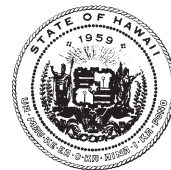

Procurement Audit of the Department of Education: Part 2

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

Report No. 09-04
February 2009



THE AUDITOR
STATE OF HAWAI'I

Office of the Auditor

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

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

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

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



THE AUDITOR

STATE OF HAWAII

Kekuanao'a Building

465 S. King Street, Room 500

Honolulu, Hawai'i 96813

OVERVIEW

Procurement Audit of the Department of Education: Part 2

Report No. 09-04, 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 process, 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 initial phase of our audit uncovered numerous reportable findings and deficiencies in the department's leadership and oversight related to its procurement process. We also identified a material weakness involving the department's lack of monitoring of internal controls over compliance with procurement requirements. These results are presented in Report No. 09-03, *Procurement Audit of the Department of Education: Part 1*.

Given the high volume of violations and the identification of several risk factors and fraud indicators in the initial phase of work, we were compelled to expand the scope of our audit. As part of our expanded work, we reviewed department emails and detailed project files to better understand the decisions made and actions taken with respect to select contracts. We also interviewed numerous department employees to gain further insight into the specific facts and circumstances surrounding each contract. The results of the additional work performed are presented in this second report.

The second phase of our audit revealed an organizational culture of disregard for procurement rules in the Office of School Facilities and Support Services (formerly known as the Office of Business Services and referred to herein as the "Office of School Facilities"). That culture has allowed office directors, managers, and staff to believe they have the discretion to unilaterally determine whether compliance with procurement laws and rules is in the best interest of the department.

We encountered numerous instances of department personnel manipulating the professional services selection process and awarding contracts to predetermined consultants. For instance, for a \$300,000 construction management project selection, the Project Control Section head bypassed established procedures by hand-picking the selection committee members and recommending a specific firm. The public works administrator then led the committee as its chair, documented the results selecting the recommended firm, addressed the results to himself as public works administrator, and approved the results on behalf of the branch.



We discovered several other alarming practices within the Office of School Facilities that appeared to be fraudulent and unethical. In one example, a high-ranking department official instructed a consultant to hire a specific sub-consultant in exchange for additional contract funding, thereby evading the competitive procurement process. The sub-consultant, who has close ties with the department, performed work under a department program that was unrelated to the contract's scope. Another inappropriate action involved selection committee members agreeing via email to change a prior selection decision to award the project to a vendor who was previously unranked, but had been improperly allowed to begin work on the project. The committee then falsified the selection documents to reflect the modified decision as the original selection.

The Office of School Facilities' regular outsourcing of large-dollar program and construction management contracts appears to be inefficient and wasteful. A key example is the most recent phase of the department's Whole School Classroom Renovation Program, which was appropriated \$160 million in 2006 to renovate 96 schools. The department has executed four management contracts totaling \$20,964,000 to oversee and manage the \$160 million. The management contracts outsource basic management functions that should be performed in-house, including responsibility for overseeing, evaluating, and negotiating with other vendors. On top of the inherent conflicts of interest, the poorly planned and structured contracts also lacked competition and had the potential for abuse. For example, a project management consultant assisted the department in procuring these significant management contracts while simultaneously competing for some of the work, and ultimately was awarded a related \$2.4 million program management contract.

The inappropriate procurement practices and culture of disregard in the Office of School Facilities are the indirect result of the lax tone from department leadership and the resulting weak environment, discussed in detail in the first report. In addition, the assistant superintendent of the Office of School Facilities perpetuates the culture by demonstrating to his staff that compliance with procurement rules is secondary to getting the job done.

Recommendations and Response

In addition to the recommendations to improve the department's leadership and oversight of its procurement process, we recommended that the department conduct detailed investigations into the specific procurement violations, and the outsourcing of program and construction management services, cited in this report and take appropriate and visible action.

The department generally welcomed our recommendations, described steps already taken to address some of our findings, and expressed its commitment to adopting procurement best practices.

Marion M. Higa
State Auditor
State of Hawai'i

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Procurement Audit of the Department of Education: Part 2

A Report to the
Governor
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the State of
Hawai'i

Conducted by

The Auditor
State of Hawai'i
and
Grant Thornton LLP

Submitted by

THE AUDITOR
STATE OF HAWAI'I

Report No. 09-04
February 2009

Foreword

This is the second 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

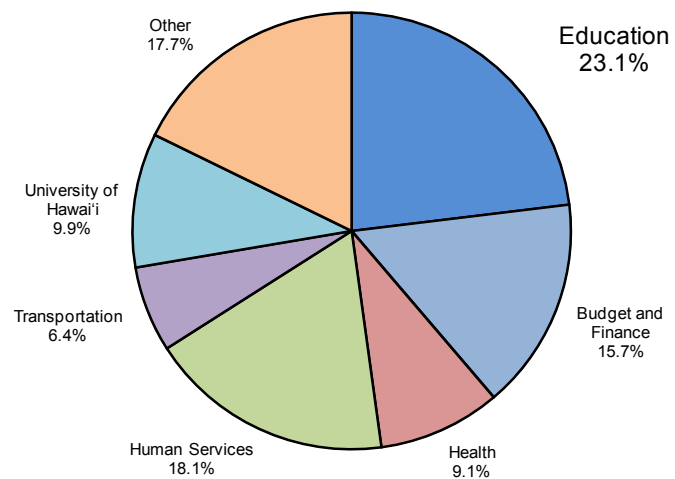
Introduction

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.

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:

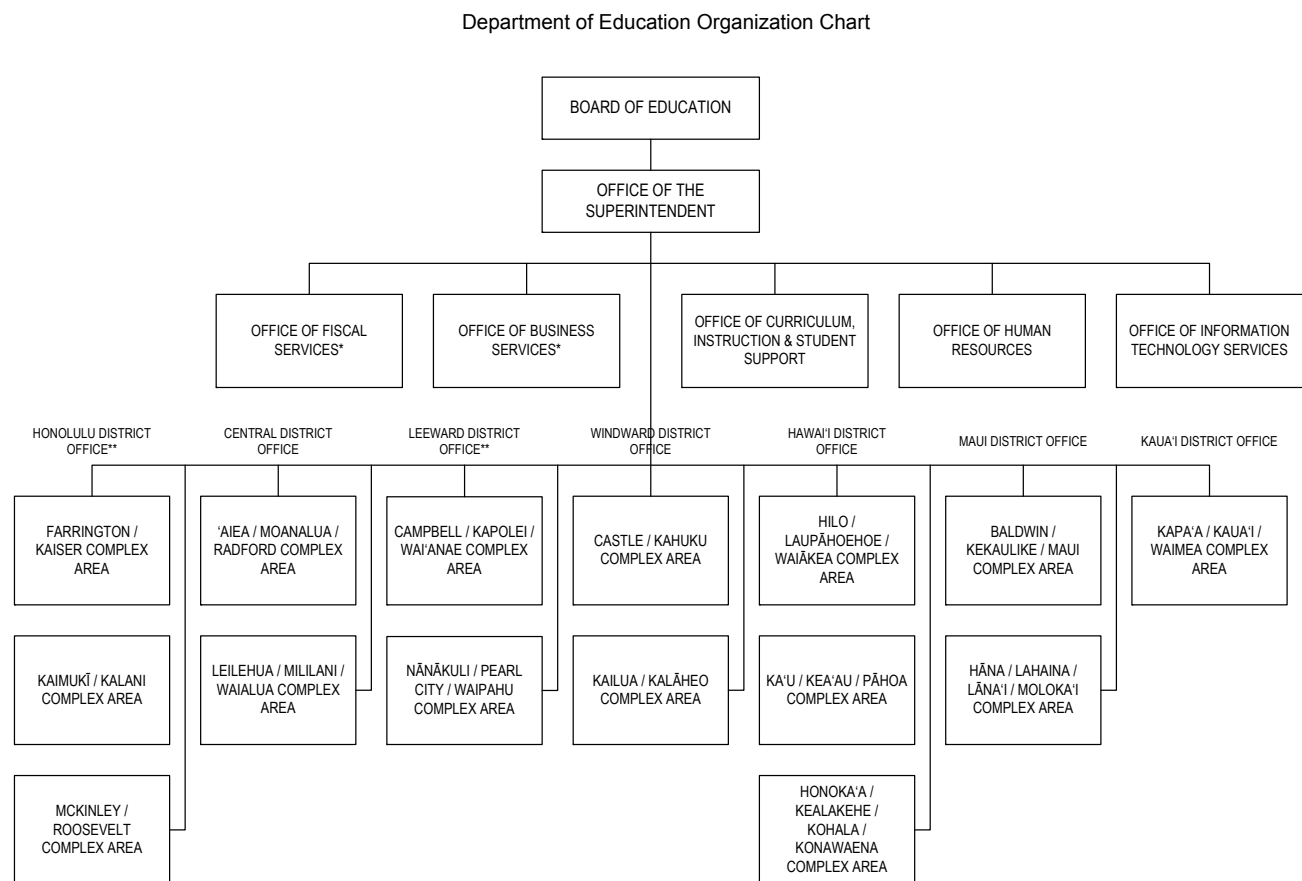
1. **Office of Business Services (currently the Office of School Facilities and Support Services).** Provides administrative, fiscal, and logistical services and programs.
2. **Office of Curriculum, Instruction and Student Support.** Provides leadership in standards-based curriculum and instruction, 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**



