

Review of the Department of Accounting and General Services' Verification of the Honolulu Authority for Rapid Transportation's Invoices

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

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OFFICE OF THE AUDITOR
STATE OF HAWAI'I



OFFICE OF THE AUDITOR STATE OF HAWAII

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Foreword

Act 1, codified as Section 23-14, Hawai‘i Revised Statutes (HRS) requires the Auditor to conduct an annual review of the Honolulu Authority for Rapid Transportation (HART) to determine whether (1) expenditures by the authority comply with the criteria established by Section 46-16.8(e), HRS, and (2) whether the authority follows accounting best practices in substantiating its expenditures. Act 1, however, did not appropriate any funds to the Auditor to perform the annual review. To perform a meaningful review of the authority’s expenditures requires construction knowledge and expertise. Without funding to retain a construction consultant, we examined the policies and procedures the Department of Accounting and General Services (DAGS) has implemented to assess whether invoices for capital costs submitted by HART are eligible for payment from the Mass Transit Special Fund pursuant to the criteria in Section 46-16.8(e), HRS, and the adequacy of the controls DAGS has created to ensure that the invoices certified by the comptroller are in accordance with the requirements of Act 1. We believe our assessment of those policies, procedures, and controls provides meaningful information for the Legislature to understand the risk that HART may be receiving payment from the Mass Transit Special Fund for costs that may be inconsistent with the Legislature’s intent.

We express our appreciation to the staff of HART and DAGS and other individuals whom we contacted during the course of our review work, for their cooperation and assistance.

Leslie H. Kondo
State Auditor



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Lack of Fundamentals: Review of the Department of Accounting and General Services' Verification of the Honolulu Authority for Rapid Transportation's Invoices

Introduction

ACT 1, passed by the Hawai'i State Legislature during the 2017 First Special Session, provided an additional source of state tax revenue for the Honolulu rail project and established the Mass Transit Special Fund to hold this revenue and other state funding collected for the construction of the rail project (collectively, the "state revenues"). The Legislature, however, limited the use of the state revenues to "capital costs" and, further, identified certain specific expenses that cannot be paid with the state revenues. To access the moneys in the special fund, Act 1 requires the Honolulu Authority for Rapid Transportation (HART) to submit invoices to the Department of Accounting and General Services (DAGS), which must verify that the costs comply with Act 1.

DAGS' implementation of its responsibilities under Act 1 is arbitrary, opaque, and subject to change without any notice.

We found that DAGS has not promulgated administrative rules, as required by law, to implement its invoice verification responsibilities and has no plans to do so. Administrative rules, which are defined as “each agency statement of general or particular applicability and future effect that implements, interprets, or prescribes law or policy, or describes the organization, procedure, or practice requirements of any agency,” supplement the general statutory scheme established by the Legislature with details necessary for an agency to properly implement its responsibilities. Without these rules, DAGS’ implementation of its responsibilities under Act 1 is arbitrary, opaque, and subject to change without any notice – all of which administrative rules are intended to prevent.

We also found that DAGS fundamentally misunderstands its responsibilities under Act 1¹ and, as a result, is performing tasks and other work peripheral to its sole mission of verifying compliance with Act 1. For instance, DAGS is performing time-consuming and redundant spot checks that mimic more extensive reviews that HART previously performed and is re-performing other work for which HART is responsible to do, like assessing the sufficiency of documentation that supports HART’s approval of change orders. To compound matters, DAGS has not provided its audit staff with the proper training, guidance, and support to adequately carry out their verification duties, instead relying on its staff auditors’ ability to independently understand and construe Act 1.

“... [R]evenues derived from the county surcharge on state tax shall not be used: (1) To build or repair public roads or highways . . . ; (2) For operating costs or maintenance costs of the mass transit project . . . ; and (3) For administrative or operating, marketing, or maintenance costs, including personnel costs[.]”

— Section 46-16.8(e), HRS

Background

Act 1 provides additional state funding for HART’s capital costs

During the 2017 First Special Session, the Legislature passed Senate Bill No. 4, which became Act 1, to provide the City and County of Honolulu (City) with additional revenue sources for the construction of its rail project. More specifically, Act 1 authorized the City to extend the one-half of one percent (0.5 percent) surcharge on state general excise tax (GET) by three years through the end of 2030 and, beginning January 1, 2018, increased the transient accommodations tax (TAT) to 10.25 percent. Revenues from the surcharge on the GET and 1 percent of TAT revenues are deposited into the Mass Transit Special Fund, which was created by Act 1 and is administered by the Department of Budget and Finance.

¹ Codified as Section 40-81.5, Hawai‘i Revised Statutes (HRS).

