

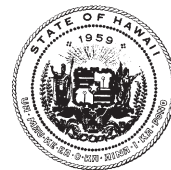
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# Procurement Audit of the Department of Education: Part 1

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

Report No. 09-03  
February 2009



**THE AUDITOR**  
STATE OF HAWAII

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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

STATE OF HAWAII

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# OVERVIEW

## Procurement Audit of the Department of Education: Part 1

Report No. 09-03, February 2009

### Summary

The Office of the Auditor and the certified public accounting firm of Grant Thornton LLP conducted a procurement audit of the Department of Education, State of Hawai'i, for the fiscal year July 1, 2006 to June 30, 2007. The audit examined the procurement processes, policies, and transactions of the department and included inquiry, analytical procedures, and inspection of relevant records and documents to assess the department's compliance with state procurement laws and regulations. The firm also performed procedures to evaluate the design and operating effectiveness of the department's controls over compliance with state procurement laws for transactions procuring goods and services in excess of \$25,000, the department's small purchase threshold.

Our audit revealed a lack of proper leadership and controls over the department's procurement process and a resulting indifference toward procurement compliance among department personnel. Although the department inherited a flawed procurement system from other state agencies pursuant to the State's Reinventing Education Act of 2004, the department had pushed for the act's passage on the belief that the existing procurement process was dysfunctional and obsolete. In short, the department undertook the responsibility of its own accord.

Upon assuming that responsibility, procurement authority for the department was hastily delegated to the branch and school levels in an attempt to meet the demands of the 250+ schools statewide. However, many of the delegated procurement officers lacked sufficient knowledge and experience to effectively carry out those duties. This shortfall was compounded by the department's failure to establish an adequate system to standardize and monitor its procurement activities. More than three years later, there is still no formal internal control system over procurement in place. Further, the department lacks corrective or disciplinary procedures for procurement violations, and the Board of Education has not maintained a sufficiently involved role in oversight of procurement.

The result is much confusion among employees and dissent within the department over proper procurement policies and procedures. We discovered numerous occurrences of non-compliance with procurement laws and regulations for each of the various procurement methods utilized by the department. Many of the infringements appeared to be inadvertent. For example, we found 20 purchases made in fiscal year 2007 using purchasing cards (or P-cards) that exceeded the \$2,500 limit without proper approval. Those 20 purchases were also for prohibited items, including computers and travel coupons.

Other findings, particularly those that occurred in the Office of School Facilities and Support Services, appeared to have been done in an attempt to circumvent



proper procurement practices. The office's many large-dollar capital projects were commonly procured with minimal planning and oversight. For example, for 7 of 21 professional service contracts we reviewed, ranging from \$848,000 to \$7,350,000, the budget was based on the vendors' proposed amounts. Significant budget overruns were also common—of 36 repair and maintenance staff purchase order contracts, 10 were at least 10 percent and \$5,000 over budget; 4 of those were more than 100 percent and \$50,000 over budget. In addition, contractors were routinely permitted to start work before contracts were executed, which office personnel admit is a regular practice but believe is warranted due to the lengthy contract process.

Based on the results of our initial testwork, which included identification of several risk factors and fraud indicators, we were compelled to expand the scope of the audit. Due to the nature of the expanded scope of work and the resulting findings, the results of the additional work are presented in a separate report, Report No. 09-04, *Procurement Audit of the Department of Education: Part 2*.

With respect to the firm's evaluation of internal controls, in the opinion of the firm, the department has not maintained effective internal control over compliance with the Hawai'i Procurement Code for the procurement of goods and services exceeding the department's \$25,000 small purchase threshold for the fiscal year ended June 30, 2007. The firm identified a material weakness—that the department lacks required monitoring controls over its internal controls related to procurement and is therefore unable to assess the effectiveness of its internal controls.

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## Recommendations and Response

We made several recommendations regarding the department's leadership and oversight over its procurement process. Among them, we recommended that the Board of Education adopt a code of ethics and a conflicts of interest policy and institute a formal fraud risk management program. We recommended that the department establish an effective internal control system over procurement and implement standardized procurement policies and procedures.

The department acknowledged independent audits as key components of accountability and public transparency, and generally welcomed our findings and recommendations. In addition, the department described steps already taken to address some of our findings and expressed its commitment to implementing recommendations and adopting best practices to improve the procurement process throughout the department.

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State of Hawai'i

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Conducted by

The Auditor  
State of Hawai'i  
and  
Grant Thornton LLP

Submitted by

**THE AUDITOR**  
STATE OF HAWAI'I

Report No. 09-03  
February 2009

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## Foreword

This is the first of two reports on our procurement audit of the Department of Education, State of Hawai‘i, for the fiscal year July 1, 2006 to June 30, 2007. The audit was conducted pursuant to Section 23-4, Hawai‘i Revised Statutes, which requires the State Auditor to conduct postaudits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions. Additionally, Chapter 103D, Hawai‘i Revised Statutes, requires the State Auditor to periodically audit procurement practices within government. The audit was conducted by the Office of the Auditor and the certified public accounting firm of Grant Thornton LLP.

We wish to express our appreciation for the cooperation and assistance extended to us by the Board of Education, the superintendent and staff of the Department of Education, and others whom we contacted during the course of the audit.

Marion M. Higa  
State Auditor

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# Chapter 1

## Introduction

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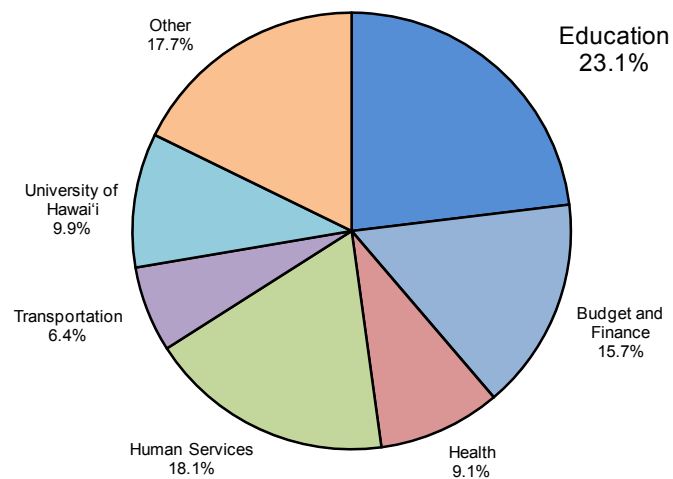
This is a report of our procurement audit of the Department of Education, State of Hawai‘i, for the period July 1, 2006 to June 30, 2007. The audit was conducted by the Office of the Auditor and the independent certified public accounting firm of Grant Thornton LLP. The audit was undertaken pursuant to Section 23-4, Hawai‘i Revised Statutes (HRS), which requires the State Auditor to conduct post audits of the transactions, accounts, programs and performance of all departments, offices and agencies of the State of Hawai‘i and its political subdivisions. Additionally, Chapter 103D, HRS, Hawai‘i Public Procurement Code, requires the State Auditor to periodically audit procurement practices within government.

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## Background

The Department of Education, the only statewide public school system in the nation, is one of the largest government agencies in the State. For the fiscal year ended on June 30, 2007, the department’s \$2.4 billion budget consisted of an operating budget of \$2.2 billion and a capital improvement projects (CIP) budget of \$170 million. The department’s FY2007 operating budget approximated 23 percent of the entire state operating budget. During FY2007, the department expended over \$840 million for the procurement of goods and services.

**Exhibit 1.1**  
**State of Hawai‘i FY2007 Operating Budget**



Source: State of Hawai‘i



**DOE operational structure**

The Department of Education is governed by the Board of Education. Composed of 13 members elected on a nonpartisan basis and one non-voting public high school representative, the board sets statewide educational policy within general laws enacted by the Legislature, adopts student performance standards and assessment models, and monitors school success. The board also appoints the chief executive officer of the public school system, the superintendent of education.

The superintendent is accountable for the efficient and effective administration of the public schools and is assisted by the following five division-level staff offices that provide system-wide support services. Each office is headed by an appointed assistant superintendent:

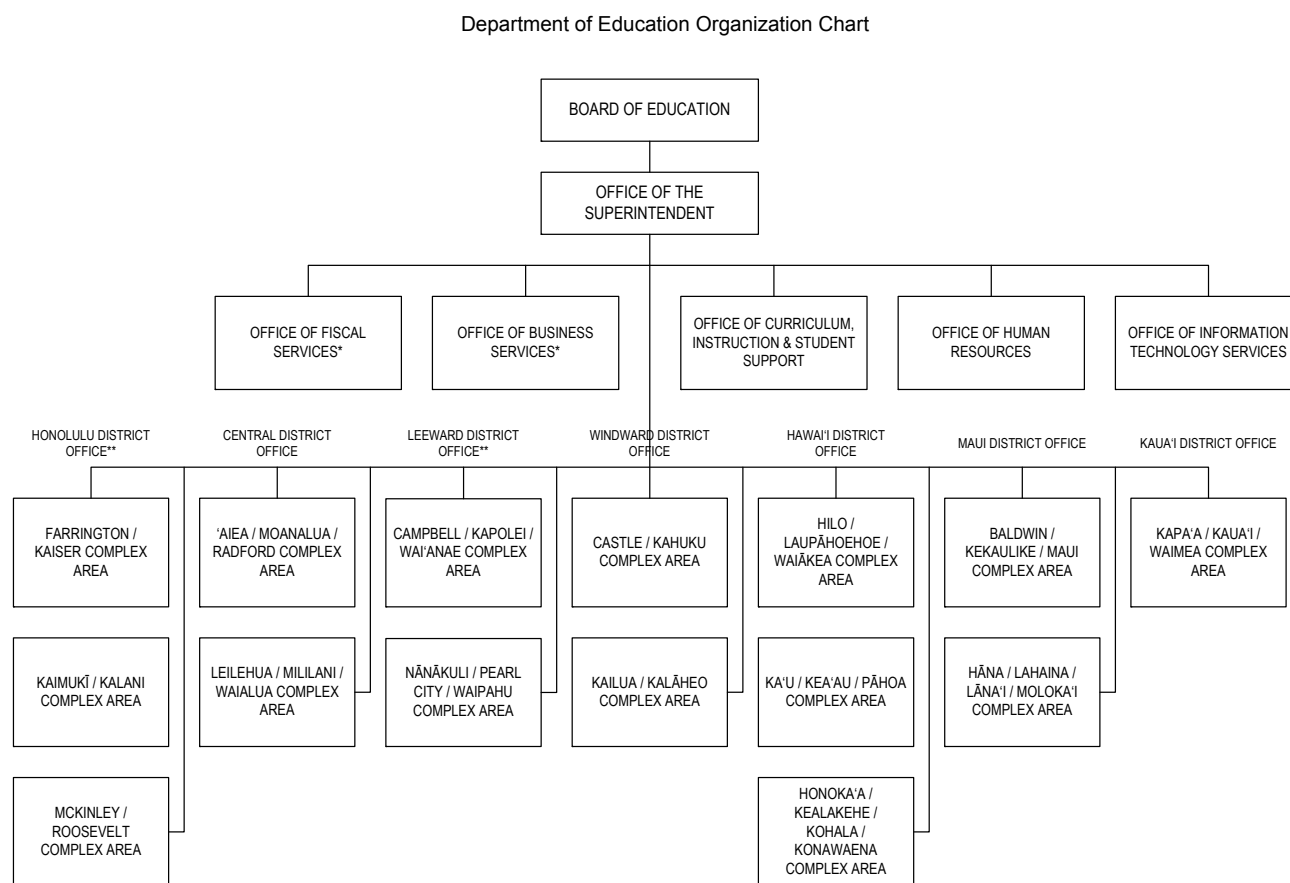
1. **Office of Business Services (currently the Office of School Facilities and Support Services).** Provides administrative, fiscal, and logistical services and programs.
2. **Office of Curriculum, Instruction and Student Support.** Provides leadership in standards-based curriculum and instruction, educational accountability and student support systems.
3. **Office of Human Resources.** Provides employment and personnel management services and programs.
4. **Office of Information Technology Services.** Provides information and telecommunication systems and support services.
5. **Office of Fiscal Services.** Manages the DOE's budget, accounting, internal auditing, and procurement activities and systems to serve the needs of schools, school complexes, complex areas and the DOE's state office. This office was established in February 2007.

The Hawai'i public school system is divided into 15 complex areas in seven geographic districts throughout the state. Each complex area is supervised by a complex area superintendent. A complex area is composed of one or more school complexes. Each school complex is made up of a high school and feeder middle and elementary schools. Each school is overseen by a principal and an established school community council.

The department is comprised of 257 public schools (not including 27 charter schools) providing general and special education for grades kindergarten through 12 for more than 179,000 students. In addition to regular programs of instruction and support services, the department

provides special programs and services, such as Special Needs, Gifted/Talented, English for Second Language Learners, Learning Centers and Academies, Community Schools for Adults, Hawaiian Education, and the A+ After-school Program. The department's 2007 organization chart is shown in Exhibit 1.2.

