

EXHIBIT

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Procurement Audit of the Department of Business, Economic Development and Tourism

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

STATE OF HAWAII

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THE AUDITOR
STATE OF HAWAII

**Exhibit
128**

Seven agencies are attached to the department for administrative purposes. They include the Aloha Tower Development Corporation, Convention Center Authority, Hawaii Community Development Authority, Hawaii Strategic Development Corporation, High Technology Development Corporation, Land Use Commission, and Natural Energy Laboratory of Hawaii Authority.

Objectives of the Audit

The objectives of the audit were to:

1. Determine whether the department's purchases of goods and services comply with the provisions of the Hawaii Public Procurement Code.
2. Determine whether the department's contract administration process ensures the efficient and effective use of state resources.
3. Make recommendations as appropriate.

Scope and Methodology

This audit focused on purchases from July 1994 to May 1997. We sampled purchases from the four divisions and four offices of the department. We did not review purchases of the administratively attached agencies or the contracts with the Hawaii Visitors and Convention Bureau.

We selected a sample of the department's purchases of goods and services and tested them for compliance with the provisions of the Hawaii Public Procurement Code and related administrative rules. We performed specific tests to determine compliance with the provisions governing small purchases and purchases of \$10,000 or more. We examined purchases made through competitive sealed bids, competitive sealed proposals, emergency, and sole source methods. We also examined the department's purchase of professional services.

We also selected 20 contracts using a judgmental sampling method. Our sample represented about 54 percent of the total dollar value of departmental contracts. The sample was tested to determine whether the department performed adequate analyses to determine the need for contracting, developed scopes of services that were sufficiently specific to ensure expected outcomes and benefits, and developed clearly defined monitoring and evaluation procedures.

Exhibit 1.1 shows the expenditures and encumbrances for those divisions and offices covered within the scope of our audit from FY1993-94 through FY1995-96. The total amounts have declined substantially over the past three years—from \$24.0 million to \$11.7 million.

To initiate a request for contract services, a division or office submits a "Request for Project Proposal" to the ASO's contract specialist. The request outlines the objectives, goals, justification, description, and measures of effectiveness of the proposed project. The division or office also sends a request for the governor's approval, and, if appropriate, a request for sole source procurement.

The contract specialist reviews each request for adherence with the mission of the department and for compliance with the provisions of Chapter 103D, HRS. The contract specialist may then forward the request to the director with a recommendation for approval or deny the request and return it to the division or office.

If the request is approved by the director, the contract specialist oversees all steps of the procurement process to ensure compliance with Chapter 103D, HRS. The contract specialist also develops forms for the division or office to monitor and evaluate the contractor's services. The contract specialist periodically audits the contract administration of the division or office to ensure compliance with proper monitoring and evaluation procedures.

For purchases not requiring a formal contract, a requisition/purchase order is completed and must be approved by the division/office head or a designee. The purchase order and any supporting documents are then sent to the ASO's fiscal officer. The fiscal officer reviews the purchase order and documents to ensure compliance with the Hawaii Public Procurement Code and all applicable policies and rules. The purchase order may be denied and returned to the division or office for correction and reprocessing. The fiscal officer approves the purchase order when all requirements have been met. The fiscal officer retains a copy of the purchase order and returns the remaining copies to the requisitioner who then initiates the purchase.

For purchases of \$10,000 or more, or for travel and equipment purchases, the purchase order is sent back to the requisitioner after it has been reviewed by the fiscal officer and approved by the director.

Exhibit 2.1 illustrates the functions within the department for purchase approval and compliance oversight.

The department has made serious efforts to improve its contracting practices over the past two years. Also, the contract specialist has tried to enforce strict compliance with the Hawaii Public Procurement Code by working closely with the State Procurement Office and the fiscal officer.

The department was in general compliance with the tested requirements of competitive sealed bids, with one exception. The department classified an \$11,650 repair of a building's air conditioning system as construction and did not solicit bids. Department officials reasoned that this major repair constituted construction and was therefore considered a small purchase under the \$25,000 ceiling. However, we questioned whether this repair actually constituted construction. The object code used by the department on the purchase order classified the repair as "repairs and maintenance" rather than as a "fixed asset." It is reasonable to assume that all construction costs be capitalized, that is, added to the fixed asset records. Since it was not capitalized, we question whether this repair was truly construction. If it were not construction, then the expenditure exceeded the \$10,000 limit set for small purchases of goods and services and should have been subject to bid.