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 rail project. Act 1, however, expressly prohibits using the special fund revenues for administrative, marketing, operating, or maintenance costs, including personnel costs, as well as for the construction or repair of public roads and bicycle paths or to support existing public transportation systems.²

To access the moneys in the special fund, HART is required to submit invoices to DAGS, which must verify that the costs are eligible for payment in accordance with Act 1.

Department of Accounting and General Services’ Invoice Verification Programs and Staffing

To perform its responsibilities under Act 1, DAGS has developed “audit programs,” which DAGS calls Invoice Verification Programs, that document the procedures DAGS staff auditors use in their review of HART’s invoices. The staff auditors note their completion of each step of the Invoice Verification Programs by making a check mark adjacent to the specific step as they review a given invoice. We found that the check marks are the primary record of the review, and in most cases, the only record of review, with no other documentation of the auditors’ work or analysis to verify that costs are eligible for reimbursement under Act 1. A sample Invoice Verification Program is included as Appendix 1.

Once the invoices are verified as acceptable uses of the state revenues, DAGS submits a “certification statement” to the Department of Budget and Finance, which then disburses the moneys to the City’s director of finance.³ For the periods January 1, 2018 through March 31, 2018; April 1, 2018 through June 30, 2018; and July 1, 2018 through September 30, 2018, DAGS certified HART invoices totaling \$75.3 million, \$81.7 million, and \$83.4 million as eligible for reimbursement for those respective periods.⁴

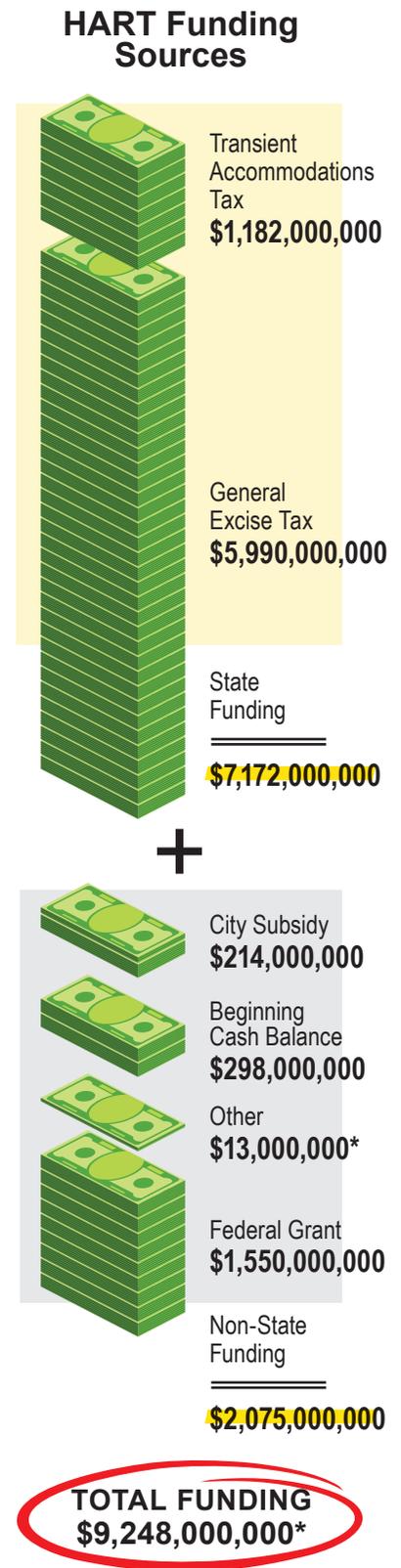
Act 1 appropriated \$400,000 to DAGS to establish three full-time equivalent (FTE) civil service exempt positions to assist in verifying that HART receives payment for only those costs that the Legislature deemed appropriate.⁵ Currently, DAGS has an audit supervisor (approximately 0.75 FTE) and two staff auditors whose duties are to review and verify

² Codified as Sections 248-2.7 and 46-16.8(e), HRS.

³ Section 248-2.7(c), HRS. The Department of Budget and Finance is required to post the DAGS certification statements on its website within 10 days after it has made payment to the City. Section 248-2.7(d), HRS.

⁴ See <http://budget.hawaii.gov/act-1-first-special-session-of-2017-mass-transit-special-fund/>.

⁵ Act 1, Part VII, Section 15.



* Numbers may not match due to rounding.
Source: 2018 HART Recovery Plan

that the costs submitted by HART are eligible for reimbursement from the Mass Transit Special Fund.⁶ The audit supervisor told us that he believes that the current staffing is sufficient to perform DAGS' invoice verification responsibilities.