**Exhibit 1.2  
State of Hawai'i Department of Education Organization Chart**



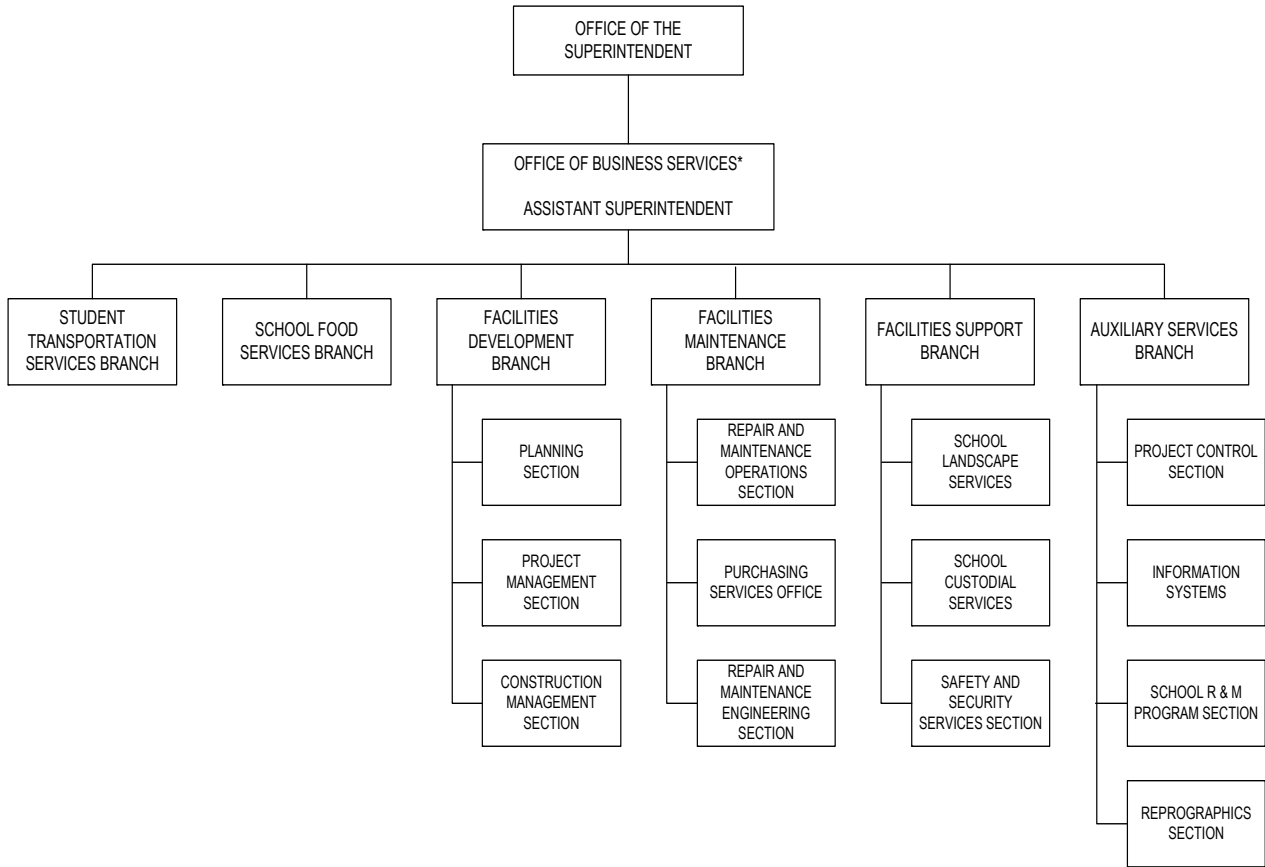
\*See Expanded Office Organization Chart. Note: The Board of Education approved the renaming of the Office of Business Services to Office of School Facilities and Support Services at its October 18, 2007 meeting.

\*\*District Office Complex Areas reorganized in 2008.

Source: Department of Education, Plan of Organization, June 30, 2007

**Exhibit 1.2  
State of Hawai'i Department of Education Organization Chart (continued)**

Department of Education, Office of Business Services\* Organization Chart

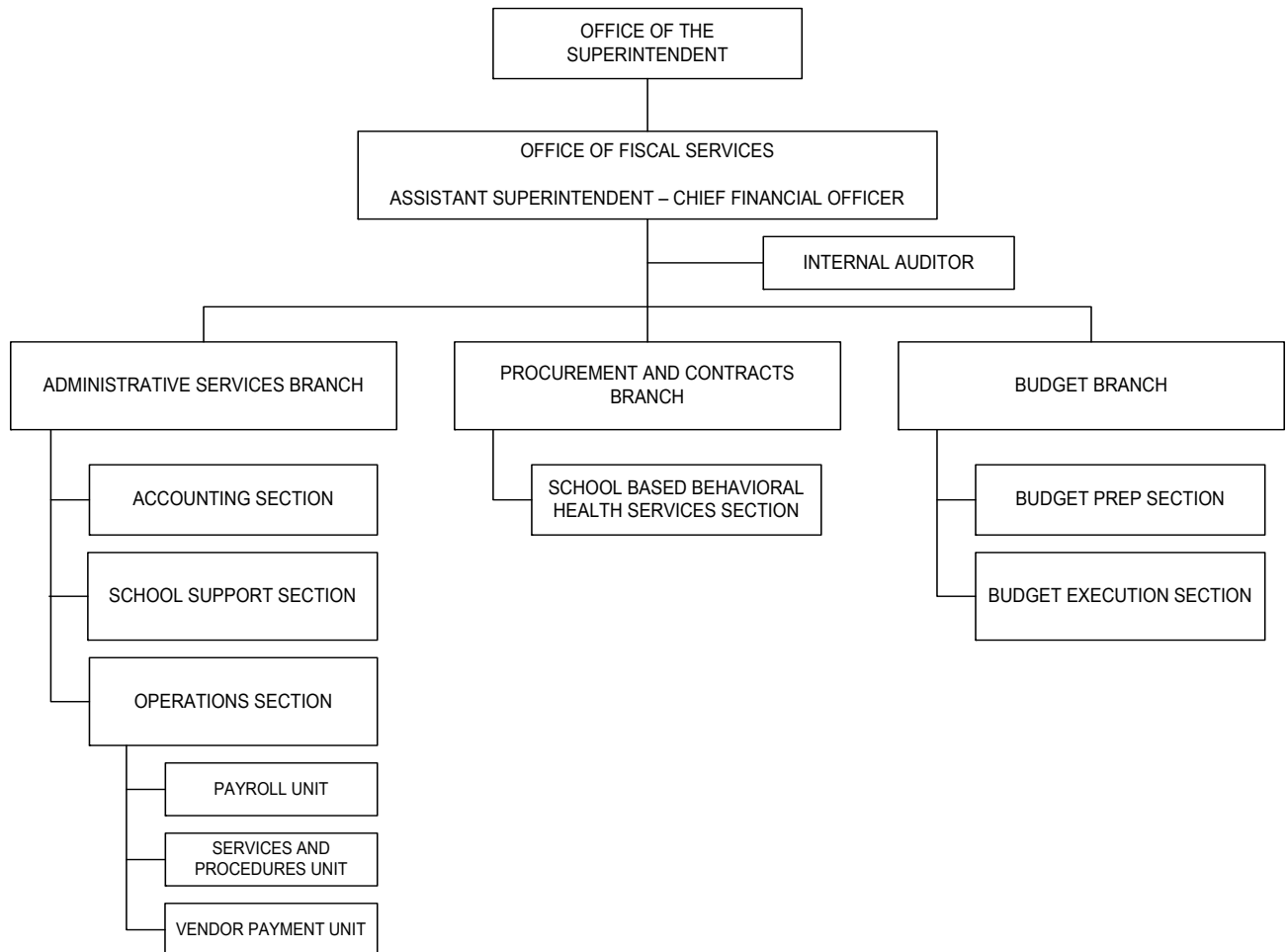


\*The Board of Education approved the renaming of the Office of Business Services to Office of School Facilities and Support Services at its October 18, 2007 meeting.

Source: Department of Education, Plan of Organization, June 30, 2007

**Exhibit 1.2**  
**State of Hawai'i Department of Education Organization Chart (continued)**

Department of Education, Office of Fiscal Services Organization Chart



Source: Department of Education, Plan of Organization, June 30, 2007

## **Act 51**

On July 1, 2005, Act 51, Session Laws of Hawai‘i (SLH) 2004, entitled the *Hawai‘i Reinventing Education Act of 2004*, took effect and implemented comprehensive education reform in Hawai‘i’s public schools through changes related to school-level accountability and community involvement, while reducing bureaucracy. Act 51 empowered the department to manage its own procurement process and develop its own policies and procedures.

Prior to Act 51, the Department of Accounting and General Services (DAGS) maintained procurement authority and responsibility for the Department of Education’s construction projects. On January 28, 2004, the superintendent delivered the first State of Public Education address to the Legislature. In her address, the superintendent stated that the public education system was not working as it should, and more specifically, that the process for school construction and repair and maintenance was dysfunctional and obsolete. She thus called for a transformation of the system, including giving the department the resources and authority to carry out its capital and repair and maintenance projects. The superintendent followed up on her speech with an open letter to the Legislature, reiterating the department’s reform proposals, including “de-linking” the department from other state agencies and allowing the department to manage its own support services.

In passing Act 51, the Legislature recognized that the governmental bureaucracy had been hindering the effectiveness of the public education system, and accordingly mandated the transfer of services and functions provided by other agencies to the Department of Education. In addition to empowering the department to manage its own procurement process and develop its own policies and procedures, Act 51 transferred the authority and responsibility for design, construction, and maintenance of school facilities from DAGS to the department. In conjunction with the transfer of procurement authority over capital improvement projects, 200 employees were rapidly reassigned from DAGS to the department, accompanied by the procurement-related forms and practices that had been utilized by those employees.

## **State procurement process**

Statewide procurement is governed by the Hawai‘i Public Procurement Code and the State Procurement Office. Together, they provide a central authority for procurement rules and procedures for all governmental bodies in the State.

### **State Procurement Code and regulations**

Chapter 103D, HRS, *Hawai‘i Public Procurement Code*, is based on the American Bar Association’s Model Procurement Code and applies to the procurement of goods and services by governmental bodies solicited

or entered into from July 1, 1994. Chapter 103F, HRS, governs the procurement of health and human services.

Chapter 3-120, Hawai‘i Administrative Rules (HAR), implements Chapter 103D, HRS, when requirements or procedures are not specified in the procurement code. Similarly, Chapter 3-143, HAR, implements Chapter 103F, HRS. Any revisions or changes to the administrative rules are approved by the Procurement Policy Board (PPB).

### **State procurement organizational structure**

Each jurisdiction in Hawai‘i has its own authority to procure goods, services, and construction. The State Procurement Office serves as the central authority on procurement statutes and rules for all governmental bodies of the State and its counties. The procurement function is carried out by the 20 chief procurement officers (CPO) designated throughout the State. The chief procurement officer for the Department of Education is the superintendent. Chief procurement officers are allowed to delegate any authority conferred by Chapter 103D, HRS, to designees or to any department, agency, or official within their respective jurisdiction.

### ***DOE procurement structure***

Following Act 51, the department was empowered to manage its own procurement of goods and services. Act 51 decentralized the procurement authority away from the State Procurement Office and instructed the department’s Office of Fiscal Services and Office of Business Services (currently Office of School Facilities and Support Services) to work together to procure all necessary goods and services for the State’s schools, teachers, and students.

### **Office of Fiscal Services**

The Office of Fiscal Services manages the department’s budgeting, accounting, internal auditing, and procurement activities. It is responsible for: (1) developing and implementing long-term and short-term financial activities; (2) leading the department’s budgeting, accounting, internal auditing, and procurement operations; and (3) providing timely, accurate, and user-friendly information, such as guidelines and procedures, that are aligned with the department’s goals and objectives. The branches within the Office of Fiscal Services that focus on the procurement of goods and services are the Procurement and Contracts Branch and the Administrative Services Branch-Vendor Payment Section.

- 1. Procurement and Contracts Branch.** Provides departmental procurement direction, oversight and expertise in compliance with HRS Chapters 103D and 103F, and represents the superintendent of education on all matters of procurement. Schools and offices contact this branch for assistance in procurement and contracting areas that have not been delegated directly to the school principals or office directors.
- 2. Vendor Payment Section, Administrative Services Branch.** Responsible for paying all department vendor obligations, performing final pre- and post-audits for legality and propriety of claim vouchers, examining invoices, maintaining records and authorizations relating to disbursement of checks, and reporting expenditures to the statewide Financial Accounting Management Information System.

### **Office of Business Services (currently Office of School Facilities and Support Services)**

The Office of Business Services, which was renamed in 2007 as the Office of School Facilities and Support Services (hereinafter referred to as the “Office of School Facilities”), exercises technical oversight of business activities, construction and maintenance of facilities, food services, and transportation support for the public school system. The Office of School Facilities develops and administers administrative rules and regulations, publishes operational guidelines, and provides related in-service training, monitoring, and technical assistance to schools to ensure that support is provided in accordance with laws, policies, and accepted principles of management. The Office of School Facilities is comprised of the Facilities Development Branch, Facilities Maintenance Branch, Auxiliary Services Branch, Facilities Support Branch, and School Food Services Branch.

- 1. Facilities Development Branch.** Plans, coordinates, organizes, directs, and controls a variety of engineering and architectural services including land acquisition, planning, designing, project management, construction inspection, design and construction quality control, contracting, construction management, and the equipping of facilities and improvements for the department. The branch plans and directs the expenditure of capital improvement projects (CIP) and repair and maintenance (R&M) funds and other operating funds released to the department for projects.
- 2. Facilities Maintenance Branch.** Plans, coordinates, organizes, directs, and controls a variety of services, including maintaining and repairing public school buildings and facilities, providing

technical support to school HVAC and electrical systems, and providing the overall planning and managing of repair and maintenance support to school facilities.

3. **Auxiliary Services Branch.** Provides services support to the Facilities Development Branch and the Facilities Maintenance Branch, develops and monitors the Neighbor Island Services Level Agreements with DAGS, monitors the school's responsibility in meeting facilities related Energy Conservation Requirements, and provides management analyses services, including methods and procedures studies, personnel staffing requirement reviews and organizational analyses.
4. **Facilities Support Branch.** Develops and administers policies, rules, regulations, and department budgets for the safety and security, school custodial, school landscaping and ground maintenance, and school inspection programs.
5. **School Food Services Branch.** Develops and administers statewide program plans, budgets, policies, standards, and specifications for food services operations of the public school system.

### **Neighbor Island Service Level Agreement with the Department of Accounting and General Services**

The Department of Accounting and General Services (DAGS) Neighbor Island district engineers and the Department of Education's Neighbor Island complex area superintendents entered into a Service Level Agreement effective July 1, 2005. Because the department lacked sufficient resources to service the needs of the schools on the Neighbor Islands, the agreement was executed to establish and formalize an arrangement for the DAGS Neighbor Island district engineers to provide support services to the department to satisfy those needs. The agreement transferred the supervision of R&M services (including emergency, minor, and major repairs), service and maintenance contracts, and construction contract administration for Neighbor Island schools to the DAGS Neighbor Island district engineers. The agreement details the responsibilities of both the department and DAGS for such projects.

### ***DOE procurement process***

The procurement of goods and services for the department is directed by the Guidelines for Procurement and Contracting issued by the Procurement and Contracts Branch. The guidelines provide direction on the proper methods to procure various types of goods and services.



## DOE Guidelines for Procurement and Contracting

In March 2006, the superintendent and the Procurement and Contracts Branch issued the *Guidelines for Procurement and Contracting* in an attempt to standardize and decentralize the department’s procurement process.