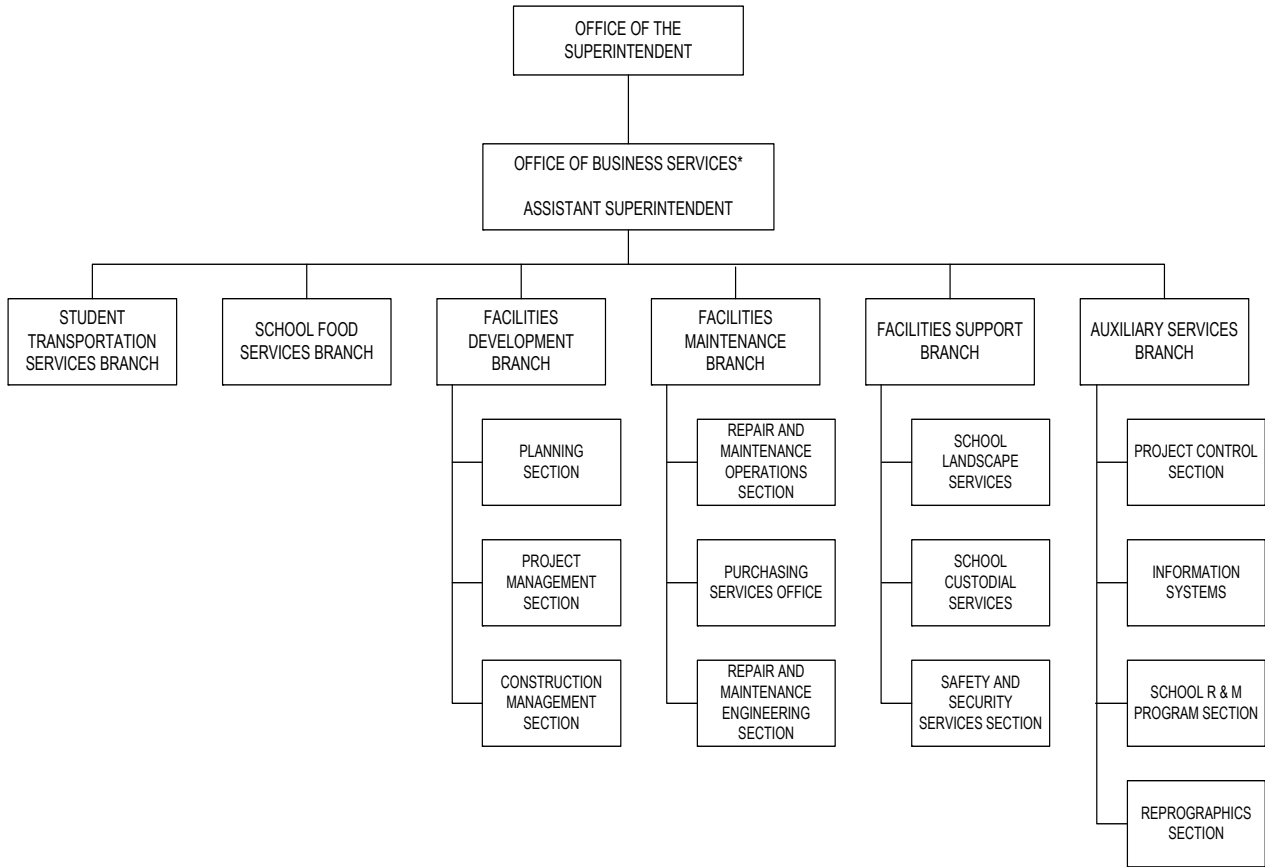
*See Expanded Office Organization Chart. Note: The Board of Education approved the renaming of the Office of Business Services to Office of School Facilities and Support Services at its October 18, 2007 meeting.

**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

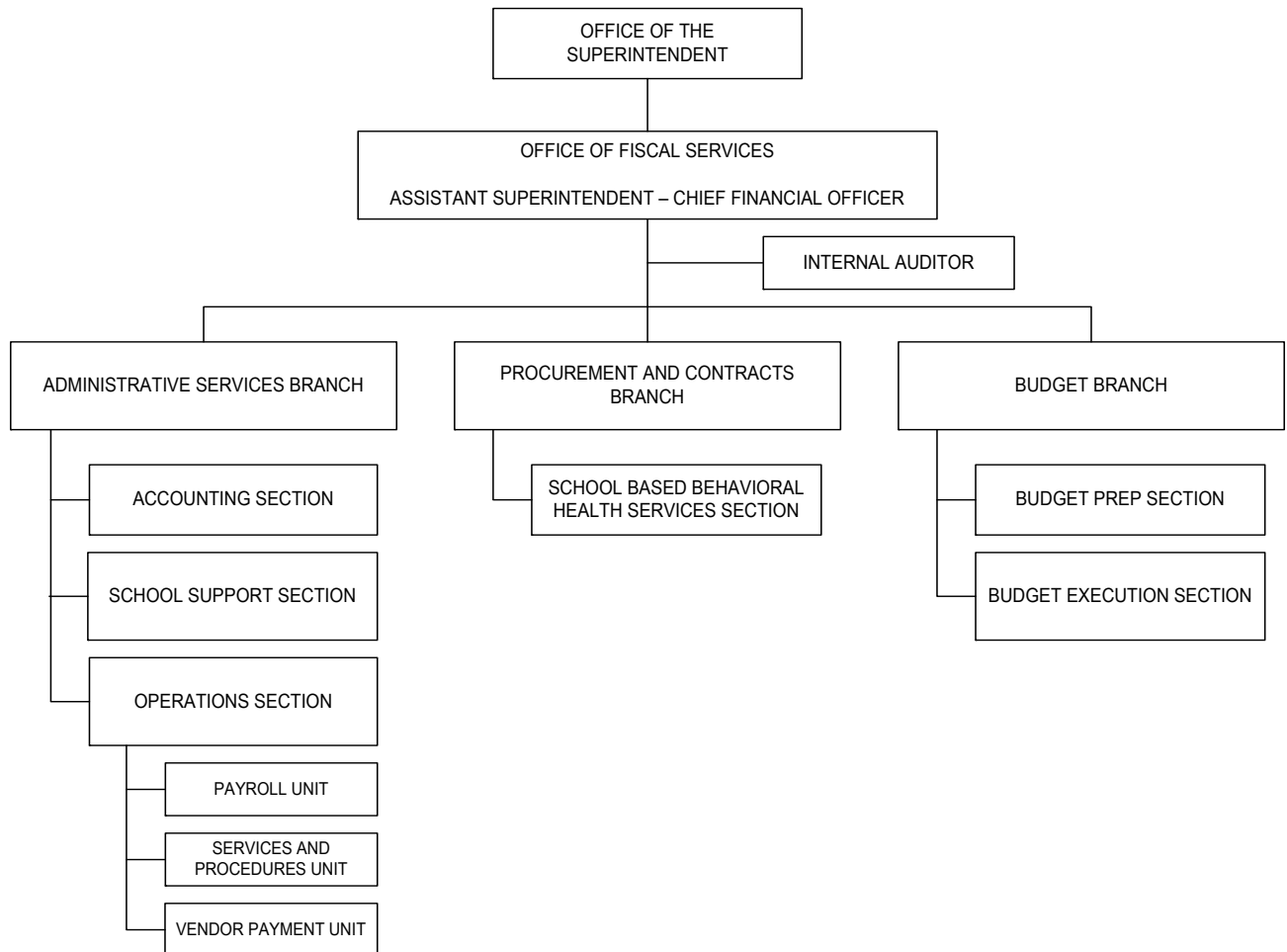


*The Board of Education approved the renaming of the Office of Business Services to Office of School Facilities and Support Services at its October 18, 2007 meeting.

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 2008 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.

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.

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:

Procurement Type	Sample Size
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 the first 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 this 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.

Chapter 2

Without Proper Leadership, Procurement Waste and Abuse Are Prevalent in the Office of School Facilities

The passage of Act 51, Session Laws of Hawai‘i 2004, 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. 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. As discussed in our first report, the department lacks the appropriate mechanisms and functions to monitor procurement and ensure compliance with appropriate rules and procedures, resulting in numerous instances of non-compliance and procurement violations. Of greater concern, however, was the presence of an organizational culture that has fostered a disregard for procurement laws in the Office of School Facilities and Support Services (formerly known as the Office of Business Services and hereinafter referred to as the “Office of School Facilities”) and provided opportunities for unethical and potentially fraudulent behavior.

Summary of Findings

1. The lack of emphasis on compliance has fueled inappropriate procurement practices in the Office of School Facilities.
2. The outsourcing of program and construction management services has led to waste, abuse, and improper consultant relationships.
3. The lax environment and leadership void has provided both opportunity and incentive for procurement abuses.

The Lack of Emphasis on Compliance Has Fueled Inappropriate Procurement Practices in the Office of School Facilities

The Office of School Facilities has the daunting responsibility of planning and directing the department's capital improvement, repair and maintenance, and other project-related funds, which had a total budget of \$170 million in fiscal year 2007. The Office of School Facilities faces external pressure from the public to quickly and effectively repair the hundreds of school facilities and classrooms that have fallen into disrepair over the decades. There are also numerous internal pressures, which arise from limited resources such as understaffing and budget restrictions. The Office of School Facilities must balance these pressures with carrying out its duty in accordance with the procurement laws and regulations designed to ensure open and fair competition and maximize the value received in spending taxpayer dollars.

During our initial scope of audit fieldwork, we encountered an alarming number of procurement violations in the Office of School Facilities, as well as several risk factors and indications of fraud. As a result, we expanded our efforts by reviewing related department emails and detailed project files in an attempt to better understand the procurement-related decisions and actions. These documents revealed numerous potential instances of disregard for procurement laws, including falsifying supporting documentation, overriding internal controls, ignoring rules and policies, and committing potential fraud. We focused our attention on six specific issues, three of which involved department personnel manipulating the contractor selection process, signaling a severe lack of ethics. The three other issues were even more serious, involving potential procurement fraud and falsification of documents.