HART will be submitting as much as 70 percent of its administrative and operating expenses, including personnel costs, to DAGS for payment

According to HART's former chief financial officer (CFO),⁷ HART construes Act 1 to allow it to use the state revenues for any "capital cost," which HART defines to include all costs related to the acquisition, development, and construction of the rail system. He provided us with HART's proposed Capitalization Policy,⁸ dated June 30, 2018, which declares "the *majority* of costs incurred by HART are clearly related to the acquisition, development and construction of the rail system." (Emphasis in original.) More specifically, the proposed Capitalization Policy identifies "Primary Capital Costs" as those associated with construction management; construction support; planning; right of way acquisition; public construction information; and testing and start-up. HART also includes costs relating to its administrative and office functions as capital costs. Those functions include:

- **Cost accounting** – activities involved in maintaining cost accounting records for the project;
- **Human resources** – functions relating to employees involved in primary activities, such as hiring, firing, payroll, and maintenance of personnel records;

⁶ Upon the passage of Act 1, DAGS assigned existing internal audit division staff auditors to review the HART invoices. DAGS hired two staff auditors specifically to review the HART invoices, one in April 2018 and the second in October 2018.

⁷ HART's CFO resigned his position effective January 15, 2019. The references to the CFO are to that individual, i.e., the former CFO. We did not confirm the former CFO's statements reported herein with the acting CFO.

⁸ The CFO said that HART has not yet adopted the policy, and he has asked HART's external financial auditor and one of the directors on the HART board to review the proposed policy.

Capitalization policies, generally, are used to define the types of expenditures an organization records as capital assets or which are charged as expenses for financial accounting purposes. Consistent with that understanding, the purpose clause at the beginning of the draft Capitalization Policy states:

To provide a Capitalization Policy to account for infrastructure project costs for the acquisition, development and construction of the rail project. The objective is to clarify guidelines to provide a consistent framework for accurate and timely reporting of capital asset values.

From our discussion with HART's external financial auditor, it is our understanding that HART historically has recorded most of its expenditures as expenses, not capital assets, and intends to change its accounting policy for the fiscal year beginning July 1, 2018.

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- **Procurement and accounts payable** – activities necessary to procure project construction contracts and buy materials and supplies needed for the project; and
 - **Other project administration** – staff in project departments who are involved in personnel functions, the ordering of supplies, and other duties that are directly supporting the project.⁹

For those departments within HART whose functions are primarily administrative, the CFO evaluated each staff person’s duties and estimated the percentage of the person’s work that supports the project, or said differently, the percentage of work that is not related to the “general administration” of HART. According to the CFO, cumulatively, 70 percent of the functions performed by HART staff support the project; therefore, HART believes 70 percent of its administrative and overhead costs, *including personnel expenses*, are “capital costs” that can be paid using the state revenues.

According to the CFO, HART has not yet submitted any administrative and overhead-type expenses to DAGS for payment; however, he said HART intends to submit these expenses for DAGS verification once HART’s Capitalization Policy is adopted.

Impetus, Scope, and Methodology

Act 1, codified as Section 23-14, Hawai‘i Revised Statutes (HRS), requires the Auditor to conduct an annual review of HART to determine that:

1. HART’s expenditures comply with the criteria established pursuant to section 46-16.8(e), HRS, and
2. HART follows accounting best practices for substantiating its expenditures.

Act 1, however, did not appropriate any funds to the Auditor to perform the annual review. As detailed later in this report, the invoices for which HART has received payment from the special fund are voluminous, some more than 100 pages, listing the “tasks” that the contractor performed. However, the tasks often are cryptic and do not describe the specific work the contractor performed to complete each task. Fully understanding the work that was performed to complete a task – and then determining whether the invoice was for work that can be paid using the state revenues – requires construction knowledge and expertise.

⁹ The policy excludes expenses associated with “the receptionist” from the costs that it has decided to capitalize.

Without funding to retain a construction consultant, we examined the policies and procedures DAGS has implemented to assess whether invoices for capital costs submitted by HART are eligible for payment from the Mass Transit Special Fund pursuant to the criteria in Section 46-16.8(e), HRS, and the adequacy of the controls DAGS has created to ensure that the invoices certified by the comptroller are in accordance with the requirements of Act 1.¹⁰ Our assessment of those policies, procedures, and controls provides meaningful information for the Legislature to understand the risk that HART may be receiving payment from the Mass Transit Special Fund for costs that may be inconsistent with the Legislature's intent. In the background section above, we reported the policy HART has adopted to provide some context about the risk that HART may be requesting and subsequently receiving payment for costs that are prohibited by Section 46-16.8(e), HRS.

We do believe an assessment of the costs that DAGS has certified as eligible for payment from the special fund, as contemplated by Section 23-14, HRS, may provide greater assurance that the state revenues are being used only as intended by the Legislature. However, to perform that review, the Legislature will need to appropriate funds for us to retain a consultant with the requisite construction experience and knowledge to meaningfully assess whether the invoices DAGS has certified as eligible for payment, and for which HART has received payment, are consistent with Act 1 and Section 46-16.8(e), HRS.