The guidelines were based on established state procurement laws and administrative rules, and were issued to the department’s complex area superintendents, assistant superintendents, principals, and directors in order to bring greater awareness, understanding, and appreciation of the various methods of procurement and contracting. The guidelines provided direction on the procurement of goods and services, including professional services, health and human services, contracting and encumbrance procedures, other miscellaneous agreements, and federal grant funds. The guidelines also provided work flow processes for each procurement scenario and procurement and contracting forms.

The guidelines were accompanied by a memorandum from the superintendent entitled “Delegation of Procurement Authority for Chapters 102, 103D and 103F, Hawai‘i Revised Statutes (HRS),” dated April 7, 2006 and updated on February 2, 2007. This memorandum delegated the superintendent’s authority to procure goods and services as the chief procurement officer to the deputy superintendent, assistant superintendents, complex area superintendents, directors, and principals. In a subsequent memorandum entitled “Authority to Contract,” dated April 7, 2006, the superintendent stated that “[t]he decision of what to buy, how to buy it, and how it will be accounted for or administered is now the authority of the officers covered by this delegation, along with the responsibility for ensuring it was done correctly.” In essence, these memoranda decentralized procurement authority within the department and empowered the delegated officers to take control of their own procurement needs.

### Procurement methods and related departmental procedures

The guidelines provide direction on the following types of procurement, which are discussed in more detail below:

1. Competitive sealed bids	6. Emergency procurement
2. Competitive sealed proposals	7. Exempt procurement
3. Professional service procurement	8. Price/vendor list
4. Small purchase	9. Purchasing card (P-card)
5. Sole source procurement	

**Competitive sealed bids and proposals** - Purchases at or above the department's small purchase threshold of \$25,000 must be obtained through competitive sealed bids and require an executed contract from the Procurement and Contracts Branch. The competitive sealed bid process is used when the specifications of the project are known and clearly defined. The process includes the issuance of a public notice and the publication of an Invitation for Bid containing the scope of work and the contractual terms and conditions applicable to the procurement. The project is awarded based on the lowest bid price, provided the bidder is responsive and responsible.

Competitive purchases can also be made through the competitive sealed proposals process by issuing a Request for Proposals (RFP). An RFP is used when the program objective is known but the method(s) of accomplishing those objectives are unknown. The RFP process provides an opportunity to evaluate several approaches to meet the department's needs when factors other than price could prevail.

**Professional service procurement** - Section 103D-304, HRS, and the department's Guidelines for Procurement and Contracting contain specific procedures for the procurement of professional services. Professional services are defined as services:

...within the scope of the practice of architecture, professional engineering, law, medicine, accounting, education, or any other practice defined as professional by the laws of the State of Hawai'i or the professional and scientific occupation series contained in the United States Office of Personnel Management's Qualifications Standards Handbook.

Professional services are retained when in-house staff expertise is not available for the required services or when staff is unable to perform the work due to workload and time constraints. "Professional services" is a type of contract as well as a method of source selection. Professional services can be procured in accordance with the following methods of source selection: (1) professional services; (2) competitive sealed bidding; (3) competitive sealed proposals; (4) small purchase; (5) sole source procurement; and (6) emergency procurement.

The Procurement and Contracts Branch and the administrators of the school or office share responsibility for certain portions of soliciting, procuring, and contracting for professional services, which are as follows:

**Step 1**

Legal Notice

Place annual or as needed legal notice for professional services inviting interested firms to submit statements of qualifications and expressions of interest. Additional notices must be given if: 1) the response to the notice is inadequate; 2) the response to the notice does not result in adequate representation of available sources; 3) new needs for professional services arise; or 4) rules adopted by the Procurement Policy Board so specify.

**Step 2**

Review  
Committee  
("long list")

The administrator of the school or office appoints a review committee, consisting of at least three qualified members, to evaluate all submissions. The administrator of the school or office must ensure impartiality and independence of members, whose names are placed in contract file. The committee prepares a "long list" of all qualified applicants for each type of professional service, which is documented on *Attachment B – Long List of Qualified Applicants*. Only applicants on the "long list" are eligible for selection for related professional service contracts.

**Step 3**

Selection  
Committee  
("short list")

When need for service arises, the administrator of the school or office appoints a selection committee to evaluate the statements of qualifications of applicants on the "long list." The committee consists of a minimum of three qualified members. The administrator of the school or office must ensure the impartiality and independence of members, whose names are placed in the contract file. Evaluation of submissions are based on criteria stipulated in *Attachment A – Standard Screening Criteria*, as follows: 1) relevant experience and professional qualifications; 2) past performance on projects of similar scope; 3) capacity to accomplish the work in the required time; and 4) any additional criteria determined in writing by the selection committee.

The committee may conduct confidential discussions with any applicant on the long list regarding required services and services applicant is able to perform. The committee must rank, by consensus, at least

the three most qualified applicants. This ranking is known as the “short list” and documented on *Attachment D – Short List Ranking of Qualified Applicants.*” The committee also prepares a summary of qualifications of each applicant on the “short list,” which is documented in *Attachment C – Summary of Qualifications* and placed in the contract file.

#### **Step 4**

##### Negotiation/ Award

The administrator of the school or office negotiates a contract with top ranked applicant from “short list.” If more than one candidate possesses the same qualifications, the selection committee should rank the candidates in a manner that ensures equal distribution of contracts among the providers holding the same qualifications. The recommendations of the selection committee are not to be overturned without due cause. If a contract cannot be negotiated with the top-ranked applicant, negotiations with that applicant will be terminated and negotiations with the second-ranked applicant on the short list will commence. In the event that a fair and reasonable price cannot be negotiated with any of the applicants from the short list, the selection committee may be asked to submit at least three more applicants to the administrator of the school or office to resume contract negotiations.

#### **Step 5**

##### Contract Formation

For contracts of \$25,000 or more, the administrator of the school or office must forward to the Procurement and Contracts Branch the following documents for contract preparation:

- Attachment B, Long List of Qualified Applicants
- Attachment C, Summary of Qualifications
- Attachment D, Short List of Qualified Applicants
- SPO Form 24, Affidavit, if applicable
- Professional Services Awards, New Record Input Form
- Scope of Work
- Compensation and Payment Schedule
- Special Terms and Conditions, if any
- Civil Service Exemption Certificate, if applicable

Once the Procurement and Contracts Branch has reviewed the documentation, the Procurement and Contracts Branch will prepare a contract and obtain approvals from the Department of the Attorney General, contractor, and superintendent.

**Step 6**

**Award Posting** Contracts for \$5,000 or more must be posted electronically on the State Procurement Office's Procurement Notices System within seven days of the contract award and must remain posted for at least one year. The Procurement and Contracts Branch is responsible for the posting of the department's professional services contract awards. For all professional services contracts between \$5,000 and \$25,000, schools and offices must complete and submit to the Procurement and Contracts Branch the "Professional Services Awards New Record Input Form" and fax it to the Procurement and Contracts Branch immediately after the small purchase contract is signed by the administrator of the school or office.

**Step 7**

**Debriefing/  
Protest** Once a contract is awarded, non-selected applicants have three working days to submit a written request for debriefing to the administrator of the school or office regarding the basis for non-selection. The administrator of the school or office must provide the requester a debriefing within seven working days, to the maximum extent practicable. Any protest by the requester following the debriefing must be filed in writing with the chief procurement officer within five working days after the debriefing.

**Step 8**

**Availability of  
Records** After the contract is awarded, the following information shall be open to public inspection: 1) the contract; 2) the list of qualified persons; 3) the screening committee's criteria for selection established under Section 103D-304(d), HRS; and 4) the statements of qualifications and related information submitted by the qualified persons, except those portions for which a written request for confidentiality has been made subject to Section 3-122-58, HAR.

**Step 9**

**Amendment** Any amendment to a professional services contract requires prior approval of the administrator of the school or office when the contract amount is at least \$25,000 and the increase is at least 10 percent or more of the initial contract price.

**Small purchases** – Although procurements of less than \$50,000 for goods, services or construction are considered small purchases under Section 103D-305, HRS, the department has implemented its own policies and procedures lowering the threshold from \$50,000 to \$25,000. Procurements of goods or services below \$25,000 do not have to go through the competitive procurement process and thus allow more flexibility. The following guidelines are used for small purchase procurements:

**Step 1**

**Quotations** The administrator of the school or office is required to obtain competitive price quotes and a determination of the best value prior to the award. The administrator of the school or office can solicit and document small purchase quotations by completing Forms 10a & b. Depending on the amount of the procurement, the following guidelines apply:

- Expenditures with an estimated total cost less than \$5,000 are purchased from the best available source.
- Expenditures with an estimated total cost between \$5,000 and \$15,000 must solicit at least three quotations.
- Expenditures with an estimated total cost between \$15,000 and \$25,000 must solicit at least three written quotations.

Note: If three quotations are required, but less than three quotations are received (insufficient sources, sole sources, emergencies, etc.), justification must be recorded and placed in the procurement file.

**Step 2**

**Award** The small purchase award is given to the most advantageous quotation. This means that in addition to price, the administrator of the school or office must also consider factors such as quality, warranty, and delivery.

### Step 3

**Purchase Order** Purchase orders are used in place of contracts for small purchase procurements.

According to the Guidelines for Procuring and Contracting, small purchases should not be parceled by dividing the purchase of same, like or related items or goods into several purchases of smaller quantities during any twelve month period to evade the statutory competitive procurement process.

**Sole source procurement** - According to Section 103D-306, HRS, sole source procurement is justified when there is only one source available for the purchase of goods, services, or construction. The department's policies and procedures state that sole source contracts for services greater than \$25,000 are subject to department review and must be submitted through the Procurement and Contracts Branch. To justify a sole source purchase, the following criteria must be established:

1. The service has a unique feature, characteristic, or capability;
2. The unique feature, characteristic, or capability is essential for the department to accomplish work; and,
3. The particular service is available from only one source.

The contract period for sole source procurement cannot exceed one year, unless approval is granted for a multi-term contract pursuant to Section 3-122-149, HAR. The Procurement Policy Board maintains a list of procurements that do not require sole source approval.

**Emergency procurements** - According to Section 3-122-90(a), HAR, *Emergency Procurement General Provisions*:

Prior to the procurement or if time does not permit, as soon as practicable thereafter, the head of the purchasing agency responsible for the emergency procurement shall prepare a written determination requesting the approval from the Chief Procurement Officer, indicating the following: 1) Nature of the emergency; 2) Name of contractor; 3) Amount of expenditure; 4) Listing of the good, service, or construction; and 5) Reason for selection of the contractor.

Such information should generally be included in the Facilities Development Branch Work Order form, with the exception of the reason for contractor selection.

**Exempt procurements** - In certain cases, procurement by competitive means is either not practicable or not advantageous to the department.

Such goods or services are declared to be exempt from procurement requirements. There are three ways exempt status can be granted: (1) under the provisions provided in Section 103D-102, HRS; (2) under the provisions provided in Section 3-120-4, HAR; or (3) through a request to the chief procurement officer. Examples of exemptions under the statutes and rules include 1) procurement of research, reference, and educational materials; 2) procurements related to satisfy obligations that the State is required to pay by law or settlements; and 3) procurement related to advertisements in specialized publications.

According to the department's guidelines, whenever a school or office purchases exempt goods, the purchase orders must state the applicable exemption (e.g., "Exempt from Chapter 103D, HRS, pursuant to 103D-102, HRS" "Exempt from Chapter 103D, HRS, pursuant to Section 3-120-4(b), HAR," or "Exempt by CPO approval"). Further, the exact HRS or HAR exemption number must be noted in the approval number of the purchase order.

**Price/vendor list** - According to Section 3-121-6(c), HAR, and the Guidelines for Procurement and Contracting, certain services are available from a department or State Procurement Office price/vendor list. In order to minimize the time needed to solicit quotations and determine competitive pricing and vendor qualifications, the State and the department have developed price/vendor lists for frequently purchased services. These lists assure access to competitively priced services provided by qualified vendors.

Some price/vendor lists are mandatory, requiring purchasers to utilize that particular list. Other lists are optional, allowing purchasers to purchase from another source if the list does not meet their needs. There is no dollar limit for purchases made from a price/vendor list. If the service on the list does not meet school or office needs, request for approval to purchase from another source can be made by completing a DOE Form 5, Request for Exception from Price List.

**P-card** - The purchasing card (P-card) program is co-sponsored by the State Procurement Office and the State comptroller. P-cards act much like credit cards and are intended to streamline the small purchase and payment process by eliminating the use of purchase orders. Once a month, the department makes a single payment to the card issuer for all P-card purchases made.

Another benefit of using P-cards is that they have built-in controls that can be customized to meet the specific needs of the cardholder and agency. These controls include purchasing limits and restricting purchases charged to blocked Merchant Category Codes (MCCs). Authorization criteria include purchase limits on single transactions,



the number of transactions allowed per day and month, and monthly spending limits. The single transaction purchase limit for FY2007 was \$2,500. At the request of the agency, additional MCCs can be selected so that some or all of the agency's P-cards will not work at those establishments. Exceptions to restricted MCCs may be granted by the purchasing card administrator on a limited basis based on sufficient justification or extenuating circumstances. It is the responsibility of the purchasing card administrator to determine the transaction/charge limits, allowed or disallowed MCCs, and any additional guidelines for each cardholder. The department first distributed 40 P-cards in April 2005 to principals and administrators who approve purchase orders. In FY2007, 399 P-cards were active in the department.

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## Prior Audits

While there have been numerous audits relating to the Department of Education's operations, this audit is the first to focus on the department's procurement process since the passage of Act 51.

The Office of the Auditor conducted the *Audit of Selected State Agencies' Procurement of Professional Services Contracts*, Report No. 05-05, in May 2005. This audit concentrated on the Departments of Accounting and General Services, Human Services, and Transportation. In the audit, we found that the State Procurement Office's lax oversight had contributed to problems with procuring professional services. The State Procurement Office failed to periodically review the procurement practices of all government bodies and to maintain a procurement manual. We also found a lack of a common understanding of the process of procuring professional services. Most importantly, we found untimely and questionable professional services practices occurring within the audited agencies. We discovered contracts that strongly suggested work had begun prior to contract execution and contracts that were executed without a clearly defined scope of services and fee compensation.

We recommended that the 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 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.

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## Objectives of the Audit

1. Examine the design and operating effectiveness of the Department of Education's internal controls over the procurement of goods and services exceeding the department's small purchase threshold.

