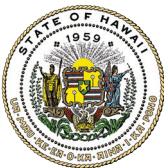


Audit of the Honolulu Authority for Rapid Transportation: Report 2

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

Report No. 19-04
January 2019



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.

For more information on the Office of the Auditor, visit our website:
<http://auditor.hawaii.gov>

Foreword

Our audit of the Honolulu Authority for Rapid Transportation (HART) was conducted pursuant to Act 1, which the Hawai‘i State Legislature passed during the 2017 First Special Session. Act 1 requires the Auditor to conduct an audit of the financial records and an analysis of the financial management of HART. This audit report focuses on HART’s management structure, decision-making processes, and use of third-party consultants in key management positions.

This audit was somewhat unique for us in that HART is a quasi-independent agency of the City and County of Honolulu and not an agency of the State of Hawai‘i. However, the State Constitution, Article VII, Section 10, empowers the Auditor to conduct audits of all departments, offices, and agencies of the State and its political subdivisions.

During the course of our audit work, we gained information about HART from the Office of the City Auditor (City Auditor), City and County of Honolulu. The City Auditor previously audited HART and is conducting another audit of HART concurrent with our audit. We appreciate the City Auditor’s generous support of our work.

We also express our thanks to HART and members of its Board of Directors whom we contacted during the course of our audit for their assistance.

Leslie H. Kondo
State Auditor

Table of Contents

Introduction.....	1
Audit Objectives	3
Audit Scope and Methodology	3
Background.....	5
HART’s Organizational Structure	6
HART and Board policies delineating decision-making responsibilities are still in flux.....	10
Board’s increased oversight authority yet to be implemented.....	10
Permitted Interaction Group proposes policy on Board oversight and decision-making.....	11
Despite recent Board actions clarifying lines of authority, gray areas may persist.....	12
HART withholds contingency amounts from budget reporting.....	12
Decision to pursue public-private partnership to complete construction was left to the discretion of the CEO.....	14

**HART relies on third-party consultants to oversee
and manage other third-party consultants.....16**

 HART oversight: reactive and after the fact..... 18

 HART relies on consultant to determine whether
 its own staff’s work is satisfactory.21

 HART does not retain complete documentary
 evidence of its quality assurance audits of
 consultants.....23

Conclusion25

Recommendations26

**Office of the Auditor’s Comments on the
Honolulu Authority for Rapid Transportation’s
Response to the Audit Report.....29**

Attachment 1 Response of the Honolulu Authority
for Rapid Transportation33

List of Exhibits

Exhibit 1 HART’s Organizational Structure –
Relating to Design and Construction..... 8



PHOTO: HONOLULU AUTHORITY FOR RAPID TRANSPORTATION

The Buck Stops...Where?

Report on HART's Management Structure, Decision-Making Processes, and Use of Third-Party Consultants in Key Management Positions

Introduction

DURING THE 2017 First Special Session, the Hawai'i State Legislature passed Senate Bill No. 4, which was signed by the Governor as Act 1. Act 1 provided additional sources of funding for the Honolulu Rail Transit Project (Project), extending the surcharge on the Hawai'i general excise tax (GET) and increasing the Transient Accommodations Tax (TAT). Act 1 also called for an audit by the State Auditor of the Honolulu Authority for Rapid Transportation (HART). The audit dictated under Act 1 includes, among other things, an "analysis of the financial management" of HART to determine whether funds received by HART from the County surcharge on State tax "are being managed and used in a reasonable manner." This report examines some of these issues.

The audit dictated under Act 1 includes, among other things, an "analysis of the financial management" of HART to determine whether funds received by HART from the County surcharge on State tax "are being managed and used in a reasonable manner."

To assess HART's use of the State revenues, it is essential to understand HART's management and decision-making structure as a foundation for this and other reports to come. This report is intended to describe and explain this foundation. We report HART's current management structure, the relationship between HART and its Board of Directors (Board), and HART's use of third-party consultants – notably, the project management support consultant, HDR Engineering, Inc. (HDR) – to manage the Project.

Our review and analysis of HART's management structure revealed some concerns that we also detail in this report. First, we found that HART's decision-making processes, in particular the interaction and division of responsibilities between HART's Chief Executive Officer (CEO) and the Board, have changed over time and remain unsettled. After several years of operation, billions of dollars in expenditures, numerous delays, and substantial cost increases, these responsibilities – and the corresponding accountability – should have been clearly defined well-before now. Instead, it took a 2016 amendment to the Revised Charter of the City and County of Honolulu to spur proposed changes, which were still under consideration at the time of our audit.

Second, we found that HART uses third-party consultants rather than HART employees for many key management positions. While this may be a concession to certain operational realities, we also found that HART's oversight of these consultants given their critical roles on the Project is superficial, not well-documented, and does not adequately ensure performance and accountability to HART and the City and County of Honolulu (City). For example, consultants often manage consultants who manage other consultants, with little, if any, oversight by HART staff or management. HART also does not evaluate the performance of its consultants and has not been keeping complete records of its audits of consultants' quality assurance work. At a minimum, this limits accountability, undermining confidence in the process and hurting quality controls.

This is the second of four reports relating to HART that we plan to issue pursuant to Act 1. The first report presented the background and issues relating to, among other things, the estimated project costs, construction schedules, and completion dates from 2014 through 2016; other reports will present the process HART and the Department of Accounting and General Services have implemented related to the payment of "capital costs" from the Mass Transit Special Fund; and HART's invoice payment process for selected construction and consultant invoices.

Audit Objectives

1. Describe the current condition of HART's administration and operations.
2. Assess whether HART's oversight and management of selected consultants is in compliance with applicable laws, policies, procedures, and other relevant best practices.
3. Make recommendations as appropriate.

Audit Scope and Methodology

This audit was performed pursuant to Act 1, First Special Session 2017, which directs the State Auditor to conduct an audit of HART. Act 1 requires the audit to include an examination of the financial records and an analysis of the financial management of HART. This is our first audit of HART.¹

The part of our audit reported herein focused on fiscal years 2017 and 2018; however, we also reviewed HART activity and documents outside of that period, where relevant. We conducted interviews with the HART CEO and other managers, HART staff, the Board Chair, and certain HART consultants. We reviewed applicable laws, policies and procedures, board minutes, and other documentation. Additionally, we judgmentally selected consultant contracts based on their relevance to project oversight. We examined consultant contracts, the consultants' applicable policies and procedures, reports submitted to HART by the consultants, and other relevant documents to assess HART's oversight of the consultants.

Difficulties with access to information

Pursuant to Chapter 7, Section 7.11 of *Government Auditing Standards* issued by the United States Government Accountability Office, "Reporting Standards for Performance Audits," auditors should report "information limitations . . . including denials or excessive delays of access to certain records or individuals."

HART management and the Board expressly pledged HART's full and complete cooperation with our audit. However, that promise was not kept, as we encountered numerous difficulties in obtaining cooperation and information during the course of our work.

¹ HART has been audited numerous times by its financial auditors, the City and County of Honolulu Auditor, the Federal Transit Administration (FTA) via its Project Management Oversight Contractor, and other consultants. We reviewed these reports during the course of our fieldwork.

HART initially represented that we would have full and unrestricted access to documents and other information maintained in HART's Contract Management System and Microsoft SharePoint platform. HART maintains the majority of its contract documents in this electronic document management platform; however, we were not given access to the Contract Management System for months after our initial requests, and the access we were finally given was limited. During the course of our audit, we repeatedly encountered areas in the system that we could not access, and despite repeated requests, HART refused to confirm that we had unrestricted access to its electronic records.

We also experienced significant delays in receiving documents from HART and never received some documents that we had requested, notwithstanding multiple follow-up requests. The minutes of the board's executive sessions that we did receive were redacted so extensively as to render them indecipherable and meaningless. However, even then, HART only provided minutes of the board's executive sessions held from June 8, 2016 to September 14, 2017. We had requested the minutes of the board's executive sessions for the period January 2014 through December 2016. HART did not address or otherwise respond to our request for the minutes that it did not provide, i.e., from January 2014 through June 2016. Based on the board meeting agendas posted on HART's website, the Board held numerous executive sessions during that period.

We were also informed by HART staff that management had instructed its employees and consultants to audio record the audit interviews. Because of that requirement, we were unable to obtain as complete and unfiltered responses to our questions and other information as we expected. Despite repeated objections to the Board and management about the audio recordings, we were informed that the CEO continued his direction that staff and consultants record the interviews.

We report these challenges and limitations on our information gathering in accordance with applicable government auditing standards. Notwithstanding these challenges, we do believe that the evidence is sufficient and appropriate to support the findings and conclusions made in this report.

Our audit was performed from March 2018 through November 2018 and conducted 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 the evidence we obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Act 1, 2017 First Special Session

During the 2017 First Special Session, the Hawai‘i State Legislature passed Senate Bill No. 4, which became Act 1, to provide the City with additional revenue sources for the construction of the Project. More specifically, Act 1 authorized the City to extend the expiration of the one-half percent GET surcharge from 2027 to the end of 2030 and, beginning January 1, 2018, increased the TAT from 9.25 percent to 10.25 percent.² Revenues from the surcharge on GET and one percent of TAT revenues are deposited into the Mass Transit Special Fund, which was created by Act 1 and is administered by the State Department of Budget and Finance. The revenues from the Mass Transit Special Fund can be used by HART only for “capital costs,” broadly speaking, expenses directly related to construction of and land acquisition for the Project.

HART History³

In November 2010, O‘ahu voters passed an amendment to the Revised Charter of the City and County of Honolulu that set the framework for the creation of HART, a semi-autonomous public transit authority, which was initially charged with the design, construction, operation, maintenance, and expansion of the fixed guideway rail transit system. Prior to the amendment, the Director of the City Department of Transportation Services (DTS) was responsible for the planning, operation, and maintenance of all transportation systems on O‘ahu. This charter amendment explicitly limited the DTS Director’s authority, stating that the Director “shall have no power, duty, or function with respect to transportation systems, facilities, or programs which are under the jurisdiction of [HART].” To carry out the Charter’s new mandate, all DTS Rapid Transit Division staff and functions were transferred to HART. HART began operating on July 1, 2011.

In November 2016, voters approved an amendment to the Revised Charter of the City and County of Honolulu that transferred responsibility of the operations and maintenance of the rail system from HART back to DTS. Therefore, HART now has an expiration date; once the rail system is operating, HART’s mission will end. However, until then, HART is still responsible for construction and completion of the rail system. HART’s latest recovery plan (November 19, 2018) estimates that the rail system will be fully operational in December 2025 at a cost no greater than \$8.165 billion (excluding financing costs).⁴

² Act 1 amended Section 237D-2, Hawai‘i Revised Statutes (HRS), by establishing the TAT at 10.25 percent for the period beginning January 1, 2018 to December 31, 2030.

³ A comprehensive history of the Project can be found in Report No. 19-03, *Audit of the Honolulu Authority for Rapid Transportation: Report 1*.

⁴ While HART believes that its own cost estimate and schedule are achievable, HART has agreed to use the FTA’s recommended project cost of \$8.299 billion (excluding financing costs) and opening date of September 2026.

Funding Sources (in millions)

2018 HART Recovery Plan



\$9,248,000,000**

*American Recovery and Reinvestment Act, interest income, and rent.

** Numbers may not match due to rounding.

Source: Office of the Auditor

HART's Organizational Structure

Board of Directors

HART is governed by a 14-member Board of Directors (Board). The Board is the policy-making body of the authority and appoints and evaluates HART's CEO. The Board approves HART's annual operating and capital budgets, a six-year capital program, rules and regulations, and carries out other duties as authorized by law.

The Feds are Watching ... and Reporting.

HART's \$1.55 billion in federal funding comes with federal oversight.

IN EXCHANGE for the Federal Transit Administration's (FTA) commitment to provide \$1.55 billion in funding under the New Starts program, the City and HART committed to completing the project on time, within budget, and in compliance with all applicable federal requirements. These mutual commitments are embodied in a binding contractual agreement – a Full Funding Grant Agreement, which was executed by the City and the FTA on December 19, 2012. The agreement places numerous conditions and requirements for the funding on HART. One of those requirements is participation in FTA project management oversight reviews and evaluations of the Project's various processes to ensure satisfactory progress is being made, as well as compliance with statutory, administrative, and regulatory requirements. The FTA or its project management oversight contractor evaluates a project to ensure project sponsors, in this case the City and HART, have the financial capacity to complete the project according to the terms of the Full Funding Grant Agreement.

As of November 2018, HART has received \$806 million in FTA funding, with \$744 million awaiting FTA approval for release of funds.

One of the Project's oversight reports, referred to as a "risk refresh," was released in October 2012, prior to the execution of the Full Funding Grant Agreement in December of that year. The report noted that the project cost was kept at \$5.12 billion despite the emergence of multiple issues that pushed up costs. Among other issues, the report identified that the suspension of construction due to an August 2012 Hawai'i Supreme Court ruling could increase costs ranging between \$64 million and \$95

million, excluding escalation for future contracts and extended staffing costs.

Concerns about cost containment and schedule maintenance would persist in subsequent risk refresh reports in 2014 and 2016. For instance, in the 2016 report, the FTA's oversight contractor determined that HART's cost estimates of \$6.43 billion fell short of the FTA's model by \$1.19 billion. It estimated that the total cost to complete the Honolulu Rail Transit Project would range between \$7.73 billion and \$8.02 billion and the opening date would be delayed from December 2022 until December 2024.

According to the report, HART did not provide evidence that it "fully evaluated the costs of design changes, the schedule implications, the effects on existing construction contracts, and the political will to entertain any such changes."

According to the FTA, if at any time during its efforts to complete the project HART determines that the total project cost will exceed the baseline cost estimate, HART must immediately notify the FTA of the amount of the difference and the reasons for the difference. Further, HART must provide the FTA with a "recovery plan" that demonstrates it is taking and will take every reasonable measure to eliminate [recover] the difference between the total project cost and the baseline cost estimate. Requiring the submittal of a recovery plan is an action that neither project sponsors nor the FTA wants to invoke.

In June 2016, the FTA directed HART to submit a recovery plan. In September 2018, the FTA directed HART to submit a revised recovery plan.

