

Financial Statements and Report of Independent Certified
Public Accountants

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

June 30, 2012

November 29, 2012

To the Directors
Honolulu Authority for Rapid Transportation
City and County of Honolulu

Gentlemen:

We have completed our financial audit of the Honolulu Authority for Rapid Transportation (a component unit of the City and County of Honolulu) ("HART") as of and for the fiscal year ended June 30, 2012. The audit was performed in accordance with our agreement dated April 17, 2012.

Objective of the audit

The primary purpose of our audit was to form an opinion on the fairness of the presentation of HART's financial statements as of and for the fiscal year ended June 30, 2012.

Scope of the audit

Our audit was performed in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The scope of our audit included an examination of the transactions and accounting records of HART for the fiscal year ended June 30, 2012.

Organization of the report

This report is organized into five parts:

- PART I. FINANCIAL STATEMENTS
- PART II. SUPPLEMENTARY INFORMATION
- PART III. REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
- PART IV. SCHEDULE OF FINDINGS
- PART V. RESPONSE OF THE AFFECTED AGENCY

At this time, we wish to thank HART's personnel for their cooperation and assistance extended to us. We will be happy to respond to any questions that you may have on this report.

Very truly yours,

PKF PACIFIC HAWAII LLP

Contents

| | Page | |
|-----------------|---|----|
| PART I | FINANCIAL STATEMENTS | |
| | Report of Independent Certified Public Accountants | 5 |
| | Management's discussion and analysis | 7 |
| | Basic financial statements | |
| | Statement of net assets | 12 |
| | Statement of revenues, expenses and change in net assets | 13 |
| | Statement of cash flows | 14 |
| | Notes to financial statements | 16 |
| PART II | SUPPLEMENTARY INFORMATION | |
| | Schedule of funding progress | 29 |
| PART III | REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS | |
| | Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> | 31 |
| PART IV | SCHEDULE OF FINDINGS | 34 |
| PART V | RESPONSE OF THE AFFECTED AGENCY | 36 |

PART I
FINANCIAL STATEMENTS

Report of Independent Certified Public Accountants

To the Directors
Honolulu Authority for Rapid Transportation
City and County of Honolulu

We have audited the accompanying statement of net assets and the related statements of revenues, expenses and change in net assets and cash flows of the Honolulu Authority for Rapid Transportation (a component unit of the City and County of Honolulu) ("HART"), as of and for the year ended June 30, 2012, which collectively comprise HART's basic financial statements as listed in the table of contents. These financial statements are the responsibility of HART's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of HART's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of HART, as of June 30, 2012, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 19, 2012 on our consideration of HART's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 7–11 and schedule of funding progress on page 30 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States



of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PKF PACIFIC HAWAII LLP

Honolulu, Hawaii
November 19, 2012

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2012

The Honolulu Authority for Rapid Transportation ("HART") is a semi-autonomous government unit of the City and County of Honolulu ("City"), which came into being on July 1, 2011 pursuant to a 2010 amendment to the Revised Charter of the City and County of Honolulu ("RCH"). HART consists of a board of directors (Board), executive director, and staff. HART is authorized under the RCH to "develop, operate, maintain and expand the city fixed guideway system..."

The Honolulu Rail Transit Project (the Project) consists of design and construction of a 20-mile, grade-separated fixed rail system from East Kapolei to the Ala Moana Center in Honolulu, Hawaii. The Project begins in East Kapolei, proceeds to the University of Hawaii at West Oahu, then turns east to Pearl Harbor and the Honolulu International Airport, and ends at Kona Street adjacent to the Ala Moana Center. The Project will operate in an exclusive right-of-way and will be elevated except for a 0.6-mile, at-grade section near Leeward Community College. The Project includes 21 transit stations; a Maintenance and Storage Facility; 80 light metro fully automated (driverless) rail vehicles and associated core systems; and four park-and-ride facilities at several locations.

This section presents the management's discussion and analysis of HART's financial condition and activities for the fiscal year ended June 30, 2012. This summary is designed to provide an introduction to the financial statements and the financial condition of HART. This information should be read in conjunction with the financial statements. Prior to July 1, 2011, the financial position and results of operations of the Project were reported as a governmental fund in the City Comprehensive Annual Financial Reports.

Overview of the Financial Statements

The financial statements are presented using the economic resources measurement focus and the accrual basis of accounting, whereby revenues and expenses are recognized in the period earned or incurred.