2. Assess the adequacy, efficiency, and effectiveness of the department's organizational structure, systems, procedures, and practices related to the procurement of goods and services.
3. Ascertain whether the department's procurement activities have been carried out in accordance with applicable federal and state laws, rules and regulations, and policies and procedures.
4. Make recommendations as appropriate.

## Scope and Methodology

The scope of our audit was to review the procurement of goods and services by the Department of Education for the fiscal year ended June 30, 2007. Our review therefore focused on FY2007, but included prior and subsequent fiscal years as necessary. We procured the services of a certified public accounting firm (Grant Thornton LLP) to evaluate the procurement process of the Department of Education, including any policies, procedures, and internal controls in place related to procurement.

The firm interviewed department personnel involved in procurement, including those responsible for management and oversight, and performed observations of the department's procurement process and activities. In addition, the firm reviewed records and performed tests of the department's compliance with applicable provisions of State procurement laws, rules, and regulations, as well as with the department's own guidelines. Several types of procurement methods utilized by the department were evaluated; the sample sizes for each procurement method tested were as follows:

<b>Procurement Type</b>	<b>Sample Size</b>
Professional Services (Contracts)	21
Small Purchases	21
Sole Source	1
Emergency	4
Exempt	4
Price/Vendor list	14
Purchasing Card (P-card)	16,364
Staff Purchase Orders	36

As part of our audit objectives, we attempted to obtain and analyze a report of purchases for goods and services that exceeded the small purchase threshold made by the department in FY2007. However, the department was unable to provide us with a report containing the relevant

detail and instead produced an ad hoc list of all payments made for FY2007 by vendor. We selected our samples for testing procedures from that list.

The firm's initial review of the department's procurement activities and of the selected samples identified significant deficiencies, weaknesses, and instances of non-compliance. The firm accordingly made recommendations for improvements related to, among other issues, the department's planning and administration of contracts, oversight of controls in place for P-card purchases, and management of contracts related to construction and repair and maintenance work.

Based on the results of the initial review and testing, the scope of the audit was expanded to include further investigation into select contracts with questionable procurement activity. In addition to the work performed in the initial phase of the audit, we reviewed project files and obtained and reviewed department emails to better understand the decisions made and actions taken with respect to the select contracts. We also interviewed more than 20 department employees to gain further insight into the specific facts and circumstances surrounding each contract. We made recommendations for improvements and for further investigation and corrective action where appropriate.

Due to the expansion of the scope of work and the nature of the resulting additional findings, as described above, we are simultaneously issuing two separate reports. The findings and recommendations related to the original scope of work, including the independent auditor's attestation opinion regarding internal controls over procurement, are presented in Chapters 2 and 3, respectively, of this report, entitled *Procurement Audit of the Department of Education: Part 1*. The findings and recommendations resulting from the expanded scope of work are presented in Chapter 2 of our follow-on report, entitled *Procurement Audit of the Department of Education: Part 2*.

The audit was conducted from August 2007 through November 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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# Chapter 2

## The Department's Poor Control Environment Has Resulted in Widespread Procurement Violations and Inefficiencies

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In May 2004, the Legislature passed Act 51, overriding a veto by the governor. Also known as the Reinventing Education Act of 2004, the law was intended to comprehensively reform Hawai'i's public schools by placing a far greater number of decisions, and a much higher percentage of moneys, directly in the hands of individual schools and their leaders. Act 51's package of initiatives included such wide-ranging elements as lowering class size in kindergarten, grade one, and grade two; enhancing teacher education; and improving the educational accountability system.

One of the reform effort's highest priorities was reducing bureaucracy by "de-linking" the Department of Education from other state agencies, allowing the department to manage its own support services. According to the superintendent of education, the old system, in which the department was reliant on the Departments of Accounting and General Services (DAGS) and Budget and Finance for capital improvement projects, was obsolete and dysfunctional, taking far too long to deliver basic services. "Give us the resources and authorities to do the job and then hold us accountable," wrote the superintendent in a January 28, 2004, open letter to the Legislature.

In November 2004, the governor authorized the transfer of half of the \$100 million in repair and maintenance projects under DAGS to the department's management. On July 1, 2005, the department assumed full responsibility for directly contracting the projects when more than 200 DAGS employees involved with school repair and maintenance and capital improvement projects were transferred to the department.

Three years later, Department of Education officials cannot assure the Legislature that their new responsibilities and powers have indeed come with accountability. In our report, we found no evidence that the department has the mechanisms and functions to monitor and review procurement compliance on a regular basis. As a result, even though our audit was based on a relatively small sample size, we uncovered numerous instances of non-compliance and violations of procurement rules and regulations.

In addition to the high volume of violations, we also identified several risk factors and indications of potential fraud, which compelled us to expand the scope of our work. Due to the significant amount of time

involved in performing that additional work and the serious nature of the findings discovered, we have issued a separate report presenting the results of that expanded work.

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## Summary of Findings

1. A lack of leadership and controls has permitted a culture of indifference toward procurement.
2. Unconcern for procurement rules has resulted in numerous instances of non-compliance.

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## A Lack of Leadership and Controls Has Permitted a Culture of Indifference Toward Procurement

In 2004, the superintendent, advocating for the passage of Act 51, asked the Legislature for responsibility over her department's procurement process. She promised full accountability. Shortly after receiving these new responsibilities, the superintendent delegated procurement authority to the deputy superintendent, assistant superintendents, complex area superintendents, school principals, and directors, thereby providing those individuals and their staff with the responsibility and freedom to procure their own goods and services. However, these duties and responsibilities were handed down without the establishment of an adequate control system, including formalized policies, procedures, and processes throughout the department.

Top department officials have also failed to communicate the importance and necessity of complying with procurement rules. As a result, department managers and staff express ambivalence toward the necessity for procurement rules and the requirements to follow them. Many of the violations that we found during this phase of our audit therefore appear to be the result of a general lack of awareness and concern for procurement rules and procedures. Further, the department has not properly monitored its procurement activities nor taken appropriate action to identify and correct non-compliance. Finally, the Board of Education has not established policies to promote efficient and effective spending by the department and has not maintained a sufficiently involved role in overseeing procurement.

***The superintendent has delegated procurement responsibilities without establishing proper controls or ensuring employees have sufficient knowledge and training***

The superintendent of education, the official appointed by the board to carry out its mission, has not taken the action needed to establish a tone stressing an ethical and compliant procurement culture. The Committee of Sponsoring Organizations of the Treadway Commission (COSO)—an organization recognized for sponsoring and disseminating guidance on critical aspects of organizational governance, internal control, risk management, and financial reporting—has issued a control framework that has been widely accepted and implemented. According to the COSO framework, “more than any other individual, the chief executive sets the ‘tone at the top’ that affects integrity and ethics and other factors of a positive control environment.” The superintendent has overall responsibility for fostering the proper culture in the department and for implementing an adequate internal control system.

As the department’s chief procurement officer, the superintendent delegated procurement authority to the deputy superintendent, assistant superintendents, complex area superintendents, school principals, and directors, thereby making those individuals procurement officers of the department and giving them the authority to procure their own goods and services. Procurement officers are responsible for monitoring the quality of, ensuring the effectiveness of, and properly administering the purchase of goods and services.

However, by not establishing an adequate internal control system over the procurement process, the superintendent did not ensure requisite measures were in place for the department to carry out the immense undertaking. Such an internal control system is vital considering that procurement is not the primary focus or responsibility of the delegated procurement officers, as well as the fact that many of them lacked sufficient training and experience in public procurement.

At the beginning of our audit, we requested documentation of the department’s internal control system; however, the department was unable to provide us with any documentation resembling a formal control system. Further, during our audit, we did not observe any formal processes to monitor procurement activities, identify or report potential violations, or resolve violations or other procurement issues. Our interviews with the superintendent and other department personnel confirmed a general awareness that procurement controls and procedures are lacking and acknowledgement that the procurement process is not operating effectively and efficiently. The superintendent has been extremely supportive of our audit efforts throughout the process and must now set clear expectations that all employees will be held to high standards of ethical conduct and compliance with respect to procurement.

We recommend the department develop and implement a formal internal control system over procurement. The internal control system should

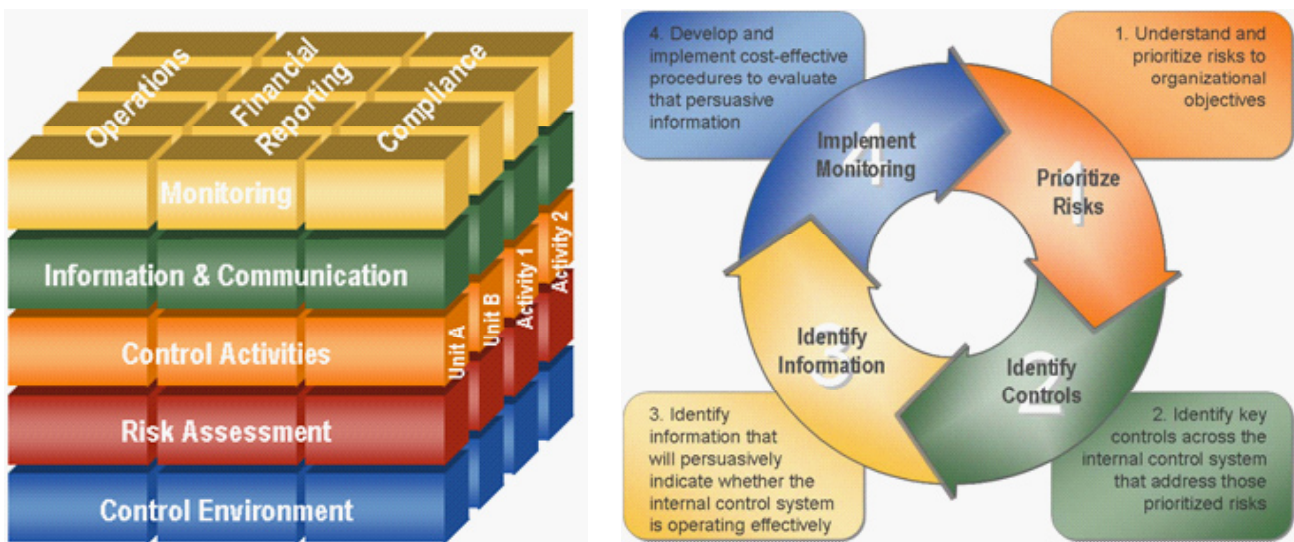
be based on a well-accepted framework such as COSO, and it should begin with the identification and prioritization of risks to achieving the department's procurement objectives. Given the magnitude of establishing and implementing a proper internal control system, the department should consider engaging professional assistance to accomplish this task. However, the superintendent and relevant department personnel should be involved in overseeing the development of the internal control system, and the superintendent and the board should ultimately approve the system before implementation.

***The department lacks clear and standard procurement policies and procedures***

The department has yet to establish any formal procurement policies and procedures. While it is understandable that a transition period is necessary to transfer personnel and train employees on procurement rules and procedures, the department has had ample time to develop and implement a formal procurement code with department-specific policies and procedures.

The superintendent originally assigned responsibility for all procurement matters to the Procurement and Contracts Branch in the Office of Fiscal Services. The branch authored and distributed the Guidelines for Procurement and Contracting in March 2006. However, the guidelines

**Exhibit 2.1  
COSO Internal Control Integrated Framework and Implementation Progression**



Source: COSO Guidance on Monitoring Internal Control Systems, Exposure Draft, June 2008

were issued as a reference for employees and do not represent formal policies and procedures. Our interviews with various department personnel confirmed that the guidelines are viewed as just that—guidance—and not as mandated policies and procedures. We also found a general lack of understanding by employees of their procurement responsibilities. Most personnel in charge of procurement do not have much experience in the area, since procurement has never been and is not currently their primary responsibility. While some employees demonstrated an interest in better understanding the procurement process, others readily dismissed the guidelines and related training provided by the Procurement and Contracts Branch.

We recommend the superintendent establish a single division to develop and formalize standard procurement policies and procedures for the department. The personnel tasked with this responsibility should have sufficient procurement knowledge and experience and should consult with other key departmental personnel involved in procurement in developing the policies and procedures. The superintendent and the board should review and ultimately approve the procurement policies before they are implemented. In addition, the division responsible for establishing the policies should develop an adequate training program to ensure that all department personnel involved in procurement become familiar with the policies and comprehend that compliance is mandatory.

***Procedures to correct and deter procurement violations are deficient***

In addition to the lack of established procurement policies and procedures, there are no corrective procedures in place to properly address procurement violations and deter repeat behavior. When procurement violations occur and are detected, the violating party must complete a departmental “Violation/Approval To Render Payment” form, describing the circumstances that led to the violation and what the party plans to do to prevent reoccurrence. The violation form is submitted to the Procurement and Contracts Branch, which investigates the violation and makes a recommendation for approval or disapproval. Although the form requires final approval by the superintendent or a designated procurement officer, based on our audit, it appears the form is generally approved and payment is therefore permitted to be made on improper procurement actions.

We discovered a number of procurement violations during our audit, but did not observe any counseling or discipline being issued to the violating employees to inform them of their mistakes and to deter repeat behavior. Because the guidelines are not enforced and there are no consequences for violations, it is not surprising that they are often bypassed or overlooked. Without a strong incentive to understand and comply with procurement rules, guidance and training become ineffective.



This lack of personal accountability and consequences for non-compliance further promotes the attitude that the rules are inconsequential. The department should better track procurement violations and develop an approach to address and resolve violating behaviors. The approach should include a system of progressive discipline, such that repeat offenders are subject to heightened consequences.

***The department did not establish an adequate internal audit branch before taking on its increased procurement responsibilities in 2005***

According to *Managing the Business Risk of Fraud: A Practical Guide* (“Fraud Risk Guide”), a report sponsored by the Institute of Internal Auditors, the American Institute of Certified Public Accountants, and the Association of Certified Fraud Examiners, one of the primary roles of internal audit is to provide objective assurance that there are adequate internal controls in place to address the organization’s risks and that those controls are functioning effectively. The importance an organization attaches to its internal audit function is an indication of the organization’s commitment to internal control.

During the time of our audit, the Department of Education’s Internal Audit Branch—administratively attached to the Office of Fiscal Services—consisted of one person, clearly an insufficient staff to monitor an organization with a budget of \$2.4 billion. In addition, over the course of our fieldwork, we did not observe any internal audit involvement in the items that we tested. The assistant superintendent of the Office of Fiscal Services explained to us that the Internal Audit Branch is limited in its capabilities to perform internal reviews over the procurement process due to its size, but that there are efforts to increase the number of internal audit staff. Subsequently, during a follow up interview, the superintendent explained that the department has increased its internal audit staff to three, still insufficient staffing to monitor an agency the size of the Department of Education.