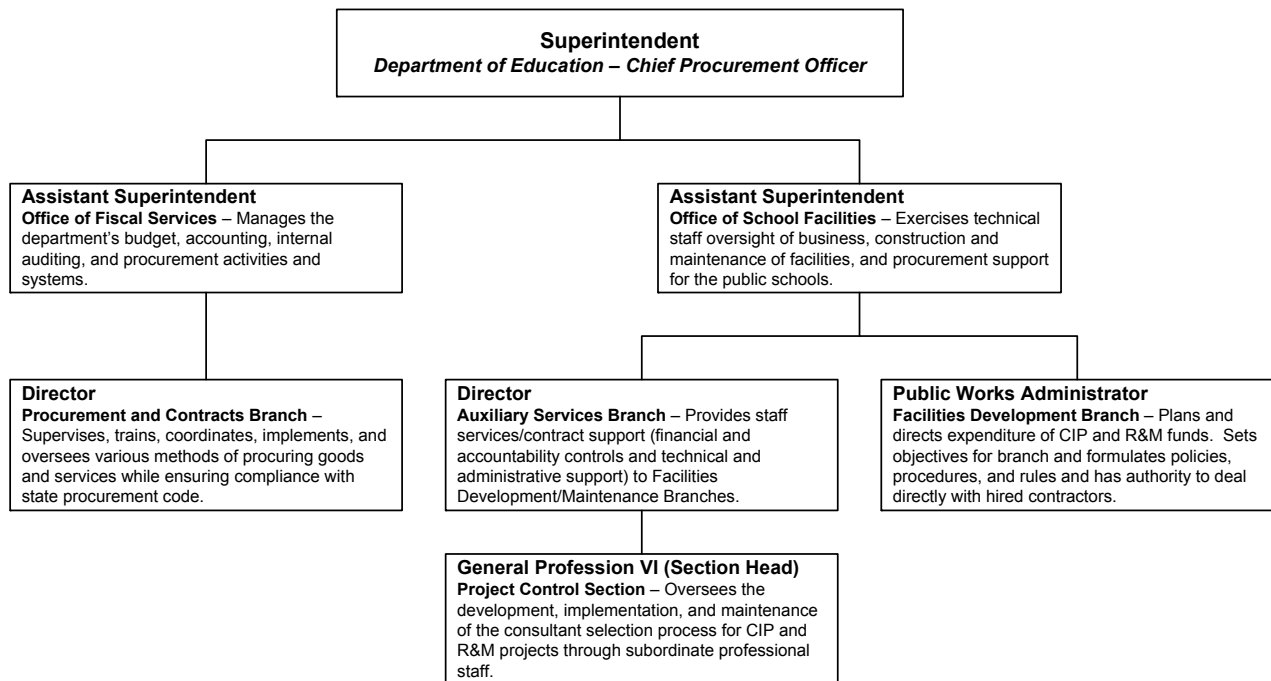
Procurement actions and decisions by the Office of School Facilities personnel raise serious ethical concerns

The Office of School Facilities is responsible for procuring professional services (engineers, architects, surveyors, etc.) under the procurement of professional services method governed by Section 103D-304, HRS. Although general oversight over the department's procurement process has been delegated to the Procurement and Contracts Branch within the Office of Fiscal Services, the Office of School Facilities has been granted

an exemption from the standard departmental process, which limits the Procurement and Contracts Branch’s involvement in the Office of School Facilities contracting process. Thus, in procuring professional services related to its construction, repair and maintenance, and other capital projects, the Office of School Facilities has more flexibility in the selection, award, and negotiation of its contracts because of less monitoring by the Procurement and Contracts Branch.

The following diagram (Exhibit 2.1) provides an overview of the primary units and personnel involved in the procurement of professional services for Office of School Facilities contracts:

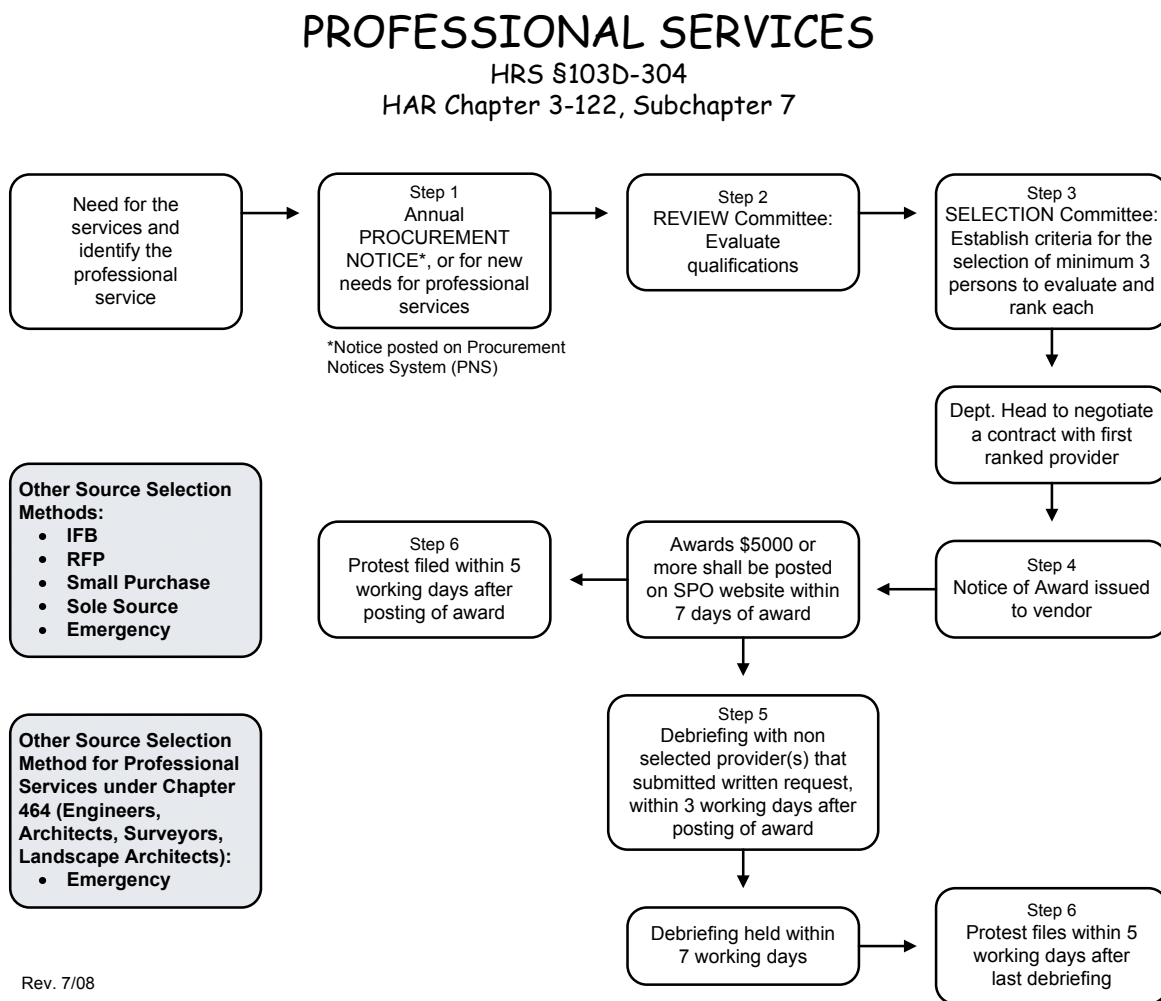
Exhibit 2.1
Department of Education–Professional Services Procurement Organization Chart



Source: Adapted from Department of Education functional statements and respective position descriptions

Contracts procured under the professional services method should be awarded on the basis of demonstrated competence and qualification, and at fair and reasonable prices. Review and selection committees, consisting of at least three independent members, are utilized to promote fair competition and best value for the State. However, when directors, managers, and staff feel empowered to unilaterally determine the best interest of the department, regardless of laws, rules, and established procedures, all intended benefits of the process are lost. Our audit uncovered several abuses of the professional services selection process, many of which involved improper actions by all department personnel involved, including branch directors and section heads.

Exhibit 2.2
Professional Services Method – Selection Process



Source: Hawai'i State Procurement Office's website

Solicitation and selection process manipulated to award contract to predetermined contractor

The selection of a \$300,000 construction management contract was predetermined to be awarded to an engineering firm where a former department assistant superintendent was employed in a high-ranking position. The process was subsequently manipulated to give the impression of a fair and competitive selection.

A project coordinator overseeing construction projects at two schools (Wilson Elementary and ‘Anuenue Elementary) left the department. The department needed to assign a construction manager to these projects since construction was already 25 percent complete, so it attempted to modify an existing contract with an engineering firm that had been hired to provide similar services to other schools in the district. When a department official raised concerns that the attempted modification was not within the department’s procurement process, his supervisor (the Project Control Section head) replied in a February 2, 2006 email: “I am not so inclined to work within a process, since the process is currently a moving target.”

Nonetheless, fearing opposition from the Procurement and Contracts Branch, the Auxiliary Services and the Facilities Development Branches decided to go through a competitive selection process to award the construction management services for these two schools. However, emails and interviews indicate that the Project Control Section head hand-picked the selection committee members, which included the public works administrator. The Project Control Section head also recommended awarding the contract to the previously specified engineering firm. On April 23, 2006, the engineering firm was awarded the contract for \$300,000.

The hand-picking of selection committee members by the Project Control Section head is not an accepted practice. Under normal procedures, the selection committee coordinator has the responsibility to fill the committee seats. In this situation, it appears the Project Control Section head deliberately circumvented the normal selection committee process to obtain a specific outcome and to avoid any confrontation with Procurement and Contracts Branch officials.

The public works administrator, who was one of three members on this selection committee, leads the Facilities Development Branch and is responsible for approving all professional services selections. As the selection committee chair, he signed and approved the selection results on behalf of the committee, then addressed the selection results to himself as the public works administrator for branch approval. Given his influential position within the department, the public works

administrator's presence on a committee of only three members had the potential to create an unbalanced and biased discussion.

Interviews with the other two committee members revealed that they relied on, and deferred to, the opinion of the public works administrator, whom they trust. Even putting aside the possible inappropriateness of the public works administrator sitting on a selection committee, he should not have then approved the selection made by the committee. That should have been done by the assistant superintendent or another department director or manager. In this situation, the public works administrator sat on the selection committee, directed the meeting, signed the selection results memo, addressed the memo to himself, and reviewed and approved the selection results. Additionally, the engineering firm that was awarded the contract employs a former department assistant superintendent of the Office of School Facilities, who had supervised both the current Project Control Section head and public works administrator.

Section 84-15, HRS, *Standards of Conduct*, specifically precludes the department from entering into a contract with a business that has been assisted by a person employed by the department within the two preceding years and who participated while employed in the matter with which the contract is directly concerned. The former assistant superintendent left the department during December 2005, and emails show that she was employed by the engineering firm and involved in March and April 2006 discussions between the engineering firm and the department leading up to the April 23, 2006 contract award. Further, the former assistant superintendent was listed as the department's contact person for the September 13, 2005 award of the existing contract with the engineering firm to which the department initially attempted to add the two projects via modification.

