

PROCUREMENT ETHICS & COMPLIANCE WITH HRS CHAPTER 103D  
WORKSHOP #126 – September 2014

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Welcome to the Procurement Ethics and Compliance workshop. Procurement ethics and compliance are governed by Hawaii Revised Statute 103D-101, 106, and Hawaii Administrative Rules Chapter 3-131. With procurement delegation and authority comes certain responsibilities. We will cover these responsibilities and the consequences if you fail to conduct or participate in public procurement ethically and in compliance with the Hawaii Public Procurement Code.

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The code of ethics applies to any person, including any actual or prospective bidder, offeror, contractor, or business. This means it also applies to you as a state or county government employee

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We often hear the word ethics, but what is ethics? Ethics is defined as rules of behavior based on ideas about what is morally good and bad. *Ethics is knowing the difference between what you have the right to do and what is right to do.* Specifically, purchasing ethics is a breach of public trust for personal gain, contrary to the procurement code. Sometimes rules are silent and we must use our common sense when conducting public procurement.

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Through workshops like this, the State Procurement Office tries to ensure that employees and vendors understand the Hawaii Public Procurement Code and are given opportunities to attend training workshops. Employees are encouraged to seek guidance about any situation prior to conducting the procurement. SPO staff is available to assist you by phone, e-mail, or if necessary in meetings. When conducting any procurement, all statutes and rules must be followed. Once informed of a problem, staff must take immediate corrective action to remedy the situation that is found to be contrary to the Hawaii Public Procurement Code to prevent it from reaching the level of a procurement violation.

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Ethics in procurement was formalized by the 2010 Legislative session which was passed and enacted into law. Act 207, effective 7/6/2010, amended Hawaii Revised Statutes Section 103D-101. It requires officers and employees of the State and Counties, responsible for conducting public procurement to do so in an ethical manner. It also requires that any person, including any actual or prospective bidder, offeror, contractor or business taking part in public procurement, to act in good faith to practice purchasing ethics, and display business integrity. Hawaii Administrative Rules (HAR) chapter 3-131 on Compliance currently provides parallel provisions for “procurement code of ethics” for procurement personnel and private sector entities doing business with the government.

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Specifically HRS 103D-101(a) requires public employees to:

- 1) Act as a fiduciary and trustee of public (taxpayers) moneys;
- 2) Remain independent from any actual or prospective bidder, offeror, contractor or business;
- 3) Act only in the public interest;
- 4) Abide by the statutes and administrative rules relating to public procurement;

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- 5) Identify and maximize efficiencies in the public procurement process;
- 6) Encourage economic competition by ensuring that all persons are afforded an equal opportunity to compete in a fair and open environment and researching innovative goods and services to meet the public needs;
- 7) Avoid the intent and appearance of unethical behavior;
- 8) Avoid social interactions with any actual or prospective bidder, offeror, contractor business, or other interested parties during the procurement process;

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- 9) Maintain confidentiality in a manner that ensures a fair procurement process;
- 10) Remain impartial in dealings with any actual or prospective bidder, offeror, contractor, business or other interested parties; and finally public employees must
- 11) Identify and eliminate any conflicts of interest.

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In addition to the statute, the Hawaii Administrative Rules 3-131-1.02 also requires employees who engage in procurement to:

- Diligently follow the procurement laws, rules and procedures;
- Avoid soliciting or accepting money, loans, credits, discounts, favors, or services from present or potential suppliers which may influence or appear to influence purchasing decisions.

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Ethical behavior is not only a requirement for public employees, but also any entity doing business with the state. All actual or perspective bidder, offeror, contractors, or business entities taking part in the conduct of public procurement, shall act in good faith to practice purchasing ethics, and display business integrity as a responsible offeror. Additionally they must:

- 1) Avoid the intent and appearance of unethical behavior or business practices;
- 2) Refrain from any activity that would create the appearance of impropriety or conflicts of personal interest and the interests of the State or counties;
- 3) Identify and eliminating any conflicts of interest;
- 4) Ensure that all persons are afforded an equal opportunity to compete in a fair and open environment.

