office (SPO) has not routinely performed periodic reviews of procurement files and practices of government agencies. Numerous significant concerns and issues have had a bearing on the actions of the SPO, and they include:

- Annually, legislative statutory amendments and changes to the procurement code have had a domino effect. Any amendments or repeals lead to changes to the Hawaii Administrative Rules, which then affect many other documents (circulars, directives, training documents, etc) that require amendments or repeal;
- Increases in procurement services requests from departments, and the complexity of procurements;
- Adapting to the needs of business, while meeting the needs of users and the public in an open procurement environment through information on the Internet;
- SPO initiatives on the pCard (Purchasing Card) and Hawaii electronic Procurement System (HePS) programs, and the SPO website development, have all been accomplished with existing resources, and are on-going, ever evolving undertakings; and
- Professional staffing shortages have plagued our program, and we have encountered difficulties recruiting for these positions with qualified personnel. When we have been able to fill positions, intensive in-house training for new personnel is expended to meet the work requirements of our office.

The SPO made the decision that it could best expend its limited resources to provide procurement services through alternate means. It was necessary to determine how we could best utilize our limited resources in terms of providing procurement services that would best serve the needs of the requesting agencies and the public.

2. *The State Procurement Office and audited state agencies have failed to provide formal training for personnel responsible for procuring professional services.*

While we agree that formal training by the SPO is an important tool in ensuring proper procurement practices, it is ultimately the agency's responsibility to understand the process and to ensure procurement files are thoroughly completed and contains all the necessary documentation. The head of the agency is ultimately responsible, having the authority to make decisions that affect the procurement practices of the agency. The SPO cannot be held responsible for actions by an agency that practices poor management decisions that ultimately affects actions done by its procurement personnel. If an agency is not sure of what is expected in completing a particular procurement, it is their responsibility to request clarification of the HAR/HRS, or to seek instructions from the SPO.

Although the original concept of an "up-to-date" procurement manual on the website can be a valuable tool for agencies conducting procurement, in practice we found it to be a very time consuming commitment to revise the manual to incorporate revisions due to statutory and rule changes, and situations encountered in our normal procurement practices.

In order to balance the limited resources of the SPO, the determination was made to concentrate our efforts on the SPO webpages. This vehicle served as the means of providing up-to-date procurement information to the purchasing agencies, as well as the interested public. The SPO has made available various tools (i.e., forms, rules, circulars, directives, training materials including FAQs and simplified flowcharts, etc.) necessary for the agency to complete all types of procurement.

To supplement the information available on our webpages, and to mitigate formal training, we concentrate our efforts on providing procurement guidance and information on the SPO webpages, and consultation by telephone or e-mails to the agencies and vendors. If we were not able to provide written responses to address the situation, we would provide on-site training subject to availability of staff resources. The SPO has, and continues to accommodate all request for information, assistance, and training from purchasing agencies to the interested public.

Page 12, second paragraph requires clarification. As stated, "The former administrator explained that the office did not have the resources to maintain the manual and that it was difficult to update the [~~website~~] manual and apprise everyone of procurement requirements."

**Recommendations (page 31)**

The State Procurement Office should:

- a. *Take a proactive role in ensuring that agencies process contracts more effectively and post awards in a timely manner;*

The State Procurement Office (SPO) will develop a comprehensive plan and timetable which encompasses a statewide training program, updating and posting of an on-line procurement manual, and the periodic reviews of procurement practices of governmental bodies. Included in this plan will be success criteria and evaluation steps to ensure objectives are met and refinements in the plan can be made.

- b. *Comply with its statutory responsibility to develop and administer a statewide training program;*

The SPO will develop and implement a plan and timetable for a statewide training program.

The SPO has, and will continue to employ the concept of 'train the trainer'. This involves the SPO providing the initial training and any follow-up or update training, and thereafter the department will train their purchasing staff. For those agency employees that procurement is not their major responsibility, this training method will best meet their needs.

- c. *Maintain and distribute a procurement manual; and*

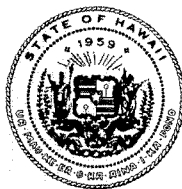
An on-line website procurement manual will be maintained to provide purchasing personnel with an accessible up-to-date manual.

