



DEPT. COMM. NO. 14

October 16, 2018

VIA EMAIL & HAND DELIVERY (senkouchi@capitol.hawaii.gov)

The Honorable Ronald D. Kouchi
Senate President
415 South Beretania Street
Hawaii State Capitol, Room 409
Honolulu, Hawaii 96813

Re: Follow-Up on Recommendations from Report No. 15-09, Procurement Examination of the Department of Health: Lack of Procurement Controls Exposes Health Department to Waste and Abuse (Report No. 18-13)

Dear President Kouchi:

We are attaching a copy of our "Follow-Up on Recommendations from Report No. 15-09, *Procurement Examination of the Department of Health: Lack of Procurement Controls Exposes Health Department to Waste and Abuse*", Report No. 18-13. The follow-up audit was performed pursuant to Section 23-7.5, Hawaii Revised Statutes, which requires the Office of the Auditor to report to the Legislature annually on each audit recommendation more than one year old that has not been implemented by the audited department or agency.

The report is accessible through our website at:

<http://files.hawaii.gov/auditor/Reports/2018/18-13.pdf>.

If you have questions about the report, please contact me.

Very truly yours,

Leslie H. Kondo
State Auditor

LHK:emo

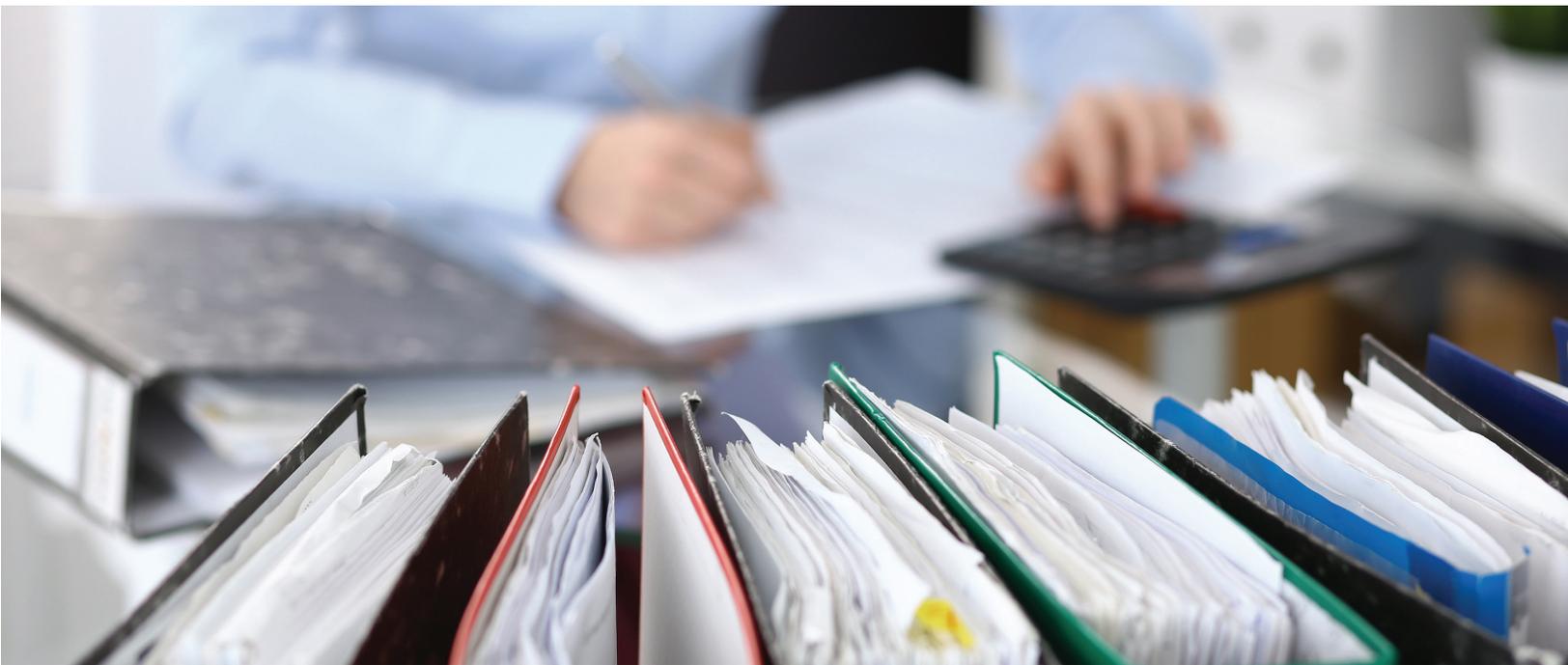
Enclosure

cc/encl: Senate Members (via email only)

Follow-Up on Recommendations from Report No. 15-09, *Procurement Examination of the Department of Health: Lack of Procurement Controls Exposes Health Department to Waste and Abuse*

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

Report No. 18-13
October 2018



OFFICE OF THE AUDITOR
STATE OF HAWAII



OFFICE OF THE AUDITOR STATE OF HAWAII

Constitutional Mandate

Pursuant to Article VII, Section 10 of the Hawai'i State Constitution, the Office of the Auditor shall conduct post-audits of the transactions, accounts, programs and performance of all departments, offices and agencies of the State and its political subdivisions.

The Auditor's position was established to help eliminate waste and inefficiency in government, provide the Legislature with a check against the powers of the executive branch, and ensure that public funds are expended according to legislative intent.

Hawai'i Revised Statutes, Chapter 23, gives the Auditor broad powers to examine all books, records, files, papers and documents, and financial affairs of every agency. The Auditor also has the authority to summon people to produce records and answer questions under oath.

Our Mission

To improve government through independent and objective analyses.

We provide independent, objective, and meaningful answers to questions about government performance. Our aim is to hold agencies accountable for their policy implementation, program management, and expenditure of public funds.

Our Work