Selected contractor given unfair advantage due to improper communications and apparent bias

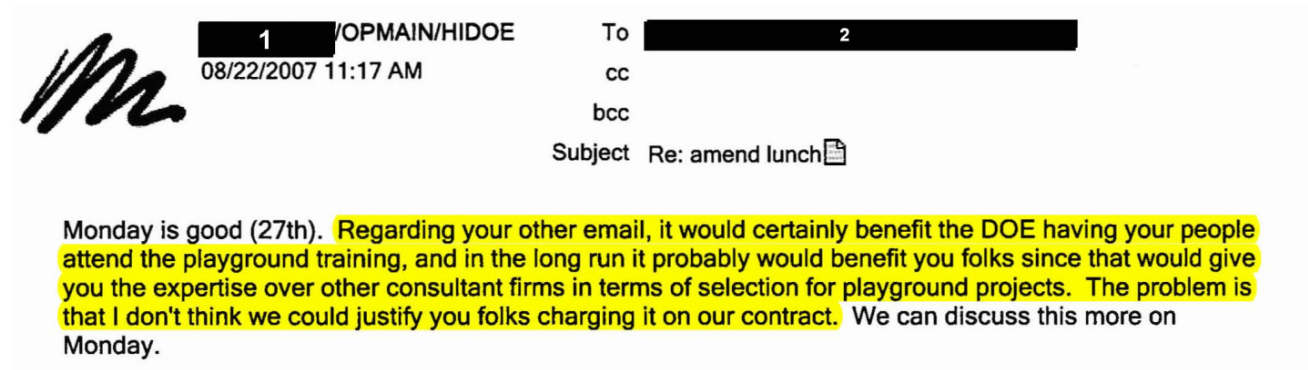
On May 24, 2007, a seven-member selection committee, which included the Auxiliary Services Branch administrator, selected an engineering firm to provide construction management services for various playground equipment projects across the state. The selected firm was the same company discussed above that employed a former department assistant superintendent in a high-ranking position.

Contract negotiations and discussions were conducted between the department and the engineering firm in June through September 2007. The former assistant superintendent was directly involved in these discussions on behalf of the selected firm. In one email exchange regarding the project's scope and budget, the former assistant

superintendent advised the Auxiliary Services Branch administrator on how to manage the project, stating: “Do you have a budget—you may want to give out tasks with some sort of budget (time for each person and \$) in mind so that you can control the work.” In a subsequent email, as shown in Exhibit 2.3, the Auxiliary Services Branch administrator appears to inform the former assistant superintendent that obtaining the required playground training could give the firm a procurement advantage over other firms:

Exhibit 2.3

Email from Auxiliary Services Branch Administrator to Former Assistant Superintendent Employed at Selected Firm



Legend:

1 = Auxiliary Services Branch administrator

2 = Former Assistant Superintendent-Office of School Facilities / Officer at selected firm

Source: Department of Education

As previously noted, both the public works administrator and Auxiliary Services Branch administrator were subordinates of the former assistant superintendent while she was employed with the department. The engineering firm submitted its fee proposal for the project in September 2007. However, the award was abruptly rescinded on September 27, 2007; the reason for the rescission is unclear.

During our interviews, key personnel involved with the project stated that the rescission was due to department personnel questioning the qualifications of the selected firm and of the committee members. Documents indicate that the May 2007 selection was made using an old (2005) list of eligible consultants rather than the then-current list, which was available at the time. Further, the selected firm was not on the then-current list of consultants eligible to perform the type of work required for the project.

A second selection committee was convened the same day of the award rescission, using an updated list of eligible consultants that included the previously selected firm. The same engineering firm was again selected for the project. During interviews with members of the second selection committee, almost all indicated that the firm was selected because it was planning to send two of its employees to obtain the required playground training and certification. However, this reasoning was not reflected in the selection minutes and documentation submitted to the Procurement and Contracts Branch. In fact, the documented reasons for selecting the firm were not only vague and ambiguous, but were also almost identical to the stated reasons for selecting the firm in May 2007 (as were the stated reasons for ranking the second and third firms in each case). In addition, no explanation was provided for the May 2007 award and its abrupt termination.

Upon reviewing the submitted documentation, the procurement branch identified errors and deficiencies in the documentation and raised concerns regarding the way the selection was conducted. The branch specifically noted that awarding the contract to the selected firm was not justified by the documentation. In light of the numerous issues, the procurement branch was compelled to hold the processing of the contract. As of June 2008, the last time we conducted our interviews for this matter, a contract for this project has not been executed. Given the extent of bias and inappropriate conduct displayed in this situation, we recommend the department investigate the specific actions of those involved with the selection and award of this project.

Recently awarded study contract displays apparent lapses in ethics and judgment

In February 2007, the Auxiliary Services Branch initiated the process to procure professional services to develop a Request-for-Proposals for a facilities asset management (FAM) system. During May 2007, the department issued the “Notice to Providers of Professional Services,” which is the first notice to the public of the project requirements and provides instructions for submitting expressions of interest. However, during the two preceding months (March and April 2007), department personnel conducted a series of inappropriate meetings with the vendor that was ultimately awarded the contract.

The public works administrator met with the president of this particular vendor during March 2007, then arranged a series of meetings between that vendor and at least three Office of School Facilities branch and section heads during April 2007. The public works administrator and one of the attending branch heads claim that these meetings were for a separate upcoming project. However, they both explained that the purpose of these meetings was to provide the vendor with descriptions

of the department's facilities development and maintenance workflows and processes, including how they interact with any existing facilities management systems. These descriptions are virtually identical to the scope of the contract under question—the first task under the scope of the final contract includes “identifying and documenting the business and work process framework for the existing FAM environment within the department's Facilities Development Branch and Auxiliary Services Branch.” Additionally, the other two branch/section heads in attendance clearly understood that these meetings were directly related to the upcoming FAM requirements study project.

On June 21, 2007, the review and selection committee met and awarded the contract to the vendor that had been meeting with department personnel. Highlighting the advantage given to that vendor, one committee member (who appeared to have been unaware of the pre-proposal meetings) recalled that the difference between the awarded vendor's proposal and the other two offerors' was “striking.” Not surprisingly, the awarded vendor proposal displayed a much better understanding of the department's operations and processes.

During June through September 2007, the department engaged in negotiations with the awarded vendor. When the vendor submitted its final proposal on September 16, 2007, it asked the public works administrator and the Auxiliary Services Branch administrator for permission to start work by scheduling meetings and field interviews with department employees, in order to meet project deadlines. Although the contract had not been executed, both the public works administrator and the Auxiliary Services Branch administrator sent emails to the vendor authorizing the work to begin and providing instructions to their staff to coordinate and cooperate.

In a separate email dated October 6, 2007, the Auxiliary Services Branch administrator provided instructions for his staff to cooperate with the vendor, stating:

[P]eople, we've hired [vendor] to develop our Facilities Asset Management system requirements. Part of their scope of work is to determine the work flow within the Office of School Facilities as it interfaces with our facilities constructions and maintenance.

Accordingly, the vendor conducted numerous interviews and meetings with department staff related to the project during October 2007—approximately six months before the contract was executed in April 2008.

In November 2007, upon learning that work started without an executed contract, the Procurement and Contracts Branch advised the Project Control Section head to complete a Procurement Violation form and to

notify the vendor to stop work immediately. As shown in Exhibit 2.4, the Project Control Section head acknowledged the Procurement and Contracts Branch's instructions but also emailed the Auxiliary Services Branch administrator on November 18, 2007, expressing dismay that it may take four to six more weeks to execute a contract and proposing that the vendor continue work under the contract offsite.

Exhibit 2.4

Email from Project Control Section Head to Auxiliary Services Branch Administrator

Anyway, in order for **1** to help us, she needs the info below and a letter to **2** telling him to stop. Also, an amount of work up to know, which would be a violation. The part I don't like is that it's going to take 4-6 weeks to get a contract executed. Of course, **2** could continue but we would have to meet outside of state facilities? I have only Monday, then off for a week. I can write the stuff **1** wants and a letter to **2**. However, you would need to explain to **2** or **3**? Let me know where we go with this. For now, I am following what **1** is recommending.

Legend:

1 = Contract Specialist, Procurement and Contracts Branch

2 = Consultant

3 = Assistant Superintendent, Office of School Facilities

Source: Department of Education

During follow-up interviews, the Project Control Section head explained that this was just an emotional reaction and "probably inappropriate to write in an email." We were informed that no work was conducted after the vendor was requested to stop.

Since the vendor had incurred \$100,325 worth of work through November 2007, the department's project managers had to complete a Procurement Violation form in order for the vendor to get paid without an executed contract. The form, which was prepared by the Project Control Section head and certified by the Auxiliary Services Branch administrator on December 3, 2007, stated that:

...it should be clarified that the program did not issue any form of written or verbal notice to proceed. The actions of the consultant were strictly voluntary, although the program did provide meeting locations, staff time to answer questions, and resource materials.

This is a clear misstatement of the facts as evidenced by the email exchanges noted above, which we confirmed through interviews with the respective department personnel involved.

On April 18, 2008, a \$325,000 contract was executed for this project. Three days later, the vendor submitted a \$100,325 invoice dated December 11, 2007, for “work completed to date,” which was subsequently paid by the department.

***Office of School
Facilities personnel
engaged in apparent
fraudulent and illegal
acts***

We discovered disturbing practices within the Office of School Facilities that may be fraudulent and illegal. Documents show that department employees have instructed contracted vendors to hire specific subcontractors, who had close ties to the department, to perform work apparently unrelated to the scope of services of the contract. The work of the subcontractors was paid by the original contracted vendor but ultimately billed to the department. Another practice involved department employees agreeing to override proper procurement decisions and falsify official department records. In a third practice, Office of School Facilities employees admitted requesting contracted vendors to bill for work not yet performed to avoid losing the funds for the project. In this case, department employees sign off that the work has been performed in order to obtain the final check, then hold the check until the work is actually completed.

Subcontractors are used to evade the procurement process

On February 4, 2005, the department awarded and executed a contract for Project Management and Technical Assistance on Repairs & Maintenance and Capital Improvement Projects in the amount of \$600,000. However, in the months prior to this award, a former assistant superintendent of the Office of School Facilities violated state procurement laws by instructing the construction consultant to hire a specific sub-consultant to perform work directly for the department and unrelated to the contract. This email discussion is reflected in Exhibit 2.5.

Exhibit 2.5

Email from Former Assistant Superintendent/Office of School Facilities to Consultant

I want to hire **1** to advise on labor issues but also work on measures and benchmarks for CSD operations and the neighbor islands. Further, I want to have him make sure internal controls are in place at CSD (given the **2** debacle).
Would you sub him for me at the same \$85 per hour pay rate that we're paying you? I'll add another \$100,000 to your contract from operating funds.