The basic financial statements include a statement of net assets, a statement of revenues, expenses and change in net assets, a statement of cash flows, and notes to the financial statements. The statement of net assets presents the resources and obligations of HART at June 30, 2012. The statement of revenues, expenses and change in net assets presents the resultant ending net asset balance.

The statement of cash flows present changes in cash and cash equivalents resulting from operating, investing, capital and related financing activities, and non-capital financing activities.

The notes to the financial statements provide required disclosures and other information necessary for the fair presentation of the financial statements. The notes detail information about HART's significant accounting policies, account balances, related party transactions, employee benefit plans, commitments, contingencies, and other significant events. Supplementary information on post-employment benefits is also included.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2012

Financial Highlights

Condensed Statement of Revenues, Expenses and Change in Net Assets

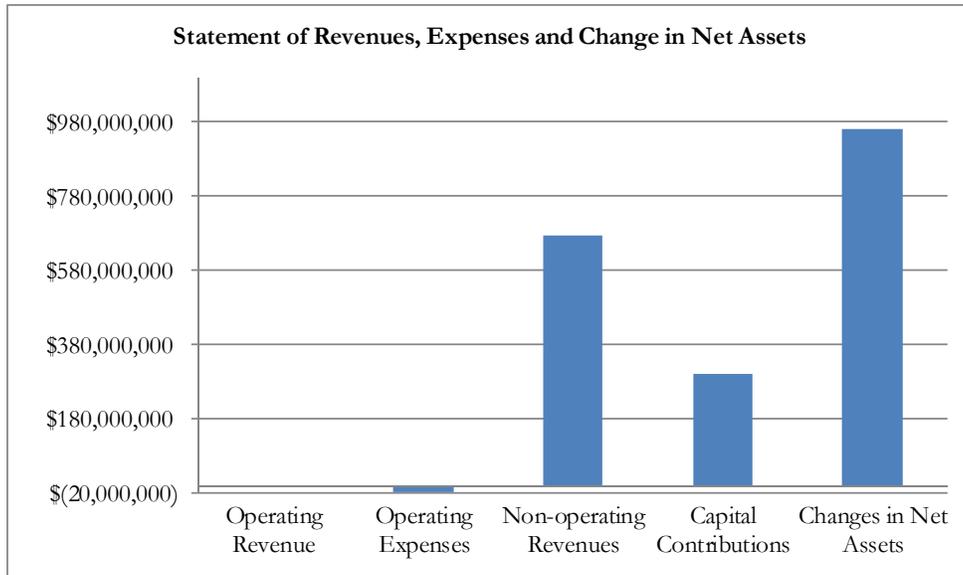
| | June 30, 2012 |
|---------------------------------|----------------------------|
| Operating expenses | |
| Administration and general | \$ 9,248,406 |
| Contractual services | 2,501,403 |
| Fringe benefits | 3,554,872 |
| Other operating expense | 599,752 |
| | <hr/> |
| Total operating expenses | 15,904,433 |
| | <hr/> |
| Operating loss | (15,904,433) |
| Non-operating revenues | |
| Intergovernmental revenues | 631,760,417 |
| Federal grants | 42,662,749 |
| Interest income and other | 487,724 |
| Total non-operating revenues | <hr/> 674,910,890 |
| | |
| Income before contributions | 659,006,457 |
| Capital contributions | <hr/> 303,390,475 |
| Change in net assets | 962,396,932 |
| Net assets at beginning of year | <hr/> - |
| Net assets at end of year | <hr/> <hr/> \$ 962,396,932 |

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

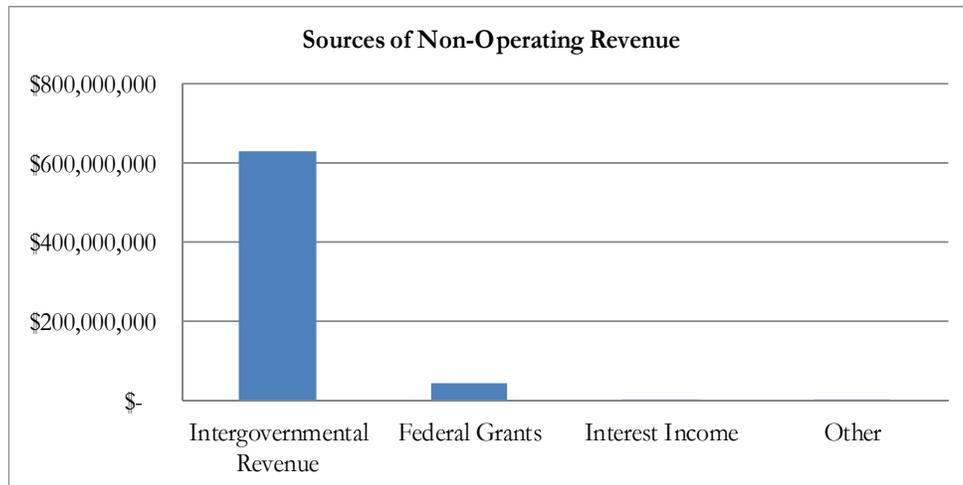
MANAGEMENT’S DISCUSSION AND ANALYSIS (continued)