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The bottom line: *All parties involved in the negotiation, performance, or administration of state contracts shall act in good faith.* In public purchasing everything we do is transparent. We need to ensure that all our decision-making processes are of the highest ethical standards. We not only need to know our rules, but we need to follow them. If the rules do not achieve the highest ethical outcomes, they need to be changed

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Ethical expectations pervade every area of our professional and personal lives. The Hawaii Revised Statutes and Hawaii Administrative Rules provide clear direction on ethical behavior. However, it is those gray areas that are most challenging. A 2009 article in *Go Pro*, the official Publication of the

National Institute of Government Purchasing outlined 9 misconceptions to the ethical dilemma in public procurement. Of the nine, 4 are the most profound.

1. "No one is watching." In this example, an accounting clerk failed her character test. She was responsible for cancelling city-owned credit cards for former employees. Because of staff cutbacks, a review of credit card cancellations by another staff member was eliminated. Investigators later found several cards were not cancelled but retained by the accounting clerk. A bank employee questioned the use of the city's credit card to pay a utility bill on a private resident. Auditors later discovered over \$100K in unauthorized use. The employee ultimately served more than 3 years in jail. Someone should always be watching.
2. "If didn't know it was wrong, it must be OK." For example a central purchasing agency has a mandatory use statewide contract for certain goods. A new employee negotiated a contract with a vendor near her office for the same goods. After several discussions why the employee's action was in violation of the existing mandatory contract, the new contract was terminated. When the supplier of the new contract realized that the person who negotiated the contract did not have the authority for such action, they reluctantly canceled the contract. Ignorance is not an excuse.
3. "As long as I am not receiving personal gain, it must be OK." At the request of the director, an employee ordered 11 vehicles instead of the 10 needed to replenish the agency's fleet. The 11<sup>th</sup> vehicle would be for the director's personal use, and the director wrote out a check when the vehicle was delivered. One employee did not think the transaction was right and reported the incident to the ethics commission. An investigation was conducted and the judge stated, "but for your position as an employee of the government agency, you would not have had the opportunity to make that purchase. Therefore, you violated the ethics rules." The bottom line, employees of a government entity should not use their position for any type of personal gain, regardless if it is for themselves or any employee.
4. "The end justifies the means (or if it saves the agency money, it must be OK)." Occasionally people who have contracting authority don't see the harm of "steering" contracts to family or friends. This is an unethical practice. For example, one contracting manager, steered more than \$85,000 over a two year period, to a company owned by his son. Many of the contracts were under \$5,000 requiring competition. An investigation revealed the pattern of routing contracts just under \$5000 to his son's company. The manager was quoted as saying, "The work was performed satisfactorily, and I believe the city received a good product for a fair price. I received no personal gain from the work." Parceling or any other practice which inhibits or eliminates competition is unethical.

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Employees and business entities not only need to be ethical in procurement proceeding, but they also must be in compliance with the Hawaii Procurement Code which governed by Hawaii Administrative Rules 3-131.

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Parceling is one of the most common procurement challenges. What is parceling? Parceling is the artificial or intentional division of multiple procurements that, when combined, exceed the Small Purchase threshold set by statute for any 12-month period. Since there is no definitive definition of

artificial division or intentional division that addresses every circumstance, the procurement officer would consider certain factors when deciding if parceling is artificial or intentional:

1. The higher the price of a group of procurements, the more likely they should be consolidated;
2. The more similar the good, service, or construction, or the more likely it is to purchase a group of goods, services, or construction from one type of vendor, the more likely it should be consolidated. (ex: tree trimming, refuse or disposal services on the same island); and

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3) The more foreseeable the procurement of similar goods, services, and construction is, the more likely it should be consolidated.

Whenever possible, a purchasing agency shall consolidate to allow for a competition process, for example Invitation for Bid (IFB) or Request for Proposal (RFP), particularly when the consolidated estimated expenditure for any twelve month period exceeds the Small Purchase threshold. The procurement officer is responsible for decisions to proceed with small purchase procurements rather than with a competitive sealed process.