We performed our work between June and November 2018. We believe that the evidence we obtained is sufficient and appropriate to reasonably support the findings and conclusions stated herein.

Summary of Findings

1. DAGS has not promulgated administrative rules required by law to implement its invoice review responsibilities and to establish the procedures for HART to obtain payment of its capital costs.
2. DAGS provides no formal training for its staff auditors and has no documented policies or procedures for its staff auditors.

¹⁰ Codified as Section 40-81.5, HRS.

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3. Instead of verifying that costs comply with Act 1 and Section 46-16.8(e), HRS, DAGS performs unnecessary, duplicative, and counter-productive audit procedures that not only waste time and money but also increase the risk of improper payment.
 4. DAGS' verification procedures do not ensure adequate review of allowable construction-related costs.

DAGS has not promulgated administrative rules required by law to perform its invoice review responsibilities and to establish the procedures for HART to obtain payment of its capital costs.

Legislative acts often provide the general framework of a program, and agencies are required to “fill in the details” to implement the program through administrative rules, which are the agency’s statements that implement and interpret a statute, including the procedures the agency requires others to follow.¹¹ Administrative rules provide a check on an agency’s discretionary power by requiring pre-established rules and standards that guide consistent agency behavior in its implementation of legislative directives.¹² The Hawai‘i Supreme Court has explained, “[r]ule-making is an agency governing the future conduct either of groups of persons or of a single individual; it is essentially legislative in nature, not only because it operates in the future but also because it is concerned largely with considerations of policy.”¹³

Act 1 conferred upon DAGS the power to promulgate administrative rules necessary to implement its verification responsibilities and exempted DAGS from the procedural requirements to establish rules set forth in the Hawai‘i Administrative Procedures Act, Chapter 91, HRS, which include, amongst other things, public notice and public hearings on proposed rules.¹⁴ In other words, Act 1 empowered DAGS to expeditiously establish rules to fill in the “gaps,” i.e., to dictate how it intends to implement its responsibilities, including its interpretation of certain terms, as well as the procedures that DAGS intends HART to follow in submitting invoices to DAGS for payment. However, we found that DAGS has not established any rules and has no intention of doing so.

¹¹ Section 91-1, HRS.

¹² See *In re Terminal Transportation, Inc.*, 54 Haw. 134 (1972); *Aguiar v. Hawai‘i Housing Authority*, 478 Haw. 44 (1974).

¹³ *Pila‘a 400 vs. Bd. of Land and Natural Resources*, 931 Hawai‘i 247 (2014) (quoting Note, ‘*Rule Making, Adjudication and Exceptions Under the Administrative Procedures Act*, 95 U. Pa. L.Rev. 621 (1946-47)).

¹⁴ Codified as Section 40-81.5(d).

In the absence of relevant administrative rules, we found that DAGS is relying upon a Department of the Attorney General's legal opinion to interpret and apply the phrase "[t]o build or repair public roads." Based on the department's advice, DAGS construes Section 46-16.8(e), HRS, to allow HART to use the state revenues to repair *existing* public roads damaged during construction.

Act 1 does not allow HART to use the Mass Transit Special Fund to "build or repair public roads," for the project's "operating and maintenance costs," or for HART's "administrative or operating, marketing, or maintenance costs, including personnel costs." Because Act 1 does not define those terms, it requires DAGS to decide how to construe those terms to implement its statutory responsibility. Those "statement[s] of general or particular applicability" that implement and interpret the law are required to be formally established through administrative rules, creating the transparent and consistent framework necessary for DAGS to perform its responsibilities under Act 1, and not through confidential attorney general opinions that can be reconsidered and reissued without any notice.

We found other instances where DAGS' interpretation of Act 1, as well as the procedures by which HART needs to submit its invoices, are unseen and secreted. For instance, DAGS reads Act 1 as obligating HART to ensure that the costs it submits to DAGS can be paid using the state revenues¹⁵ and has demanded that HART "improve its internal controls with respect to compliance with [Act 1]." However, DAGS also told HART not to ask for guidance about how to comply with the requirements of Act 1, directing HART to reference "other authoritative sources . . . includ[ing] the accounting standards and related guidelines of the Government Accounting Standards Board (GASB) and Financial Accounting Standards Board (FASB)" to support its requests to use the state revenues to pay for costs that are not specifically included in the statutory definition of capital costs, like costs associated with training and for warranties.¹⁶

Similarly, the law is silent as to the procedures that DAGS expects HART to follow as well as those that document its own practice. For instance, among other things, Act 1 does not dictate if HART must submit invoices to DAGS daily, once a week, once a month, quarterly, or some other frequency; Act 1 does not dictate whether DAGS must process the invoices it receives from HART daily, once a week, once

¹⁵ In August 2018, the former DAGS Comptroller wrote to HART, "I would like to remind you that HART is responsible to ensure that the invoices for capital costs submitted to the State Comptroller comply with HRS §46-16.8(e)."