June 30, 2012

Financial Highlights (continued)



HART’s primary non-operating revenue sources are the 0.5% county surcharge on the State of Hawaii’s General Excise Tax (GET) and grant assistance from the U.S. Department of Transportation’s Federal Transit Administration (FTA). Pursuant to Section 248-2.6 of the Hawaii Revised Statutes, the State Department of Taxation remits 90% of the surcharge to the City on a quarterly basis. During FY 2012, HART recognized \$631,760,417 of intergovernmental revenue, consisting of \$447,284,489 of net assets of the City’s Transit Fund as of June 30, 2011, less certain other City liabilities as of June 30, 2011 of \$6,189,065, and \$190,664,993 from the GET county surcharge. HART also received \$42,662,749 in FTA grant assistance. Additional non-operating revenue sources include interest income and property rental income.



Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2012

Financial Highlights (continued)

The Project has executed \$2,079,519,564 in contracts since October 2009 to date for the planning, design, and construction of the Project. This amounts to 40.6% of the anticipated cost of the total project.

Condensed Statement of Net Assets

| | June 30, 2012 |
|--|--------------------------|
| Assets | |
| Current Assets | |
| Cash and cash equivalents | \$ 417,956,751 |
| Receivables | 48,614,490 |
| Prepaid expenses | 4,906,695 |
| Capital assets - net | 548,631,678 |
| Total assets | \$ 1,020,109,614 |
| Liabilities | |
| Current Liabilities | |
| Current liabilities | \$ 55,089,557 |
| Deferred credits and other liabilities | 2,623,125 |
| Total liabilities | \$ 57,712,682 |
| Net assets | \$ 962,396,932 |
| Total liabilities and net assets | \$ 1,020,109,614 |

Total assets at year-end were \$1,020,109,614. Total liabilities at year-end were \$57,712,682. Net assets increased by \$962,396,932 primarily due to intergovernmental revenues and capital contributions from the City.

The Project will affect an estimated 184 parcels of real property. As of June 30, 2012, HART has acquired title to or use of 19 parcels of real property.

As of June 30, 2012, 2% of the utilities have been relocated. Utility relocations are performed by the respective companies owning the equipment.

The design work of the guideway structure continues. The first segment, from Kapolei to Waipahu, is 95% completed. The second segment, from Waipahu to Pearlridge is 90% completed, and design on the third segment is scheduled to begin in FY 2013.

The design work on the maintenance and storage facility is 90% completed.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

June 30, 2012

Capital Assets and Long-Term Debt

Capital assets of HART include land, infrastructure, buildings and improvements, and equipment and machinery. HART has not issued any long-term bonds. Additional information on HART's capital assets can be found in note D to the financial statements.

Risks

The project faces several risk factors until it is completed. Among the highest risk is cost inflation over the period of construction. As of June 30, 2012, the construction contracts executed have been below HART's estimated costs to construct. It is not certain or clear how the national or local economy will affect this inflation risk going into the future.

Also identified as a risk are environmental factors. HART is conducting early surveys of the areas that may be impacted by the rail construction to mitigate the risk of disturbing burial sites.

On June 29, 2012, HART submitted the City and County of Honolulu's request to the Federal Transit Administration (FTA) for a Full Funding Grant Agreement (FFGA). The maximum Federal New Starts financial contribution under the FFGA is \$1.55 billion for the Honolulu Rail Transit Project. The risk identified for this grant is that the grant may be delayed (for unknown reasons) and that the cash flow for construction may also be adversely affected.

HART is party to various legal proceedings arising in the normal course of business. Further information regarding these legal proceedings can be found in note H to the financial statements.