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Let's take a look at a couple of case samples.

Case #1

*An employee conducts seven to ten small purchases procurement each fiscal year for plumbing supplies and repairs services for the past two years. In a 12-month period, the agency purchases plumbing supplies and repair services from various vendors totally \$110,000. (Assuming you are not using an SPO approved vendor/price list.)*

The 3 issues identified in this scenario:

1. Based on prior procurement history, plumbing supplies and repair services are foreseeable procurements;
2. Activities are available from one type of vendor.
3. Executive branch departments are required to use electronic procurement for goods, services, and construction for procurements \$15K to less than \$100K.

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The agency should review the history of regular maintenance or services, which would include a list of the most commonly purchased items to determine if a formal method of procurement is necessary, for example competitive sealed bidding (IFB), or request for proposals (RFP). If a competitive process is warranted, the solicitation would result in an "indefinite quantities" or "as needed" type of contract where the exact number of supply or services are unknown. The contract does not have to include every item, but those most commonly purchased. In these types of contracts, there is no commitment to purchase any of the items listed.

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In case #2, the janitorial services contract will expire in three weeks and there are no options to extend. You plan to issue purchase orders for the next few months (beyond the expiration date) until a new contract is executed. What would you do?

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If janitorial services are needed without interruption the agency may ask for a contract extension:

Pursuant to HAR 3-122-3, if a contract has exhausted its provisions for extension, or if the contract does not include a provision for extension, the agency may request, using form SPO-003, an extension for up to 180 days. The form must be submitted and approved by the CPO prior to the expiration of the contract. Otherwise agency would have to cease the janitorial contract upon expiration date, until a new contract is in place.

\*Any purchase made after a contract has expired is considered a procurement violation.

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The head of the purchasing agency is responsible for the agency's compliance with the law. Failure to adhere to the procurement rules & procedures will result in a procurement violation. Procurement violations are normally inadvertent and the result of administrative error, lack of knowledge, or simple carelessness, which may be avoided through the implementation of better procedures, employee training, and progressive discipline. Documentation is important in reviewing and making determination where improvements in procurement processes can be made by individual department/agencies. Any improvements can best be achieved through the agency's own initiative. In the event of a procurement violation and request for payment, a form SPO-016 shall be completed, reviewed, and signed by the HOPA. If a procurement violation requires after-the-fact payment to the vendor, the form SPO-016 must be approved and signed by the CPO and Chief Financial Officer. For those in the Executive Branch that would be the comptroller.

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Procurement violations may result in civil or criminal penalties. A civil penalty occurs when a person contracts for, or purchases goods, services or construction, and knows that the procurement is contrary to the requirements of the procurement law. In this situation the person may be liable for all costs and damages to the State arising out of the violation.

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Violations that are the result of administrative error or mistake, ignorance, or carelessness are usually not subject to the civil penalties. The determining factor is what the person understood the procurement requirements to be when the violation occurred, and whether or not the person believed he or she was acting in compliance with those requirements.

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A person who contracts for, or purchases goods, services, or construction, in a manner the person knows to be contrary to the requirements of the procurement law is liable for all costs and damages to the State arising out of the violation. Additionally, the person may be assessed an administrative fee.

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In order for criminal penalties to apply, a person must have knowingly or intentionally engaged in a scheme to avoid the requirements of the law. The violation must have been committed in a deliberate manner, involving some calculated means, such as parceling for a single procurement, a deliberate misstatement of fact, or an after-the-fact purchase, which is purposefully designed to avoid the requirements of the law.

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To undertake criminal prosecution, there must be legally admissible documentary evidence of the wrongdoing, available to law enforcement authorities. Law enforcement authorities will also need to

determine whether personal gain was intended or involved for either the person committing the violation, a friend or relative of the person, or the vendor, or whether some other vendor was significantly injured, whether intended or not.