The department should continue to increase the number of employees in its Internal Audit Branch. If it is unable to do so, it should consider outsourcing some of this function. In addition, the Internal Audit Branch should be kept informed as management develops the internal control system over procurement and should be tasked with developing an audit plan to regularly monitor and test the effectiveness of controls that are implemented.

While we understand there may be budgeting and other constraints over expanding internal audit, this function plays a critical role in improving not only the procurement process, but the department’s overall operations. Internal audit must receive a priority in the department’s budget which matches its vital function.

***There is no effective monitoring of the department's expenditures***

In addition to the lack of monitoring over the procurement process, the department also fails to regularly monitor its expenditures and disbursements. As one of our audit objectives, we requested the Office of Fiscal Services to provide us with a report listing the total number of purchases made in fiscal year 2007 by type of good or service, procurement method, related disbursements, and ending encumbrances, to assist us in analyzing the purchases made by the department that exceeded the small purchase threshold. The Office of Fiscal Services did not have such a report available, and explained that the department does not normally manage or review its expenditures in the format requested. During an interview with the assistant superintendent of the Office of Fiscal Services, he explained that the current financial reporting system used by the department is limited and unable to produce such a procurement report.

The department's failure to regularly monitor expenditures impedes the effective management of spending and makes it difficult to ensure compliance with procurement policies and procedures. We recommend the department explore different options to develop a regular procurement reporting process within its current financial reporting system. The procurement reporting process should obtain, consolidate, and disseminate relevant procurement data to key management personnel within the department.

***The assistant superintendent of the Office of School Facilities and Support Services exemplifies the nonchalant attitude toward procurement compliance***

The Office of School Facilities and Support Services (formerly known as the Office of Business Services, hereinafter referred to as the "Office of School Facilities") plans and directs the capital improvement and repair and maintenance projects of the department. The office is thus responsible for improving and maintaining the department's schools and other facilities throughout the state.

Shortly after being delegated authority over certain areas of procurement, the assistant superintendent of the Office of School Facilities requested a temporary exemption from the contracting process requiring Procurement and Contracts Branch involvement. He argued that eliminating the involvement of the Procurement and Contracts Branch would allow the Office of School Facilities to engage contractors more expeditiously and accordingly complete projects in a timelier manner. The superintendent granted the Office of School Facilities the temporary exemption.

The assistant superintendent of the Office of School Facilities has admitted frustration towards state and departmental procurement rules and requirements. His sentiment toward public procurement was plainly conveyed to us during an interview when he stated: "If everybody

followed the rules, the world would stop.” The assistant superintendent also noted that he does not involve himself in procurement activities unless a problem arises and is brought to his attention, essentially allowing the directors and managers within the Office of School Facilities to manage their own procurement process with little oversight and accountability.

This loose culture has resulted in extensive non-compliance with procurement rules in the Office of School Facilities. Because of the high volume and dollar amounts of contracts administered by the office, its contracts comprised a substantial segment of our selected audit samples. Although the sample size was comparatively small in relation to the office's total contracts, we discovered an alarmingly high number of procurement violations that extended to the various procurement types and methods utilized by the office. Even more startling was the evidence discovered during the latter phase of our audit which revealed that many directors, managers, and staff within the office knowingly executed improper procurement decisions and actions when they believed (rightly or not) that it was in the best interest of the department. That evidence is discussed more fully in our second report.

The attitude and resulting procurement violations in the Office of School Facilities are the foreseeable result of the department's failure to establish an adequate control environment. Although not the direct cause of the violations, the lax tone from the top and the failure to actively mandate and monitor for compliance have contributed to the now vulnerable procurement environment.

In September 2008, the assistant superintendent of the Office of School Facilities requested that authority to procure construction contracts be formally transferred from the Procurement and Contracts Branch under the Office of Fiscal Services to the Facilities Development, Facilities Maintenance, and Auxiliary Services Branches within the Office of School Facilities. The written request contended that transfer of this function to one office would greatly improve accountability and transparency—somewhat unsound reasoning since the department was recently reorganized to segregate the functions of contract solicitation/award and contract execution/approval from reporting to the same assistant superintendent.

Despite the flawed logic and the office's record of noncompliant procurement practices, the superintendent granted the request. The new procedures, which became effective September 15, 2008, gave the Office of School Facilities full procurement authority and responsibility over construction contracts up to \$1 million. Not only does the new process remove any review and approval by the Procurement and Contracts Branch, it also eliminates review by the attorney general unless the

project cost is more than \$1 million or the Auxiliary Services Branch determines that attorney general review is required.

The superintendent must make clear to the assistant superintendent of the Office of School Facilities and his staff that compliance with procurement rules is mandatory. In addition to establishing a proper tone from the top and an adequate internal control system over procurement, we recommend the superintendent retract the transfer of procurement authority over construction contracts to the Office of School Facilities and subject the office to the internal control system and departmental procurement policies and procedures that are implemented. Without appropriate oversight and controls, it is likely that procurement violations will continue to occur.

***The Board of Education does not exercise oversight of the department's procurement practices***

According to the *COSO Guidance on Monitoring Internal Control Systems Exposure Draft* ("COSO Monitoring Guidance"), an entity's board is ultimately responsible for setting the tone of the organization and ensuring that an effective control framework is in place. This should generally be accomplished through the establishment of a mission, vision, and strategic objectives. The Board of Education has established the following mission and vision statements for Hawai'i public schools:

- **Mission.** The mission of the Hawai'i State Board of Education is to promote excellence and equity in Hawai'i's public schools and enable all students to meet their own unique and varied potentials.
- **Vision.** Hawai'i's public schools are institutions of learning that parents want their children to attend and students want to attend. All schools, regardless of size, are safe, nurturing learning communities where members work together and all students achieve high academic standards and become contributing members of society.

The board's mission is—as it should be—focused on student learning, including setting education policies and adopting student performance standards. However, it is unclear if the board's mission and vision have been broadened to address the department's additional financial management duties as a result of the passage of Act 51.

The board has yet to implement policies to monitor procurement, which would help ensure that the department has implemented an effective system of controls. As part of such policies, the board would need to mandate regular reporting by management on its progress in establishing an internal control system, as well as on capital projects and other

significant expenditures, including any noteworthy issues that arise in the selection, award, negotiating, and contracting phases of the procurement process.

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## **Unconcern for Procurement Rules Has Resulted in Numerous Instances of Non-Compliance**

Shortly after the passage of Act 51 in 2004, the department quickly inherited an enormous responsibility and an expansive system replete with myriad staff, forms, and procedures. Procurement authority and responsibilities were delegated to the deputy superintendent, assistant superintendents, complex area superintendents, school principals, and directors; however, department managers and staff admittedly lacked sufficient training and experience in public procurement to effectively carry out those responsibilities.

During our audit, we uncovered numerous instances of non-compliance with procurement laws and regulations, as well as several issues of inefficiency in the department's procurement process. There were many findings for each of the procurement methods utilized by the department, including professional services contracts, purchase orders, small purchases, purchasing cards, and emergency, exempt, and sole source procurements. Our findings were corroborated by statements gathered through interviews with department personnel and suggest that the problems exist department-wide. Our interviews with employees also confirmed the general lack of understanding and awareness regarding procurement rules and responsibilities. Many of the infringements thus appear to be inadvertent and due to lack of sufficient procurement knowledge and experience, as well as inadequate monitoring. Given the absence of a procurement internal control framework, formal departmental policies and procedures, and proper oversight, the widespread non-compliance and inefficiencies are not surprising.

## ***Planning and oversight of professional services contracts are deficient***

Proper planning is integral to the contract award and monitoring process. Planning entails a walkthrough of what needs to be done and organizing activities before work is started. With proper planning, the type of service, timing to deliver the service, and budget to procure the service may be developed and understood. A fully developed plan enables an agency to structure an effective contract to secure the required services and increase the chances of a successful project outcome.

Similarly, adequate monitoring of contracted projects is necessary to ensure the State's interests are being served. Particularly in the initial stages of developing the contract and prior to execution, the vendor and project must be closely supervised to ensure that work is not being performed without a contract in place, which protects the State's interests. Without proper planning and oversight of contracted projects,

state funds may be inefficiently expended, vendors may deliver unwanted services, and ultimately, liabilities to the State may increase.

**Contract prices are negotiated without an initial budget in place**

Proper budgeting for projects is an important part of the planning phase because it necessitates an evaluation of the project's needs and identification of available resources. Creating a budget assists in the cost/benefit analysis and helps management determine whether to contract the work or perform it in-house. If the decision is to outsource, a budget assists in price negotiation and establishment of fair and reasonable contract terms.

We discovered a lack of budgeting during the planning phase for professional service contracts. The department appears to develop budgets for large projects only during the vendor selection phase, if at all. Out of 21 professional service contracts tested, eight contract files indicated that the planned budget amount for each project was undetermined.

	<b>Description</b>	<b>Procurement Type</b>	<b>Contract Amount</b>
1.	Design and construction management services for classroom renovation projects	Professional Services	\$4,440,000
2.	Design and construction management services for classroom renovation projects	Professional Services	\$7,350,000
3.	Design and construction management services for classroom renovation projects	Professional Services	\$6,825,000
4.	Design and construction management services for classroom renovation projects	Professional Services	\$2,349,000
5.	Project management and technical assistance for R&M and CIP projects	Professional Services	\$848,000
6.	Comprehensive restructuring services	Professional Services	\$4,985,000
7.	Development and administration of science assessments	Request for Proposal	\$2,142,063
8.	Student bus transportation services for Special Education	Invitation for Bid	\$1,323,660

For seven of the findings, the department did not formulate a budget until after the proposals had been received from prospective vendors. The project management and technical assistance for R&M and CIP projects contract file indicated there was no effort to create a budget at any time during the procurement process. In all findings, the final contract amounts were based on the proposed vendor amounts. Without an initial budget prepared by the department, the department appears to lack a full understanding of the work it is attempting to outsource and it is difficult to determine how a favorable price with the vendor was negotiated.

The department should be more diligent during the planning phase by developing detailed budgets prior to submitting requests for proposals. A detailed budget should list the expected services to be provided and an estimated cost to provide each service. The estimated budget should be maintained as part of the contract file.

### **Poor budgeting for repair and maintenance projects results in significant cost overruns**

Repairs and Maintenance (R&M) appears as a lump-sum item under the State Biennium Budget. This means that R&M work is done using a “soft-budgeting” system that gives the Office of School Facilities more flexibility in how funds are allocated to projects. However, the “soft-budgeting” also makes it difficult to manage the total fiscal cost due to the large volume of R&M projects. Many R&M projects are run concurrently and at their own pace, making it difficult to get a complete picture of the available R&M funds at any given point in time.

R&M project cost is budgeted prior to the bidding process and is generally stated in a “Job Activation Request” form used by the Office of School Facilities. During the bidding process, if the vendors’ quoted cost exceeds the budgeted amount, proper administrative approval is required to fund the difference. In general, a “Notice of Insufficient Funding” form is used to record the cost overrun amount and determine if additional funds may be allocated to proceed with the project.

We selected 36 staff purchase orders for testing and found ten orders that were at least \$5,000 and 10 percent greater than the original budget.

	<b>Budgeted</b>	<b>PO Amount</b>	<b>Difference</b>	<b>Percentage</b>	<b>Notice of Insufficient Funding</b>
1.	\$22,000	\$93,318	\$71,318	324.17%	No
2.	\$35,000	\$95,000	\$60,000	171.43%	Yes
3.	\$26,000	\$65,000	\$39,000	150.00%	No
4.	\$45,000	\$96,238	\$51,238	113.86%	Yes
5.	\$25,000	\$42,811	\$17,811	71.24%	No
6.	\$50,000	\$82,000	\$32,000	64.00%	Yes
7.	\$69,000	\$97,135	\$28,135	40.78%	No
8.	\$60,000	\$75,337	\$15,337	25.56%	No
9.	\$32,000	\$35,482	\$3,482	10.88%	No
10.	\$54,000	\$59,566	\$5,566	10.31%	No

The fact that ten out of 36 purchase orders were significantly over budget emphasizes the fact that estimated amounts for projects are constantly understated, resulting in under-budgeted projects. Such understatements may add to the budget overrun for repairs and maintenance unless efforts are made to reevaluate the project estimation process.

For seven out of the ten projects over budget shown in the table above, a “Notice of Insufficient Funding” form was not attached to the purchase order file to ensure that proper approval was granted to proceed with the project. Controls such as this form help the Office of School Facilities manage the “soft-budget” and should be enforced.

**Contractors are commonly permitted to start work prior to contract execution**

Contracts serve the purpose of protecting the interests of the stakeholders, state the responsibilities of the contracted parties, define the final deliverables, and document the agreed upon terms and conditions. When work proceeds without a contract, the vendor may complete and bill for services that are out of scope, leading to possible disputes and cost overruns. For six out of the 21 contracts tested, documentation indicates that consultants started work before contract execution or receipt of a Notice to Proceed.



	<b>Description</b>	<b>Procurement Type</b>	<b>Contract Amount</b>
1.	Construction management services for tree trimming inspection and related services	Professional Services	\$194,200
2.	Enhancement and maintenance of tracking system	Professional Services	\$42,650
3.	Design and construction management services for classroom renovation projects	Professional Services	\$4,440,000
4.	Design and construction management services for classroom renovation projects	Professional Services	\$7,350,000
5.	Design and construction management services for classroom renovation projects	Professional Services	\$6,825,000
6.	Design and construction management services for classroom renovation projects	Professional Services	\$2,349,000

For the first two of the findings, we reviewed the first invoices submitted for payment for each contract. We noted that the invoices listed several hours of worked performed approximately one month before the contract was executed. The other four findings were for contracts related to design and construction management services for classroom renovation projects at various schools. Part of the services included meetings with the various schools to perform an on-site investigation. Upon review of the first invoices for each contract, we noted that on-site investigative work and meetings with the schools occurred several months before the contract was signed. In one case, the first invoice with an amount of \$346,000 was dated prior to the contract date. In addition, this invoice indicated that 15 percent of the service was performed over a four-month period prior to contract execution.

The department acknowledged that work began before the contracts were formalized, but explained that the contract process is long, sometimes taking several months to complete, and it is therefore common practice for work to start without a contract to meet project deadlines. The department also indicated that delays in the start dates cause cost increases because vendors are forced to remobilize their resources.