¹⁶ In its letter dated August 2, 2018, DAGS instructed, "HART's written justification should refer to the specific sections in these sources that would support HART's position that costs comply with the relevant sections of the HRS."

a month, quarterly, or some other frequency; Act 1 does not dictate whether DAGS must reject capital costs if it determines that Section 46-16.8(e), HRS, prohibits the state revenues from being used to pay other costs contained in the same invoice; Act 1 is silent as to the procedure for HART to challenge DAGS' rejection of its costs. Without administrative rules, HART can only guess as to how DAGS intends to implement its responsibilities under Act 1.

DAGS provides no formal training for its staff auditors and has no documented policies or procedures for its staff auditors.

DAGS' Invoice Verification Programs start with "General Procedures," the first of which directs the staff auditors to "[o]btain an understanding of the verification requirements by gaining an understanding of the relevant provisions (sections) of Act 001, 2017 First Special Session." However, we found that DAGS has no formal training program for its staff auditors and no written policies or procedures relating to its verification responsibilities other than the audit programs.

DAGS expects its auditors to read, understand, and apply the language in Act 1, with little, if any, guidance.¹⁷ According to the supervising auditor, new staff auditors are given copies of the Invoice Verification Programs relating to invoices that DAGS had previously approved as examples of how to perform their verification responsibilities. He and the staff auditors are expected to independently develop their own understanding of the law, including the meaning of specific terms. One of the staff auditors said his training consisted of a "brief description of the work" by the supervising auditor and the administrator of DAGS' audit division. He described Act 1 as their "bible." However, the supervising auditor acknowledged that some costs that Act 1 prohibits are vague and subject to interpretation; yet, he also said that DAGS has not documented how to construe those costs.

Without documented procedures on how its staff auditors are supposed to perform their verification responsibilities, there is substantial risk that the staff auditors' review is arbitrary and inconsistent. While the Invoice Verification Programs may document the general process that DAGS expects its staff auditors to follow, it is not sufficiently detailed

¹⁷ DAGS' supervising auditor explained, "we have them study the law, audit programs, and previous work papers." He said that he wasn't given any formal training; he said that he trained himself by "review[ing] [the American Institute of Certified Public Accountants] reference material and researched on the internet and [the Financial Accounting Standards Board] and [the Governmental Accounting Standards Board] codifications."

Deferring (the definition of) Maintenance

ACT 1 specifies that state funds cannot be used, among other things, to repair roads or for the project's operating, marketing, or maintenance costs, including HART's personnel costs. But, according to the audit supervisor, they have not been instructed how to construe those terms. With the revenue service date, i.e., the date by which HART projects the rail system will start full operations, still almost seven years away, it is likely that HART will incur costs to "upkeep" parts of the system that it has completed – from removing graffiti from guideway columns to maintaining transit stations to repairing the Maintenance and Storage Facility, which was completed in July 2016. Will these costs to upkeep the system while under construction be considered maintenance costs that Act 1 does not allow the state revenues to be used to pay? In addition, according to the 2018 HART Recovery Plan, the agency plans on operating the transit system's first two segments on an interim basis, starting in 2020. Will the costs associated with operating and maintaining the partially completed rail system during this period qualify for payment? Without documented instructions, the answers to these questions may be dependent on which DAGS auditor is reviewing the invoice at the time.

to provide meaningful directions to the auditors as to how to perform their responsibilities. It is fundamental that DAGS must develop a documented internal control process to provide reasonable assurance that it is performing the verification responsibilities required under Act 1.¹⁸

Instead of verifying that costs comply with Act 1, DAGS performs unnecessary, duplicative, and counter-productive audit procedures that not only waste time and money but also increase the risk of improper payment.

DAGS' responsibility with respect to HART's invoices is relatively narrow: verify that the invoices HART submits for reimbursement from the Mass Transit Special Fund comply with Section 46-16.8(e), HRS.¹⁹ As previously noted, that provision authorizes HART to use the surcharge on the state GET only for capital costs associated with construction of the rail project, but expressly prohibits using the surcharge revenues to build or repair public roads; to support an existing public transportation system; for operating costs or maintenance costs of the rail system; and for HART's administrative, operating, marketing, or maintenance costs, including personnel costs.