Request for Information

This financial report is designed to provide a general overview of HART's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Honolulu Authority for Rapid Transportation, 1099 Alakea Street, Suite 1700, Honolulu, Hawaii 96813.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

STATEMENT OF NET ASSETS

June 30, 2012

ASSETS

CURRENT ASSETS

| | |
|---------------------------|------------------|
| Cash and cash equivalents | \$ 417,956,751 |
| Receivables | |
| Intergovernmental | 48,540,693 |
| Other | 73,797 |
| Prepaid expenses | <u>4,906,695</u> |
| Total current assets | 471,477,936 |

| | |
|---------------------|--------------------|
| Capital assets, net | <u>548,631,678</u> |
|---------------------|--------------------|

| | |
|--------------|-------------------------------|
| TOTAL ASSETS | <u><u>\$1,020,109,614</u></u> |
|--------------|-------------------------------|

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES

| | |
|---------------------------|----------------|
| Accounts payable | \$ 54,835,171 |
| Accrued payroll and other | <u>254,386</u> |
| Total current liabilities | 55,089,557 |

| | |
|--|------------------|
| Deferred credits and other liabilities | <u>2,623,125</u> |
|--|------------------|

| | |
|-------------------|------------|
| Total liabilities | 57,712,682 |
|-------------------|------------|

NET ASSETS

| | |
|--|--------------------|
| Invested in capital assets - net of related debt | 518,674,109 |
| Unrestricted | <u>443,722,823</u> |
| Total net assets | <u>962,396,932</u> |

| | |
|----------------------------------|-------------------------------|
| TOTAL LIABILITIES AND NET ASSETS | <u><u>\$1,020,109,614</u></u> |
|----------------------------------|-------------------------------|

The accompanying notes are an integral part of this statement.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

STATEMENT OF REVENUES, EXPENSES AND CHANGE IN NET ASSETS

Year ended June 30, 2012

| | |
|-------------------------------------|----------------------|
| Operating expenses | |
| Administration and general | \$ 9,248,406 |
| Maintenance | 7,403 |
| Depreciation | 18,069 |
| Contractual services | 2,501,403 |
| Fringe benefits | 3,554,872 |
| Materials and supplies | 231,840 |
| Insurance | 326,600 |
| Utilities | 15,840 |
| | <hr/> |
| Total operating expenses | 15,904,433 |
| | <hr/> |
| Operating loss | (15,904,433) |
| Non-operating revenues and expenses | |
| Intergovernmental revenue | 631,760,417 |
| Federal grants | 42,662,749 |
| Interest income | 240,233 |
| Other | 247,491 |
| | <hr/> |
| Total non-operating revenues | 674,910,890 |
| | <hr/> |
| Income before contributions | 659,006,457 |
| Capital contributions | 303,390,475 |
| | <hr/> |
| CHANGE IN NET ASSETS | 962,396,932 |
| Net assets at beginning of year | <hr/> |
| | - |
| Net assets at end of year | <hr/> |
| | <u>\$962,396,932</u> |

The accompanying notes are an integral part of this statement.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

STATEMENT OF CASH FLOWS

Year ended June 30, 2012

| | |
|---|------------------------------|
| Cash flows from operating activities: | |
| Cash payments to suppliers for goods and services | \$ (8,474,929) |
| Cash payments to employees | <u>(8,794,366)</u> |
| Net cash used in operating activities | (17,269,295) |
| Cash flows for noncapital financing activities: | |
| Intergovernmental revenue | <u>626,133,498</u> |
| Net cash provided by noncapital financing activities | 626,133,498 |
| Cash flows from capital and related financing activities: | |
| Acquisition and construction of capital assets | (245,259,272) |
| Non-operating revenue | <u>54,115,121</u> |
| Net cash used in capital and related financing activities | (191,144,151) |
| Cash flows from investing activities | |
| Interest on cash and cash equivalents | <u>236,699</u> |
| Net cash provided by investing activities | <u>236,699</u> |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 417,956,751 |
| Cash and cash equivalents at beginning of year | - |
| Cash and cash equivalents at end of year | <u><u>\$ 417,956,751</u></u> |

The accompanying notes are an integral part of this statement.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

STATEMENT OF CASH FLOWS (continued)

Year ended June 30, 2012

| | |
|---|------------------------------|
| Reconciliation of operating loss to net cash used in operating activities: | |
| Operating loss | \$(15,904,433) |
| Adjustments to reconcile operating loss to net cash used in operating activities: | |
| Depreciation | 18,069 |
| Changes in assets and liabilities: | |
| Increase in receivables | (73,797) |
| Increase in prepaid expenses | (4,906,695) |
| Increase in accounts payable | 720,050 |
| Increase in payroll and other | 254,386 |
| Increase in deferred credits and other liabilities | <u>2,623,125</u> |
| Total adjustments | <u>(1,364,862)</u> |
| Net cash used in operating activities | <u><u>\$(17,269,295)</u></u> |

Non-cash investing, capital and related financing activities:

During the year ended June 30, 2012, HART received capital contributions of \$303,390,475.