The voting membership of the Board is composed of the Director of the State Department of Transportation; the DTS Director; six volunteers from the community, three appointed by the Honolulu Mayor and three by the Honolulu City Council; and a ninth member of the Board appointed by the other voting members. These appointed board positions serve five-year terms. The term limit for these positions is two full consecutive terms or ten years, whichever is greater. The Director of the City Department of Planning and Permitting serves as a non-voting member. Act 1 added four more non-voting members to the Board, two of whom are appointed by the President of the State Senate and two of whom are appointed by the Speaker of the State House of Representatives.

Chief Executive Officer

The CEO is responsible for the performance of the entire HART organization and is directly accountable to the Board. The CEO manages the various areas of responsibility utilizing certain key managers, or “direct report” staff, many of whom are employees of a third-party project management support consultant, as noted in the organizational chart in Exhibit 1. In addition, the CEO interfaces with the Honolulu City Council and Honolulu Mayor, the State Department of Transportation, the U.S. Department of Transportation, the FTA, and other relevant regulatory agencies. The CEO is also the “face” of HART, representing the organization with the general public, property owners impacted by the Project, the media, and the design and construction industries.

Staff

During the period of our audit, HART’s targeted project staffing was 135 full-time equivalent staff, comprised of civil service and personal services contract HART employees and employees of HART’s third-party project management support consultant, HDR. There is also an unspecified number of staff (not reflected in the organizational chart) from various City departments who provide support to HART.

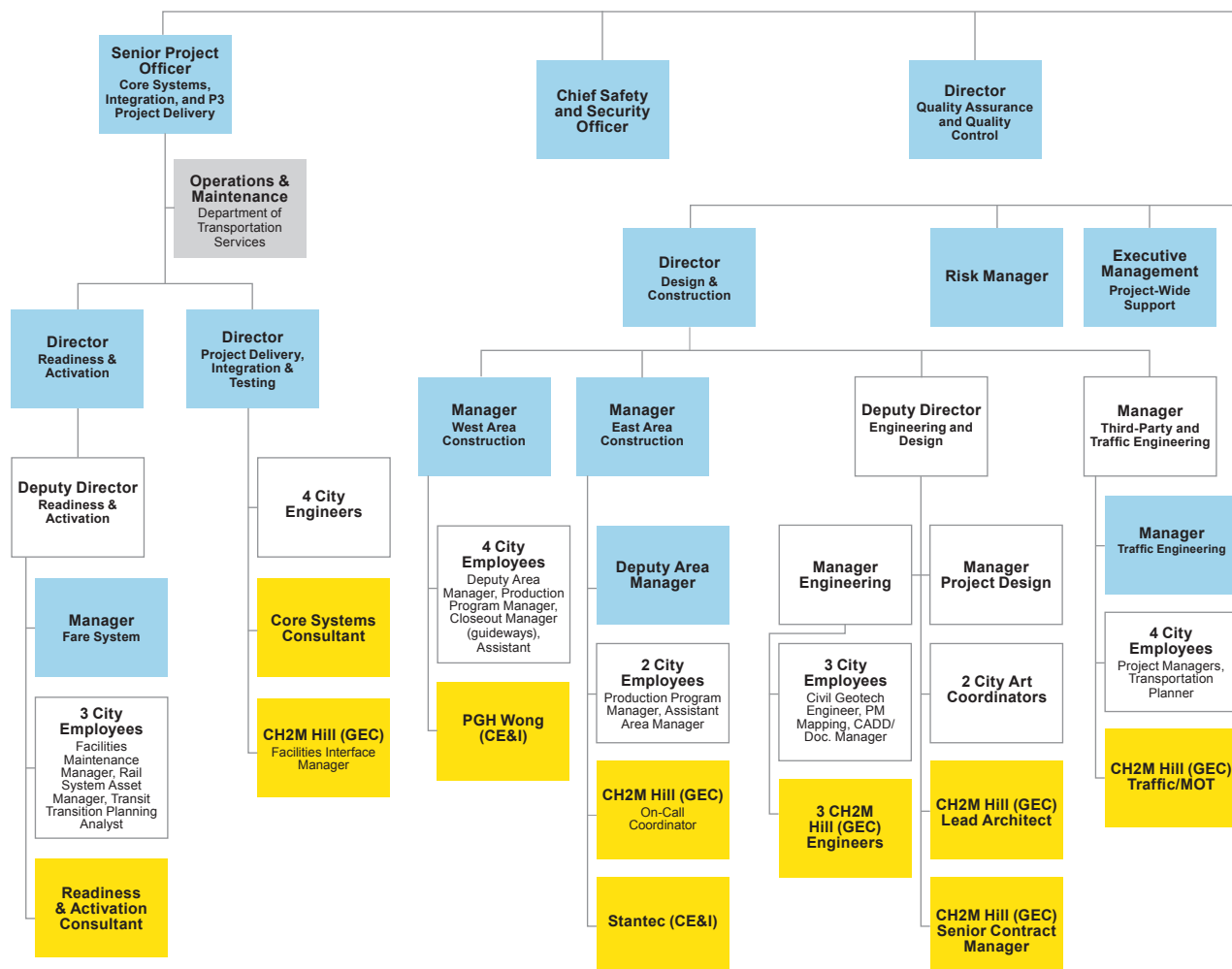
As of November 2018, HART’s organizational structure consisted of 117 HART employees (112 personal services contract and 5 civil service) and 18 HDR employees, totaling 135 staff.

According to HART, HDR employees are completely integrated into HART’s technical and managerial positions. The CEO stated that HART does not draw a distinction between HDR employees and HART employees. HDR staff are highlighted blue in the organizational chart in Exhibit 1.

Exhibit 1

HART's Organizational Structure – Relating to Design and Construction

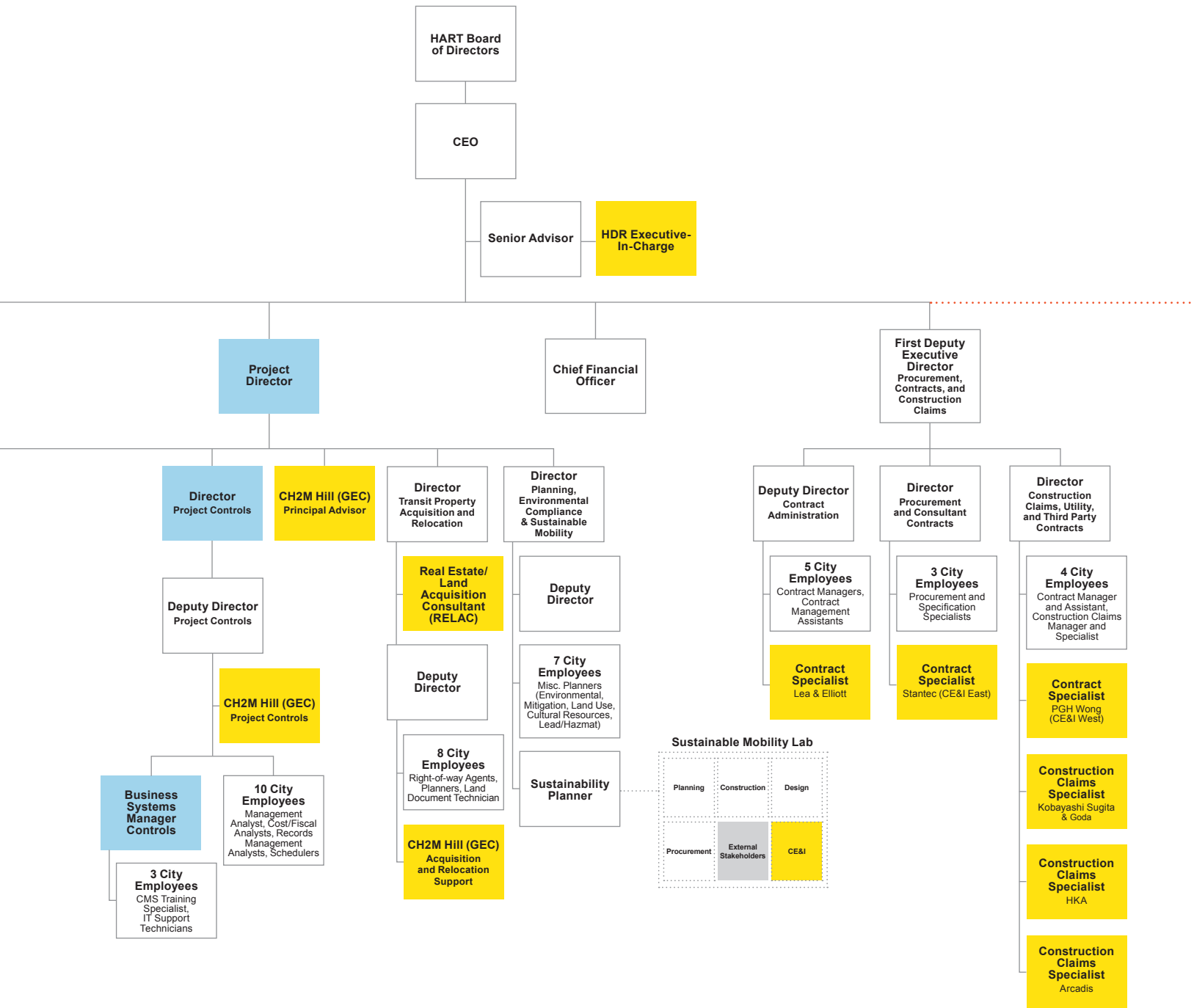
This is a modified organizational chart based on charts provided by HART.



- HART Employee
- HDR Employee
- Third-Party Consultant
- Other

General Engineering Consultant (GEC)
Construction Engineering and Inspection Consultant (CE&I)

Source: Office of the Auditor



HART and Board policies delineating decision-making responsibilities are still in flux.

Per the Revised Charter of the City and County of Honolulu, the Board exercises its policy-making authority through various means, including hiring/terminating the CEO, evaluating the CEO and determining his/her compensation, adopting and enforcing rules and regulations pertaining to the organization and internal management of HART, and allocating decision-making responsibility between the Board and HART management. In contrast, the CEO is responsible for administering “all affairs of [HART],” including signing all necessary contracts, recommending to the Board the creation or abolishment of HART positions, maintaining HART’s financial accounts, and recommending rules and regulations for adoption by the Board.

Board’s increased oversight authority yet to be implemented.

The original City Charter provisions creating HART provided that one of the powers, duties, and functions of the Board was to “determine the policy for planning, construction, operation, maintenance, and expansion of the fixed guideway system.” The Board also had (and still has) the authority to adopt HART’s annual operating and capital budgets, a six-year capital program, rules and regulations, as well as other actions authorized by law. Prior to 2016, however, the Board’s authority was limited in the City Charter to the extent that “*neither the board nor its members shall interfere in [any way] with the administrative affairs of the authority.*” Notwithstanding its otherwise broad authority to oversee HART, the Board believed that its primary method of oversight of administrative matters rested in its ability to hire, evaluate, and terminate the CEO.

In November 2016, the voters of the City and County of Honolulu approved Charter Amendment 4, which, among other things, expressly expanded the powers, duties, and functions of the Board to include oversight and decision-making over HART’s administrative operations.

We asked the current Board Chair how the 2016 charter amendment has affected communication between HART and the Board. He said that the current Board is more involved in the day-to-day operations of the Project because, in the past, the Board was structured such that information about the Project was split among the Board’s subject area committees (e.g., Project Oversight Committee, Finance Committee, etc.) rather than being presented to the entire Board. Now, he explained, the entire Board is receiving more reports and is notified of project updates as they occur, whereas in the past the Board would wait for the next board meeting to receive a project update.

Permitted Interaction Group proposes policy on Board oversight and decision-making.

In October 2017, the Board established a Permitted Interaction Group to work on policies, rules, and regulations to implement its increased oversight authority. In September 2018, the Board's Permitted Interaction Group issued its report and recommendations regarding how the Board should implement the 2016 charter amendment. The Permitted Interaction Group offered a proposed policy on the Board's oversight and decision-making over HART's administrative operations. The Board was expecting to vote on the Permitted Interaction Group's report and proposed resolution in November 2018.⁵

Generally, Board approval is required for all *policy* decisions pertaining to HART and for actions otherwise specified by law. The Permitted Interaction Group recommended that the scope of Board oversight over administrative operations should focus on HART's ability to complete the Project by the Board-approved opening date and within the financial plan. Similarly, in regard to decision-making, the group recommended that the Board's role should be limited to actions that affect HART's ability to complete the Project. The recommended policy explicitly states that all other administrative matters shall be within the discretion of the CEO and his staff.

The group also recognized that the Board's existing rules do not specify actions requiring Board approval (an area we explore further below). The group recommended a list of 13 items which would require Board approval:

- Certain arrangements and agreements with the federal government and with any public entity or utility
- Change orders in excess of \$1 million or which could have a significant impact on the "critical path" of the Project
- Operating and capital budgets
- Six-year capital program
- Additions and deletions of contract packages relating to the annual operating and capital budgets and six-year capital program
- Appropriations, grants, loans, and gifts
- Appointment and removal of the CEO
- Issuance of the annual report
- Creation/abolishment of positions within HART

⁵ After the conclusion of our fieldwork, the Board adopted the Permitted Interaction Group's report and proposed resolution as Resolution No. 2018-14 on November 15, 2018.



Where the Sun Don't Shine

THE HART BOARD is subject to the State's open meetings law, commonly referred to as the "Sunshine Law," part I of Chapter 92, Hawai'i Revised Statutes. As a government board, its discussions, deliberations, decisions, and actions must be conducted as openly as possible, with public notice and an agenda of its meetings posted in advance and minutes reflecting the substance of the board's actions. There are certain limited exceptions that allow board members to privately discuss board matters, without keeping minutes of those discussions, one of which is a "Permitted Interaction Group." That exception allows two or more board members, but less than the number needed for quorum, to "investigate" a matter relating to the official business of the board, so long as the group is created and the scope of its investigation is defined at a board meeting. The Permitted Interaction Group also must present its findings and recommendations to the entire board for decision-making, if any.

- Selection of the Board's ninth voting member
- Contracting for the annual independent financial audit of HART
- Eminent domain actions
- Bond sales

Despite recent Board actions clarifying lines of authority, gray areas may persist.