We found that much of the work DAGS is performing is well-outside of the responsibilities that it has been tasked with doing under Act 1.²⁰ Specifically, a large portion of DAGS' audit procedures consist of "re-performance," i.e., repeating aspects of the far more extensive review that HART contract administrators (who unlike DAGS' staff auditors are familiar with construction practices) have already performed. DAGS auditors review invoices for mathematical errors and verify that HART complied with its invoice review and approval process; DAGS auditors confirm the contractor's labor rates, overhead charges, and direct costs are consistent with the contract; DAGS auditors also review, among other things, monthly progress reports, daily inspection reports, shipping documents and bills of lading, and attend monthly meetings that HART has with its engineering and inspection consultants and contractors to verify the percentage of completion contained in invoices.

When reviewing invoices from Ansaldo Honolulu JV (Ansaldo), the rail system's train car vendor, the DAGS staff auditor said he looks

¹⁸ See United States Government Accountability Office's *Standards for Internal Control in the Federal Government* (the "Green Book").

¹⁹ Section 40-81.5, HRS.

²⁰ Codified as Section 40-81.5, HRS.

to confirm that the train cars are being manufactured at the location represented by Ansaldo and, if delivered to HART, will confirm delivery through reports and photographs.

The audit supervisor explained that DAGS believes that the math checks, verifying the percentages of completion, and other re-performance tasks are required to verify that the costs are eligible for reimbursement. DAGS construes its responsibilities under Act 1 to include verifying that the work reflected in the invoices was actually performed and the quantities of materials which are invoiced were actually delivered.

We do not read Act 1 (or Section 40-81.5, HRS) so broadly. Act 1 clearly did not intend for DAGS to be involved in managing the rail project or to otherwise interfere with HART's management of the project, which may be the unintended consequence of DAGS' misplaced interpretation of its responsibilities under Act 1. HART is responsible for holding its contractors accountable, which includes ensuring that payments are consistent with contract terms. DAGS should not be involved in or otherwise re-perform HART's duties.

DAGS' verification procedures do not ensure adequate review of allowable construction-related costs.

We also found the Invoice Verification Programs that DAGS uses to review HART's invoices reflect a poor understanding of construction practices, specifically, the manner in which work is invoiced. For instance, construction contracts are often broken down by "tasks" the contractor will perform to complete the work under the contract and their invoices often are based on those tasks. However, some of the task descriptions are impossible to decipher without construction expertise and experience with construction invoices. For example, an invoice from Shimmick/Traylor/Granite JV²¹ includes \$15,278 for "*CW Other Trkwrk Pkgs RFC IDR/CR/QC.*" (See Exhibit 1.) In addition, tasks often involve "sub-tasks" that are the more detailed description of the work that is involved to perform the task, but those sub-tasks may not be included in the contractor's invoice; and those sub-tasks, like the example of the task description, require construction knowledge to understand the specific work a contractor performed to complete the sub-task. Without a thorough understanding of the work for which a contractor seeks payment, DAGS is unable to assess whether the costs can be paid with the state revenues.

²¹ Shimmick/Traylor/Granite JV is contracted to construct the transit system's third segment, which includes the guideway from Aloha Stadium to Middle Street and the four transit stations along the route.

Cursory word searches and sampling approach increase risk of improper payment

To sort through the invoices, DAGS staff auditors manually search for certain keywords, such as “marketing” or work related to “operating and maintenance,” instead of performing procedures that would help identify prohibited costs.²² One staff auditor said that, unless he sees those terms, he does not ask HART or HART’s engineering and inspection consultants for information about the specific work the contractor performed to complete each task on the contractor’s invoice. Such cursory reviews substantially increase the risk that DAGS is approving costs that cannot be paid for with the state revenues.

Since its audit procedures are so time consuming, the audit manager said that DAGS audit staff cannot review all the costs contained in the

²² For the consultant invoices, the audit supervisor said that DAGS assumes that all the consultants’ work are capital costs, as defined in the statute, and primarily reviews the consultants’ time sheets.

Exhibit 1 Shimmick/Taylor/Granite JV Invoice

VALIDATION OF SCHEDULE OF VALUE PROGRESS PREPARED BY CLIENT PAGE 3 OF 7 PAGES
 INVOICE NO.: 00013
 PERIOD TO: October 27, 2017
 CONTRACT NO.: CT-HRT-1600385
 CONTRACTOR: Shimmick/Taylor/Granite JV