The department should develop and enforce formal policies that limit vendors from starting work without a contract. Vendors should be monitored more closely by the department and instructed not to start without a contract because of the risks involved for both parties. In addition, since the department understands that the contract process is

lengthy, the appropriate amount of time should be scheduled to plan for upcoming projects. Such planning should involve all department stakeholders in the contract process as early as possible. Early meetings may identify and resolve issues that normally delay the procurement process. The department should also examine its contracting procedures to streamline and shorten the process.

***Professional services contract files are disorganized and incomplete***

We encountered difficulties obtaining and reviewing contract files, particularly files for professional services contracts. We noted that the DOE does not keep complete contract files in a single location by branch or office. For example, the Procurement and Contracts Branch maintains the contract, the project manager holds the documents to administer the contract, and a branch person possesses the planning forms. Upon our request for certain contract files, the department took several days to weeks to consolidate the documents from different locations into a single contract file. When we reviewed the files, we noted many of the documents required by the department guidelines were missing or nonexistent. When contract documents are either incomplete or not filed in a single location, reviewers cannot obtain a clear picture of what occurred. More importantly, the state personnel involved in the contract process, such as the Procurement and Contracts Branch and the Department of the Attorney General, may raise legitimate questions regarding the contract which significantly delay the procurement process.

**Contracts lack documentation to ensure selection committee members are qualified, independent, and impartial**

The impartiality and independence of review and selection committee members are essential in maintaining the integrity of awards for professional services contracts. Contracts should be awarded by independent committee members who objectively review proposals. Since the department procurement guidelines are meant to promote equal and fair competition for department projects, the presence of biased committee members would quickly undermine the ideals of the procurement process.

Section 103D-304(c), HRS, requires that the head of the purchasing agency shall ensure the impartiality and independence of members of a review committee designated to review statements of qualifications submitted by interested vendors to provide professional services. Section 103D-304(d), HRS, imposes a similar requirement for members of the designated selection committee to evaluate the statements of qualifications against the selection criteria for a specific needed professional service and rank a minimum of three vendors based on the selection criteria. Of the 21 professional services contracts

tested, 19 contracts did not have any documentation demonstrating the independence and impartiality of the review and selection committee members.

In addition to ensuring the independence and impartiality of the procurement committee members, the department guidelines require the review and selection committees to consist of at least three members each with sufficient knowledge to serve on the committee. Of the 21 professional services contracts tested, the documentation for one contract file indicated the selection committee consisted of two individuals instead of the required minimum of three. Twelve contract files contained no documentation to indicate sufficient experience and professional qualification of the members on the review and selection committees. Five files failed to list the individuals who served on the review and selection committees.

In 2007, the Procurement and Contracts Branch implemented procedures requiring review and selection committee members to sign an affidavit declaring that they have no conflicts of interest. The use of this affidavit should be enforced throughout the department. We recommend that the affidavit include the job title and professional certifications, if applicable, of the individuals signing the affidavit to indicate professional qualification. Such a form helps prove the objectivity of the committee members and support their selection decisions.

### **Selection and award documentation are deficient**

The award decisions from each committee (i.e., creating a short list of vendors, initial ranking of vendors on the short list based on qualifications, and final recommendation to award) are required to be documented and made part of the contract file. This documentation is usually in the form of meeting minutes. Meeting minutes for each review/selection committee should be specific and unique, listing the various issues and committee member responses thereto, which support the final decision award for that procurement.

Once the selection committee recommends the top-ranked vendor, the administrator of school or office is responsible to negotiate a contract with that vendor. Negotiations are conducted in confidence. However, the guidelines require the administrator to contract for a fair and reasonable price. We tested 21 contract files for compliance with the guidelines and discovered numerous violations. For ten of the contract files, the notes and minutes of the selection committee appeared to be generic and utilized for every contract file. In other words, the comments in the selection committee minutes appeared to be in template form with a blank field to add the name of the recommended vendor. Two contract

files did not include the minutes from the selection committee. Finally, for two contracts, there was no evidence in the file to indicate that the administrator negotiated a fair and reasonable price with the vendor.

### **Contract files are missing required documentation, indicating lack of proper review and controls**

During our review of procurement contract files, we found that contract files for procured goods and services that exceeded the department's small purchase threshold of \$25,000 lacked sufficient documentation and management review. Many files were missing documentation required by Chapters 103D and 103F, HRS. We found numerous contract files missing certifications of available funds (Form-C41), which ensure that the department can adequately and properly fund the good or service. We also discovered that a contract related to bus transportation on Moloka'i that received only one bidder did not have the required "Award of Single Responsive Offeror" form in the contract file. Contracts are usually awarded to the lowest qualified bidder; however, in instances where only one bidder responds, an "Award of Single Responsive Offeror" form must be included in the contract file to justify the award.

Invitations for bid generally require the awarded contract vendor to obtain a performance or payment bond, which limits the liability to the department by guaranteeing that the contractor will adequately complete the project and pay all subcontractors, laborers, and material suppliers associated with the project. We discovered one contract file that did not include the required performance or payment bond. We also found a contract file that did not include a Certificate of Good Standing from the Department of Commerce and Consumer Affairs. A Certificate of Good Standing provides conclusive evidence that a business is in existence or authorized to transact business in the state and that the company is in compliance with all state-required formalities. Finally, we discovered two professional services contract files that did not include "Attachment C, Procedures for Consultant" forms, which contain selection committee members, signatures of the committee members and evaluation ratings of the consultants. This form ensures the independence and impartiality of the committee members by bringing visibility and transparency to the selection process. Without documented explanations, selection committee decisions cannot overcome the appearance of subjectivity.

The DOE should implement formal procedures ensuring the maintenance and completeness of contract files. The DOE should also utilize checklists to ensure that contract files include all required documentation and implement an independent review of contract files.

### **Contract closure is not properly documented**

Contract closure requires formal recordkeeping in order to protect the legal interests of the department and the vendor. Such records include, but are not limited to, verifying that the work was completed correctly, making final payments, and assessing lessons learned. According to the National State Auditors Association (NSAA) Best Practices for Contracting, an agency should also evaluate the vendor's performance against a set of pre-established standard criteria. The evaluation should occur after contract completion and should be maintained for future use.

For five out of the 21 contracts tested, the contract term had expired, but there were no documents in the contract files indicating that the contracts were administratively closed. In addition, there were no evaluation forms to document how well or poorly the vendor performed. Without formal closure, there is less protection to the State and department in case arguments or legal actions arise from the vendor. If the vendor performed poorly and proposes on another job, there is no document for the selection committee to review which would indicate the past poor performance. The department should enforce the practice to administratively close contracts once the work has been completed.

### ***Procedures to ensure proper use of staff purchase orders are not followed***

For fiscal year 2007, the Office of School Facilities requested and obtained an exemption from the departmental contracting process. The exemption was approved by the superintendent. The exemption allowed the Office of School Facilities to procure services for projects less than \$100,000 through the use of staff purchase orders, which in essence permits them to bypass the contract approval process with the Procurement and Contracts Branch. The Office of School Facilities justified the exemption by explaining that "given the volume, magnitude, importance that the work be performed quickly, and the general need to expedite these repairs, procurement through the normal process is not practicable or advantageous to the State." To obtain the exemption for fiscal year 2007, the Office of School Facilities created its own set of procedures.

Under this exemption, the Office of School Facilities secured professional services through 408 staff purchase orders totaling \$10,222,000 in fiscal year 2007. We selected a sample of 36 staff purchase orders totaling \$1,411,000 in expenditures to test for compliance with the Office of School Facilities' established procedures.

### **Purchase orders appear to be used to circumvent competitive procurement requirements**

The exemption requires that the total cost of the contracted service to be less than \$100,000. Projects greater than \$100,000 should be procured

through a competitive sealed bid regulated by Chapter 103D, HRS, and require an executed contract from the Procurement and Contracts Branch. Three of the 36 purchase orders tested had an original planned budget greater than or equal to \$100,000.

All three projects related to re-roofing a building at three different schools. The planned budgeted amounts were \$115,000, \$105,000, and \$100,000. Ultimately, the winning bids were less than the \$100,000 cap at \$99,950, \$92,086, and \$99,110 respectively. However, since the Office of School Facilities originally planned for a budget of \$100,000 and more, the Office of School Facilities deliberately disregarded its own procurement rules by using a purchase order instead of contracting for the services using competitive procurement procedures. If the department provides future procurement exemptions based on predetermined procedures and controls, it should take steps to monitor that the procedures are being followed and the controls are working as planned.

### **Solicitations and selections of vendors for purchase orders appear to be unfair**

In its request for the exemption, the Office of School Facilities represented to the superintendent that,

selection of which vendors are contracted for each project shall be determined on a rotational basis, ensuring that each vendor will receive roughly equal opportunities to bid on projects [and that] this process shall be strictly controlled by the Facilities Support Services Branch.

However, the Office of School Facilities did not illustrate how the vendor rotation control would be enforced. We inquired with the Office of School Facilities on its procedures to rotate the selection of vendors and noted there were no formal policies or procedures on the matter.

The selection process for the exemption includes a project pre-bid meeting that all vendors must attend to qualify to bid on a project. If vendors are not given an opportunity to attend the pre-bid meeting, those vendors are unfairly excluded from the selection process, and questions about the validity and impartiality of the selection are likely to arise. Out of the 36 purchase orders we reviewed, the supporting documents for seven purchase orders for various installation and replacement projects indicate the invitation to bid on the project occurred on the same day as or after the pre-bid meeting. This strongly suggests that not all qualified vendors were notified of the opportunity and given sufficient time to attend and prepare for the pre-bid meeting.

We also found eight separate purchase orders for various installation and resurfacing projects did not contain evidence that a pre-bid meeting was held. Sign-in sheets are usually used at pre-bid meetings to document the vendors in attendance. However, for these eight purchase orders, sign-in sheets were not utilized or the dates of the pre-bid meetings were not documented to prove that the pre-bid meetings took place.

The Office of School Facilities policy includes a list of qualified vendors to be established by the DOE and to be organized by subject matter or expertise. This list is developed through a public solicitation to vendors who provide these services. The Office of School Facilities may only choose vendors on this list during the vendor selection process for purchase orders. For seven purchase orders for various installation and replacement projects, one or more of the vendors who were requested to bid were not on the pre-established list of vendors.

For nine purchase orders related to various replacement, installation and repair projects, the selected vendor's proposal appears to have been received after the submittal due date and time based on the fax transmittal date listed on the proposals. The Office of School Facilities' policy explicitly states that "all bid documents must be submitted on time or the bid will be rejected." Based on a review of the proposals received by the Office of School Facilities, there was no consistent way to determine that the proposals were received by the submittal deadline. Since the receipt of the proposal is a time-sensitive issue, an indicator such as a time stamp or a "received by" sign-off is expected. Neither of these controls nor documentation was consistently utilized by the Office of School Facilities. For ten purchase orders for various installation, replacement and renovation projects, the Office of School Facilities did not list a date received on the selected vendor's proposal.

Overall, the solicitation and bidding process does not give assurance of impartiality or fairness to all qualified vendors. We recommend that the Office of School Facilities develop and implement formal controls over vendor selection to be in compliance with its own policies. Such controls include standardizing the solicitation documentation, consistently utilizing sign-in sheets at pre-bid meetings, and stamping receive dates/times for time-sensitive documents. We also recommend the development and implementation of formal policies and procedures regarding vendor rotation.

### **Established guidelines to ensure competitive pricing are not followed**

In order to obtain competitive pricing for purchase orders, the Office of School Facilities stated that at least five vendors will be solicited to submit proposals on a given project. From the invitation to bid, the

following guidelines are used to determine the number of required bids to be received by the Office of School Facilities based on the contract amounts:

- For projects less than \$5,000, the purchase order may be negotiated with a single vendor, provided that the purchase is made on the basis of fair price and adequate and reasonable competition.
- For projects between \$5,000 and \$15,000, no less than three quotations shall be received.
- For projects between \$15,000 and \$100,000, no less than three written quotations shall be received.

Less than five solicited vendors and less than the applicable number of quotations received is allowable, but the justification for the inability to obtain the minimum number is required to be documented. For 14 out of the 36 purchase orders we tested, less than the required minimum of five vendors was solicited for a bid without a justifiable reason.

Purchase Order Description	Number of Vendors Solicited	Purchase Order Amount
1. Remove sidewalk between buildings	4	\$7,658
2. Replace dining room doors	3	\$48,631
3. Maintain football field	3	\$6,100
4. Repair gym showers	2	\$95,000
5. Remove shed	3	\$2,700
6. Install security screens	3	\$16,386
7. Resurface tennis and handball courts	4	\$96,613
8. Repave and coat court, asphalt and poles	4	\$93,318
9. Reroof building	3	\$99,950
10. Repair sidewalk	2	\$21,700
11. Install handrails	3	\$8,990
12. Replace front step rails	3	\$9,800
13. Relocate cattle gate	3	\$6,560
14. Improve restroom and waterline	4	\$24,920

Furthermore, the Office of School Facilities did not obtain the required minimum of three quotations for 13 purchase orders and failed to document the justification. From the aforementioned findings, seven purchase orders did not have both the required minimum of solicited vendors and received bids.



	<b>Purchase Order Description</b>	<b>Number of Quotations Received</b>	<b>Purchase Order Amount</b>
1.	Reroof building	2	\$92,087
2.	Maintain football field	2	\$6,100
3.	Repair gym showers	1	\$95,000
4.	Replace A/C units	1	\$75,337
5.	Replace water heaters	1	\$96,238
6.	Resurface tennis and handball courts	2	\$96,613
7.	Reroof building	1	\$99,950
8.	Reroof building	2	\$99,110
9.	Add water fountain	2	\$16,200
10.	Repair sidewalk	2	\$21,700
11.	Clear debris	2	\$42,811
12.	Relocate cattle gate	2	\$6,560
13.	Improve restroom and waterline	1	\$24,920

Based on our inquiries with the Office of School Facilities, this finding could be the result of management oversight. Many department project coordinators indicated that they solicited the required number of vendors and received more than the minimum amount of quotations, but failed to document in the files due to the lack of understanding the process. The Office of School Facilities should be more diligent in its documentation to secure purchase orders. Without such documentation, the Office of School Facilities cannot support that it has been following its own policy to obtain competitive pricing.