The appropriate division of responsibility between an organization and its governing board is subject to some interpretation. According to the American Public Transportation Association's *Transit Board Member Handbook*, the distinction between governance and management is complex, dynamic, and not absolute; the roles of the CEO and board members occasionally and naturally enter the other's domain.

However, we found that certain aspects of those respective roles have yet to be clarified. For instance, HART's internal policies and procedures establishing the process for communicating information to the Board, as well as policies outlining what project information must be brought before the Board for decision-making, have not been revised in more than six years. But, more importantly, we identified two issues which appear to fall within a gray area of HART governance. We believe that these matters either critically affect or fundamentally alter the way the authority operates and therefore should be reported and vetted. Instead, according to the CEO, the decision-making authority on these matters fell well-within his purview, giving him the discretion to report to and consult with the Board – or not.

HART withholds contingency amounts from budget reporting.

Construction contracts, especially for a project the size and complexity of the Honolulu Rail Transit Project, cannot anticipate every issue that the contractor may encounter once work begins. For instance, often project conditions may differ from what was reasonably anticipated by both the project owner and a contractor; a contractor may incur additional costs because of delays to its scope of work that are caused by others.

To cover these unexpected costs, HART includes a "cushion" or "reserve" as part of the total amount it budgets for each contract, both awarded and anticipated. Those funds, referred to as "allocated contingency," vary in amount, depending on the contract's scope of work and/or the risk associated with the work. (For a further description of contingencies, see "The Budgeted Contingency: Expecting the Unexpected" on page 13.) However, we found that HART does not include the allocated contingency when it publicly reports the budget

for a particular contract or phase of work. Although HART reports the cumulative total contingency that it has allocated for all its contracts, HART does not disclose contract-specific contingency amounts, *even to its own Board*. The CEO justifies this decision to withhold the information because he believes that disclosure of the allocated contingency for a specific contract will result in higher project costs. According to the CEO, if contractors know how much contingency has been set aside, they may seek change orders to exhaust the contingency.

However, it is because costs have greatly exceeded the amount budgeted for certain contracts that HART has needed additional funding. Starting with the Project's very first construction contract – the \$483 million contract to Kiewit Pacific Co. (Kiewit) – the allocated contingency has been tapped and often exceeded for many contracts. In Report No. 19-03, *Audit of the Honolulu Authority for Rapid Transportation: Report 1*, we chronicled the Project's turbulent financial history, reporting that the original budget of \$5.122 billion included \$644 million in total project contingency, but the delay claims and other unexpected issues associated with certain of those first contracts resulted in \$354 million in change orders.⁶ HART incurred almost \$198 million in unexpected costs relating just to the Kiewit contract.

⁶ In total, approved change orders total over \$559 million, as of December 2018.

The Budgeted Contingency: Expecting the Unexpected

IT IS IMPOSSIBLE to predict all the variables that may be encountered during a project the size and complexity of the Honolulu Rail Transit Project. Lawsuits, unanticipated site conditions, property acquisition, utility relocation, market fluctuations, delays – potential roadblocks and their related risks are myriad.

A means of mitigating such challenges – expecting the unexpected – is to build an analysis-based contingency into the project's budget, adding moneys to the estimated project cost to absorb the impacts of risks and to cover cost overruns. An effectively managed contingency helps ensure that cost adjustments associated with risk can be covered without having to seek additional or new funding.

The amount of project contingency is directly related to the risk associated with completing a particular scope of work. In the case of the Honolulu Rail Transit Project, the original budget of \$5.122 billion included \$644 million in contingency funding.

Contingency moneys would be tapped early and often. In November 2009, the City executed a \$482.9 million contract with Kiewit to design and build the West O'ahu Farrington Highway portion of the guideway, the system's first 6.5 miles, from East Kapolei to Pearl Highlands. In June 2011, Kiewit was also awarded a \$372.2 million contract for the construction of the 3.9-mile Kamehameha Highway guideway, which stretched from Pearl Highlands to Aloha Stadium. Also, that month, the City awarded a \$195.3 million contract for the train's maintenance and storage facility to Kiewit/Kobayashi. Construction of the West O'ahu Farrington Highway guideway did not start until April 2012.

The "unexpected" – for example, lengthy environmental review, lawsuits and an unfavorable court decision, and poor planning – contributed to \$312.3 million in change orders, eating up nearly half of the Project's original contingency budget.

Despite the Project's heavy reliance on its contingency, each year we found that the Board is asked to – and does – approve HART's construction budget, which includes a list of each executed and unexecuted contract anticipated to complete the Project with the corresponding budget for each, *minus the allocated contingency*.

Without the allocated contingency, the Board does not know the total amount HART has budgeted for the scope of work under each contract and does not know whether the actual construction costs exceeded the amount that HART had budgeted for that work. Without this information, how can the Board ensure that the CEO is accountable for the work being completed within a contract's budget? How does the Board ensure that the Project stays on budget? How does the Board assess HART's budgeting process?

HART has pledged to be more transparent in its operations. Considering the Project's estimated cost has swelled almost 80 percent to \$9.188 billion, we agree that transparency is paramount. Although we understand the CEO's concerns, we question whether the CEO has sufficiently considered the public interest in the entire budget for each contract, especially given the Project's history and the greatly expanded amount of the Project's costs that State residents and visitors are now obligated to fund, and public policy determined by the Legislature. The Hawai'i Supreme Court recently reaffirmed the State's policy requiring "[o]pening up the government processes to public scrutiny."⁷

We also disagree with the CEO that disclosure of the allocated contingency will necessarily result in higher project costs. According to HART's Contract Change Procedure, HART assesses every change order seeking to increase the contract amount for "merit." Without that finding of merit, HART will reject the change order. That requirement – i.e., merit for additional moneys – should not change even if the contractor knows the amount of allocated contingency associated with its contract.

Decision to pursue public-private partnership to complete construction was left to the discretion of the CEO.

In September 2018, the Board voted to support HART's plan to pursue a public-private partnership, commonly referred to as "P3," to help pay the \$1.4 billion cost of the City Center Guideway and Stations segment of the Project and build the Pearl Highlands Parking Garage and Transit Center. This matter was brought before the Board despite some HART managers' belief that the issue did not need approval since it was a matter of "project delivery," an area outside of the Board's authority.

⁷ *Peer News LLC, dba Civil Beat v. City and County of Honolulu*, --- Hawaii ---, --- P.3d ---, No. SCAP-16-114 (December 21, 2018) (quoting Section 92F-2, HRS).

To P3 or not to P3?

HART's midstream pivot to a P3 project delivery model raises more questions than answers.

CONSTRUCTION OF THE RAIL PROJECT

to date has used a conventional design-build model in which HART enters a fixed-price contract with a construction firm and makes progress or "milestone" payments as construction is completed. However, in September 2018, HART's Board of Directors approved the use of a new model for the design, construction, and financing of the system's City Center Guideway and Stations segment (Kalihi to Ala Moana Center) and Pearl Highlands Parking Garage. Under this new model, commonly referred to as a public-private partnership, or "P3," HART enters into a contract with a developer, which then partners with construction, operating, and financial partners who have the responsibility, and the associated risks, of delivering the Project. In addition, the private partner will be given a 30-year concession to maintain and operate the entire system. The City repays the developer for construction costs using tax revenue sources and, unlike the present model, payments continue for five years after construction is completed.

HART's choice of P3 represents a shift in the completion of the Project and eventual operation and maintenance of the rail system. According to a 2018 analysis of the commercial viability of public-private partnerships commissioned by HART, by transferring key project delivery risks to the private sector, P3s increase certainty of on-schedule, on-budget delivery, as well as provide long-term operating cost reliability. The analysis also claims that the size and scope of a P3 for the Project could attract major international firms, which could promote competition and "directly harness global best practices and drive innovation."

According to HART, P3s have been used by numerous major transit projects internationally

for decades and, more recently, in the United States by such cities as Denver, Los Angeles, and the suburbs of Washington, D.C. However, HART will be introducing a new delivery model midstream, with the rail's West Side segments under one model and its East Side segments under another. According to HART's November 19, 2018, Recovery Plan, the completion of the airport guideway and finalization of West Side contracts and related systems installation will not be included under the P3 contract.

There are also questions regarding the City's role in operations and maintenance of the Project once construction is complete. For instance, in 2016, with the passage of Charter Amendment 4, operations and maintenance responsibilities were shifted from HART to the City and County of Honolulu's Department of Transportation Services. In its November 19, 2018, recovery plan, HART was unclear exactly how the P3 approach would change responsibilities for operations and management, but it appears that the Department of Transportation Services will now have an oversight role over the eventual P3 vendor, who will be given a 30-year concession to operate the rail system. Terms of the allocation of risk between the City and P3 developer, and terms of the developer's concession to operate and maintain the Project, have yet to be negotiated.

Those opposed to P3 conversion claim that there is no evidence that P3 reduces construction costs and can be used to avoid debt limits. Opponents also claim that in order to make money off of the partnership, a private partner would insist on structured payments that would guarantee a set amount of income each year, instead of payment based on ticket revenue.

But the CEO felt that switching to a public-private partnership was a significant decision that should go through the Board. He believes that anything related to policy or that would enhance transparency is something that should go to the Board. When things are “on the bubble,” the CEO considers whether bringing them before the Board will help rebuild trust in the Project.

While we support the CEO's effort to restore public confidence through transparency, we believe that the transition to P3, an entirely different business model, represents a fundamental shift in not only how HART delivers the Project but how it will operate. A matter of such critical importance should not be left to the discretion of the CEO.

HART relies on third-party consultants to oversee and manage other third-party consultants.

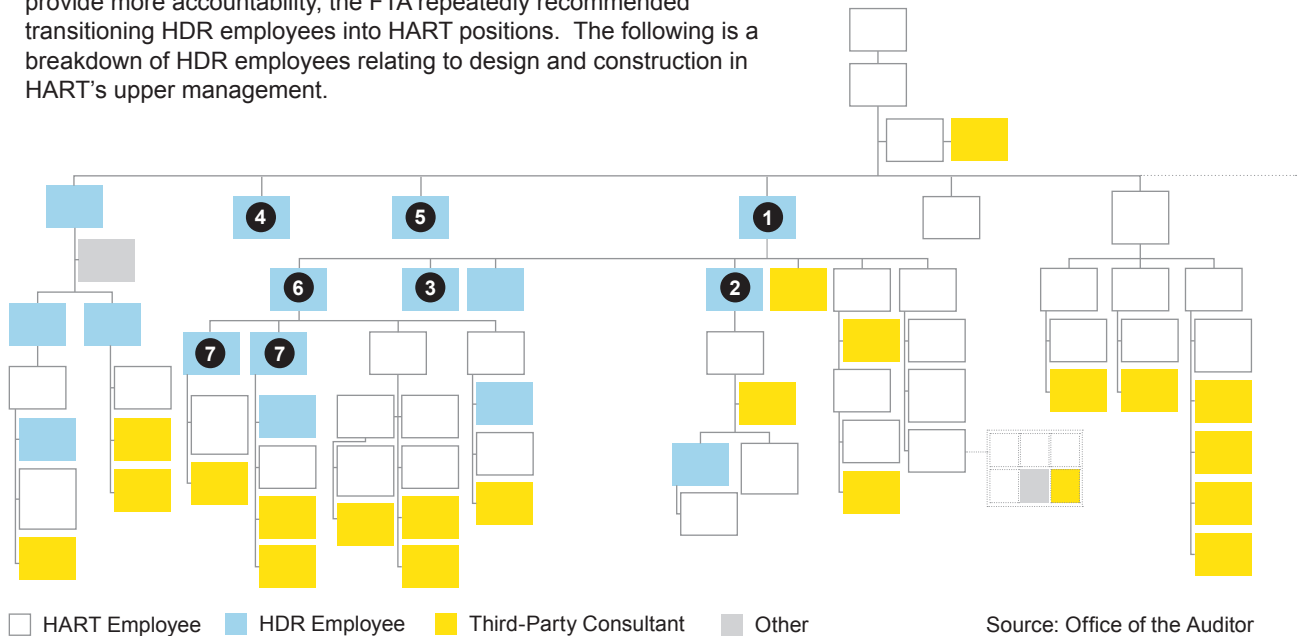
As of November 2018, HART's organizational structure had 117 HART employees (112 personal services contract and 5 civil service) and 18 HDR employees, its third-party project management support consultant. While HDR employees make up a relatively small percentage of HART's total staffing, they serve in critical positions overseeing the final design and construction of the Project and include the Project Director; Senior Project Officer of Core Systems, Integration, and P3; Director of Design and Construction; West and East Area Construction Managers; Director of Project Controls; and Risk Manager. Other HDR employees also serve in other director, manager, and deputy director/manager positions.

According to HART, HDR employees operate as an extension of HART staff and are completely integrated into the organization. Although HART's organizational chart and culture may not differentiate between HART employees and those of HDR, these embedded consultant employees are employed by a private, third-party organization, not HART; they are paid and evaluated by their private employer, not HART. In addition, many HDR employees directly oversee the work of other third-party consultants, some of whom are also HDR employees.

The predominance of third-party consultants in HART's upper management has been an ongoing concern for the FTA. In its 2014, 2016, and 2018 Risk Refresh reports, the FTA recommended that key management positions be transitioned from third-party consultants to HART employees in order for the organization to “have more ownership and maintain stronger continuing control of the project.” As part of its risk assessment process, the FTA assigns a project management oversight contractor to evaluate the reliability of the project scope, cost estimate, and schedule, which includes an updated “risk refresh” report

At the Heart of HART

As the FTA noted, HART's current structure does not provide adequate levels of ownership and control over the Project. To provide more accountability, the FTA repeatedly recommended transitioning HDR employees into HART positions. The following is a breakdown of HDR employees relating to design and construction in HART's upper management.



1. Project Director

The Project Director, who reports to the CEO, is responsible for design and construction, right-of-way, planning, project development, project budget, schedule control, risk management, contingency management, and dispute resolution. The Project Director is also responsible for managing Full Funding Grant Agreement compliance.

2. Director of Project Controls

The Director of Project Controls reports to the Project Director and is responsible for overseeing all cost estimating, cost management and control, scheduling, document control, management information system, and reporting activities within the Project.