Legend:

1 = Sub-consultant

2 = Unknown reference

Source: Department of Education

The construction consultant agreed, but because the contract was already being reviewed by the Department of the Attorney General, the former assistant superintendent decided to add the sub-contractor through a contract modification. In a January 19, 2005 email, reflected in Exhibit 2.6, the former assistant superintendent explained the situation to the construction consultant, noting that the contract's vague scope would allow the modification.

Exhibit 2.6

Email from Former Assistant Superintendent/Office of School Facilities to Consultant and Sub-consultant

1 contract is at the AG for review. 1, I didn't stop it in time to add the \$100,000 for 2. I talked to 3 and he says we can just do a modification, which would not need to go to AG. I would rather let the contract go thru the AG and get it completed as is asap. I don't plan to add scope, just the additional money, as the current (very broad) scope should cover it and I will get charged by the hour.

Legend:

1 = Consultant

2 = Sub-consultant

3 = Then-Head of Procurement and Contracts Branch

Source: Department of Education

On February 5, 2005, one day after its execution, the contract was modified to add \$100,000 and to allow the construction consultant to designate any other individuals to charge for work at the highest allowable rate. No justification was given for this modification, which was approved by the Procurement and Contracts Branch administrator, who reported directly to the former assistant superintendent at that time. Although the invoices submitted by the construction consultant were vague, providing no details of the work performed, we were able to determine that the sub-consultant was paid \$17,100 under the contract during February through June 2005.

Interestingly, a second sub-consultant was paid the bulk of the funds under the \$100,000 modification (\$85,310) during the period of June 2005 through June 2006. Only one invoice during this period contained a description of the services performed by the second sub-consultant—*providing consultative services to ASAs and schools regarding Restroom Cleaning and Restoration Project.*

We confirmed through interviews and reviews of related documents and emails that this individual is a former public school principal, with

no construction experience. She was also hired by the construction consultant at the instruction of the former assistant superintendent to perform work directly for the department. Both the current Auxiliary Services Branch administrator and public works administrator acknowledged that they were aware of, and approved of, the actions of the former assistant superintendent. We noted that the former principal was employed or contracted by the department in a variety of other ways, including being hired as a sub-consultant with a \$100,000 allowance to perform similar services under a separate project management contract that is currently in progress.

The file for the \$600,000 contract was missing most procurement-related documents. The invoices submitted by the construction consultant for the first year of the contract were just as vague as the contract scope. However, we noted three other possible abusive situations involving individuals that were paid under this contract. The first individual was paid \$65 per hour to provide fire security inspection services while providing similar services under another contract with the department. Two other individuals provided clerical services at \$22 per hour. One of these individuals was married to the head of the Construction Management Section at that time, and both processed other contractor invoices for the department while housed in the department's facilities and while provided with security badges and network email accounts. These services appear to be the direct responsibilities of the department, yet the department has not provided a reasonable explanation for outsourcing these services.

Having the two functions of contract solicitation/award and contract execution/approval report to the same assistant superintendent allowed that official to direct and control the entire contracting process for the Office of School Facilities. Through recent reorganizations, these functions now report to separate assistant superintendents, providing added control by segregating the duties. However, as discussed in detail later in this chapter, these functions with respect to construction contracts have been recently consolidated back under the assistant superintendent of the Office of School Facilities.

The actions noted above are possible instances of procurement fraud, committed by department personnel and the construction consultant, and may be subject to civil and criminal penalties as defined by Section 3-131-4, HAR. We recommend the department perform a detailed investigation of this contract and the related use of sub-consultants. Furthermore, the department should develop contracts with specific and detailed scope of work to avoid any potential abuse of state funds. The superintendent should also reconsider the consolidation of procurement authority of constructions contracts under a single assistant superintendent.

Selection changed after-the-fact to award contract to a firm that had almost completed work

In January 2007, the department engaged a contractor to provide \$25,000 of architectural and engineering design services to replace air conditioning equipment at a school library. The air conditioning equipment was located on the library roof. The contract file showed that the contractor's previous site investigation discovered that the roof was in need of repairs. The design work for the roof was scheduled to be conducted at a later date and competitively bid as a separate contract. However, after reviewing emails and conducting interviews, we found that with the approval of department supervisors, the project coordinator decided to combine the design work for the roof with the original air conditioning contract.

The decision was based on potential cost savings of having one contractor perform both design services and the assumption that the roof required repairs to support the air conditioning equipment. On December 18, 2006, the project coordinator emailed the air conditioning design contractor and instructed him to proceed with the design work for the roof, promising to issue a contract modification to include the added services.

When the project coordinator attempted to develop the contract modification, the Procurement and Contracts Branch rejected the modification, noting the roof design work was out of scope from the original contract and was slated to be procured separately. The project coordinator was instructed to conduct a professional services selection to procure the roof design under a separate contract.

In strategizing how to proceed, the project control section head stated to the public works administrator and another staff member in a May 12, 2007 email that: "Our alternatives are to: a) Add the additional reroof in and PCB say no, or b) Make another selection for the same firm and proceed." Ultimately, the decision was made to perform a selection for a separate contract because it would be the "cleanest" approach. The contract file reflects that a legitimate selection was conducted on May 18, 2007 to award the roof design to the same firm conducting the air conditioning design. However, after reviewing department emails and interviewing department staff, we found that the entire process and related documents were manipulated.

Department emails show that a five-member selection committee did convene on May 18, 2007. However, the resulting ranking of the top-three firms did not include the firm that was ultimately awarded the contract. On May 21, 2007, one of the committee members emailed the rest of the committee requesting that the firm contracted to perform the

air conditioning design work—which had been previously unranked—be added as the top-ranked firm because that firm had already completed 95 percent of the roof design work. All the committee members agreed via email without questioning the change or reconvening the committee. The additional award was worth \$22,000.

No evidence of the initial ranking is found in the contract file and the true reason for selecting the awarded firm is not documented anywhere. The “Project Ranking Sheet” in the file, dated May 18, 2007, and signed by each of the committee members appears to be a falsification. During interviews, the project coordinator denied authorizing the contractor to begin work on the roof design without a contract, and some of the committee members denied the initial ranking, until presented with email evidence. Alarming, even after being presented with the email evidence, no one involved expressed regret or believed that anything wrong had been done. They each felt that while procedures may not have been followed, their actions were justified as they had the school’s best interest in mind and, ultimately, they believed their approach would have saved time and money. Clearly, the deceptive approach taken did not accomplish this goal as the project had yet to be “awarded” at the time of our interviews during June 2008—over a year after the initial selection.

Based on the procedures used by Office of School Facilities personnel in attempting to procure this project, it appears the blatant disregard for procurement rules has trickled down to the staff levels, empowering them to circumvent rules and manipulate processes and documents whenever they determine it is in the department’s best interest to do so. This situation also highlights the conflict that has arisen between the Auxiliary Services and Facilities Development Branches, which initiate projects and conduct vendor selections, and the Procurement and Contracts Branch, which reviews procurements for compliance and executes contracts.

Although the argument that the combination of the projects would save time and money may have merit, a mistake was clearly made in authorizing the contractor to begin roof design without a contract. However, rather than admit the mistake and work within the process to achieve the best outcome, the Auxiliary Services Branch and Facilities Development Branch leaders and staff worked together to cover up the facts and present a “clean” file to facilitate the Procurement and Contracts Branch’s review and approval.

Staff hold checks to avoid lapsing funds

During an interview with the Project Control Section head, he admitted to deliberately advising a vendor to submit a falsified invoice to avoid

lapsing funds. When asked his most recent action of holding a check, the section head informed us of a purchase of \$80,000 of office furniture that had been delivered but not yet installed. Because the funds were about to expire and the work was not complete, the section head wanted to secure the funds by issuing a check to the vendor in the full amount. However, vendor payment requires a final invoice for completed work before the check may be released. Therefore, the section head instructed the vendor to mail to the department an invoice for the full amount that falsely stated the layout and installation services had been delivered. The section head received and approved the vendor's final invoice on January 10, 2008 and issued a check on February 22, 2008. However, the check was not processed until July 10, 2008, as the section head held the check until he was satisfied that all work had actually been completed.

During the interview, the section head acknowledged that this conduct is clearly inappropriate, but claimed he had little choice in the matter, since the related funding was in danger of lapsing. As previously discussed, the attitude of getting the job done despite the rules has trickled down to management and has empowered them to make decisions contrary to policies and rules. Furthermore, the culture within the Office of School Facilities has apparently resulted in complicit vendors. The section head, who formerly worked at the Department of Accounting and General Services, said that although this is not a common practice, he has witnessed this act for many years while working for the State. Surprisingly, at the end of the interview, the section head claimed that since he had never received training that specifically addressed the practice of holding checks, there was no way for him to know that it was prohibited.

Separately, we discovered through a review of department emails that this practice of "holding checks" to avoid lapsing funds is not isolated. On January 4, 2007, a department secretary notified a unit head and his section head within the Facilities Development Branch about outstanding purchase orders that needed to be paid by January 19, 2007 to avoid losing the funds. For the first purchase order, the contractor had already completed the original scope of work. However, a change order was added to the purchase order, which extended the project beyond January 19, 2007. The unit head asked the Project Control Section head for advice, who responded: "If the change order adds to the original PO amount, then the entire amount must be paid off before 1/19/07. Alternatively, you can have the contractor bill for the whole amount now, cut the check and hold it until the work is done."

The unit head also asked his supervisor if it was acceptable to pay the original purchase order, issue a check for the change order work, and hold payment until the change order work was completed. As noted in Exhibit 2.7, his supervisor sent the following response:

Exhibit 2.7

Email Response From Section Head to Unit Head

Have Contractor submit 2 final payment requests, one for the original and the other for the change order po. Then process the payments but have 1 hold the check until the work is completed and lights operating. 1 can then mail the check to the Contractor.

Legend:

1 = Secretary, Facilities & Development Branch/Office of School Facilities

Source: Department of Education

The work for the second purchase order was delayed because of a manufacturer's quality control problem. This delay pushed the date of completion past January 19, 2007. The unit head suggested to his supervisor that they pay 75 percent of the purchase order now and cut another purchase order when the carpet was fixed in March. As noted in Exhibit 2.8, his supervisor sent the following response:

Exhibit 2.8

Email Response From Section Head to Unit Head

Have the Contractor submit 2 payment requests, one for 75% partial payment and the other for a final payment of the remaining 25%. Then process the both invoices, but have 1 hold the check for the final payment of the remaining 25%. After the problem is resolved, 1 can then mail the 25% check to the Contractor.