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A person who intentionally or knowingly contracts for or purchases goods, services, or construction, under a scheme or deceit to avoid the requirements of the procurement law shall be guilty of a misdemeanor, and any applicable criminal penalties. Additionally, the persons may be subject to removal from office and liable to the State or county for any sum paid by it in connection with the violation, and that sum, together with interest and costs. The state or county may also impose administrative fines.

The AG would determine whether or not to pursue civil or criminal charges. In order for civil penalties to apply, a person must have knowingly violated the requirements of the law. In other words, the person committing the violation must be aware that he or she is acting contrary to the requirements of the law at the time the violation occurs.

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In addition to any civil or criminal penalties allowed by law, the CPO may take action against any a **government employee** found to be in violation of any provision of the Hawaii Public Procurement Code, HRS 103D. Action may include:

1. Require reimbursement for any sum paid in connection with the violation, including interest and costs;
2. A recommendation for termination of employment;
3. Reduction or rescission of delegated procurement authority; and
4. Administrative fine.

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The chief procurement officer may render a written decision on any person found in violation of any provision of this chapter, and impose any of the following (person or actual prospective offeror):

1. Payment for any sum paid in connection with the violation, including interest and costs;
2. Suspension and debarment action pursuant to statute
3. Administrative fine.

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Prior to imposition of an administrative fine, the CPO shall notify the person in writing that the CPO intends to assess an administrative fine. A CPO may assess an administrative fine in the amount of \$5,000 for each violation involving a procurement which amount is in excess of the dollar levels specified as small purchases.

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A chief procurement officer may assess an administrative fine in an amount not to exceed \$1,000 for each violation involving a procurement which is less than the dollar levels specified as small purchases. The person shall be given the opportunity to be heard by the CPO. A request for a meeting shall be made within seven calendar days after the receipt of the CPO's letter.

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After the meeting, if any, should the CPO determine that the imposition of an administrative fine is appropriate, the person may request the review of the assessment through an administrative review of the CPO's decision pursuant to section 103D-709, HRS (Administrative proceedings for review) with DCCA.

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In addition to administrative fines to the employee, the 2008 Legislature passed Act 203 which allows the Administrator of the SPO to impose an administrative fine on a Procurement Officer or a CPO who fail to take corrective action to remedy the situation, or prevent its reoccurrence. Action may include training, or reduction of an employee's purchasing authority.

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The administrative fines would apply if the Procurement Officer or CPO fails to take corrective action within 30 days from the date of notification for each day of noncompliance. The fines may be assessed for every day of noncompliance.

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The form SPO-016 is used to report a procurement violation and request after-the-fact payment. The form must include:

1. Description of the goods, services, or construction procured.
2. The applicable method of procurement used (i.e. RFP, IFB, Small Purchase, Sole Source, Emergency, Exemption, Professional Services, or the SPO Price/Vendor List).

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3. Facts and circumstances that led to the procurement and why appropriate procedures were not followed (i.e., unanticipated, unplanned, lack of planning, etc.). Comments in this section must also address the questions:

- ✓ Where there any indications of intent to deliberately evade appropriate purchasing procedures (i.e., parceling, use of pCard/purchase orders, etc)?
- ✓ Was there a lack of procurement information or training that contributed to the violation (i.e., person did not attend mandatory training, no written procedures, inadvertent mistake, etc.)?
- ✓ Is this a first occurrence?

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And finally,

4. The corrective action that has or will be taken to prevent recurrence. SPO wants to know what appropriate written assurances and safeguards have been established to preclude a subsequent violation (meeting, attendance at mandatory training, procurement authority rescinded, posting of written procedures, etc.).

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Thank you for attending. Please take a moment to fill out the self-certification form that will pop up shortly. You will also be requested to fill out a short survey by clicking on a link. We appreciate your feedback. Thank you very much for attending this workshop. If you have any questions please feel free to contact me at 587-4702, or [bonnie.a.kahakui@hawaii.gov](mailto:bonnie.a.kahakui@hawaii.gov).