We conduct performance audits (also called management or operations audits), which examine the efficiency and effectiveness of government programs or agencies, as well as financial audits, which attest to the fairness of financial statements of the State and its agencies.

Additionally, we perform procurement audits, sunrise analyses and sunset evaluations of proposed regulatory programs, analyses of proposals to mandate health insurance benefits, analyses of proposed special and revolving funds, analyses of existing special, revolving and trust funds, and special studies requested by the Legislature.

We report our findings and make recommendations to the governor and the Legislature to help them make informed decisions.

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<http://auditor.hawaii.gov>



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Follow-Up on Recommendations from Report No. 15-09, *Procurement Examination of the Department of Health: Lack of Procurement Controls Exposes Health Department to Waste and Abuse*

Section 23-7.5, Hawai‘i Revised Statutes, requires the Auditor to report to the Legislature annually on each audit recommendation more than one year old that has not been implemented by the audited department or agency. This report presents the results of our review of recommendations made to the Department of Health in Report No. 15-09, Procurement Examination of the Department of Health: Lack of Procurement Controls Exposes Health Department to Waste and Abuse, which was published in July 2015.

Why we did the 2015 Audit

The Department of Health (DOH) has a broad mission to protect and improve the health and environment for all people in Hawai‘i. Its responsibilities range from initiatives to prevent disease and injury

We found that DOH has implemented one recommendation, partially implemented two recommendations, and has not implemented two recommendations; and that one recommendation is no longer applicable.

to promoting and facilitating recycling efforts. In carrying out its mission, the department, which at the time was responsible for almost \$660 million in annual expenditures, chose to decentralize its procurement functions. Given the size and scope of the DOH's expenditures, and based on findings made in previous audits, we determined that a procurement examination was advisable.

Report No. 15-09, *Procurement Examination of the Department of Health: Lack of Procurement Controls Exposes Health Department to Waste and Abuse*, dated July 2015, 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. The examination was conducted from September 2014 through January 2015 by the Office of the Auditor and the certified public accounting firm KMH LLP, covering fiscal years ending June 30, 2012, and June 30, 2013.