Legend:

1 = Secretary, Facilities & Development Branch/Office of School Facilities

Source: Department of Education

When interviewed, the supervisor originally denied engaging in "holding checks" until shown the related email correspondence. He said that he relies on the Project Control Section to give direction in these situations, even though it is ultimately his call on how to proceed. The supervisor said that he would have concerns if this was done all the time, but that this must have been an exception.

Through our review of documents and emails and our discussions with DOE personnel, we noted a general sentiment that the practice of

“holding checks” is wrong, but is an acceptable alternative to allowing funds to lapse. This process should be disallowed and the department should identify employees who follow this practice and discipline them appropriately. Instructing vendors to submit falsified documents to the State is a fraudulent act, by both department personnel and vendors. As previously discussed, the assistant superintendent of the Office of School Facilities agrees that holding checks is a “terrible practice,” but understands why it is done. He planned to issue a memorandum to the department to stop this practice; however, he did not mention the possibility of disciplinary action. A strong message from senior management that holding checks will not be tolerated is necessary to stop this practice.

Outsourcing of Program and Construction Management Services Leads to Waste, Abuse, and Improper Consultant Relationships

The Office of School Facilities outsources *program* and *construction* management services for a large part of its capital improvement programs. The department may procure professional services when in-house staff expertise is not available for the services needed or department employees are unable to perform the work due to workload and/or time constraints. Many professional services firms have deeper resources, including more personnel and expertise, which enables them to complete the work effectively and efficiently. However, hiring professional service firms is often much more expensive than using in-house personnel and may result in waste, if not properly managed.

The inefficiency and wastefulness of outsourcing *construction* and *program* management services is best illustrated by the department’s Whole School Classroom Renovation Program. The renovation program was initially established in 2001 as a six-year effort to renovate classrooms in more than 230 schools 25 years or older by 2007. In 2006, the Legislature appropriated an additional \$160 million to the program to complete the renovation of the 96 schools remaining at that time.

The management of department programs and other contractors should have been performed in-house. However, the department contracted out these functions through large-dollar contracts. Allegedly short on time and staff, the Office of School Facilities placed an inordinate amount of responsibility on these *program* and *construction* management consultants, including determining the scope of the program and the scope of their own contracts. Since the office did not have an adequate understanding of the program’s scope, the resulting contracts contain inherent conflicts of interest, lack competition, and provide incentives to drive up costs. The role of the *program* management consultant is particularly alarming, since that consultant is tasked with assisting in the procurement process, including evaluating proposals and negotiating the contracts on behalf of the department, while simultaneously competing

for those contracts. Consultants are paid large sums of money to monitor and approve other consultants' work, responsibilities that should be performed by the department and which may lead to waste of taxpayer moneys.

The department is outsourcing basic management functions

The department has executed several layers of contracts to manage the renovation program, all under the direction of the Office of School Facilities. One layer consists of three large *construction* management contracts to provide design and construction management services for identified schools within assigned school districts. The first contract was for \$4,440,000 to provide services for the renovations at 22 schools located in the Honolulu district. The second contract was for \$6,825,000 to provide services for the renovations at 24 schools located in the Hawai'i, Kaua'i, and Maui districts. The third contract was for \$7,350,000 to provide services for renovations at 25 schools located in the Central and Leeward districts on the island of O'ahu. These *construction* managers have direct oversight of individual projects and contractors at the assigned schools.

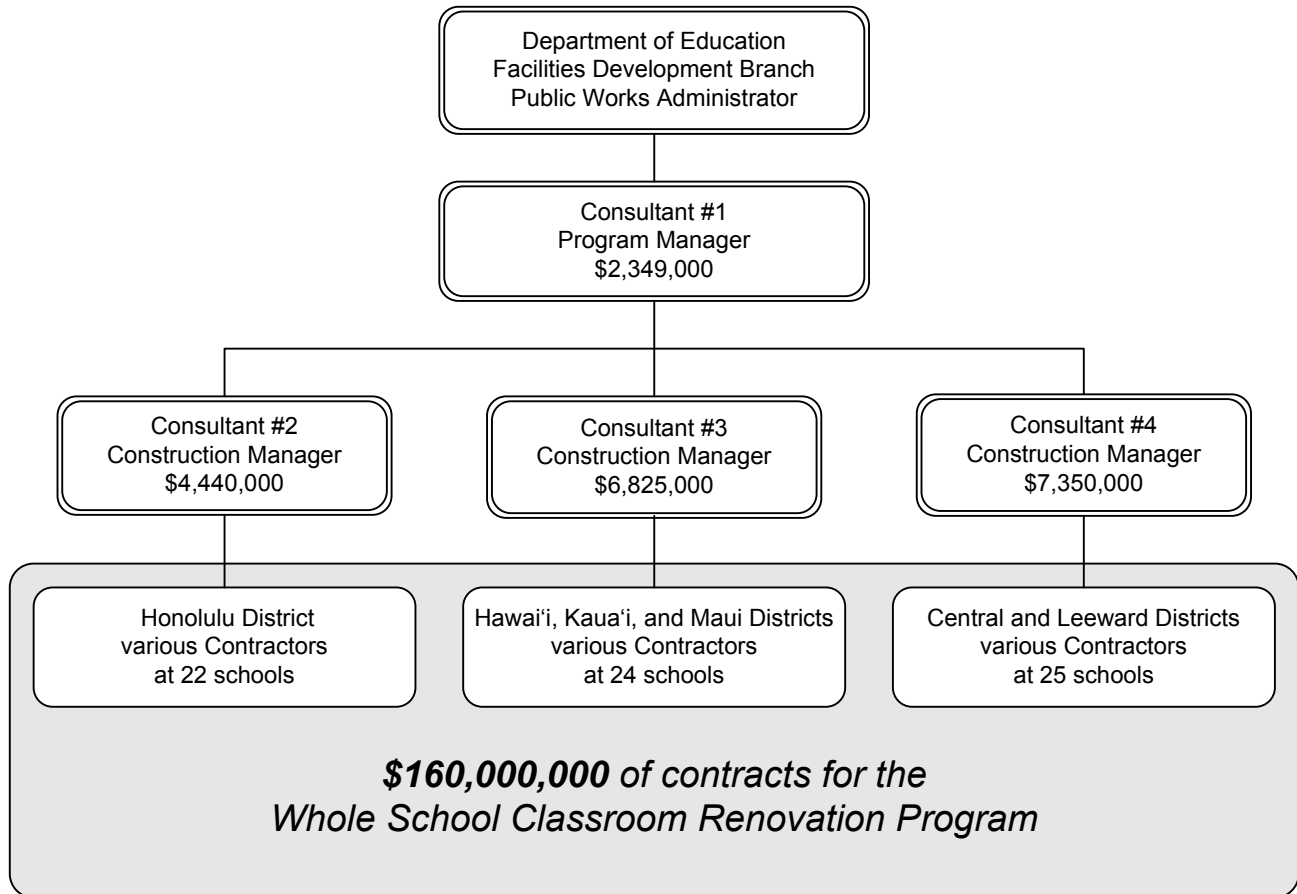
The top management layer consists of a \$2,349,000 professional services contract for *program* management services over the entire renovation program and *program* management services for 13 additional schools located in the Windward district on O'ahu. The three *construction* management consultants, who supervise the school-level contractors, are in turn managed and overseen by the *program* management consultant, who reports to the department's Public Works Administrator. Exhibit 2.9 depicts how the renovation program management contracts are structured.

We question the wisdom of creating multiple layers of contractors, which in turn manage other contractors. The scopes of services for the *program* and *construction* management services contracts appear to include tasks that should be the direct responsibilities of the department. Others are troubled about this management structure. On November 21, 2006, a deputy attorney general asked a procurement specialist why the department needed to outsource these contracts, stating:

it appears that the services to be performed by the Consultant are services already being performed by DOE personnel. Why is the DOE now contracting out these services?

The department's *program* management contract did not provide adequate justification for procurement outside the department and was for a multi-year *program* management and technical assistance for repair and maintenance and capital improvement programs for the Office of School Facilities. Tasks such as *program* management are regularly performed by department personnel, and there was no documentation

Exhibit 2.9
Whole School Classroom Renovation Program Management Hierarchy



Source: Interviews with department personnel and review of related contracts

in the contract file explaining the need to outsource, such as lack of resources or scheduling difficulties. Office of School Facilities personnel explained to us that they lacked the manpower to complete the work within the prescribed deadlines. They do admit that not including a written justification in the contract files was an oversight.

The use of multiple consultants to manage other consultants and contractors redirects moneys designated for school improvements away from school facilities. Under the Whole School Renovation Program structure, the department is paying \$21 million in management fees to oversee \$160 million in actual improvements to schools. This means that for every dollar of construction, 13 cents is needed to pay a *program*

or *construction* manager. As an example of the allocation of funds at the school level, we randomly reviewed one *construction* management contract invoice as of June 2007, and noted that in order to complete \$1,022,000 worth of improvements, the department paid the construction manager \$159,400, broken down as follows:

Lehua Elementary:

Program Management Fee Allocation	\$111,100
Air Monitoring During Construction Expense Allocation	25,300
Reproduction/HAZMAT Survey Allowance Allocation	23,000
Total Allocation of Management Fees	<u>\$159,400</u>
Percentage of Total Construction Costs	<u>15.6%</u>

Note that this does not factor in an allocated share of the *construction* management contract’s fixed start-up costs of \$50,000, or an allocated share of the \$2,349,000 *program* management contract.

While oversight and inspection of construction work by a qualified person is critical, the assistant superintendent of the Office of School Facilities acknowledged during an interview that contracting out *program* and *construction* management functions is an inefficient way of doing business. He stated that it was nonetheless necessary due to the large amount of money (\$160 million) and work (renovation of 96 schools) that was quickly thrown at the department in 2006. More than two years later, however, the department has had ample time to change this approach but instead has attempted to add more money to these types of contracts. Given the current economic challenges faced by the department, it may be imprudent for the department to continue outsourcing management functions and department jobs.

The department should perform an analysis of each current and planned professional service contract to determine the costs and benefits of outsourcing. If the analysis suggests the benefits outweigh the costs, the analysis should be included in the contract file. If the costs are greater than the benefits, the department should consider performing the work in-house. When the department decides to outsource professional services using a contract, all state stakeholders within the contract process (for example, the attorney general and the Procurement and Contracts Branch) should be promptly informed of the decision and the reason behind the decision.