LINE ITEM	ACT ID	WBS	DESCRIPTION	PERCENT CURRENT	ACHIEVED CURRENT \$	SUBMITTAL FIELD REPORT NO.	CHECKED BY INITIALS	VERIFIED BY INITIALS	VALUE	ACHIEVED PREVIOUSLY \$	ACHIEVED TO DATE PERCENT	\$
00287	405.30.0710	00.01.30.00.80.02	CW Other Trkwrk Pkgs RFC	12%	\$4,545.32				\$38,196.00	\$33,650.68	100%	\$38,196.00
00288	405.30.0720	00.01.30.00.80.02	CW Other Trkwrk Pkgs RFC IDR/CR/QC	100%	\$15,278.00				\$15,278.00	\$0.00	100%	\$15,278.00
00289	405.30.0730	00.01.30.00.80.02	CW Other Trkwrk Pkgs RFC Pre-Submittal Wrkshp	100%	\$15,278.00				\$15,278.00	\$0.00	100%	\$15,278.00
00323	407.20.0710	00.01.30.00.80.02	CW Stas Pkgs RFC	64%	\$225,005.87				\$349,388.00	\$35,288.19	75%	\$260,294.06

Some of the task descriptions are impossible to decipher without construction expertise and experience with construction invoices.

LINE ITEM	ACT ID	WBS	DESCRIPTION
00287	405.30.0710	00.01.30.00.80.02	CW Other Trkwrk Pkgs RFC
00288	405.30.0720	00.01.30.00.80.02	CW Other Trkwrk Pkgs RFC IDR/CR/QC
00289	405.30.0730	00.01.30.00.80.02	CW Other Trkwrk Pkgs RFC Pre-Submittal Wrkshp
00323	407.20.0710	00.01.30.00.80.02	CW Stas Pkgs RFC

invoices submitted by HART. Instead, DAGS has adopted a “sampling” approach, under which its auditors review only a fraction of the items in each invoice. For invoices submitted by HART’s construction contractors, DAGS reviews only 31 of the items (or tasks) listed in each invoice. For consultant invoices, DAGS reviews only five line-items pertaining to direct labor (i.e., actual labor charges to the project) and five line-items pertaining to other direct costs.

Invoices, especially the construction-related invoices, often contain hundreds of items (or tasks), each with an associated cost for which the contractor requests payment. DAGS’ sampling approach verifies, at best, only that those items (or tasks) it sampled can be paid using the state revenues. There is no assurance that the invoiced items (or tasks) that are outside of those sampled by DAGS are capital costs, as defined by the statute, and do not include work for which Section 46-16.8(e), HRS, prohibits using the state revenues to pay. And, as noted above, HART believes that it can use the state revenues to pay most administrative and office-related overhead costs, including its personnel costs. In our view, DAGS’ sampling approach does not fulfill its responsibility to verify that the costs for which HART seeks to be paid – i.e., *all* the costs – are allowed under Section 46-16.8(e), HRS.

Conclusion

DAGS’ responsibility with respect to HART’s invoices is relatively narrow: verify that the invoices HART submits contain only capital costs and none of the specific costs that cannot be paid using the state revenues under Section 46-16.8(e), HRS. Stated more simply: does it qualify for payment or not?

We found that DAGS misunderstands its responsibilities under Act 1²³ and has not promulgated the administrative rules that Hawai‘i law deems necessary for DAGS to implement its verification responsibilities. Instead, DAGS staff auditors do “re-performance” checks, repeating aspects of the far more extensive review that HART contract administrators (who unlike DAGS’ staff auditors are familiar with construction practices) have already completed. For example, DAGS auditors confirm that the contractor’s labor rates, overhead charges, and direct costs are consistent with the contract; DAGS auditors also review, among other things, monthly progress reports, daily inspection reports, shipping documents and bills of lading, and attend monthly meetings that HART has with its engineering and inspection consultants and contractors to verify the percentage of completion contained in invoices. And, DAGS relies on the staff

²³ Codified as Section 40-81.5, HRS.

auditors to educate themselves as to DAGS' responsibilities under Act 1 and to independently develop their own interpretation of the costs that can be paid – and, more importantly, those that the Legislature prohibited from being paid – from the Mass Transit Special Fund.

Since this busy work is so time consuming, DAGS auditors cannot review all the costs submitted by HART for payment. Instead, DAGS auditors “sample” only a very small fraction of the costs contained in each invoice. Therefore, besides wasting time and money, DAGS' review efforts provide nothing more than a false sense of assurance that revenues from the Mass Transit Special Fund are spent properly.