What we found in 2015

In Report No. 15-09, *Procurement Examination of the Department of Health: Lack of Procurement Controls Exposes Health Department to Waste and Abuse*, we found DOH's delegation of procurement functions to individual staff understandable due to the diversity of the department's programs. However, we found there was minimal oversight over these staff and no process to provide them with procurement service support. When procurement issues arose, staff did not have clearly defined procedures for how they should obtain technical assistance. We found that DOH did not systematically review procurement activities to monitor and promote compliance to ensure that all staff adhere to key procurement requirements. Consequently, monitoring practices among divisions were generally informal and vastly inconsistent. We also found there was no oversight of contract administrators nor a periodic and systematic review to ensure that functions were being conducted appropriately.

In addition, we pointed to one contract in particular -- the contract for an audit of redemption centers -- that epitomized the flaws in DOH's procurement process. We concluded that even minimal review and oversight should have detected numerous procurement violations and irregularities relating to this contract.

What we found this year

Our follow-up on the implementation of recommendations made in Report No. 15-09 was conducted from January through June 2018. To determine if DOH's actions addressed the recommendations

made in Report 15-09, we interviewed DOH administrators and State Procurement Office personnel, and reviewed various documents that were provided by DOH. Our follow-up efforts were limited to reviewing and reporting on the implementation of our audit recommendations. We did not explore new issues or revisit old ones that did not relate to the original recommendations.

We found that, following the issuance of Report No. 15-09, DOH's Administrative Services Office (ASO) underwent a substantial reorganization to address the findings and recommendations made in Report No. 15-09. DOH cited our report as one of the primary driving factors for initiating a reorganization of their ASO in 2016. Although changes associated with the reorganization of the ASO are ongoing, we found that DOH has implemented one recommendation, partially implemented two recommendations, and has not implemented two recommendations; and that one recommendation is no longer applicable.

Exhibit 1 Audit Recommendations by Status



Source: Office of the Auditor

The following details the audit recommendations made and the status of each recommendation based on our review of information and documents provided by DOH.

Definition of Terms

WE DEEM recommendations:

Implemented

where the department or agency provided sufficient and appropriate evidence to support all elements of the recommendation;

Partially Implemented

where some evidence was provided but not all elements of the recommendation were addressed;

Not Implemented

where evidence did not support meaningful movement towards implementation, and/or where no evidence was provided;

Not Implemented - N/A

where circumstances changed to make a recommendation not applicable; and

Not Implemented - Disagree

where the department or agency disagreed with the recommendation, did not intend to implement, and no further action will be reported.

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Kaizen

THE CONCEPT OF KAIZEN was introduced in 1986 by Masaaki Imai, a Japanese organizational theorist, management consultant, author, and the founder of the Kaizen Institute Consulting Group, Ltd. Kaizen is a combination of two Japanese words, Kai (change) and Zen (good), translated as “change for the better” or “continuous improvement.” The Kaizen concept relies on the participation from everyone in an organization. One of the notable features of Kaizen is that big results come from many small changes accumulated over time. While the majority of changes may be small, the greatest impact may be Kaizens that are led by senior management as transformational projects, or by cross-functional teams as Kaizen events.

Recommendation 1

The Department of Health should improve its procurement practices by increasing organizational oversight over procurements. The Administrative Services Office should provide greater oversight over departmental procurements by defining what oversight responsibilities the office will provide, including determining the level of review and approval required for solicitations and awards that are deemed high risk; determining whether an evaluation committee has the appropriate knowledge, expertise, and composition reflective of the complexity and dollar value of the procurement; determining the level of review and approval required for significant contract modifications; identifying what its technical support will be and what role the State Procurement Office should have in conjunction with Administrative Services Office oversight; notifying departmental divisions, branches, and offices of any procurement violations or noncompliance; and enforcing any corrective actions.