Poorly structured contracts create conflicts of interest and potential for abuse

Inherent conflicts of interest – As noted above, the *program* management consultant has oversight over a \$160 million department program, including direct oversight of construction management consultants. The *construction* managers are responsible for direct

management of the school-level programs and contractors. Upon review of the related contracts, we found that the *program* and *construction* management consultants have the following responsibilities that create a severe conflict of interest:

Program Management Consultant Responsibilities (\$2,349,000 contract):

1. Primary management of \$160 million department program (Classroom Renovation Program/Projects).
2. Direct management of \$18,615,000 of construction management contracts.
3. Evaluation of other consultants' proposals, scopes of services, fees, reimbursable allowance items, and time frames.
4. Negotiating and drafting agreements for services with other consultants, including change orders.
5. Evaluation of the performance of other consultants and contractors.
6. Management evaluation services, including evaluating and recommending improvements to the department's procurement and contracting procedures and the department's internal approval procedures.

Construction Management Consultant Responsibilities (three contracts totaling \$18,615,000):

1. Unknown work products (deliverables and timetables) at time of execution.
2. Oversight by another consultant, including preparation and evaluation of modifications and change orders, and evaluation of performance.
3. Oversight of other consultants.
4. Responsibility for determining the scope of their own contracts:
 - a. Determination of which school projects should be completed.
 - b. Procurement of program services from other consultants, including evaluation of proposals, scope of services, fees, reimbursable allowance items, and time frames.

- c. Negotiation of proposed fees and scope of services.
 - d. Evaluation of the performance of other consultants and vendors.
5. Setting of fees is based on programs managed, providing incentive to create more programs than may be necessary.

As demonstrated above, the department has effectively outsourced basic management functions, providing consultants with the ability to monitor each other, review each other's proposals, negotiate fees and modifications with each other, and evaluate each other's performance, all at the department's expense. In addition, the *program* management consultant is responsible for evaluating and recommending changes to the department's procurement and internal routing process. The levels and extent of management authority and responsibility the department has outsourced to private consultants are excessive.

Unspecified scope and timetable – The contract scope and terms for the renovation program contracts are likewise vague and undefined. According to the National State Auditors Association (NSAA) Best Practices for Contracting, an agency should develop performance requirements to hold vendors accountable for the timely delivery of quality services. Performance requirements should be included in the contract, which should clearly state and define the scope of work and contract terms and provide specific measurable deliverables, including due dates.

The department executed \$18.6 million worth of *construction* management contracts with no specified scope. Each contract's scope of services contained a provision stating that "the specific work required for each school shall be determined after the consultant has completed their on-site investigation as part of Phase I – Investigation and Proposal Phase. . . ." Essentially, the department received \$160 million for renovation and paint programs at 96 schools but had no idea of how the money would actually be spent. It then contracted the responsibility of defining the scope of work out to *construction* managers, who determined which projects at each school would be funded and how much the *construction* managers should get paid for managing each project. Consequently, the \$2.3 million *program* management contract also has no specific scope, as it is designed to manage the three *construction* management contracts.

Although each contract has a stated compensation ceiling or allowance amount, against which the design and management fees and other allowable expenses are applied, because the department had no idea what the actual scope of each contract was when it set the ceiling, the

figure does not provide any measure of control over the contract. The ceiling was merely a best-guess dollar amount and was driven by the consultants' proposals and estimates.

While it is understandable that an investigation and discovery phase may be necessary to determine the specific scope of work for the large-scale program, given the substantial size of each contract, it would have been more prudent for the department to initially execute smaller-dollar contracts to perform the discovery phase, then execute more defined contracts for the later phases, rather than executing undefined, multi-million dollar contracts spanning multiple years. Such a controlled approach would provide the department with a better understanding of the program's needs and the expected services to be performed, and accordingly would allow the department to better monitor progress and control costs. Further, for large scale programs such as the renovation program, dividing the overall program into phases that can be contracted separately would allow the department to better plan for and manage the overall program, as well as the specific scope of work, schedule, and costs for each separate contract.

In addition, none of the four renovation program contracts contained a performance timetable or even a target completion date. Instead, the contracts simply stated that the contracts would end upon completion of construction. Lack of a program schedule suggests to the consultant that time is not of the essence, and it provides a disincentive for the consultant to perform the work efficiently and diligently.

Lack of competition – The department essentially issued \$20,964,000 of “blank” contracts with no scope, no deliverables, and no timetables. Section 3-122-13(e), HAR, states that a contractor paid for services to develop or prepare specifications or work statements shall be precluded from submitting an offer or receiving a contract for that particular solicitation.

By allowing the consultants to determine the scope of work and related fees and then complete the work under the same contract, the department clearly violated the intent of this rule. While it may not appear that a direct violation of this rule occurred as specifications were not used in the procurement, the department has actually created a situation worse than what the rule was designed to prevent, as the department simply built both components (developing specifications and bidding out those specifications) into a single contract. Already locked into a contract and with no competition, it is difficult to expect the consultants to price each project out with the State's best interest in mind.

Fee structure poses a financial risk – As if allowing the consultants to determine the management fees without competition was not harmful

enough, the contracts' fee structures provide additional incentive to run up costs for the department. Under the three *construction* management contracts, the consultants determine which renovation projects are to be conducted at each school. For each school project, the consultants then negotiate a *design and project management* fee, which is a fixed price. In addition, the consultant is allowed to charge a *construction management* fee related to each school project. This fee is based on actual hours incurred by the consultants, charged at their direct personnel expense multiplied by a factor of 3.0, as allowed by procurement guidelines. Basically, the consultants charge a fixed and a variable fee for each school project managed.

While the fee structure itself may be acceptable, coupled with the many layers of consultant involvement and control it leads to several problems. First, there is an incentive for the *construction* management consultants to identify as many school-level projects as possible since this directly drives compensation under the contract. Second, since a portion of the consultants' fees are based on an hourly rate, there is an incentive to allow the school-level projects to exceed the contract amount and obtain change orders. Third, this particular problem is compounded by the fact that the *construction* management consultants are responsible for reviewing and approving any modifications for overruns by the school-level project contractors. Although we did not investigate and confirm whether such abuses occurred, this financial risk may cause additional costs to the Classroom Renovation Program.

Examples of potential program management abuse are widespread

The Office of School Facilities defends its use of program and construction management contracts based on the consultants' required expertise and/or shortage of qualified in-house staff. However, a detailed review of the \$2,349,000 *program* management contract and the specific actions of its president demonstrate how susceptible these types of contracts are to abuse.

Improper influence on and involvement in procurement – The *program* management consultant was already under a general contract to provide *program* management and technical assistance over CIP and R&M programs while the department was trying to procure \$21 million in *program* and *construction* management contracts for the Classroom Renovation Program. The initial contract for \$500,000 ran from April 2006 through June 2007 and required the *program* management consultant to manage programs and develop scopes, procure, evaluate proposals, and negotiate fees for new programs. During this time, the *program* management consultant played an active role in the November 2006 awarding of the three \$18.6 million Classroom Renovation Program *construction* management contracts, including drafting of the contracts. In fact, the program management consultant was actually competing

for a share of these contracts, and at one point submitted a proposal to the department, in its capacity as a contracted *program* management consultant, that would have awarded one-fourth of all *construction* management contracts to itself.

The *program* management consultant was instead awarded a Classroom Renovation Program – *program* management contract during January 2007 while still serving the department as a *program* management consultant under its original contract and having obvious influence over the procurement process.

Excessive control over negotiating fees and modifications – In one instance, the *program* management consultant appeared to have awarded a \$2,183,700 renovate and paint contract to another consultant. The *program* management consultant submitted this award to the department via Form 31, “Recommendation for Award,” but indicated on the form that he “confirmed the bid with the responsible low bidder and has accepted the award.” A department staff did question whether an actual award was made by the *program* management consultant, and it is unclear what subsequently happened to this project.

Inappropriate authority over department personnel – From reviewing department emails and contract files, we conclude that the *program* management consultant has consistently instructed department staff to prepare contract award and encumbrance documents for significant dollar amounts. While the public works administrator was often copied on these communications, it appears the contracted *program* management consultant made the award decisions, drafted the related documents, and then instructed department staff on how to process the transaction. The program management consultant was involved in the award of the \$4,440,000 construction management contract above and subsequently drafted and submitted the contract directly to the Procurement and Contracts Branch with instructions to execute, and instructed Program Control Section staff to process the encumbrance. The Procurement and Contracts Branch staff raised issue with this, noting the following in an August 14, 2006 email to her supervisor (see Exhibit 2.10).

In another instance, the *program* management consultant instructed a department staff on how to process its own contract modification. On a modification to the initial \$500,000 *program* management contract, the department staff notified the *program* management consultant that a modification to extend the contract an additional year through June 2008 and add \$200,000 had been received but additional documents were needed in order to process, including a proposal detailing the additional services to be provided. The *program* management consultant replied that he had already spoken to that particular staff’s superiors and that no further documentation was required as the department was exercising

Exhibit 2.10

Email from Contract Specialist to the Procurement and Contracts Branch Head Regarding Project Management Consultant's Actions

As far as I can see, there are 3 improprieties with the below email.

1. A consultant is directing me to award a contract to another consultant
2. A consultant is directing Project Control to prep an encumbrance for \$4.4 million
3. That same consultant is also competing under the same Prof Svs solicitation

Source: Department of Education

the extension. The department staff was then directed by the *program* management consultant to expedite the modification and inform the consultant when he could go in to sign it.

Improper communications/relationships with department personnel – During a November 2006 email exchange, the Project Control Section head requested the creation of four job numbers, one for each of the four *program* and *construction* management contracts for the Classroom Renovation Program, to capture costs for design consultants. However, the section head later noted that the department only needed one job number as the *program* management consultant had informed him that the four firms would hire their own design teams, track the design costs for the department, and provide the department detailed cost breakdowns later.

The Lax Environment and Leadership Void Has Provided Both Opportunity and Incentive for Procurement Abuses

The procurement violations and inappropriate actions that occurred within the Office of School Facilities may be attributed to the lax tone from leadership and the resulting weak environment. As discussed in detail in our first report, the department's leaders have fallen short in establishing an adequate control environment, developing formal policies and procedures, monitoring for compliance, correcting improper activities, and setting an overall tone that actively promotes integrity and ethical behavior.