- d. *Periodically review the procurement practices of all governmental bodies.*

The SPO will develop and implement a plan and timetable to conduct periodic reviews of the procurement practices of governmental bodies. On this effort, the SPO would also propose a joint partnership with the Office of the Auditor (OA) whereby the OA would provide the SPO with copies of any audit findings pertaining to procurement. The SPO could then pursue further review, training, and/or monitoring for compliance with procurement rules and statutes with the affected agency.

Should you or your staff have any questions or concerns, please call me at 586-0567.

LINDA LINGLE  
GOVERNOR



LILLIAN B. KOLLER, ESQ.  
DIRECTOR

HENRY OLIVA  
DEPUTY DIRECTOR

STATE OF HAWAII  
DEPARTMENT OF HUMAN SERVICES

P. O. Box 339  
Honolulu, Hawaii 96809-0339

May 23, 2005

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2005 MAY 24 AM 9:10

OFF. OF THE AUDITOR  
STATE OF HAWAII

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

Dear Ms. Higa:

Thank you for the opportunity to review and provide comments on the Office of the Auditor's draft report, Audit of Selected State Agencies' Procurement of Professional Services Contracts. The Department of Human Services (DHS) welcomes the recommendations that serve to improve our contracting processes by ensuring fair competition and economy as well as enhancing the efficiency and effectiveness of our programs.

We would like to provide the following additional background information and comments to the report's findings and recommendations:

- Page 7 - "We also included the Department of Human Services since it is one of the executive agencies having no written procedures for procuring professional services."

Page 15 - "There are no department procedures for the procurement of professional services; each..."

To provide instructions and guidelines to the DHS offices in the procuring of professional services, DHS has utilized the detailed procedures outlined in Hawaii Revised Statutes (HRS) 103D-304 and Hawaii Administrative Rules (HAR), Sections 3-122-63 to 3-122-70, as the Department's procedures. The HRS and HAR provide concise procedural requirements, such as the processes for notice publication, statements of qualification, review and selection committees and debriefing. In addition, the Department periodically issues internal fiscal circulars and memoranda that update the HAR as changes are enacted, and provide any clarification or information necessary to properly apply the HAR or HRS, as they relate to unique departmental processes. These documents are maintained by all of the major DHS offices involved in procuring or purchasing goods or services, serving as the primary reference resource.

It is recognized that the procedures detailed in the HAR and HRS may not provide unequivocal guidance in all professional services procurement situations. With this in mind, DHS will review its current procedures for the purposes of effecting any revisions that may be necessary to provide clear direction, especially for any unique or special circumstance.



As an additional note, DHS relies upon the professional services list issued by the State Procurement Office. Following the services listed in the schedule, DHS has procured medical and legal services through the professional services procurement method (excluding direct client services and the activities of the Housing and Community Development Corporation of Hawaii). At this time, only the hearings officer (legal) services required by the Vocational Rehabilitation and Administrative Appeals programs would be procured by the professional services method. These procurements represent a very small portion (only two) of the multitude of purchasing activities done by DHS annually.

- Page 31 – “The Department of Human Services, Med-Quest Division, should review and make appropriate changes to the status of the medical director and consultants of the Medical Standards Branch.”

During its own internal review, DHS had already discovered the same concerns with the medical consultant contracts that the auditor identified in her report. Based on that review, the Department entered into a contract with a vendor to provide medical, dental, and psychiatric consultant services. The contract was effective April 1, 2005 and was competitively procured under HRS Section 103D-303, competitive sealed proposals. The contract eliminates any direct contractual relationship between the Department and the consultants.

Thank you for the opportunity to review and respond to your report.

Sincerely,

A handwritten signature in black ink, appearing to read 'Lillian B. Koller', with a stylized flourish at the end.