Partially Implemented

Comments

In response to the findings and recommendations made in Report No. 15-09, the ASO evaluated its core functions and analyzed its organizational structure. In November 2015, DOH also completed a “Kaizen” business process activity led by an outside facilitator to evaluate how the ASO could improve its procurement process efficiencies. Based on the foregoing, a reorganization proposal was submitted to the director and approved in November 2016. Implementation of the ASO’s reorganization started in January 2017, resulting in the combination of procurement and contracting staff into a new organizational segment within the office called Contracts and Procurement Services (CAPS). CAPS is now responsible for ensuring that all procurement and contracting activities are in accordance with applicable procurement rules and regulations.

In carrying out its responsibilities, the ASO also developed a list of preliminary questions that could be used to assess the level of risk for anticipated procurement efforts, established a Contract Task Force Efficiency Committee to address contract and contract modification issues and streamline the contracting process, and created a procurement committee to establish policies and procedures for DOH procurement activities.

The procurement committee's focus includes but is not limited to:

- (1) reviewing and defining the roles and responsibilities of all entities (DOH programs, ASO/CAPS, and State Procurement Office) involved in DOH's procurement activities;
- (2) evaluating DOH's review process for procurement activities, including Request For Proposals development and evaluation committee selection processes;
- (3) creating a procurement risk assessment tool/process; and
- (4) creating written policies and procedures for procurement processes, including a process to notify departmental divisions, branches, and offices of procurement violations or non-compliance, as well as enforcement actions that the ASO may take.

The procurement committee is expected to finalize DOH procurement policies and procedures by October 2018.

Recommendation 2

The Department of Health should develop a periodic, systematic review of procurement activities to monitor and promote compliance and ensure that all employees involved in procurements adhere to key requirements, including contract administration.

Partially Implemented

Comments

The ASO currently reviews all contracts and purchase orders originating from all DOH program procurements. The office estimates they review about 13,000 individual purchase orders every year and have about 700 active contracts at any given time. To provide consistency in contract formats and streamline DOH's contracting process, the ASO started to require all contracts with vendors after July 1, 2017, to be generated through DOH's Contract Genie system, an application that provides templates allowing contracts to be generated faster, more accurately, and with more consistent formats. The ASO will also continue to be a part of the review process for all contract modifications.

The ASO held three Contracts & Procurement Training presentations between June 1, 2017 and April 5, 2018, and completed a review of procurement delegations for all DOH employees to ensure that employees participating in procurement activities have the requisite training set forth by the State Procurement Office. Furthermore, the ASO now maintains a listing of completed procurement training for all current DOH employees on its intranet, which allows DOH to monitor procurement training for staff on a monthly basis.

The procurement committee is expected to finalize DOH procurement policies and procedures, including a systematic review process to monitor and promote procurement compliance, by October 2018.

Recommendation 3

The Department of Health should improve its procurement practices by developing and implementing a department-specific procurement policy and procedures manual that defines roles, responsibilities, authority, and accountability for each step in the procurement process. The manual should include specific guidelines, instructions, and standards for acquisitions of products and services. It should explain how to handle key issues and mistakes in the procurement, contract administration, and quality assurance processes, detailing procurement controls and oversight responsibilities. The manual should be formally approved by management and periodically reviewed and updated.

Not Implemented

Comments

The ASO's intranet website currently provides links to relevant chapters of the Hawai'i Revised Statutes, workflow diagrams and samples, procurement circulars, and directives that are related to DOH's contracting of goods and services. However, the website does not contain DOH-specific policies and procedures on procurement processes at this time.

The further development of a procurement policy and procedures manual that defines roles, responsibilities, authority, and accountability for each step in DOH's procurement process is one of the ASO's expectations for the procurement committee. The procurement committee is expected to complete its work on the procurement policies and procedures manual by October 2018. Once the procurement policies and procedures manual is completed, the ASO plans to disseminate the manual on its webpage and conduct additional procurement training for DOH staff.