The lax tone from the top has unintentionally set the stage for a culture of disregard of procurement rules in the Office of School Facilities. The assistant superintendent of the Office of School Facilities exemplifies the attitude that public procurement rules just get in the way of doing the work—a mindset that is apparently shared by certain Office of School Facilities directors, managers, and staff, resulting in the unethical and potentially illegal actions previously discussed.

The department's weak control environment has allowed improper procurement activities to occur

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, however, procurement authority and responsibilities were delegated to department managers without the establishment of an adequate control system, including formalized policies, procedures, and processes. During our audit, the department was unable to provide us any documentation of a formal internal control system. We also did not observe any formal processes or controls in place to monitor procurement activities. In fact, the department's internal audit branch, which is administratively attached to the Office of Fiscal Services, was comprised of one individual during the course of our audit—clearly an insufficient staff to monitor the department's \$2.4 billion budget and a telling indication of the department's commitment to internal control.

In addition, the department was granted full responsibility over its procurement process in 2004 but has not yet implemented any formal procurement policies and procedures, including disciplinary or other corrective procedures to address procurement violations. The failure of top department officials to communicate the importance of the procurement laws and rules has resulted in ambivalence of employees toward the necessity of procurement rules and compliance with them. Further, although we discovered numerous procurement violations during our audit, we did not observe any counseling or discipline being issued to violating employees to inform them of their mistakes and to deter repeat behavior. This lack of personal accountability and consequences for non-compliance promotes the attitude that the rules are inconsequential.

These factors, discussed in detail in our first report, have created a weak control environment that has permitted a culture of disregard for the procurement rules in the Office of School Facilities. Without strong controls and leadership, Office of School Facilities employees appear to believe they have the discretion to unilaterally determine whether compliance with procurement laws and rules is in the best interest of the department, resulting in the improper procurement activities discovered in our audit.

The assistant superintendent of the Office of School Facilities perpetuates the office's inappropriate procurement practices

The assistant superintendent of the Office of School Facilities' sentiment toward public procurement is not unknown. He plainly conveyed his view to us during an interview when he stated: "If everybody followed the rules, the world would stop." Based on the numerous violations and unethical activities we observed during our audit, this mentality is apparently shared by many Office of School Facilities staff involved in procurement as well.

Shortly after being delegated authority over certain areas of procurement, the assistant superintendent of the Office of School Facilities requested and was granted a temporary exemption from the contracting process requiring Procurement and Contracts Branch involvement. However, rather than properly overseeing the procurement activities of his office, the assistant superintendent has disassociated himself from his staff, leaving them free to create “workarounds” that deviate from established procedures. The assistant superintendent 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 or accountability. Coupling this loose culture with the significant amount of dollars involved has created both the opportunity and the incentive for the procurement abuses we discovered.

When presented with evidence that key Office of School Facilities personnel, including his direct reports, had repeatedly engaged in unethical and potentially illegal procurement activity, the assistant superintendent acknowledged that the actions were wrong and stated that he planned to instruct the individuals to stop such behavior. However, he then went on to explain that the problem was with the procurement rules and procedures, not the individuals, and that any unethical actions and attitudes would be easy to fix if the rules and procedures are modified.

This tone has set the stage for a culture of disregard for procurement rules within the Office of School Facilities. The mentality that getting the work done takes precedence over compliance with the rules is prevalent among the directors, supervisors, and staff within the office. Many Office of School Facilities personnel we interviewed acknowledged that various practices are utilized to “work around” the rules and “get the job done.” Some staff expressed the view that the rules are too cumbersome and hamper the timely completion of work, thus indicating their knowledge that the workaround practices do not comply with procurement rules. Others stated that they followed the workaround practices because it was “the way it’s always been done.” Either way, most Office of School Facilities staff admitted it was not uncommon for procurement rules to be bypassed in order to achieve desired outcomes.

Although such practices appear to have existed among many staff prior to being transferred from DAGS to the Department of Education, the widely understood view of the assistant superintendent towards compliance, as well as the lack of formal discipline and other corrective action in response to violations, have allowed improper procurement practices to continue and thrive in the Office of School Facilities.

Consistent with his view that procurement rules are an impediment to getting the work done, 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 in 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 unless 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 and that disregard for the rules is unacceptable. Establishing a proper tone and adequate control system should facilitate this message, but sterner action must also be taken in light of the office’s recurring procurement violations and unconcerned attitude. We further 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 improper procurement activity will continue to occur.

Conclusion

Department of Education officials’ push for the passage of the Reinventing Education Act of 2004 was partially motivated by the desire to reduce the bureaucracy involved with capital improvement programs. With the passage of the law, the department quickly inherited an enormous responsibility and an expansive system replete with myriad staff, processes, and procedures. To meet the facility demands of the hundreds of schools statewide, officials at the Office of School Facilities consciously made the decision to carry out their duties with little regard for compliance with procurement procedures. While appearing

to be well-intentioned, this “just-get-it-done” approach has created an organizational atmosphere in which non-compliant procurement practices are not only tolerated but condoned in some instances. More importantly, unethical and possibly fraudulent behavior has been allowed to thrive.

In addition, as our report has made clear, this failure of leadership has resulted in a seriously flawed program and construction management services process in which the department has outsourced its oversight responsibilities. For instance, under this new system, consultants have been allowed to award contracts to other consultants. Even worse, they have been granted this authority without surrendering the right to also compete for the same contracts that they are administering. The result of these and other systemic flaws is that for every dollar spent on construction for the schools, 13 cents is needed to pay for program and construction management services—duties that the department should be carrying out itself.

With hundreds of millions of dollars in capital improvement projects yet to be awarded, the possibility of continued unethical and possibly of fraudulent behavior is high, and the prospect of inefficiency and waste is a certainty.

Recommendations

Regarding specific procurement violations, ethical concerns, and potential fraud

1. The superintendent of education should conduct an investigation regarding the following professional service contracts:
 - \$300,000 contract to Provide Construction Management and Professional Services at Wilson and ‘Anuenue Elementary awarded on April 23, 2006.
 - \$22,205 contract for Jefferson Elementary School Building S Reroof awarded on July 9, 2008.
 - Approximate \$80,000 contract for playground maintenance that was never awarded.
 - \$325,000 contract for Professional Services to Assist in the Development of a Facilities Asset Management System Request for Proposals awarded on April 4, 2008.

The investigation should focus on the following issues:

- a. Inappropriate discussions and meetings with contractors prior to public notice that provided those contractors with an unfair advantage.
 - b. Inappropriate discussion with and involvement of former department employees now employed by contractors.
 - c. Manipulation of the selection committee process by:
 - i. Overriding the normal process for selecting committee members.
 - ii. Providing the committee with recommended contractors.
 - iii. Placing high-ranking personnel on the committee who are also responsible for approving the committee's decision.
 - iv. Changing committee decisions after-the-fact without reconvening or adequate justification.
 - d. Authorizing contractors to start work without an executed contract, and in one case, department denial of granting such authorization.
2. The superintendent of education should also investigate the former assistant superintendent of the Office of Business Services actions regarding the \$600,000 contract for Project Management and Technical Assistance for Repair and Maintenance & Capital Improvement Projects awarded on February 4, 2005. The investigation should focus on the following issues:
- a. A review of the contract award to determine if the consultant was preselected based on emails between the department and the consultant prior to selection committee convening.
 - b. A review of emails from the former assistant superintendent to the consultant instructing him to hire specific sub-consultants in order to circumvent procurement rules.
 - c. A review of the sub-consultants' work performed to determine whether these fit under the scope of the contract and whether these services should be performed by department employees.

- d. A review of other work performed by these sub-consultants, whether directly or indirectly, for the department.
 - e. A review of other contracts involving sub-consultants to determine whether this practice is widespread.
3. The superintendent of education should also investigate the practice of “holding checks” within the Office of School Facilities. This practice should be banned immediately and individuals responsible should be properly disciplined.

Regarding outsourcing of program and construction management services

1. The superintendent of education should review the use and structure of the following project and construction management contracts:
 - \$2,349,000 contract for Program and Project Management for Classroom Renovation Projects for Various Schools Statewide awarded on January 12, 2007.
 - \$7,350,000 contract for Classroom Renovation Project for Various Central & Leeward District Schools awarded on November 21, 2006.
 - \$6,825,000 contract for Classroom Renovation Projects for Various Hawai‘i, Maui, and Kaua‘i District Schools awarded on November 21, 2006.
 - \$4,440,000 contract for Classroom Renovation Projects for Honolulu District Schools awarded on November 21, 2006.

The review should focus on the following issues:

- a. Inappropriate involvement and influence of project management consultants in awarding these contracts.
- b. Whether these management functions qualify as professional services and should be performed in-house.
- c. Why consultants were able to influence/determine the contract and program budgets.
- d. Why consultants were responsible for determining scope, and ultimately compensation, of their own contracts.
- e. Why consultants were provided with so much authority, including:

- i. Responsibility for reviewing and approving other consultants' and contractors' proposals.
 - ii. Negotiating other consultants' and contractors' fees and change orders.
 - iii. Evaluating the performance of other consultants and contractors.
 - iv. Recommending changes to the department's procurement and internal routing processes.
- f. Determine whether these contracts violate the procurement code, specifically Section 3-122-13(e), HAR, by allowing the consultants to determine their own scopes and fees.

Regarding the lax environment and leadership void

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 should 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 and having the branch report directly to the board. 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.
- g. Perform a detailed investigation on the specific procurement violations cited in this report and take appropriate and visible action.

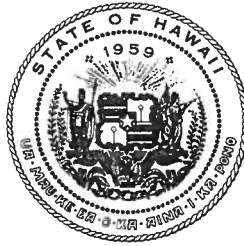
Responses of the Affected Agencies

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. The department recognized the severity of some of our findings and indicated an internal investigation would be conducted and that the Department of the Attorney General – Criminal Division would be consulted. In addition, the department described steps already taken to address some of our general 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 black ink, 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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OFFICE OF THE AUDITOR
STATE OF HAWAII

RE: Procurement Audit of the Department of Education: Part 2

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

During the exit conference, I was apprised of disturbing practices between Office of School Facilities and Support Services (OSFSS) employees and private contractors "that may be fraudulent and illegal." The DOE recognizes the seriousness of the audit findings. An internal investigation will be conducted regarding the various contracts and personnel allegations, and pending the results, appropriate action will be taken. This audit report will also be forwarded to the Office of the Attorney General – Criminal Division for further action.

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.