3. Risk Manager

The Risk Manager reports to the Project Director and is directly responsible for developing and administering HART's Risk and Contingency Management Plan by reviewing and approving any changes made to existing risk and mitigation strategies, providing risk management input to Project Controls on the necessary level of allocated contingency, and developing risk management reports.

4. Chief Safety and Security Officer

The Chief Safety and Security Officer is primarily responsible for the development, coordination, and implementation of the Project's Safety and Security

Management Plan which describes the policy and methodology to ensure safety and security for passengers, employees, and the general public.

5. Director of Quality Assurance and Quality Control

The Director of Quality Assurance and Quality Control is responsible for the development and implementation of HART's Project Quality Management Plan. The director reviews and approves each consultant, contractor, and supplier's individual quality assurance plan to ensure that their respective plans meet the FTA requirements and HART's own Quality Management Plan.

6. Director of Design and Construction

The Director of Design and Construction is responsible for project development activities related to design and construction. The director's specific duties include overseeing all project design, construction, and inspection, and adhering to the Project's construction budget and schedule.

7. Area Construction Managers

The Project is divided into two distinct sections, the West and the East, with each under the oversight of an Area Construction Manager, who is responsible for overseeing the delivery of the Project and managing consistency across the various contracts within his/her respective area.

which represents the FTA oversight contractor's assessment of Risk and Contingency Management.

According to the CEO, HART hires third-party consultants to fill HART management and staff positions rather than City employees because it is unable to find highly qualified candidates willing to accept a City salary for the positions. The flexibility to attract and hire appropriately qualified applicants is also the reason why HART stopped hiring civil service employees in 2016. In addition, since the construction of the rail system has a finite duration, it is the CEO's contention that HART will eventually "work its way out of business," and he does not want to be in a position where it will have to terminate civil service employees at the conclusion of the Project. As a result, HART pays HDR \$9.6 million per year for, on average, 19 embedded HDR employees at an annual average cost of \$505,260 per HDR employee as depicted in the graphic on page 22.

HART oversight: reactive and after the fact.

Our review of HART's oversight of third-party consultants, including those hired to fill many of the Project's key management positions, showed a lack of consistent follow-through and monitoring of performance. This was apparent even where HART identified deficiencies in performance and communicated them to their contractors.

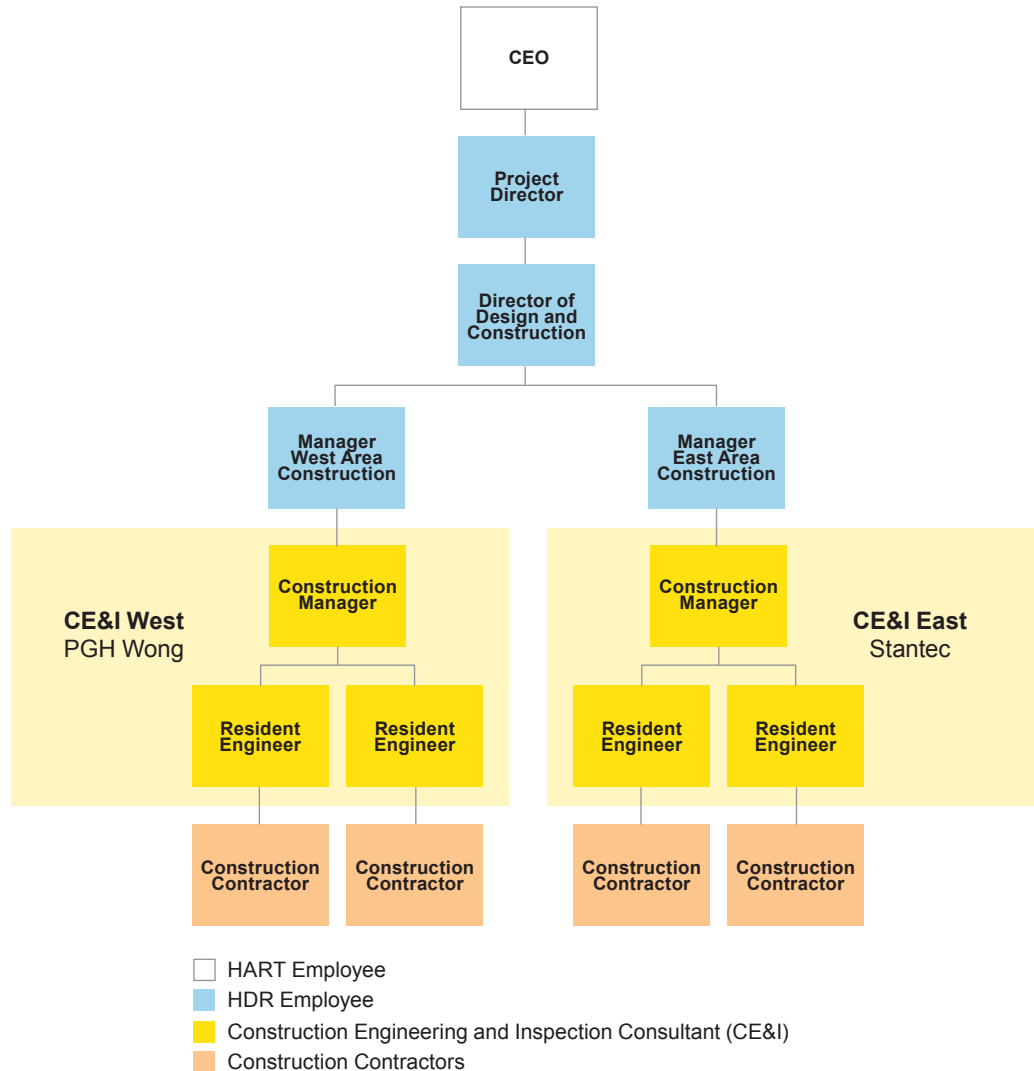
In July 2017, HART's then-interim CEO sent letters to third-party consultants, including HDR, CH2M Hill, Inc. (CH2M Hill), PGH Wong Engineering, Inc. (PGH Wong), and Stantec Engineering, Inc. (Stantec), directing them to conduct evaluations of their own performance under their respective contracts and provide feedback to HART. For three of the four letters, HART called attention to specific deficiencies that required remediation.

HART's letter to HDR alleged that HDR "has not enforced and ensured satisfactory delivery for the Project." Specifically, HART claimed that HDR staff failed to "enforce contractual terms, such as seeking indemnification against third parties when they fail to perform work on time causing delays to other contractor's [sic] work." As HART noted in its letter, unlike other consultants working on the Project, HDR's primary and overarching task is to oversee the successful design and construction of the *entire* Project.

In its letter to CH2M Hill, HART's General Engineering Consultant, HART asserted that "there was no Master Schedule for the Project" and that, in 2017, "there was a serious deficiency in the areas of interface management and coordination and design management." As a result, HART believed that CH2M Hill's "lack of action on issues related to interface and schedule-driven performance of work in the field has resulted in cost and schedule impacts to the Project."

Three Degrees of Separation

HART uses third-party consultants to manage third-party consultants to manage construction.



Source: Office of the Auditor

PGH Wong Engineering, Inc. / Stantec Engineering, Inc.

THE PROJECT is divided into two distinct sections, the East and the West, each under the oversight of a construction engineering and inspection consultant. PGH Wong Engineering, Inc. (PGH Wong) serves as HART's consultant for the Project's West area. Stantec Engineering, Inc. (Stantec) oversees the Project's East area. These consultants provide key specialty resources for strategic efforts, including construction support, design and constructability reviews, systems integration, permitting, and stakeholder liaisons. Each construction engineering and inspection consultant is overseen by a HART Area Construction Manager – an HDR employee.

In response, some of the third-party consultants challenged the accuracy of HART's assertions. For instance, HDR responded that HART's letter contained statements that were not only inconsistent with the history of the Project, but also inconsistent with HART's own assessment of its work when it signed a new contract with HDR on January 1, 2017.

Moreover, HDR noted that "at no point since the initiation of the Project was HDR considered by HART or others to be a cause of cost or schedule increases." Similarly, CH2M Hill noted in its response that the feedback it had received from HART over the past three years had been favorable. CH2M Hill also suggested that the interim CEO lacked the context and background of the contract terms and conditions, as well as the status of implementation to that point. In July 2017, the interim CEO had been with the Project for approximately seven months.

In other words, the buck stops at HDR, and perhaps, as a result, HART oversight comes in the form of a "get-your-act-together" letter.

HART's interim CEO believed that the progress of the Project justified his writing of the letters. Despite identifying numerous deficiencies and receiving responses from the consultants, HART did not implement an action plan to address these deficiencies. In addition, HART was unable to provide any memoranda or written evaluations of the consultants to support the assertions in the letters. We also learned that HART does not conduct formal performance evaluations of any of its third-party consultants or their employees assigned to the Project and does not conduct an evaluation of any of its third-party consultants' performance at contract closeout. HART's interim CEO explained that, rather than analyzing the past, he wanted to move the Project forward and communicate to the consultants that each needed to "get their act together."

In September 2018, the current CEO informed us that HDR had recently agreed to conduct internal evaluations of its employees assigned to the Project. HDR will also offer HART "insight" into how better to structure and manage the Project from an organizational perspective. This change is in contrast to the services HDR provided in the past, which the current CEO likened to a "body shop," or a staffing agency that only provided people to fill positions. Now, HART expects HDR to recommend where staffing redundancies can be eliminated and how the organization can be streamlined to prepare for changes like the public-private partnership.

HART's CEO acknowledged that HDR's internal evaluations of its own employees are not shared with HART. As a result, awareness of employee or section performance does not percolate to the CEO. In other words, the buck stops at HDR, and perhaps, as a result, HART oversight comes in the form of a "get-your-act-together" letter. In addition, according to the interim CEO, HART's organizational structure (i.e., HDR employees supervising other HDR employees and other consultants) makes management of consultants a greater concern than it would be otherwise. He recalled instances where consultants

would try to shift blame to other consultants – a situation he felt occurred more frequently because of the number of consultants on the Project.

HART relies on consultant to determine whether its own staff's work is satisfactory.

HART's process to review third-party consultant invoices for payment relies heavily on the work of two key people: the contract manager and the project manager assigned to the specific consultant's contract. The contract manager is the "first reviewer" and is responsible for reviewing invoice documentation for compliance with contract terms and conditions. The project manager subsequently certifies that all work invoiced was performed in accordance with the contract terms and any materials/deliverables were accepted by HART. The project manager is also responsible for verifying that the invoice is accurate and complete and that the work invoiced was accomplished during the period.

HART's First Deputy Executive Director (First Deputy) serves as the project manager for the HDR contract. Although she has extensive procurement experience, her professional background, as reported in the November 2018 Revised Recovery Plan, does not include experience in managing construction projects, design/engineering work, or other areas where HART has concluded that third-party consultants are needed for their technical expertise. In addition, she is not the direct supervisor for any of the HDR employees.

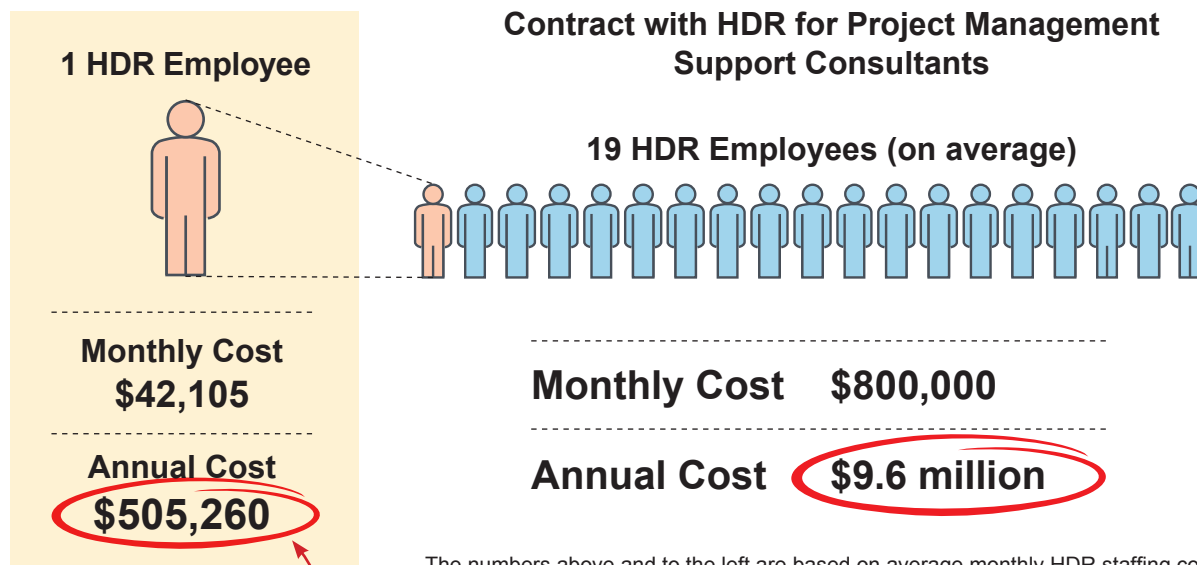
Because HDR staff perform work as embedded employees in the organization, HART's contract with HDR requires that each HDR employee provide a narrative log of his/her tasks and deliverables achieved during each month. In addition, the contract states that the description should justify the hours billed. Notwithstanding this contract provision, we found that when the employee narrative logs are reviewed, it is not a review for appropriateness of the work. For example, if the narrative log for an Area Construction Manager indicated that he did not visit the field at all during a given month, the project manager will not question his decision to spend his time in that manner. Rather, determining whether HDR staff work is appropriate is left to the HDR staff's supervisor in the organizational chart, often another HDR employee.

HART believes that this level of invoice review is appropriate given that all HDR employees report to a supervisor who provides oversight of that employee. Additionally, HART explained that HART's Project Director – also an HDR employee – signs off on every HDR employee's hours to certify that the work performed is appropriate.

The First Deputy is expected to review the logs from, among others, the Project Director, Quality Assurance Manager, Risk Manager, Director of Design and Construction, and Area Construction Managers. However, we also learned that she only reviews the narrative logs once every three months.