**Documentation of mandatory final inspections and contractor evaluations are lacking**

The Office of School Facilities requires a mandatory final inspection with school officials and the contractor prior to final payment. An evaluation of the contractor is also required. Three out of 36 purchase orders relating to contractors' services did not indicate that an inspection was performed prior to final payment. Generally, the final invoice is stamped, and the project coordinator signs off with the date that the inspection was performed. Without a signature for inspection, it is unclear whether an inspection was performed or not.

One of the findings related to a \$6,000 job to install an air conditioning drain. The other two findings were for the repair work on the restroom waterlines at a high school at costs of \$25,000 and \$15,000. The department should ensure that all final payment invoices include

evidence of a final inspection of the contractor's services. The stamp and signature prove that a review was performed and that the completed work met the scope specifications.

In addition, for 11 out of 36 purchase orders tested relating to contractors' services, an evaluation of the contractor was not performed. Contractor evaluations are useful in selecting contractors for future work. The quality of work performed by the contractor should be indicated on the standardized evaluation form. A tracking system should be implemented to document contractor evaluations, which may be utilized in making future contractor selections.

***Total small purchases of related goods and services from the same vendor exceeded the \$25,000 threshold***

According to the department's policies and procedures, procurements under \$25,000 are considered small purchases and do not require a competitive procurement process. The small purchase process allows department officials to procure goods or services through a purchase order. This provides department officials with the flexibility to quickly determine which vendor is the best available source to obtain goods or services. The department guidelines explicitly disallow the practice of parceling, which divides the purchase of same, like, or related goods or services into smaller quantities during any 12-month period to avoid a competitive procurement process. We randomly selected nine vendors solicited through the small purchase process and found two instances where the total payments to the vendor exceeded \$25,000 in a 12-month period. There is no evidence indicating that the purchases were parceled to intentionally avoid a competitive procurement process. However, the total payments in a 12-month period to these noted vendors were \$82,232 and \$86,930.

The first case involved the purchase of materials and labor for the replacement of boilers in the cafeteria of various schools. These were procured by the School Food Services Branch in the Office of School Facilities over a six-month period. The second case involved the purchase of audio/video equipment for a new elementary school. According to the school, the purchases were made throughout the year as newly hired staff requested the items. The school stated that only one quote was necessary for these purchases because the company was the only vendor in Hawai'i that was both a seller and service center of a particular digital projector. If this is true, a sole-source procurement process should have been followed, which would subject the purchase to board review and require the Procurement and Contracts Branch's involvement.

Branches and schools should group anticipated purchases by goods and procurement type. If the grouped goods exceed the small purchase threshold, a competitive bid process should be utilized. With better

planning in both situations noted above, a contract could have been formed to obtain a more competitive price.

***Purchasing cards are being used improperly***

The purchasing card (P-card) is a credit card issued to certain departmental faculty and staff. The P-card system simplifies the department small dollar purchases by eliminating paper work and saving time from requesting purchase orders and requesting check payments. According to the department's Purchasing Card Procedures & Requirements issued by the Office of Fiscal Services, schools and offices may use the P-card to purchase predetermined types of goods and services. In addition, a \$2,500 purchase limit is set for a single transaction.

By working with the financial institution that issues the P-cards, the department may set automatic controls to ensure department policies are enforced. For example, any single purchase exceeding the \$2,500 limit may be denied at the time of purchase. Also, the department may disallow certain P-card expenses such as retail liquor and taxicab fares by blocking specific Merchant Category Codes (MCC).

We obtained a list of fiscal year 2007 P-card purchases from the Office of Fiscal Services. The total amount of P-card purchases for the year was approximately \$2 million. We reviewed the fiscal year 2007 P-card list and noted several issues of non-compliance with the department's P-card policies.

**Single P-card purchases exceeded the \$2,500 purchase limit**

Twenty-four P-card purchases exceeded the \$2,500 purchase limit in fiscal year 2007. Four of these purchases were acceptable since they were pre-approved by the Office of Fiscal Services and used to purchase textbooks and pay for hotel conferences. However, the remaining 20 purchases that exceeded the \$2,500 limit were for prohibited items such as vacuum cleaner parts, window coverings, travel coupons, and computers.

According to Procurement Circular No. 2003-06 Amendment 1,

Cardholders are prohibited from making single purchase transactions \$2,500 or more unless the purchase is from a price/vendor list. Agencies have the authority to determine the single transaction limits for their cardholders at any lower level as they require.

It does not appear that this dollar limitation is automatically validated when a transaction is made. Furthermore, cardholders appear to be unaware of the transaction limit. None of the individuals who made purchases above \$2,500 provided any explanation or documentation

for these purchases. The department should work with the financial institution to reject any attempted single transaction of \$2,500 or more.

### **P-cards were used to purchase prohibited items**

Purchases for equipment are generally not allowed on P-cards. However, ten of the 24 transactions that exceeded the \$2,500 threshold were for computer equipment. These purchases suggest that the department is not enforcing restrictions on blocked MCCs.

A comprehensive list of restricted MCCs is not readily available to department personnel. As the State Procurement Office explained in its Procurement Circular No. 2003-06 Amendment 1: "All specific types of MCCs that should be blocked are too numerous to be listed in this circular." If the department wants to strictly enforce the disallowed codes, the department should 1) provide a complete list of restricted MCCs to all P-card holders; 2) create a master list of restricted MCCs that applies to all schools and offices; and 3) work with the financial institution to apply vendor restrictions or only allow purchases from pre-approved vendors.

### **P-cards were used by department personnel other than the registered cardholder**

According to the State's Purchasing Card Program and Procedures, P-cards can only be used by the individual whose name appears on the face of the card. The card should not be loaned to another individual for any reason. It is the cardholder's responsibility to ensure that the P-card is returned to the P-card administrator upon termination of employment, transferring of agencies, change in employment that no longer requires a P-card or upon request from the P-card administrator.

During our review of certain single transactions more than \$2,500, we discovered through interviews that some of these purchases were made by an individual other than the registered cardholder. In one case, the registered cardholder had left their director position in July 2006, leaving the P-card with the branch. However, purchases, including transactions of more than \$2,500, were made on this P-card after July 2006 and through October 2006 without the cardholder's knowledge. According to the registered cardholder, someone from this branch must have continued to use the card until a card was issued to the new director. The department Vendor Payment Unit confirmed that it received the paperwork for terminating the card on October 23, 2006, but did not terminate the card until November 16, 2006.

Although P-cards do not affect the individual cardholder's personal credit, cardholders should not allow other individuals to make purchases

under their name. The P-card should have been terminated immediately following the director's departure.

These instances of improper use of P-cards highlight a flawed control system that leaves the department prone to procurement code violations. Under the current controls, violations may not be found until after they take place. The department should implement more proactive detective controls over P-card transactions. The department should take advantage of the customizable controls that are available for P-cards transactions. The department should work with the financial institution to enforce the \$2,500 transaction limit for all cards. Restricted MCCs should be distributed to all employees and strictly enforced to prevent any disallowed purchases before they occur. If any exceptions are made to adjust transaction limits or allow purchasing of restricted MCCs, the department should document the exceptions and have controls in place to ensure that these exceptions are justified and approved.

***Emergency procurements are not properly justified***

Certain circumstances may create an emergency condition that threatens public health, welfare and safety. In an emergency situation, the department must act immediately and must therefore have the authority to purchase the goods and services required to address the emergency. As soon as practicable, a written determination of the basis of the emergency is required to be included in the contract file.

When an emergency situation arises on the Neighbor Islands, the Department of Accounting and General Services (DAGS) has the authority to procure goods and services on behalf of the department. Such authority is granted by the Service Level Agreement between the department and DAGS. Under the agreement, DAGS is responsible for completing the work to abate the emergency, and the department has administrative responsibility, which includes tracking the situation, issuing purchase orders, and receiving/verifying invoices.

We reviewed four emergency purchase orders issued in fiscal year 2007. All four purchase orders appear to relate to an emergency situation. However, upon closer review of the contract files and conversations with DAGS personnel, we discovered possible abuses of using the emergency procurement process to circumvent the competitive procurement process.

**Emergency procurements lack necessary supporting documentation**

Our sample of emergency purchase orders related to events that occurred on the Neighbor Islands, although it was not our intent to only focus on work procured outside O'ahu. Two of the four purchase orders were for construction services at two separate schools where certain buildings

were damaged by the October 2006 earthquake. The governor issued a proclamation to provide relief for the earthquake damage and to ensure the safety of department faculty, staff, and students. The other two purchase orders addressed severe fire damage to buildings and a classroom at two separate schools.

We found that three of the four emergency procurements tested had no supporting documentation (i.e., work orders or scope of work) detailing the work performed. All related purchase orders required the work to be in compliance with the scope of work as described in the work order. In the case where multiple buildings were involved, one work order was requested per building. Through a phone interview, DAGS confirmed that it had not received any work orders from the contractors for the projects in question. Although it may not be practical to be concerned about the proper procurement documentation during an emergency situation, the paperwork and necessary approvals should still be completed as soon as practicable to document the events that occurred, the manner in which the vendor was selected, and the work actually performed. Such documentation reduces the liability to the State and department, holds contractors accountable for their work, and provides transparency on the selection process.

We recommend that the department and DAGS make a more conscious effort to obtain work orders for every purchase order and invoice related to emergency work. Further, DAGS should make an effort to retrieve or create work orders for these three emergency procurements and ensure that only emergency work was performed.

### **Emergency work continued nine months after the emergency occurred**

For one of the schools damaged by the earthquake, the selected contractor was paid \$884,342 between December 18, 2006 and June 18, 2007. According to DAGS, payments continued to be made to the contractor until at least July 2007. Work was performed under the emergency proclamation for nine months after the earthquake occurred.

The initial purchase orders for this emergency procurement were detailed, listing the exact building names and descriptions of the scheduled work. However, about five months after the initial purchase order, the purchase orders became vague, with descriptions such as "Other Repair Work" or "Various Buildings." No work orders were submitted with the invoices. There was also no evidence that the work was monitored to ensure that it still pertained to earthquake-related damage.

Since the emergency repair work occurred over a nine-month period and the detail of the work performed was not provided for the last five months of the project, we question if much of the work was to abate an emergency. Closer examination may reveal that a competitive procurement process may have been warranted, at least for the later stages of work performed. We recommend that DAGS review the services related to the \$884,342 charged to this procurement and ensure that only emergency work was performed.

***Justification for  
exempt procurements  
is not documented***

We reviewed four vendors who were selected through the exempt process and received payment from the department in fiscal year 2007. The support documentation on file for three of the four vendors properly explained the exemption. One of the four vendor files lacked adequate documentation and required us to obtain explanations of the exemption through an interview with a department personnel specialist.

The exempt contract lacking adequate documentation involved a staffing company for special education teachers, dated September 1, 2000, and signed by the former superintendent. The contract stated that it was an agreement for “a procurement expenditure of public funds for goods and services that is otherwise expressly exempt from public bidding,” but no law or regulation was referenced. We reviewed the 18 purchase orders issued in fiscal year 2007 related to this contract and noted that none of these purchase orders made any reference to the law or regulation supporting the exempt status. Total payments made in fiscal year 2007 to this vendor were over \$4 million.

Upon further review of the staffing company's proposal to the department, it became apparent that this contract was initiated based on a June 30, 2000 court order that found the State in contempt of the 1994 Felix Consent Decree. The court had provided the State with a detailed compliance timeline that addressed issues of immediate concern. A department personnel specialist told us that the judge in the 2000 review had granted the superintendent “super powers” that enabled the department to bypass procurement procedures in contracting services resulting from the Felix Consent Decree. According to the personnel specialist, this contract was executed with the staffing company to provide the State with sufficient emergency staff to address court mandates. However, the contract file and related purchase orders do not contain appropriate documentation to provide a background explanation of the use of these “super power” rights. The personnel specialist, who is also the current contract administrator for this contract, learned this information verbally and never received any documentation of the court order.

The original contract term for the staffing company was from September 1, 2000 through August 31, 2003, with three additional one-year extensions contingent on continued funding and the consent of both parties. The contract was extended using all three extensions, creating a modified expiration date of August 31, 2006. However, the Procurement and Contracts Branch was hesitant to extend the contract because the Department of the Attorney General did not review the terms and conditions of the contract. A handwritten note dated September 20, 2004 indicated that there would not be any extensions after the final 12-month period. However, the contract was extended through August 31, 2008.

Procurement and Contracts Branch specialists were concerned that the contract was executed quickly and hastily in order to meet the pressing deadlines set forth by the June 30, 2000 court order. Even though there were provisions to extend the contract, there was still uncertainty because the Department of the Attorney General never reviewed the contract. In addition, the State was released from the Felix Consent Decree as of June 2005, raising the question of whether the exempt status of this contract continued to apply after that date.

There is little to no supporting documentation in the vendor file or on the purchase orders for this exempt contract. This creates a lack of transparency and difficulties for an external reviewer to understand the unique situation for this contract. We recommend that the department research the rulings and regulations released subsequent to the 1994 Felix Consent Decree to determine whether the exempt status for this contract is currently applicable and update the files with adequate documentation or consider terminating the contract as appropriate.

***Sole source procurements lack documentation that negotiations were conducted***

Sole source procurement is allowed when there is only one source for the good or service, the good or service has a unique feature, and the unique feature is essential for the department to meet its objective. However, it is still necessary for the Administrator of School or Office to negotiate with the sole source vendor to determine cost, quality, terms, and delivery. We reviewed the contract file for a computer vendor selected through the sole source process and found no documentation to evidence that the administrator conducted negotiations with the vendor to determine cost, quality, terms, and delivery.

According to the current administrator, the director of the Information Resource Management Branch, the sole source procurement process with the vendor began during the tenure of the previous director. The previous director passed away and did not explain or leave documentation evidencing his contract negotiations with the vendor.



If the department intends to continue contracting with this vendor, the current administrator should begin negotiating cost, quality, terms, and delivery with the vendor for the upcoming contract term. Documents demonstrating the negotiation process should be included in the contract file.

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## Conclusion

The enactment of the Reinventing Education Act of 2004 initiated a comprehensive change in the Department of Education by transferring procurement authority from a centralized state system to the department's control. The department's push for the act's passage was partially motivated by the desire to reduce the bureaucracy involved with capital improvement programs and streamline the process. Following its enactment, the department quickly inherited an enormous responsibility and an expansive system replete with myriad staff, forms, and procedures.