The accompanying notes are an integral part of this financial statement.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

NOTES TO FINANCIAL STATEMENTS

June 30, 2012

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Operations

The Revised Charter of the City and County of Honolulu authorizes the Honolulu Authority for Rapid Transportation (HART) to develop, operate, maintain and expand the city fixed guideway system. HART is a semi-autonomous government unit of the City and County of Honolulu (City). It is a component unit of the City. HART is in the process of developing the rail transit system and has not begun revenue operations. As of July 1, 2011, the net assets of the City's Transit Fund were recognized as intergovernmental revenues to HART as discussed in note F to the financial statements.

2. Financial Statement Presentation

The accounting policies of HART conform to accounting principles generally accepted in the United States of America as applicable to enterprise activities of governmental units, as promulgated by the Government Accounting Standards Board (GASB). HART applies all applicable Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. HART does not apply FASB statements and interpretations issued after November 30, 1989.

3. Basis of Accounting

The accompanying financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

The operating revenues of HART are the result of providing services in connection with the delivery of transportation services of the rail system, which is not yet operational. The operating expenses of HART include the cost of services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

4. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2012

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

5. Cash and Cash Equivalents

HART considers all cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition to be cash and cash equivalents.

6. Revenue Recognition

Revenue sources that are considered susceptible to accrual when earned include a county surcharge on the State of Hawaii's General Excise Tax (GET) and grant assistance from the U.S. Department of Transportation's Federal Transit Administration (FTA). GET revenue is recognized when earned. Revenues on cost reimbursement contracts are recognized when allowable and reimbursable expenses are incurred, and upon meeting the legal and contractual requirements of the funding source. No allowance for doubtful accounts was recorded as of June 30, 2012.

7. Capital Assets

Capital assets are generally those assets with an individual price in excess of \$5,000 for equipment and machinery and \$100,000 for infrastructure, buildings, and structures with a useful life of more than one year. Capital assets are stated at cost and include contributions by governmental agencies at cost or estimated value. Additions, improvements, and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs related to repairs and maintenance are expensed as incurred.

Assets are depreciated over the individual asset's estimated useful life using the straight-line method. Depreciation on both purchased and contributed assets is charged against operations.

Depreciation on all assets is provided for on the straight-line basis over the following estimated useful lives:

| | <u>Years</u> |
|----------------------------|--------------|
| Infrastructure | 50-75 |
| Buildings and improvements | 30-50 |
| Equipment and machinery | 5-25 |
| Rail vehicles | 25-35 |

8. Net Assets

Net assets comprise the various net earnings (losses) from operating and nonoperating revenues, expenses and contributed capital. Net assets are classified in the following two components: invested in capital assets net of related debt or unrestricted net assets. Invested in capital assets, net of related

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2012

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

8. Net Assets (continued)

debt consists of capital assets, net of accumulated depreciation and reduced by outstanding debt that is attributable to the acquisition, construction, or improvement of those assets. Unrestricted net assets consist of all other net assets not included in invested in capital assets net of related debt.

9. Risk Management

HART is exposed to various risks for losses related to torts; theft of or damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if the information indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss is reasonably estimable.

10. Compensated Absences

HART accrues accumulated vacation when earned by the employee. Vacation benefits accrue at a rate of one and three-quarters working days per month. Each employee is allowed to accumulate a maximum of 90 days of accrued vacation as of the end of the calendar year.

Sick leave accumulates at the rate of one and three-quarters working days for each month. Sick leave is taken only in the event of illness and is not convertible to pay; accordingly, sick leave is not accrued in the accompanying financial statements. Employees who retire or leave government service in good standing with 60 or more unused sick leave days are entitled to an additional service credit in the retirement system. At June 30, 2012, accumulated sick leave amounted to \$2,604,787.

11. Deferred Compensation Plan

All full-time employees of HART are eligible to participate in the City and County of Honolulu's Public Employees' Deferred Compensation Program (Plan), adopted pursuant to Internal Revenue Code Section 457. The Plan permits eligible employees to defer a portion of their salary until future years by contributing to a fund managed by a plan administrator. The deferred compensation amounts are not available to employees until termination, retirement, death, or unforeseeable emergency.