Highly Placed, Highly Compensated

While HDR employees make up a relatively small percentage of HART's total staffing, they serve in critical project management positions. According to the CEO, HART hires third-party consultants rather than City employees to fill these positions because it is unable to find highly qualified candidates willing to accept a City salary. The predominance of third-party consultants in HART's upper management has been an ongoing concern for the FTA.



Each HDR employee costs HART \$505,260 per year.

This amount includes direct labor costs, fringe benefits, and general overhead.

The numbers above and to the left are based on average monthly HDR staffing costs in 2018.

Source: Office of the Auditor

HART did not find it problematic that the Project Director is himself an HDR employee. When we asked whether it would be unreasonable for HART to retain a third-party or another consultant to ensure a more thorough and objective review, i.e., so that someone with experience in large construction projects – other than someone employed by HDR – is reviewing the HDR invoices, the CEO told us that it would come down to whether hiring additional staff to review invoices would provide enough value to justify the cost. The CEO did not believe that the possible savings from retaining an invoice review consultant would outweigh the costs to retain such a person.

However, we note that, between January 2018 and October 2018, HDR submitted requests for payment approximating \$800,000 per month. HART's process for spot-checking HDR invoices once every three months means that two months of invoices, approximately \$1.6 million in payments, are approved with minimal verification that HART is receiving a fair or accurate bill.

HART does not retain complete documentary evidence of its quality assurance audits of consultants.

According to the FTA, the function of project and construction management is to assure acceptable quality while executing the project on time and on budget. To achieve this, the FTA requires that HART prepare a quality plan, which contains HART's quality policy, objectives, and written procedures governing quality assurance and quality control. Accordingly, HART developed a quality management plan that provides the controls for design, procurement, construction, inspection, and testing, which will enable HART to be assured that the quality necessary for safe and reliable operation of its transit system is achieved. Among other things, the plan requires contractors, consultants, and suppliers providing design, engineering, construction, items, and services to HART to submit a quality assurance plan that is applicable for their respective scope of work for HART's approval. HART, however, is responsible for maintaining quality assurance oversight and conducting audits of the consultants, contractors, and suppliers.

To that end, HART quality assurance audits are planned, scheduled, and performed to verify compliance with the respective contractors, consultants, or suppliers' quality management system and contract requirements. Per HART's audit procedure, HART staff must conduct audits using a specific checklist. Moreover, according to HART, the audits follow a standard audit procedure, including entrance meetings, exit meetings, and preparation of audit reports. Once audit work is completed, the audit team prepares an audit report along with documented observations and findings.

As we state in our audit objective, our work focused on HART's oversight of consultants. To that end, we reviewed the quality assurance audits of four consultants: HDR, CH2M Hill, PGH Wong, and Stantec.

HART's Quality Assurance and Quality Control division provided the files in manila folders with the name of the consultant and the year of the audit, either hand-written or printed on the top of the folder (e.g., "Stantec 2017"). While some of the quality assurance files are maintained electronically, HART explained that the physical file typically contains the completed audit checklists, meeting agendas, schedules, audit reports, and any nonconformance reports or observation reports. None of the documents we reviewed was identified or organized in a consistent manner.

Additionally, while reviewing the physical files, we came across numerous instances of incomplete Quality Assurance audit checklists. Where the files contained some notations, some were illegible. Further, there were no dated signatures indicating who performed the work to verify the elements on the audit checklist.

The FTA's *Quality Management System Guidelines* defines quality control as the "techniques that are used to assure that a product or service meets requirements and that the work meets the product or service goals." Generally, this refers to the act of taking measurements, testing, and inspecting a process or product to assure that it meets specification. Quality assurance, by contrast, refers to the actions at a management level that directly improve the chances that quality control actions will result in a product or service that meets requirements. These actions include adequate planning, ensuring that contractors are capable of meeting and carrying out quality requirements, and documenting quality efforts.

Checking the Checklists

TO VERIFY compliance by contractors, consultants, or suppliers with their respective quality management systems and contract requirements, HART staff conduct quality assurance audits using checklists. In our review of the checklists related to CH2M Hill, PGH Wong, and Stantec, we found numerous incomplete entries, illegible notations, and missing signatures. When we inquired about these discrepancies, HART told us that its quality assurance staff only indicate an observation or comment when they identify a deficiency, but we found that this is not always the case.

No.	Questions	Reference	Compliance	FOR NCR OBS SUG
3.5	How do the CE&I and GEC3 interface with each other?		Bi-weekly meeting	
3.60	Do design reviews address constructability, operability, maintainability, reliability, and availability?	Yes		
3.70	How does the CE&I assure that materials and equipment specified in drawings and specifications comply with Buy America, Ship America, and Fly America requirements?	Yes	Reviewed during final drawings	
3.80	How are field and design changes properly controlled and implemented?		By mentoring	
3.90	How is configuration control maintained, and are the latest design document revisions clearly identified?			
3.10	Are final design drawings and reports certified by an appropriate Professional Engineer (P.E.) or Architect registered in the State of Hawai'i?			

HART says it only notes deficiencies, not compliance.

No.	Questions	Reference	Compliance	FOR NCR OBS SUG
10.2	Does CE&I verify that inspections are performed by qualified personnel or organizations in accordance with approved procedures?			
10.3	How does the CE&I ensure that work performed by subcontractors, consultants, and suppliers is inspected?		Flow of the day & performed @	
10.4	Does CE&I verify that required inspections are incorporated		Shore	

illegible notation

No.	Questions	Reference	Compliance	FOR NCR OBS SUG
12.0	Element No. 12 – INSPECTION, MEASURING, & TEST EQUIPMENT			
12.0	Does CE&I verify that quality and safety-related measuring/testing devices (tools, gauges, instruments, etc.) are controlled, calibrated, and adjusted to maintain accuracy?			
12.1	Does the CE&I verify that calibration is traceable to the National Institute of Standards and Technology (NIST) or manufacturer recommendations?			
12.2	Does the CE&I verify that measuring and test equipment identified by equipment number and marked to indicate calibration status?		Independent Lab PSC	
12.3	Does the CE&I verify that records of equipment issuance and calibration are properly kept and maintained?			
12.4	Does CE&I verify that when inspection, measuring, or test equipment is found to be out of calibration, is the validity of previous inspection and test results assessed and documented?			

incomplete entry

Source: HART

When we asked HART about these discrepancies, we were told that the blank boxes indicated that the consultant had satisfied the element. Further, despite some boxes having “Yes” notations in the checklist, HART asserted that its quality assurance staff only indicate their observations/comments when they identify a deficiency – otherwise the consultant is fine.

Conclusion

It takes a large, complex organization to administer a venture the size and scope of the Honolulu Rail Transit Project, and HART, like the \$8.165 billion (excluding financing costs) project it manages, is still a work in progress. In November 2018, HART’s Board approved Resolution No. 2018-14, which, among other things, clarifies the division of responsibilities between HART’s CEO and the Board. However, some gray areas of governance still exist. For example, we found that the CEO still maintains considerable discretion in what to report to and when to consult with the Board. We identified recent issues that either critically affect or fundamentally alter the way HART operates and therefore should be reported to the Board and fully vetted. Yet the CEO continues to have the power to choose whether or not to affirmatively present information on these issues to the Board.

We also found that, when it comes to the design and construction of the Project, HART is an organization of “consultants managing consultants;” oftentimes a manager and those managed are employees of the same third-party consultant. Since employee evaluations are not shared with HART, awareness of employee or section performance does not percolate to the CEO. In other words, the buck all too often stops at a consultant, not with HART.

As the FTA noted, filling key positions with third-party consultants rather than HART’s own employees is less than optimal, leading to less “ownership” and accountability. According to its CEO, HART hires third-party consultants to fill management and staff positions rather than City employees because it is unable to find highly qualified candidates willing to accept a City salary for the positions. In addition, since the construction of the rail system has a finite duration, it is the CEO’s contention that HART will eventually “work its way out of business,” and he does not want HART to be in a position where it will have to terminate civil service employees at the conclusion of the Project.

While we recognize the CEO’s concerns as to the eventual shuttering of HART operations, the rail has a long way to go before it reaches Ala Moana Center.

Q: How does HART avoid a conflict of interest when auditing its contract with HDR?

A: It doesn’t audit the contract.

SINCE HART does not generally perform actual design, engineering, construction, manufacturing, maintenance, and servicing functions internally, it relies on its Quality Assurance and Quality Control division to monitor, oversee, and audit all contractors, consultants, and suppliers to assure that their respective quality assurance programs are being effectively implemented. HART has contracted these services out to HDR, its project management support consultant. The division’s auditors conduct quality assurance audits using checklists based on the respective contract requirements and quality assurance plans.

We asked the Director of Quality Assurance and Quality Control, who is an employee of HDR, how he avoids the conflict of overseeing his audit staff’s review of HDR’s contractual responsibilities and his fellow HDR employees’ activities under that contract. He told us that the division does not audit the HDR contract, meaning that there is no quality assurance review to assess HDR’s compliance with its contractual responsibilities. The director said that, because HDR’s employees are embedded in the HART organization, HDR employees’ performance is assessed together with and as part of the annual quality assurance assessments that HART conducts of its sections and divisions.

Recommendations

Communication between HART and the Board of Directors

1. HART should update its policies and procedures related to its and the Board's respective responsibilities to ensure that matters requiring the Board's consideration and approval are presented to the Board. HART's policies and procedures should ensure that Board members are provided all necessary materials sufficiently in advance of the Board meeting to allow members to thoroughly consider the materials.
2. HART and the Board should consider further clarifying their respective responsibilities by more clearly defining the matters requiring board approval. For example, HART and the Board's policies and procedures should clearly define the fiscal and other information that HART should include with its operating and capital budgets that are presented to the Board and when HART adds or eliminates contract packages. Given the history of the Honolulu Rail Transit Project, specifically, our finding in Report 1 that HART did not provide or delayed providing information about project costs to the Board, HART and the Board should include much more specificity in describing and defining their respective roles and responsibilities.
3. The Board should update its policies and procedures to require HART to provide allocated contingency for each contract (or contract package), both executed and anticipated.
4. If HART and the Board believe that the contract-specific allocated contingency should be withheld from the public and the Board should be able to consider the information in an executive session under Section 92-5(a), HRS, HART should consider proposing amendments to both the Sunshine Law, part I of Chapter 92, and the Uniform Information Practices Act (Modified), Chapter 92F, HRS, to allow it to privately consider and withhold the information from the public.
5. The Board should reconsider whether it is appropriate to delegate its authority and responsibility to an Executive Committee, comprised of less than the entire Board, to make Board-required decisions and/or to provide guidance on behalf of the Board to the CEO. The Revised Charter of the City and County of Honolulu created a board of nine voting members to collectively oversee and guide HART. Members should not be "disenfranchised" because the Board has struggled to convene a quorum.

-
6. HART and the Board should consider annual training on the State's public meetings law, known as the Sunshine Law, part I of Chapter 92, HRS, to ensure the public policy of opening up the Board's decision-making processes to public scrutiny and participation. The training is more important and necessary given that, according to the Board Chairperson, the Board members are receiving more reports, including project updates, outside of noticed Board meetings. The annual training should be conducted by the Office of Information Practices, which is responsible for administering and enforcing the Sunshine Law and the State's public records law, the Uniform Information Practices Act (Modified), Chapter 92F, HRS.
 7. The Board should consider creating a staff position that is hired by and reports directly to the Board. The position's responsibilities should include supporting and advising the Board, ensuring that the Board receives timely and complete information necessary for the Board to perform its oversight and management of HART as required by the Board's policies and procedures.

HART Consultant Performance Evaluations

8. ALL CONSULTANTS: HART should develop and implement policies and procedures for annual performance evaluations of its third-party consultants, including action plans to ensure that deficiencies are addressed and corrected.
9. ALL CONSULTANTS: HART should provide its annual performance evaluations of its third-party consultants, including the action plans, to the Board for its information and consideration.
10. HDR: Given HDR's role as embedded HART employees, HART management should work with HDR to develop specific performance metrics in addition to HDR's own evaluations.
11. HDR: HART should require HDR to annually evaluate the HDR employees who are embedded into the HART organization based on the agreed-upon performance metrics and require that HDR provide HART with copies of those evaluations.
12. HDR: HART should independently evaluate the performance of the HDR employees who are embedded in the HART organization and who report directly to the HART CEO and/or other HART staff.

13. HDR: HART should transition key management positions from third-party consultants to HART employees, as recommended by the FTA in its 2014, 2016, and 2018 Risk Refresh reports, in order for HART to “have more ownership and maintain stronger continuing control of the project.”

HDR Invoice Review

14. HART should establish procedures to review HDR invoices on a regular basis to verify that charges are commensurate with work performed; the procedures should include required documentation to support the approval of the invoices, or portions thereof, for payment.
15. HART should ensure that, at a minimum, HDR employee work summaries are assessed for reasonableness and appropriateness by someone with sufficient experience and substantive knowledge in the area of the employee’s work – and who is also not an employee of HDR.
16. HART should consider retaining a third-party organization with experience in major government construction projects to review, assess, and make recommendations regarding HDR’s invoices to ensure compliance with contractual terms, the appropriateness of the work, and the reasonableness of the amount of time incurred to perform the work. Although the CEO said that he didn’t believe that the cost of a third-party organization to review HDR’s invoices outweighed the possible saving, we note that the HDR contract costs HART \$9.6 million per year for 19 embedded HDR employees.

HART Quality Assurance

17. HART should review its policies and procedures regarding its quality assurance audits to ensure auditors appropriately document their audit work, including ensuring that documentation is legible and complete.
18. HART should develop policies and procedures to organize, retain, and secure quality assurance audit records to ensure that those records are readily available for internal inspection and review.
19. HART should retain complete documentary evidence of its quality assurance audits of its consultants, to provide an “audit trail” supporting its findings and conclusion.

Office of the Auditor's Comments on the Honolulu Authority for Rapid Transportation's Response to the Audit Report

WE PROVIDED A DRAFT OF THIS REPORT to the Honolulu Authority for Rapid Transportation (HART) and discussed the report at an exit conference attended by the Chairperson and Vice Chairperson of HART's Board of Directors as well as the Chief Executive Officer, the First Deputy Executive Director, the Chief Financial Officer, and the Deputy Executive Director of Government Relations. HART provided a written response to the draft report, which is included in its entirety as Attachment 1.¹

HART states that the intent of its response is to “clarify HART’s current or future actions” related to our audit findings. However, we believe certain statements warrant comment for further clarity and perspective.