We acknowledge DOH's efforts towards consolidating procurement information for staff use and the challenges presented in developing a department-specific manual. However, as of the time of our follow-up, the evidence provided did not support meaningful movement towards implementation of this particular recommendation.

Recommendation 4

The Department of Health should improve its procurement practices by identifying and communicating what constitutes a high-risk procurement that should be referred to the Administrative Services Office for guidance. Risk factors include contracts where the procurer does not have technical expertise or past experience with what is being procured, unusual contract terms or circumstances, and bid protests.

Not Implemented

Comments

DOH has developed a preliminary list of four questions to assess the level of risk of anticipated procurement efforts. The procurement committee is expected to use these questions to develop a risk assessment analysis and process by October 2018. However, the agendas for the procurement committee's first two meetings held in April and May of 2018 did not include assessing potential procurement risks. Although the four preliminary questions are an initial step to identify and communicate what constitutes a high-risk assessment, the preliminary questions alone do not represent a meaningful movement towards implementation of Recommendation 4.

Recommendation 5

The director of health should ensure that staff involved in procurements are adequately trained and appropriately supervised.

Implemented

Comments

The reorganization of the ASO that established CAPS was done to improve oversight of DOH's procurement activities in response to the findings in Report No. 15-09. As stated in their functional statement, CAPS is responsible for ensuring that all procurement and contracting activities are in accordance with applicable procurement rules and regulations. DOH's reorganization efforts also included the re-description of positions placed within CAPS to build a foundation for organizational oversight of DOH's procurement and contracting activities.

To ensure that all DOH staff involved in procurements are adequately trained, CAPS completed a review of DOH's procurement delegations together with records of completed State Procurement Office training

A list of DOH's preliminary questions that could be used to assess the level of risk of anticipated procurement efforts

- Is this service being procured highly technical that requires individuals with specialized education, training, and knowledge?
- Is the amount of resources proposed to support this service request substantial which would contribute to the risk level of non-performance?
- Is this type of procured services open to procurement protests or complaints?
- Is this type of procured services complex, unique or new to the purchasing agency?

for all DOH employees dating back to 2006 and instructed managers to make sure that delegated staff completed all required training. In addition, the ASO has conducted three in-house procurement training sessions between June 2017 and April 2018, and CAPS will continue offering procurement training sessions three times per calendar year. Furthermore, the ASO now maintains a listing of completed procurement training for all current DOH employees on its intranet. This allows CAPS, which is responsible for reviewing all procurement delegations, to monitor procurement training to ensure all DOH staff participating in procurement activities have the necessary training required by the State Procurement Office.

Recommendation 6

The department should review its procurement of the Grant Thornton/PKF contract. If the department determines that a procurement violation has occurred, it must report this violation to the State Procurement Office and rectify its process to ensure such a violation does not occur in future.

Not Implemented - N/A

Comments

Following the issuance of Report No. 15-09, DOH purportedly did an initial review of the Grant Thornton/PKF contract in July 2015 and concluded that no violation had occurred. At that time, the RFP could not be located, and the review was based only on the contract document. Moreover, we were not provided any documentation of such review. The ASO and the State Procurement Office also met in April 2018 to do another review of DOH's procurement of the Grant Thornton/PKF contract. However, although the ASO was able to retrieve administrative files that contained portions of the initial RFP and contract documents, they were unable to locate the original RFP and a complete set of the original contract documents, which were lost during the subsequent relocation of the DOH division responsible for the procurement. As a result, they were unable to provide the State Procurement Office with all the necessary documentation to confirm or deny if a procurement violation transpired.

Because of DOH's inability to provide all necessary documentation for the State Procurement Office to make a definitive determination if a procurement violation occurred, the State Procurement Office advised DOH not to submit a procurement violation to the State Procurement Office.

Despite DOH's consultation with the State Procurement Office, DOH's inability to provide all the necessary documentation has and will continue to prevent the State Procurement Office from conducting a meaningful review to determine if a procurement violation occurred. Consequently, Recommendation 6 has not been implemented and is no longer applicable.