Lillian B. Koller , Esq.  
Director

LINDA LINGLE  
GOVERNOR



RODNEY K. HARAGA  
DIRECTOR

Deputy Director  
BRUCE Y. MATSUI  
BARRY FUKUNAGA  
BRIAN H. SEKIGUCHI  
BRENNON MORIOKA

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

IN REPLY REFER TO:

CON  
5.8572

May 23, 2005

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Ms. Marion Higa  
State Auditor  
Office of the Auditor  
465 South King Street, Room 500  
Honolulu, Hawaii 96813

2005 MAY 24 AM 8:44

OFF. OF THE AUDITOR  
STATE OF HAWAII

Dear Ms. Higa:

We appreciate the opportunity to review your draft report, *Audit of Selected Agencies' Procurement of Professional Services Contracts*. We have the following comments on the report.

**Agencies blindly attempt to follow the law without determining the effectiveness and efficiency.**

We acknowledge the concerns noted in your draft report with respect to the annual notice requirement. The Department of Transportation ("DOT") will be working with the State Procurement Office to address these concerns. Part of this effort will involve evaluating the most effective means of soliciting interest in professional service projects. This could be a combination of an annual notice and project specific notices, with the project specific notices being sent directly to qualified firms that had previously submitted expressions of interest in response to the annual notice. The draft report notes that while the DOT met the minimum statutory requirements for an annual notice, the notice did not list specific projects. While the DOT will consider making this change, Section 103D-304 of the Hawaii Revised Statutes ("HRS") does not expressly require such a listing.

**Contracts were executed without clearly defining the scope of services to be provided.**

The report questioned Contract No. DOT-05-008 with Moffat and Nichol for professional services relating to the Inter-Island Ferry System, Statewide.

The general scope consisted of engineering services, including design, construction management, and project management, with an expertise in ferry systems, operations, and facilities, on an "as-required" basis.

We generally agree that contracts should contain a clearly defined scope of work. However, the State required the immediate support of a design professional experienced and knowledgeable in the design of ferry related facilities as well as typical ferry operations to assist the DOT in its negotiations with the ferry operator. The DOT may be obligated to provide ramps and barges to facilitate the loading and off loading of vehicles to and from the ferry vessels. The DOT has not previously designed or constructed such barges or ramps and therefore lacks any previous experience to draw upon. The negotiations with the ferry operator also raised numerous issues and concerns that required the support of a design professional to advise the State on costs and alternatives.

Because the negotiations with the ferry operator were constantly evolving, it was difficult to precisely define in advance the exact work required of the contractor. To address this, the DOT prepared individual work orders describing a more detailed work scope. The work order was then executed by the parties, with a subsequent notice to proceed for that work being issued to the contractor. With respect to the fees under this contract, the DOT and the contractor did agree upon the hourly compensation to be paid to the contractor, subject to the overall contract limit and the individual work order limit.

The second contract cited in the draft audit is Contract No. 52583, Construction of Inter-Island Cargo Terminal Facility at Hilo Harbor, Hawaii with Mitsunaga & Associates, Inc. The general scope of services requires the completion of designs, plans, specifications, drawings, cost estimates, schedules, studies, reports, permit applications, as-built drawings and other items necessary for the construction of the project.

The DOT has determined that this project is urgently needed to create additional berthing space to accommodate the simultaneous visit of two large cruise ships and the significant increase in inter-island barge operations.

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For the larger construction projects, the Harbors Division generally attempts to complete a development plan prior to starting the design contract. In this case, the Harbors Division could only complete a preliminary development plan just prior to the lapse date. Funding for the design contract was encumbered to ensure timely initiation of this project. Waiting for the final draft of the development plan would have delayed this project for at least a year. The Harbors Division is working on completing the final development plan after which it anticipates issuing the notice to proceed to the design contractor.

With respect to the fees under this contract, the DOT and the contractor did agree upon the hourly compensation to be paid to the contractor, subject to the overall contract limit.

**Departments take weeks to electronically post contract awards that are sometimes inaccurate.**

DOT has implemented new procedures to ensure that the contract awards are timely posted, including tracking of contracts that have not been posted and verifying the accuracy of the information to be posted.

I appreciate the opportunity to comment on the above matters.

Very truly yours,

  
s/RODNEY K. HARAGA  
Director of Transportation