HART noted one factual error in the report regarding HART’s budget transmittals to the Honolulu City Council. We have revised the report to correct the inaccuracy, which is part of the factual background. The revision, however, does not alter our audit findings.

In numbered section 2 of its response, HART attempts to minimize the difficulties that we encountered in accessing information necessary to perform our audit work. We disagree with HART’s characterization of the difficulties we report as simply a difference of “expectations.” In our comments to HART’s response to our first report, Report No. 19-03, *Audit of the Honolulu Authority for Rapid Transportation: Report 1*, we detailed some of the challenges that we confronted in obtaining information and described other information we requested from HART but never received or received only after months of delay. Because HART’s response in numbered section 2 is substantively identical to its response to the earlier report, our comments attached to that report are equally applicable here. We refer the reader to the *Office of the Auditor’s Comments on the Honolulu Authority for Rapid Transportation’s Response to the Audit Report* which starts on page 33 of Report No. 19-03.

¹ HART provided a written response to the draft report on January 4, 2019, and a second response on January 7, 2019. The second response states that it “includes input from HART staff and some of the HART Board Members,” and the email transmitting the second response says that it “supersede[s]” the earlier response.

In numbered section 6 of its response, HART addresses our finding that HART withholds from the Board the amount of allocated contingency associated with its contracts, both those awarded and anticipated. As explained in the report, the allocated contingency is the “cushion” or “reserve” that is part of a contract’s budget to cover unforeseen costs. According to HART, it considers contract-specific allocated contingency to be “confidential.” HART believes that disclosure of the information “removes important leverage when negotiating with contractors,” stating “*HART has a responsibility to the taxpayers to manage the project in a fiscally sound manner.*”

We strongly agree that HART must be fiscally responsible in its use of public funds. However, we disagree that keeping secret the total amount it has budgeted for specific work – i.e., the contract-specific allocated contingency – is consistent with that responsibility. In fact, the history of the Honolulu Rail Transit Project, specifically the significant increases to the Project’s estimated cost, belies HART’s suggestion that withholding the contract-specific allocated contingency benefits taxpayers or otherwise improves its fiscal management of the Project. Withholding financial information from the Board, the lawmakers, and the public seems to have only allowed HART to evade necessary oversight.

As we report in Report No. 19-03, *Audit of the Honolulu Authority for Rapid Transportation: Report 1*, through much of 2015 and into 2016, HART reported estimated project costs to the Board that were well-below its internal projections, obscuring the financial realities and the need for additional funding to complete the Project. And, it is because of HART’s poor fiscal management of the Project that contract solicitations for stations and the city center section of the guideway had to be cancelled and the opening date has been delayed to 2026.

As we explain in the report, HART has procedures, namely its Contract Change Procedure, that are intended to protect against contractors taking advantage of HART by requiring HART to determine “merit” before it agrees to additional compensation. If that process is insufficient to adequately protect public funds from being misspent, HART should develop a more robust process, not hide financial information from the Board or the public.

We also feel that HART dismisses our concern that, without the contract-specific allocated contingency, the Board does not have sufficient information about the total budget for a contract and, therefore, does not know when HART exceeds the budget. Without that information, we question how the Board can hold the CEO accountable for HART’s financial management, which is arguably the Board’s most important responsibility; we question how the Board can determine

whether HART’s budgeting process, including allocation of risk, is sufficient; we question how the Board can represent that the Project is on-budget if the Board is unaware whether current contracts have exceeded the budget for the particular scope of work.

In numbered section 9 of its response, HART appears to minimize the risks posed by lax consultant oversight by reasoning that “failure, in the consultant world, is expensive both monetarily and reputationally” and that “[n]o consulting firm wants to fail.” This comment paints an incomplete picture – failure is not the only motivating principle that exists in the consulting industry. An equally evident motivating principle is the desire to maximize profit. HART’s acknowledgement that “improvements should continue to be made to Consultant oversight,” and its agreement with our finding that its review of HDR monthly invoice justifications is insufficient, underscores the importance of stricter oversight of consultants on the Project – all of whom are motivated by more than just a desire to avoid failure.

In numbered section 14 of its response, HART states that “the example [consultant audit checklists] shown (inspection, measuring, testing equipment) is not relevant” to CH2M Hill, PGH Wong, and Stantec. First, as HART notes in its own response, the referenced images were meant as examples. During our fieldwork, we also came across CH2M Hill checklists that were incomplete or contained illegible notations. Second, the images we reproduce in the report are unaltered scans of the consultant audit checklists for Stantec and PGH Wong, HART’s Construction Engineering and Inspection Consultants (CE&I). As can be seen in the images, many checklist items directly reference Stantec and PGH Wong: “Does the **CE&I** verify that calibration is traceable to the National Institute of Standards and Technology (NIST) or manufacturer recommendations?” “Does the **CE&I** verify that records of equipment issuance and calibration are properly kept and maintained?” Moreover, there are notations in the “Compliance” column of the checklist and we maintain that these are relevant.

In numbered section 15 of its response, HART asserts that our statement “the buck all too often stops at a consultant” is incorrect and that, “[i]n reality, the CEO and the Board have ultimate ownership of project responsibility.” HART misunderstands our audit findings. In our report, we acknowledge that the Board is the policy-making body of HART and that the CEO, who is responsible for the entire HART organization, is directly accountable to the Board. But, the “reality” is as we describe in our findings and as HART describes in its own response – specifically, HART’s agreement that “performance oversight and evaluation needs to be strengthened” (Response Page 7); that reviews of HDR’s monthly invoice justifications are insufficient (Page 11); and that Quality Assurance/Quality Control needs to be evaluated to

identify areas of improvement (Page 14). While the Board and CEO are vested with responsibility under the City Charter, our findings support the conclusion that “the buck” does not always stop with HART when HART lacks sufficient oversight of consultants embedded into key positions of the organization.

In numbered section 15 of its response, HART states that “[t]he Project Management Oversight Consultant (PMOC) hired by the FTA to oversee the project has acknowledged that reliance on consultants in a project of this complexity is a common practice.” We believe this statement is misleading. We acknowledge in our report that HART’s use of consultants may be a concession to certain operational realities. Coupled with the obvious profit motive of consultants, HART is not absolved of its responsibility to adequately oversee those consultants and to take greater responsibility and ownership of the Project. In fact, the same PMOC that HART identifies in its response has repeatedly stated since as early as 2014 that HART should transition key management positions from consultants to City employees “in order to have more ownership and maintain continuing control of the project.”



HONOLULU AUTHORITY for RAPID TRANSPORTATION

IN REPLY REFER TO:
CMS-AP00-03384

January 7, 2019

Andrew S. Robbins
EXECUTIVE DIRECTOR AND CEOKrishniah N. Murthy
SENIOR ADVISOR

BOARD OF DIRECTORS

Damien T.K. Kim
CHAIRTerrence M. Lee
VICE CHAIRJade Butay
John Henry Felix
Wes Frysztacki
Kamani Kuala'au
Wesley K. Machida
Tobias Martyn
Glenn M. Nohara
Ember Shinn
Kathy Sokugawa
Hoyt H. Zia

VIA EMAIL:

lao.auditors@hawaii.govMr. Leslie H. Kondo, State Auditor
Office of the Auditor
State of Hawaii
465 South King Street, Room 500
Honolulu, Hawaii 96813-2917

Dear Mr. Kondo:

Subject: Audit of the Honolulu Authority for Rapid Transportation (HART) – Part 2

Enclosed is HART's Response dated January 7, 2019, which includes comments from the HART Board of Directors, to the Draft Audit Report Part 2 entitled "The Buck Stops...Where? Report on HART's Management Structure, Decision-Making Processes, and Use of Third-Party Consultants in Key Management Positions" received on December 21, 2018. Please include these comments when you issue your Final Report. HART looks forward to receiving your recommendations associated with this report and providing comments, if any, as we have been able to do with your draft audit report.

Should you have any questions on our Response, please feel free to contact me directly.

Very truly yours,

Andrew S. Robbins
Executive Director and CEO

Enclosure

Responses to State Audit Report Part 2 – Management

January 7, 2019

HART acknowledges the receipt of the Draft Audit Report Part 2 - Management of HART pursuant to Act 1, First Special Session 2017 in a document dated December 20, 2018. HART welcomes the State's constructive, vigorous and healthy oversight and will strive its best to incorporate suggested recommendations within the constraints established by its Board and their policies. We are consistent in our approach to all federal and local oversight, reviews, and audits. This response includes input from HART staff and some of the HART Board Members. It is intended to clarify HART's current or future actions related to each issue.

This response document is laid out in multiple parts. Section 1 is an overview of the Audit Report scope and findings. Section 2 is a response to statements in the Audit Report.

Section 1. Audit Report Scope and Findings

The Buck Stops . . . Where? Report on HART's Management Structure, Decision-Making Processes, and Use of Third-Party Consultants in Key Management Position (Part 2)

The objectives of Audit Report Part 2, focusing on the period FY2016-2018, were described by the State as:

1. Describe the current condition of HART's administration and operations.
2. Assess whether HART's oversight and management of selected consultants is in compliance with applicable laws, policies, procedures, and other relevant best practices.
3. Make recommendations as appropriate.

After detailed reading of the report, HART believes there are two key findings that the State Auditor is conveying with this document. Within this response, we will address the components of these findings:

- HART's decision-making processes, in particular the interaction and division of responsibilities between HART's Executive Director-Chief Executive Officer (CEO) and the Board, have changed over time and remain unsettled at the time the Audit was performed.
- HART uses third-party consultants rather than HART employees for several key management positions, and HART's oversight of these consultants is not well-documented and does not adequately ensure performance and accountability.

HART's responses to these findings are in Section 2 below.

Section 2. Responses to Statements Made in the Audit Report

1. Audit Scope & Methodology (Page 3)

The audit focused on FY2017-2018. Auditors conducted interviews with HART management, staff, the Board chair, and certain consultant contractors. HART questions if the Auditors also took the opportunity to interview past Board Members and past Board Chairs for a wider picture of past activities.

January 7, 2019

2. Difficulties with access to information (Pages 3-4)

While carrying out their mandate of designing and constructing a rail system, HART staff worked with the Auditors to accommodate their requests. HART believes that it was cooperative although it is acknowledged that timeliness of response was an issue and is an area of improvement in the future. Regrettably, HART's overall efforts fell short of the Auditor's expectations. However, this was not because of a deliberate refusal to provide the full cooperation pledged to the Auditor by the Board and HART.

While carrying out their mandate of designing and constructing a rail system, HART staff worked with the Auditors to accommodate their requests, although it is acknowledged that timeliness of responses was an issue.

During the Audit process, the Audit Team had access to over 1,600 electronic files consisting of 36,400 pages to the audit teams. These files included 472 emails, over 5,000 pages of Excel data, 350 pages in Word, and over 30,000 PDF pages. HART also provided numerous hard copy documents for the audit staff to review, in addition to the electronic documents.

HART provided access to:
*over 1,600 electronic files consisting of 36,400 pages including:
472 emails
5,000 pages of Excel data
350 pages in Word
30,000 PDF pages
35 interviews with 23 staff*

Colocation

Auditors and their consultants were provided office space and a computer with internet access within the HART offices from inception of audit to December 2018 (end of audit).

Interviews

HART participated in over 35 interviews with 23 staff, in addition to follow-up discussions and impromptu questions.

Executive Session Meeting Minutes

HART provided the publicly available Board meeting minutes as HART provided the publicly available Board meeting minutes as requested by the auditors. With respect to the non-disclosure of Board Executive Session minutes, legal impediments posed a challenging dilemma to the Board in preserving its attorney-client privilege and honoring certain contractual and legal obligations of confidentiality and privacy.

CMS

The HART CMS Support Team was tasked to provide access to all auditors from DAGS, State Office of the Auditor and consultants, City and County of Honolulu Auditors, and FTA. While every effort was made to provide full access to the system, we encountered unknown technology barriers; this was a great frustration to the CMS Support Team, HART management and to auditors. The issues experienced were technical (IT) in nature and affected both HART staff and auditors alike. Electronic access to HART's records is imperfect due to difficulties with the non-supported Oracle Contract Management System.

Responses to State Audit Report Part 2 – Management

January 7, 2019

HART is taking action in this area in early 2019 to help correct these issues. There was no intent to keep the auditors from accessing files.

Conclusion

Despite the difficulties mentioned above as well as shortcomings in the timeliness of cooperation, the Auditor concluded that they believe the evidence obtained by them was sufficient and appropriate to support their findings and conclusions made in the report.

Despite the difficulties mentioned above as well as shortcomings in the timeliness of cooperation, the Auditor concluded that they believe the evidence obtained by them was sufficient and appropriate to support their findings and conclusions in the report.

3. Background (Page 5)

The Audit Reports assert that the GET and TAT can only be used for “capital costs” characterized as “expenses directly related to construction of land acquisition for the Project.” HART would like to clarify that HRS §46-16.8 specifically includes in the definition of “capital costs,” for counties with a population greater than 500,000 “non-recurring personal services and other overhead costs that are not intended to continue after completion of construction of the minimum operable segment of the locally preferred alternative for the mass transit project.” This was not repealed by Act 1 and remains the statutory definition of “capital costs.”

4. Federal Oversight call out box (Page 7)

The Federal Oversight call-out box reports on the FTA activities and interaction with HART during the audit period, through September 2018 only. The latest Revised Recovery Plan was approved by the Board, reviewed by the City Council, and submitted to FTA on November 19, 2018. Subsequently, FTA sent HART a positive letter on December 7, 2018, acknowledging the Revised Recovery Plan and the steps recently taken to align the project with the FTA requests. The audit should show the full picture of all interactions with the FTA; as such, HART recommends that the call-out box be amended to discuss the submittal and acknowledgment of the Revised Recovery Plan.

By its approval of Board Resolution No. 2018-14 on November 15, 2018, the Board adopted new Board rules implementing the Board’s enhanced oversight authority.