DBEDT complied with competitive sealed proposal requirements

Contracting through competitive sealed proposals is permitted if the head of a purchasing agency determines in writing that this method is more appropriate than competitive sealed bidding because bidding is either not practicable or not advantageous to the State. A request for competitive sealed proposals must receive proper public notice and a register of proposals must be maintained. Proposals are ranked by a formal evaluation process. The contract is awarded to the responsive, responsible offeror whose proposal is determined in writing to be the most advantageous to the State.

We assessed several proposals and the reasons given to contract through competitive sealed proposals rather than competitive sealed bidding. We compared the given reasons with those approved by Hawaii Administrative Rule 3-122-43 and found no conflicts. Department documentation showed that proper public notices of requests for proposals were given and that registers of proposals were maintained. An examination of the formal evaluation processes also showed that the contracts were awarded to the offerors whose proposals were ranked as the most advantageous. We found the department has complied with the provisions governing competitive sealed proposals.

The department complied with sole source procurement requirements

A sole source purchase may be made when there is only one available source from which a particular good or service may be obtained. Using a State Procurement Office form called a "Request For Sole Source," the heads of purchasing agencies must certify to the best of their knowledge that the form's information is true and correct before submitting it to the chief procurement officer for approval. The State Procurement Office

About half of the project managers were not using the forms to ensure contract deliverables. This resulted in poor accountability over the contractor and led to weak controls over incremental contract payments. For example, in at least one instance we found payment being made even though contractual milestones had not been reached. The Contract Administration Verification Report was developed to correct contract monitoring concerns identified in our prior report and the department should ensure that all project managers utilize the form.

Agency fails to perform sufficient contract outcome evaluation

The project manager is responsible for evaluating the outcome of a contract. A thorough evaluation upon the completion of a contract establishes whether the intended objectives of the contract were achieved and whether the fiduciary responsibility of the department to effectively and efficiently manage public resources has been fulfilled. An outcomes evaluation answers the following questions: (1) Did the State receive what it paid for? (2) Should action be taken against the contractor for substandard performance? and (3) Should the contractor be recommended for future contracting needs?

The Contract Administration Verification Report contains a section outlining the established procedures for contract evaluation. This section reiterates contract objectives, evaluates contractor performance in achieving the objectives, and provides recommendations for follow-up or future activities. However, in over 60 percent of the completed contracts we reviewed, project managers failed to evaluate contractor performance.

Problems result from the lack of a contracting manual and insufficient oversight

The department's weaknesses in contract management and evaluation may be due to the lack of a contract administration policies and procedures manual and central oversight of project managers. The department has indicated that it is in the process of developing a contract administration manual.

A high priority should be given to complete a manual. Without a manual to ensure uniform requirements and processes, improvements may be jeopardized with the loss of key personnel. As indicated earlier, improvements in contract planning and drafting, and compliance to the Hawaii Public Procurement Code have resulted through the efforts of the contract specialist. A manual and increased centralized oversight will be useful in training and encouraging project managers to monitor and evaluate contracts.

Conclusion

The department has achieved a high degree of compliance with the Hawaii Public Procurement Code through a review and approval process that is highly centralized. However, the level of compliance gained since 1995 is

put at risk by the lack of a detailed procurement manual. The department has also made progress in planning for and drafting contracts, however, weaknesses still exist in the areas of contract monitoring and outcome evaluation. Without sufficient contract management and evaluation, the efficient and effective use of state resources is not ensured.

Recommendations

1. The Department of Business, Economic Development and Tourism should develop a detailed procurement manual for use by all operating units.
2. The department should:
 - a. Develop a contracting policies and procedures manual for use by all project managers;
 - b. Ensure that all project managers are properly trained in contracting policies and procedures; and
 - c. Audit project managers for compliance with departmental contracting policies and procedures.