Appendix 1 Invoice Verification Program

INVOICE VERIFICATION PROGRAM

GENERAL PROCEDURES:

1. Obtain an understanding of the verification requirements by gaining an understanding of the relevant provisions (sections) of Act 001, 2017 First Special Session.
2. Obtain an understanding of HART's organization and identify departments, divisions, and other functions that are relevant to the verification requirements of Act 001. Document such understanding including supporting applicable organization charts and position (job) descriptions.
3. Obtain an understanding of applicable executed contracts in force, including contract amendments, the cost management system (CMS), and the procedures for review and approval of invoices. Prepare a spreadsheet and/or memo for:
 - a. Each contract reviewed, documenting key information such as scope and description of services, contract value with itemized schedule of values, contract period, payment terms, including process for review, inspection and acceptance of work performed and other relevant procedures.
 - b. HART's contract management system including the key information and documents related to the verification procedures.
 - c. HART's process for field review, inspection and approval by its inspection function for determining the work performed or within contract terms with regard to quality and quantities and for the percentage of work completed to support the payment or invoice amount.
2. Review the contract terms as documented in the spreadsheet in 3.a. or the contract document for each invoice submitted for reimbursement.
 - a. In addition to the general contract terms as documented in the spreadsheet in 3.a., review the contract file for relevant correspondence that may impact the terms of the contract values. Inquire about the status of the contract, if necessary, with appropriate personnel.
 - b. During this review, be aware of the following features:
 - i. Determine that the contract is for capital costs as defined by Act 001.
 - ii. Type of contract (construction, professional services, etc.)
 - iii. Contract price (fixed price, cost plus fixed-fee, guaranteed maximum price, not to exceed amounts for various phases, etc.)
 - iv. Change orders.
 - v. Contract options and additions.
 - vi. Escalation benefits, if any.
 - vii. Terms of payment, including retention provisions.

- viii. Cancellation and postpone features.
- ix. Status of renegotiation.
- x. Unusual contract features (penalty for late completion, abnormal performance guarantees, bonus for early completion, etc.)
- xi. Bonding and insurance requirements.
- xii. Equipment rental provisions.
- xiii. Federal requirements.
- xiv. Requirements if subcontractors are used.

COMPLIANCE TESTS - Inspection and Payment Process

1. Payment process – to determine compliance with the payment review and approval process, coordinate the review of the substantive detail tests of invoices to review for proper approvals such as initials, and, as applicable, reperformance of key calculations for determining amount claimed for reimbursement from the Special Fund.
2. Field inspection – To determine compliance with the overall payment review and approval process, perform an inquiry and observation procedure of the inspection process conducted by HART's field inspection process to confirm existence of each itemized items in the schedule of values and the accuracy (percentage of completion, quality standards and quantities, as applicable).

SUBSTANTIVE DETAIL TESTS – Contractors' Invoices

1. Obtain invoice submitted for reimbursement.
2. Obtain a copy of the invoice packet from Kim Taira, HART accountant. The packet should consist of (Review for correctness and accuracy of calculations):
 - a. Vendor letter requesting progress payment.
 - b. Payment Invoice Review
 - c. Contractor's Participation in Approved Apprenticeship Program
 - d. HART DBE Participation Report.
 - e. HART Lien Release & Certification.
 - f. Validation of Schedule of Milestones Progress.
 - g. Schedule of Milestones Progress.
 - h. Schedule of Values
 - i. Certified Payroll Transcripts.
 - j. HART Request for Payment Routing (pink sheet).
3. Ascertain that the invoice has been paid by HART.
4. Math check the invoice as necessary. Recalculate retainage if applicable and agree percentage to contract.
5. Check for initials on "Payment Invoice Review" and "Validation of Schedule of Milestones Progress" "checked by", and "verified by". Note signatures of the Office

Verification of Contractors' Invoices Audit Program.docx

Engineer, Resident engineer, and Project Engineer. Also, note reviewers' notes for exceptions and adjustments to costs or percentages.

6. Schedule of Milestones Progress - detail tests for sample selection:
 - a. Select a sample of line items per the sample selection plan. Add and reference separate memo documenting sampling plan which includes test objectives (existence and accuracy and testing with overstatement of amount claimed for reimbursement), sampling method and justification for use of such method. Also include justification for parameters including significant items to be tested and other inputs (i.e. tolerable error).
 - b. Ascertain that the item is for capital costs as defined by Act 001.
 - c. Determine that the Summary of Costs totals math check with detail schedules.
 - d. Ascertain that required signatures were obtained and verify positions held at time of signature.
 - e. Column amounts in Milestone Value agree to the contract and any change orders.
 - f. Agree "Achieved previously \$" to previous invoice.
 - g. Agree "Achieved Current \$" to inspectors' report percentage complete multiplied by the milestone value.
 - h. Review the inspector's report and verify that an authorized HART contractor or employee signed off as concurring with the estimate of completion.
 - i. Any exceptions noted during testing will brought to the attention of the Supervising Auditor immediately upon discovery. The Supervising Auditor will investigate as necessary and consult with HART management.
7. Confirmation of payment of invoices.
 - a. Reference to payment confirmation at work paper 91000.