5. HART and Board policies delineating decision-making responsibility are still in flux (Page 10) / Board’s increased oversight authority yet to be implemented (Page 11)

January 7, 2019

As noted in the Audit Report, following the passage of Charter Amendment 4 in 2016, the Board carefully considered how to implement their enhanced oversight authority and draft corresponding rules. Board Resolution No. 2018-14 on November 15, 2018 adopted the rules, implementing the changes. It is important to note that the decision-making responsibility was being developed during the course of the audit, further, finalized following the fieldwork completion of the audit. Based on Board Resolution No. 2018-14, internal policies and procedures related to Board communications and decision-making will be updated during 2019.

Transparency and communication is continually increasing between HART staff and the Board, as noted in the Audit Report. Given that the Board meets once per month, it remains vital that the CEO, in his role as the Chief Procurement Officer, has the ability to make timely decisions related to administrative, procurement, and design issues.

6. Gray Areas may persist (Page 12) / HART withholds contingency amounts from budget reporting (Page 13)

HART discloses total, or a lump sum, contingency for the Project but considers individual contract contingencies as confidential. Disclosure of this information removes important leverage when negotiating with contractors on claims settlement, change orders, and contract close out. HART has a responsibility to the taxpayers to manage the project in a fiscally sound manner. It is common practice amongst major US transit and project-specific agencies to operate in this manner, which we understand is different than how the State operates.

HART has a responsibility to the taxpayers to manage the project in a fiscally sound manner.

The U.S. Department of Transportation's guidance on Financial Plans Contingency Fund Management for Major Projects recognizes that financial plans should provide current project information to enable government agencies, and "the public" to evaluate the fiscal health of a project and that contingencies can be identified as a separate line for each "major element" for a project. HART's financial plan is organized by major elements, including construction and design.

Accordingly, HART understands the need, and desire, for transparency in project costs, including contingencies. To address this finding, during the first half of 2019, HART will consider revising its financial reporting to separate contingencies by major elements.

In 2019, HART will consider revising its financial reporting to separate contingencies by major elements.

It should be noted that the Permitted Interaction Group of the Board of Directors that engaged in revising the Board's rules and procedures had much discussion amongst its members and HART staff on the matter of whether to disclose contract contingencies to the Board. For the foregoing reasons, the Permitted Interaction Group ultimately decided to rely on its oversight via its Project Oversight Committee. One or two members of the committee regularly participate in the Project

Responses to State Audit Report Part 2 – Management

January 7, 2019

Management Oversight Contractor meetings with HART staff, at which contract contingencies are discussed. See also the discussion of contingency in Item 8 below.

Also within this section, at the bottom of page 13, the Audit Report states that the City Council is “asked to-and does-approve” HART’s construction budget and that the approval “authorizes HART to expend funds for those purposes.” This is not correct. HART’s budget transmittals to the City Council do not ask for approval.

7. Gray Areas may persist (Page 12) / Decision to pursue P3 to complete construction left to the discretion of the CEO (Page 14)

The selection of method of procurement is within the CEO’s (who is also the Chief Procurement Officer) purview in accordance with the Hawaii Public Procurement Code. The CEO is accountable to the Board of Directors and using his professional and engineering judgment, developed over decades in the industry, identifies key and relevant issues to bring before the Board, the City, and all other appropriate stakeholders.

The method of procurement is within the CEO’s authority and discretion as prescribed by the Hawaii Public Procurement Code, as the Chief Procurement Officer for HART.

In 2017, HART initiated an analysis of procurement and delivery alternatives for the remaining segment of the project, City Center Guideway and Stations. The consulting firm Ernst & Young Infrastructure Advisors LLC conducted the detailed feasibility analysis for delivering the final portions of the project on-time and on-budget, which supported the P3 delivery methodology. This analysis was supported by industry and stakeholder input through an Industry Forum and a Stakeholder’s Forum. All report findings and stakeholder inputs were reported to the Board. The study and industry outreach results led to the procurement of a P3 legal and financial consultant and the currently-in-progress HART-City joint procurement for a P3 consortium. During every step of the process, the findings were shared with the Board and the City. The decision to maintain this transparency was made early on because of the significance of utilizing a project delivery new to this Project to ensure that all stakeholders understood the risks and potential benefits of pursuing a P3.

Within the Audit Report, the Auditor acknowledges that the CEO took appropriate action even while having authority as CPO over the method of procurement. It should also be noted that the Board of Directors believed in final deliberation that it had authority over the P3 delivery method and therefore took appropriate action.

The CEO, as Chief Procurement Officer, will continue to keep the Board and the City abreast and involved in key procurement decisions. In the case of the P3, it was approved by the Board and supported by the Mayor of Honolulu and the Honolulu City Council in a Resolution.

January 7, 2019

Within the Audit Report, the Auditor acknowledges that the CEO took appropriate action even while having authority as CPO over the method of procurement. It should also be noted that the Board of Directors believed in final deliberation that it had authority over the P3 delivery method and therefore took appropriate action. The Board's new rules, adopted in November 2018, memorializes the Board's belief that decisions such as project delivery method, which affect budget and schedule, fall squarely within the Board's authority.

8. The Budgeted Contingency: expecting the unexpected (Page 14)

Contingency exists in order to prepare for the unknown, including differing site conditions, such as unknown underground utilities. As projects achieve higher levels of completion, the amount of contingency necessary drops. Contingency is developed based on FTA guidelines, good engineering judgement based on prior experience, and continued risk assessment for each contract.

Previously, the Board reviewed for approval individual change orders in excess of \$1 million, but on November 15, 2018, the HART Board of Directors adopted new rules and procedures regarding reviews of change orders and added oversight on the planning, construction, and development of the rail project.

In particular, the Board will put forth a greater focus on how "expenditures and use of contingency funds are expended within the Board approved Financial Plan and FTA approved recovery plan for the HRTTP" to include, amongst other things, the approval of any use of unallocated contingency regardless of dollar amount, and activities that affect the scope, schedule and Financial Plan.

HART also took steps to improve its decision-making process by developing an Executive Decision Document (EDD) procedure which is currently in review by executive management of HART for approval. This process ensures "key" and/or significant decisions are made with proper input, review, and documentation from all relevant divisions within HART prior to the approval by the Executive Director. The EDD is required for key decisions, including significant changes to contracts.

9. HART Relies on Third Party Consultants to Oversee and Manage Other Third-Party Consultants (Pages 15, 17)

HART is a project-specific agency, unlike any other in the State of Hawaii. As the Audit Report states on page 6: "Therefore, HART now has an expiration date; once the rail system is operating, HART's mission will end." And on page 17 of the Audit Report, "HART hires third-party consultants to fill HART management and staff positions rather than City employees because it is unable to find highly qualified candidates willing to accept a City salary for the positions. The flexibility to attract and hire appropriately qualified applicants is also the reason why HART stopped hiring civil service employees in 2016."

Responses to State Audit Report Part 2 – Management

January 7, 2019

As such, HART utilizes embedded or “seconded” consultants to bring unique capabilities to the organization for the finite duration of the project. Including seconded, expert staff to supplement a pool of City employees is common in the industry and especially for limited-term mega-project development. For example, the use of expert, seconded staff is commonly used for rail projects in Asia which traditionally had not had a history of such project development and where local skill sets had not yet been developed. Utah Transit Authority and Los Angeles Metro Construction Authorities also operate in this manner. Given Hawaii’s remote geographic location, this project being the first rail transit project in the State, and the relatively short-term need for a full complement of professionals with specialized rail design and construction expertise, its situation is quite similar to those in Asia – and therefore the staffing solution is also quite similar to that in Asia.

The ratio of HART employees to program management support consultant staff is 117:18 (as of December 2018). The HART CEO views this as a balancing act in terms of obtaining the necessary expertise provided by seconded staff and the stability of City staff. HART will continue to replace seconded staff with City staff wherever possible, but the needs of the project must be considered.

Seconded staff by their very nature are embedded in the overall HART organization – so in this way personnel are accountable to their supervisor as with any organization. In some cases, consultant staff seconded to HART supervise other consultants. However, all consultant staff are aware that ultimately, HART is the client and the project is the goal. To not meet the tenets of the contract, the needs of the client, or the goals of the project is to fail. And failure, in the consultant world, is expensive both monetarily and reputationally. No consulting firm wants to fail.

HART does agree that performance oversight and evaluation needs to be strengthened. – in the case of seconded staff – this is anticipated to be via performance evaluations locally as well as by the consultant (HDR) themselves. HART is developing additional procedures, outlined in the responses below, in order to address both the personal performance reporting and the consultant firm performance reporting, respectively.

Looking forward, as HART recognizes the need to transition away from seconded consultants to local talent, it is proactively partnering with the University of Hawaii Leeward Community College to develop highly skilled and high wage earning electrical and mechanical technicians to work on the rail transit project operations and maintenance activities. The Integrated Industrial Technology Program at LCC provides an opportunity for workforce development where its graduates are trained to program, operate, maintain, calibrate and repair equipment that make up the rail system. Filling these jobs will be vital for the lifecycle success of the project.

HART utilizes embedded or “seconded” consultants to bring unique capabilities to the organization for the finite duration of the project. Including seconded, expert staff to supplement a pool of City employees, is common in the industry and especially for limited-term mega-project development.

January 7, 2019

To this end, HART has started a development with Waipahu High School, which is situated next to the Rail Operations Center, to stimulate interest from the Academy of Engineering students to pursue a career in rail transit.

10. To P3 or not to P3? HART’s midstream pivot to a P3 project delivery model raises more questions than answers - Call out box (Page 16)

HART is tasked with the delivery of the project within a certain schedule and budget. Neither the founding documents nor subsequent legislation dictate the method in which the program is delivered; that is left to the expertise of HART leadership and the Board of Directors. As such, when it became apparent that in order to meet our commitment to the FTA and to the taxpayers of Honolulu something would need to change, the HART Team did what many other agencies have done in similar situations: they thought out of the box. They brought in experts on global best practices, studied delivery options for over a year, and made the sound decision to deliver the last phase of the project in a manner which will best achieve the program objectives. This work was performed transparently throughout the analysis, with regular Board briefings, an Industry Forum, a Stakeholder’s Forum, presentations to business and labor groups, and involvement by various City departments and the City Council (refer to Council Resolution 18-139, CD1, FD1). The decision to deliver a project through any method is never one to be taken lightly, and the steps taken by HART to analyze options, build consensus, and achieve an outcome have been more than adequate.

The decision to deliver a project through any method is never one to be taken lightly, and the steps taken by HART to analyze options, build consensus, and achieve an outcome have been more than adequate.

Regarding the last paragraph in the call-out box, HART would like to point out that fare revenue is not sufficient to cover O&M in any lifecycle analysis, as such, it would not be sufficient to compensate the P3 entity for O&M. The City’s farebox policy assumes the City pays about 70% of the operating costs. Finally, revenue risk within a transit P3 is very uncommon and would likely result in fewer bidders and higher costs to address this risk.

11. HART oversight: reactive and after the fact (Pages 21-23)

As an organization, HART has historically had a number of consultant staff seconded to the HART organization, and without consulting an organization chart, it is often difficult to identify who is staff versus consultant. As a matrix organization, reporting relationships occur by discipline and across staff classifications. HART agrees that this has made oversight difficult in the past, but has made recent efforts to increase transparency and improve the interface between consultants and staff.

As stated in the response previously, HART is not dissimilar to other single-purpose agencies in the US and abroad, where project leadership staff are a blend of employees and consultants. Refer to Item 9.

Responses to State Audit Report Part 2 – Management

January 7, 2019

HART agrees that improvements should continue to be made to Consultant oversight. To address this, HART has initiated a formal procedure for the review and approval of staff performance reports. Specifically, HART will require that the supervising personnel of all seconded consultant staff review and approve the performance report; that appropriate work was performed by the personnel under his/her supervision. If the supervising personnel is a consultant from the same consulting firm, the supervising personnel's review will be reviewed and approved by a HART personnel. This new process will be memorialized in a formal procedure. In integrated offices where consultants and owners are co-located accomplishments of specific objectives becomes a common goal with a collaborative effort. Nevertheless, HART clearly understands the responsibility of overseeing consultants and ensuring their performance for which they are engaged.

HART has initiated a formal procedure for the review and approval of staff performance reports. Specifically, HART will require that the supervising personnel of all seconded consultant staff review and approve the performance report; that appropriate work was performed by the personnel under his/her supervision.

When the interim CEO took over his duties as CEO and Executive Director, the HART organization was under intense scrutiny and was faced with questions concerning its management capacity, technical capacity, ability to forecast cost to complete, and ability to forecast completion dates. Having previously been in management of mega projects such as HART, his first acts were to make sure that a realistic cost estimate to complete the project was developed and a master schedule to complete the project was finalized so that he could commit the organization for completion of this project in his testimonies to Honolulu City Council, and State Legislature. This was a needed exercise to assure the decision makers that this project has an end date and a total cost to accomplish that effort.

Upon review of the performances of staff and consultants, he advised the Board that some actions and changes were needed to bring more transparency and accountability by staff and consultants. As a result of that review, he decided to remind the consultants that they must recognize their commitments to the organization and fulfill their scope of work in an effective and acceptable manner. Letters were written to the consultants for their own independent evaluation of their staff and work, and to allow them to propose their intended actions. The consultants, as to be expected, came back with return responses defending their past and current performances. Several one-on-one meetings were held to discuss their letters and proposed actions. It was at that time that the permanent CEO came on board. After internal briefings, the CEO wanted to meet with the consultants and have his discussions concerning this issue. While it was important to officially notify the consultants that their performance needed improvement, for contractual reasons, it was felt that regular one-on-one meetings be held with the management of the consultant firms. This would allow needed improvements and/or changes to be implemented and monitored. The CEO established a new practice of regular meetings with HDR executives where all issues were discussed. Similar meetings were held with executives of CH2M Hill (now, Jacobs), PGH Wong, Stantec, and Lea & Elliott. As a result of these meetings, as well as in-house senior staff meetings, many changes have been implemented which have contributed to holding the

January 7, 2019

cost of the project at \$8.165 billion dollars and holding the revenue service date to December 2025. Significant changes have been made in the areas of estimating, scheduling, change order processing, as well as giving responsibility to front line CE & I managers to oversee and make decisions.