In order to meet the demands of the hundreds of schools statewide, procurement responsibility and authority was hastily delegated to the branch and school levels. However, a formalized procurement process and control system was not established to help ensure that the department was effectively and efficiently carrying out its procurement activities. Monitoring controls over the school and branch levels appear to be inadequate. As a result, there is much confusion among employees and dissent within the department over proper procurement policies and procedures. Procurement violations are thus not uncommon throughout the department, albeit oftentimes inadvertent. In some instances, however, procurement rules were directly violated in an attempt to meet project deadlines or other objectives.

Although the department underwent numerous administrative and procedural changes within a relatively short time period following the enactment of Act 51, it has had ample time since then to at least begin addressing the existing deficiencies with its procurement process. Until a systematic and controlled procurement environment is implemented, there is no reasonable assurance that the department is properly managing its hundreds of millions of dollars in capital improvement and operating funds.

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## Recommendations

The Board of Education and the superintendent of education should take immediate action to strengthen their control environment over procurement.

1. The Board of Education should:
  - a. Adopt a code of ethics and conflicts of interest policy. The department currently has draft guidelines regarding these; however, we have not reviewed these guidelines. The board should review and adopt these, or similar, guidelines and ensure they, at a minimum, incorporate Chapter 84, HRS, Code of Conduct, and Section 3-131-1.02, HAR, Procurement Code of Ethics. The board could also consider developing policies specific to senior management and require all employees to acknowledge understanding of the policies.
  - b. Establish an environment that effectively manages the department's fraud risk that incorporates the principles identified by the previously referenced *Managing the Business Risk of Fraud: A Practical Guide*:
    - i. Establish a fraud risk management program that includes a written policy conveying the expectation of board members, the superintendent, and all other employees.
    - ii. Ensure that the department develops an adequate fraud risk assessment process that would include regular reports submitted to the board. Regarding procurement, these reports could include contract awards and change orders/modifications exceeding a predetermined threshold, total awards/expenditures by procurement method, and violations.
    - iii. Ensure the department has adequate fraud prevention controls (i.e., appropriate segregation of duties, authority/transaction limits) and fraud detection controls (i.e., whistleblower hotlines, appropriate process controls such as reconciliations).
    - iv. Require the department to report on all alleged fraud and reported violations of the code of conduct/ethics, including any disciplinary or corrective actions.
  - c. Consider increasing the authority and responsibilities of the Internal Audit Branch. The Internal Audit Branch should be operationally responsible for the department's risk management program and governance processes (including procurement).

2. The superintendent of education should:
  - a. Design, develop, and operate an effective internal control system based on the Committee of Sponsoring Organizations of the Treadway Commission's published findings in Internal Control-Integrated Framework.
  - b. Ensure that procurement reports are developed and disseminated on a recurring basis for review approval by the superintendent, as well as for the assistant superintendents and applicable managerial employees. These periodic reports should contain relevant procurement information and should be disseminated quickly to be meaningful for monitoring purposes.
  - c. Formalize the existing Guidelines for Procurement and Contracting into enforceable policies and procedures. A formal process for reporting procurement violations, including remedial actions should be incorporated.
  - d. Through the Procurement and Contracts Branch, continue to provide procurement training and tailor the programs to the specific needs of each school and branch. Periodic training should be mandatory for employees having procurement authority, and attendance should be formally tracked. The superintendent should make officers, directors, and managers having procurement authority aware of Section 3-131-1.02, HAR, Procurement Code of Ethics.
  - e. Provide program/project management training to ensure projects are properly planned, budgeted, and administered. A reporting system should be developed to track budget to actual results, with explanations for material discrepancies. This system would track the project through completion and reflect any change orders or modifications.
  - f. Revoke procurement authority over construction contracts that was recently granted to the Office of School Facilities, returning such authority to the Procurement and Contracts Branch.

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# Chapter 3

## Attestation Report on the Department of Education's Internal Controls Over Procurement

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Internal controls are steps instituted by management to ensure that objectives are met and resources are safeguarded. This chapter presents our attestation report on the design and operating effectiveness of internal control over the Department of Education's procurement of goods and services in excess of \$25,000 based on our understanding of the controls and assessment of control risk, and on compliance with applicable laws, regulations and provisions in contract agreements.

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### Attestation Report

We have examined the effectiveness of the State of Hawai'i, Department of Education's ("department") internal controls over compliance with the Hawai'i Public Procurement Code for the procurement of goods and services exceeding the department's small purchase threshold of \$25,000 ("specified requirements") for the fiscal year ended June 30, 2007 based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The department's management is responsible for maintaining effective internal control to provide reasonable assurance that the department complies with the specified requirements. Our responsibility is to express an opinion on the effectiveness of the internal control over compliance with the specified requirements based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included obtaining an understanding of the internal control over compliance, testing and evaluating the design and operating effectiveness of the internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of its inherent limitations, internal control over compliance may not prevent or detect noncompliance. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies and procedures may deteriorate.

A material weakness is a significant deficiency, or combination of significant deficiencies that results in more than a remote likelihood that material noncompliance with the specified requirements will not be prevented or detected. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the department's ability to comply with the specified requirements such that there is more than a remote likelihood that noncompliance with the specified requirements that is more than inconsequential will not be prevented or detected by the department's internal control.

We have identified the following material weakness:

- The department lacks monitoring controls over its internal controls over the specified requirements. Under the criteria developed by COSO, monitoring controls are a required component of an effective internal control system. Without monitoring controls, the department is unable to assess the quality of internal control performance over time.

In addition to the above and findings noted in Chapter 2 of this report, we identified instances of noncompliance with the Hawai'i Revised Statutes:

- Contract files were missing documentation required by Chapters 103D and 103F, Hawai'i Revised Statutes:
  - A competitive sealed bidding contract file, for which there was only one bidder, did not include an "Award of Single Responsive Offeror" form.
  - A contract file did not include a performance or a payment bond, which were both required by the invitation for bids.
  - A contract file did not include a Certificate of Compliance from the Department of Labor or a Certificate of Good Standing from the Department of Commerce and Consumer Affairs.
  - Multiple contract files did not include the certificate of available funds (Form C-41).
  - Multiple professional service contract files did not include documentation listing the selection committee members and evaluation ratings of the offerees, including signatures of the committee members.

In our opinion, because of the effects of the material weakness described above on the achievement of the objective of the control criteria, the

State of Hawai'i, Department of Education has not maintained effective internal control over compliance with the Hawai'i Public Procurement Code over the procurement of goods and services exceeding the department's small purchase threshold of \$25,000 for the fiscal year ended June 30, 2007, based on the criteria established in Internal Control—Integrated Framework established by the Committee of Sponsoring Organizations of the Treadway Commission.

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## Responses of the Affected Agencies

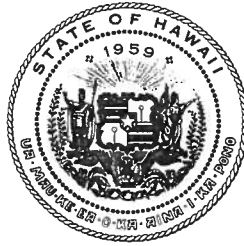
### **Comments on Agency Responses**

We transmitted a draft of this report to the Board of Education and the Department of Education on February 13, 2009. A copy of the transmittal letter to the board is included as Attachment 1. A similar letter was sent to the department. The department provided the only response to the draft. The response is included as Attachment 2.

The department acknowledged independent audits as key components of accountability and public transparency, and generally welcomed our findings and recommendations. In addition, the department described steps already taken to address some of our findings and expressed its commitment to implementing recommendations and adopting best practices to improve the procurement process throughout the department.



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

February 13, 2009

**COPY**

The Honorable Garrett Toguchi, Chair  
Board of Education  
Department of Education  
Queen Lili'uokalani Building  
1390 Miller Street  
Honolulu, Hawaii 96813

Dear Mr. Toguchi:

Enclosed for your information are 14 copies, numbered 6 to 19, of our confidential draft report, *Procurement Audit of the Department of Education: Part 1* and *Procurement Audit of the Department of Education: Part 2*. We ask that you telephone us by Wednesday, February 18, 2009, on whether or not you intend to comment on our recommendations. Please distribute the copies to the members of the board. If you wish your comments to be included in the report, please submit them no later than Monday, February 23, 2009.

The Department of Education, 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,

A handwritten signature in cursive script, appearing to read "Marion M. Higa".

Marion M. Higa  
State Auditor

Enclosures



STATE OF HAWAII  
DEPARTMENT OF EDUCATION  
P.O. BOX 2360  
HONOLULU, HAWAII 96804

OFFICE OF THE SUPERINTENDENT

February 19, 2009

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

RECEIVED

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OFF. OF THE AUDITOR  
STATE OF HAWAII

**RE: Procurement Audit of the Department of Education: Part 1**

Dear Ms. Higa,

Independent audits are a key component of accountability and public transparency for the Department of Education (DOE). This report fulfills my request to your office for an independent evaluation of our internal policies and procurement procedures. It clearly identifies the improvements we need to pursue to ensure that our actions and practices are aligned with Chapter 103D, Hawaii Revised Statutes (HRS), *Hawaii Public Procurement Code* and Chapter 3-120, Hawaii Administrative Rules (HAR).

Effective July 1, 2005, the *Hawaii Reinventing Education Act of 2004*, known as Act 51, allowed the Department of Education (DOE) to implement comprehensive reform in Hawaii's public schools. The numerous benefits derived from this transforming legislation can be reviewed in the attached document.

Act 51 also transferred school facilities construction and repair and maintenance functions from the Department of Accounting and General Services (DAGS) to the DOE. While the DOE already had guidelines for the procurement processes, which have the full effect of policy, DAGS processes were transferred as well.

In 2006, I engaged an external construction management firm to perform "a) a project management evaluation at the one-year anniversary of the DAGS de-linking to the DOE, b) to review the DOE's construction management procedures, and c) to advise the DOE of best practices to make the DOE's programs even more effective." The firm reported no findings of impropriety.

As public servants entrusted with taxpayer funds, independent audits are critical evaluations that improve our accountability. Thus, this procurement audit was requested to provide a more comprehensive examination of our various systems and practices.

Ms. Marion M. Higa, State Auditor  
February 19, 2009  
Page 2

The chief executive sets the "tone at the top" that affects integrity, ethics, and other factors of a positive control environment. DOE employees shall adhere to state procurement law and procedures when conducting and transacting business on behalf of the state, ensuring compliance with the spirit and intent of the procurement code as well as the specifics of the law. In a memo dated February 10, 2009, I rescinded the delegation of authority for construction projects previously given to OSFSS to the Assistant Superintendent of OSFSS.

The audit recommendations to strengthen our control environment are sound. The DOE shall adopt best practices to improve our processes and internal controls, not only in the construction area, but over our entire procurement jurisdiction. We are committed to improving the procurement process throughout the DOE system.

As public servants, we have a professional and moral mandate to increase transparency and raise accountability in our state government. Independent audits of the DOE will remain a standard practice as we strive to improve our services and provide a quality education for all students. Thank you for your efforts and cooperation.

Very truly yours,



Patricia Hamamoto  
Superintendent of Education

PH:JMB

Attachment

## **Act 51: Reinventing Education through Streamlining, Empowerment, and Accountability**

The 2004 Hawaii State Legislature recognized that in order for Hawaii's public schools to provide the educational experiences and outcomes the community expected, the Department of Education (DOE) needed to transform its business model and practices. Act 51 contained a coordinated package of initiatives to streamline operations and school support functions, empower students, principals, and school communities, and improve transparency and accountability system wide.

The passage of Act 51, effective July 1, 2005, prompted a multitude of activities within the DOE as a majority of the 38 initiatives had to be in place by the beginning of school year 2006-2007.

Over the past four years, the transformation of Hawaii's public school system is evident. Education statistics and information are now available and accessible via the DOE website and decision-making processes are more transparent. Student and system performance data makes accountability measurable and is being utilized for system improvement. Consequently, schools are operated more efficiently and better maintained. Most importantly, the results are reflected in increasing test scores and student achievement.

The DOE transformation in the areas of streamlining, empowerment, and accountability are summarized below.

### **Streamlining**

Information Technology. An improved information technology (IT) infrastructure provides student and human resource data for school and system improvement. There is increased training and support for school level users. Expanded IT capacity has allowed over 6,700 students to extend their learning and course credit opportunities through on-line learning.

Single School Calendar. The movement from multiple school calendars to a single school calendar has reduced staff overtime necessary to track employee pay and benefits due to worksite changes by over \$150,000. Routine "back-to-school" training previously delivered multiple times or by "recalling" employees back to work has been substantially streamlined. Time periods covered in bus contracts for student transportation have decreased by four weeks.

Facilities. The number of schools passing facilities inspection has increased to 99.6%. The repair and maintenance backlog was reduced by nearly 50%. Over 90% of emergency requests are responded to within two hours and over 90% of the urgent requests are responded to within 48 hours.

## **Empowerment**

Committee on Weights/Weighted Student Formula. Annually, the Committee on Weights (COW), comprised of principals, teachers, and elected School Community Council (SCC) members review the DOE operating budget. The COW assesses which funds would be better allocated to schools through a Weighted Student Formula (WSF). The WSF distributes funds more equitably to school communities based on student characteristics and needs in comparison to a "one size fits all" staffing allocation. Principals and SCCs develop Academic and Financial Plans (AFP) that outline how the funds will be used to support student achievement, safety and well-being, and civic responsibility.

Staffing and Academic Support. As a result of the increased flexibility given to school communities via WSF and the AFP, there are more school-level teachers and counselors this school year 2008-2009 than in school year 2005-2006. The WSF also allows schools to utilize salaries from unfilled positions to provide additional supports for student learning.

Principals' Academy. The Principals' Academy, required by Act 51, provides formal ongoing training to keep principals abreast of system changes and access to the new knowledge and skills necessary for continuous school and student performance.

## **Accountability**

Decisions by School Principals. Decisions regarding the expenditure of no less than 70% of the DOE operating budget are made by school principals. The DOE regularly provides the Hawaii Board of Education (BOE) and the public with fiscal reports.

Performance Contract. The DOE and the Hawaii Government Employees Association is implementing a performance contract for school principals.

Website Postings. SCC agendas and minutes are physically posted at schools and are electronically available to the public. School Academic and Financial Plans and Quarterly Progress Reports are also made available to the greater public through the School Documents On Line website (<http://doe.k12.hi.us/myschool>).

Accountability Website. The DOE makes available to the public through its Accountability Resource Center Hawaii website (<http://arch.k12.hi.us>) a wide variety of school performance information spanning the last eight years. The reports include information on student achievement, safety and well-being, and civic responsibility as well as staff and fiscal facts.