12. HART does not review third-party project management support consultants' monthly invoice justifications on a regular basis, relying on the consultant to determine whether its own staff's work is satisfactory (Page 24)

Pursuant to a competitive solicitation, HART awarded and negotiated a contract for program management support consultant (PMSC) with HDR Engineering, Inc. (HDR), commencing January 1, 2017.

The current First Deputy Executive Director, then the Director of Procurement and Contracts, determined when entering into the HDR contract dated January 1, 2017 that there was insufficient accountability, an insufficient documentation of day-to-day services provided by the PMSC. As such, the Deputy Executive Director made several changes: (1) a transfer of the project manager duties to Procurement and Contracts; (2) included a contract requirement for each seconded PMSC staff member to provide daily work summaries; and (3) the inclusion of express contract requirement that the PMSC's "primary and overarching task is to oversee the successful design and construction of the full Honolulu Rail Transit Project."

The PMSC contract is a "seconded personnel" contract ("PM[S]C staff will be co-located with HART in the Project space provided by HART and seconded into HART positions in the overall organizational structure," Exhibit 1 of the PMSC Contract). That is, each approved seconded PMSC personnel, is a professional staff under HART's organizational structure; this means that each PMSC approved key personnel embedded into HART's organizational chart reports to work every day (as a City employee would) a minimum 8.0 working hours a day, except when they are on approved leave. As extended professional staff under HART's organization, each personnel's compensation is based on and capped at 8.0 hours/day, 5 days a week, irrespective of extended hours; hours or days of approved leave are not billed to HART. Each seconded personnel has a distinct functional role for the Project and their individual role is to satisfactorily complete their tasks to achieve a cumulative overall objective of successfully designing and constructing the H RTP.

The daily summary of work performed, therefore, was to add documentation of daily activities to bring more accountability to each individual. There are currently 18 seconded personnel, which means there are approximately 1,800 (18 x 5 days (one week) x 20 working days per month) daily entries, submitted to HART each month.

Responses to State Audit Report Part 2 – Management

January 7, 2019

The contract manager (CM) assigned to manage the PMSC contract each month fastidiously checks that each seconded personnel has submitted a daily entry for each 8.0 hour day billed. As a part of her responsibility under HART's Consultant Invoice Payment Procedure to "review... invoice documentation for compliance with contract terms and conditions," she checks the accuracy of the rates of each seconded personnel, checks and calculates the reimbursable Other Direct Costs (ODCs) (such as travel costs) for compliance with the federal Part 31 cost principles as required under the Contract, among other reviews in accordance with the Invoice Payment Procedure. Relative to the 1,800 summaries of work performed, the CM reviews each of the 1,800 entries and notes for the PM any questions she has regarding the entries.

The First Deputy Executive Director in the first quarter (4 months) of 2017 reviewed each of the 1,800 entries each month and provided feedback, asked for comments and inquired after entries with the PMSC. Over time, the summaries of work provided by the PMSC seconded personnel improved; thereafter, the First Deputy Executive Director relied on the CM's initial review, addressing the questions the CM raised on the entries, and assessed that a detailed review of the 1,800 entries would be required more on an "audit basis," varying from 1-3 months.

Within the first quarter of 2019, HART will revise the process for reviewing the PMSC invoices. To the extent the seconded personnel are a part of the HART organizational chart, the personnel's direct supervisor, whether a consultant or HART, will be required to review the summaries of work performed and attest to the work performed.

The First Deputy Executive Director agrees with the State Audit finding regarding insufficient review of "third-party project management support consultants' monthly invoice justifications on a regular basis, relying on the consultant to determine whether its own staff's work is satisfactory," and has taken the opportunity of this audit to not only revise the process to provide a more robust review of the invoice justifications, but also implement a meaningful measurement to evaluate the performance of the PMSC in achieving its overarching requirement to successfully complete the design and construction of the Honolulu Rail Transit Project.

As such, the following actions will occur in 2019:

- Within the first quarter of 2019, HART will revise the process for reviewing the PMSC invoices. To the extent the seconded personnel are a part of the HART organizational chart, the personnel's direct supervisor, whether a consultant or HART, will be required to review the summaries of work performed and attest to the work performed. Rather than have just the Project Director approve all the work summaries and invoice, HART will enforce review of the work summaries by the direct supervisor. This will continue to hold the consultant-supervisor responsible for the work of his/her staff. An additional review will be added, however, where a relevant HART management staff will review the work summaries; for instance, HART Senior Adviser (the previous Interim CEO) will review the work summaries of the construction managers; HART Executive Director-CEO will review the work summary of the Project Director;

January 7, 2019

HART Deputy Director of Project Controls, the work summary of the CMS analyst. Each PMSC seconded personnel work summary will be reviewed by a HART management staff.

- HART will implement a more meaningful measure to evaluate the performance of PMSC in achieving its responsibility to successfully design and build the H RTP. At each 6 month interval, the PMSC will be required to provide its status by providing at minimum: (1) Tangible Objectives for each quarter (e.g., completion of stages of completion for stations; addressing change requests on timely basis); (2) Individual Input (the current daily work summaries required to meet the Tangible Objectives); (2) Contract Output (key tangible deliverables to meet objectives--e.g., construction of stations meeting target completion; change order documents submitted on a timely basis); (3) Project Outcome (whether the Tangible Objectives were met --e.g., the required percentage completion of station construction to meet the station substantial completion date). The PMSC consultant will be evaluated on these tangible measurements. The evaluation will be done bi-annually. For 2019, it will be particularly crucial to gauge the progress of the westside station construction.

HART will implement a more meaningful measure to evaluate the performance of PMSC in achieving its responsibility to successfully design and build the H RTP.

13. HART does not retain complete documentary evidence of its quality management audits of consultants (Page 26) / Is HART assuring quality: We found that they are not (Page 29)

There are two different aspects of a Quality Management Plan/System (QMP): Quality Assurance (QA) and Quality Control (QC). QA focuses on the processes that are in place to produce the project deliverables at the applicable level of quality. It is the process of auditing and analyzing the systems which produce a product in order to improve their quality. Specific to transit projects, QA is the necessary function to ensure that each contractor has a qualified manager who is familiar with the type of work that the contractor is engaged in, and that all the necessary steps in the process are followed when a product is delivered. QC is a direct measurement of the project deliverables for acceptance or rejection. At HART, QC is a function of each department head to ensure that rules, regulations, criteria, standards, and specifications are followed in the production of their work and that a responsible individual for each step is signed off by the supervisor. Both are necessary in the delivery of a mega project, but it is important to not confuse them. HART utilizes both in the implementation of the QMP. The FTA and PMOC are satisfied with HART's Quality Management Plan and its implementation.

The FTA and PMOC are satisfied with HART's Quality Management Plan and its implementation.

Responses to State Audit Report Part 2 – Management

January 7, 2019

The State Audit scope was limited to verify compliance of the HART consultants for technical services. These include HDR, Jacobs, PGH Wong, and Stantec. The scope did not involve Final Design, Construction, Manufacturing, Testing, Commissioning and Final Acceptance of the project.

Audits of Jacobs, PGH Wong, and Stantec

Jacobs, PGH Wong, and Stantec are traditional consultants in the sense that their contracts have a specific scope of work, project deliverables, and schedule. They typically perform the work in their offices and then submit it to HART as a deliverable.

The State audited the 2013-2018 HART Audits of these consultants. During 2013-2015, we used to write all our findings and sampled documents/evidence in the Checklists, including asking the consultants hard copies of the evidences for audit files. From 2016 to present, our current practice is to perform combined management systems (QA, Buy America, Environmental Compliance, and Safety and Security) per ISO 9011. Also in 2016, HART switched to electronic audits during an in-person meeting. During this process, we require the consultants and contractors to project samples of documents on the screen for the audit team to review per specific audit Checklist to verify compliance to their QA Plan and contract requirements. We then require the consultants to give the audit team an electronic copy of the samples as audit evidence. We also use photos from Cell Phones as audit records. The consultants receive the checklist two weeks prior to the audit meeting for their preparation. We found that this method is more productive and efficient for both HART and the consultants and contractors. The audit results and reports were based on the evaluation and judgement of the HART Certified Quality Auditors (CQA).

Audit of HDR

HDR is the Program Management Support Consultant and follows a different scope of work than traditional engineering consultants. HDR's scope not only includes specific deliverables and reporting requirements, but also includes the responsibility for augmenting HART staff with key personnel. These staff are experts in transit systems and experienced on projects around the world. They are filling technical roles that are not available in-State. These key personnel are infused into the HART organization at different responsibilities and capacities. The FTA has approved this method of developing the organization, and the key personnel, via the approval of the Project Management Plan (PMP) and during monthly PMOC meetings. In the past two years there have been no changes at the HDR's senior staff level and HART has been able to restructure the organization to address functions and needs of the project. HART considers that its organization structure is dynamic as we need to constantly focus on different aspects of the project, as the construction progresses, and therefore take useful and necessary steps in fine tuning the organization. During the audit process, HART explained to the auditors that HDR are to be audited based on their assigned responsibilities and scope. Recent steps taken to regularly meet with HDR's executives and providing them the feedback is reflective in our report that budget and schedule of the project remains unchanged.

Because HDR staff are a part of the HART organization, the reasonable way to determine their compliance is by Internal Audit against the PMP and sub-plans and procedures. During the audit process, HART provided all internal audit materials from 2012 to present for the auditors to review.

The focus of this audit was on FY 2017-2018 as per the audit scope. As was explained to the auditors, during this period, HART was focused on bringing the PMP and baseline sub-plans and procedures up to

Responses to State Audit Report Part 2 – Management

January 7, 2019

date to reflect organizational changes. HART decided that rather than perform audits on compliance with obsolete documents, we would focus on the updates and then audit against those. This decision was reported to, and supported by, senior management. This issue, and the deficiencies, were reported annually to the ED-CEO and senior management by the Director of QA/QC during the annual review of the adequacy and effective implementation of the Quality Management System (QMP). It should be noted that there are other methods to monitor HDR's work as well, including through review of monthly invoices, regular check-ins with senior HDR management, and annual performance reviews.

QA/QC is a continuously evolving process. HART acknowledges the audit findings related to QA/QC and in 2019 HART will evaluate the necessary processes to identify areas for improvement.

The 2012 HART Staffing and Succession Plan referred to is also known as Revision 4.0, and has been updated several times since 2012. These revisions were based on the City Charter change in 2016, the Hawaii State Legislative changes in 2017, and multiple internally driven project reorganizations. Revision 6.C is currently being developed by HART staff. Given the changes to the project, it may not be feasible or appropriate to replace consultant positions identified in 2012 with City employees. As mentioned in the report, this is a finite that requires relatively short-term complement of professionals with specialized rail design and construction expertise.

14. Consultant Audit Checklist (Page 27)

A QMP must be a holistic program that can support the project from planning through design, construction, and operations. That said, not all elements of the system will be applicable to all consultants. Specific to the three consultants listed in this call-out box (CH2M Hill (now, Jacobs), PGH Wong, and Stantec), who are responsible for supplying technical services to the project, the example shown (inspection, measuring, testing equipment) is not relevant.

15. Conclusion (Page 28)

The Audit Report refers to "gray areas" of governance. HART maintains that the Charter language which created HART in 2009, as amended in 2016, provides a framework for how the Board, Executive Director, and staff interact and how powers and duties are allocated between them. With the Charter Amendment 4 in 2016, the Board has the discretion, through actions such as Board Resolution No. 2018-14 to determine what matters need to be brought before them in the exercise of their authority, which can evolve based upon the changing needs of the project.

Regarding the statement that the CEO has the power over what issues are presented to the Board – this is not correct. The Charter sets forth the matters that require Board approval, and beyond that, gives the Board some discretion

The Audit Report states that "...the buck all too often stops at a consultant, not with HART." In reality, **the CEO and the Board have ultimate ownership of project responsibility.** If the CEO can't manage the project, including the consultants, successfully, then the Board has the ability to replace the CEO.

Responses to State Audit Report Part 2 – Management

January 7, 2019

over other matters that it may choose to oversee. The Audit reflects a judgment about issues that “should be reported to the Board and fully vetted,” but that is for the Board and the CEO to determine, within the framework created by the Charter. The CEO is ultimately held accountable to the Board to present relevant information though the Board’s power to hire and fire him/her. The recent Resolutions have delegated greater oversight responsibilities to committees. However, the fact remains that the Board hires the CEO and remains reliant on that person to remain accountable to the Board.

The Audit Report states that “...the buck all too often stops at a consultant, not with HART.” HART acknowledges and agrees that it holds the consultant responsible for its required performance under its contract. However, the CEO and the Board have ultimate ownership of project responsibility. If the CEO can’t manage the project, including the consultants, successfully, then the Board has the ability to replace the CEO.

HART competes for qualified employees on the open market, and the vast majority of HART positions are not suitable for entry-level candidates. Consultant staff is phased out at every possible opportunity when HART is able to find and hire qualified individuals as City employees. HART employees are usually expected to work at the fully functioning level upon start of employment, and they expect to be compensated accordingly. The HART Board of Directors has been very proactive in supporting HART’s efforts to pay reasonable salaries, but HART is still faced with restrictions regarding compensation based on the City classification and pay policies and established compensation schedules. Pay restrictions sometimes make it impossible to fill certain positions with City employees given the level of expertise required to do

The Project Management Oversight Consultant (PMOC) hired by the FTA to oversee the project has acknowledged that **reliance on consultants in a project of this complexity is a common practice**. Nevertheless, HART will continue to strive to place City employees in key positions wherever possible.

the job, and the compensation that level of expertise can command in the labor market. As such, there will most likely continue to be a need for a limited number of employees who possess the required skills or experience whereby the services will continue to be provided on a consultant contract basis. The Project Management Oversight Consultant (PMOC) hired by the FTA to oversee the project has acknowledged that reliance on consultants in a project of this complexity is a common practice. Nevertheless, HART will continue to strive to place City employees in key positions wherever possible.

The Auditors reviewed the Staffing and Succession Plan, Revision 4.0 (2012) during their audit. This document has been updated several times in the intervening years, based on the City Charter change in 2016, the Hawaii State Legislative changes in 2017, and multiple internally driven project reorganizations. In the first quarter of 2019, HART will complete Revision 6.C to the Staffing and Succession Plan, after critical organizational changes currently being considered are decided upon.