A trust fund was established to protect Plan assets from claims of general creditors and from diversion to any uses other than paying benefits to participants and beneficiaries. Deferred compensation plan assets of \$2,168,873 are not reported in the accompanying financial statements at June 30, 2012.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2012

NOTE B - CASH AND CASH EQUIVALENTS

Cash deposited with the City is maintained by the Department of Budget and Fiscal Services of the City. The City maintains a cash and investment pool that is used by all of the City's funds and HART. Information pertaining to credit risk and interest rate risk is available for only the total cash and investment pool, which is disclosed in the City's Comprehensive Annual Financial Report (CAFR) available at the City's website: <http://www1.honolulu.gov/budget/cafr.htm>.

The respective portion of this pool is displayed in the accompanying financial statements and cash and cash equivalents. The Hawaii Revised Statutes provide for the City's Director of Budget and Fiscal Services to deposit the cash with any national or state bank or federally insured financial institution authorized to do business in the State of Hawaii, provided that all deposits are fully insured or collateralized with securities held by the City or its agents in the City's name.

State statutes also authorize the City to invest in obligations of the U.S. Treasury and U.S. agencies, obligations of other states, cities and counties, mutual funds and bank repurchase agreements. Investments in repurchase agreements are primarily U.S. government or federal agency securities. The City does not have a policy relative to interest rate risk.

NOTE C – RECEIVABLES

Receivables as of June 30, 2012 were comprised of the following amounts:

| | |
|--------------------|-----------------------------|
| Intergovernmental | |
| General excise tax | \$ 46,988,786 |
| Federal grants | <u>1,551,907</u> |
| | 48,540,693 |
| Other | <u>73,797</u> |
| Total receivables | <u><u>\$ 48,614,490</u></u> |

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2012

NOTE D - CAPITAL ASSETS

Capital assets activity during 2012 was as follows:

| | Balance July 1, 2011 | Contributions | Additions | Balance June 30, 2012 |
|-------------------------------|-------------------------|-----------------------|-----------------------|--------------------------|
| Depreciable assets | | | | |
| Equipment and machinery | \$ - | \$ 75,103 | \$ 96,437 | \$ 171,540 |
| Total depreciable assets | - | 75,103 | 96,437 | 171,540 |
| Less accumulated depreciation | - | (25,407) | (18,069) | (43,476) |
| Total depreciable assets, net | - | 49,696 | 78,368 | 128,064 |
| Land | - | 17,673,908 | 14,208,106 | 31,882,014 |
| Construction in progress | - | 285,666,871 | 230,954,729 | 516,621,600 |
| Capital assets, net | <u>\$ -</u> | <u>\$ 303,390,475</u> | <u>\$ 245,241,203</u> | <u>\$ 548,631,678</u> |

NOTE E - COMMITMENTS

Leases

HART leases office space at 1099 Alakea Street for its operations. The future minimum rental payments for operating leases at June 30, 2012 are as follows:

| | |
|------------------------|---------------------|
| Years ending | |
| 2013 | \$ 1,090,500 |
| 2014 | 1,108,900 |
| 2015 | 1,144,900 |
| 2016 | 1,182,100 |
| 2017 | 1,079,200 |
| 2018 to 2021 | <u>2,532,900</u> |
| Total Minimum Payments | <u>\$ 8,138,500</u> |

Additionally, these leases provide for payment of common area charges. As of June 30, 2012, rent expense was \$1,600,702.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2012

NOTE E – COMMITMENTS (continued)

Other Commitments

HART has net contractual commitments at June 30, 2012 of \$1,346,012,091. These include contracts for construction, design, and professional services.

NOTE F - RELATED PARTY TRANSACTIONS

Intergovernmental Revenues

During the year ended June 30, 2012, the HART recognized intergovernmental revenues of \$631,760,417 which was comprised of \$447,284,489 of net assets of the City's Transit Fund as of June 30, 2011, less certain other City liabilities of \$6,189,065, as well as \$190,664,993 from the GET county surcharge.

Central Administrative Services Expense Fee

HART has an agreement with the City to pay a Central Administrative Services Expense (CASE) fee for treasury, personnel, purchasing, legal, and other services that the City provides to HART on an on-going basis. CASE fees totaled \$602,212 for the year ended June 30, 2012 and is included as part of administration and general expense in the statement of revenues, expenses and change in net assets.

NOTE G - EMPLOYEE BENEFIT PLANS

Defined Benefit Pension Plan

Substantially all employees of HART are members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer defined benefit public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits and is governed by a Board of Trustees. All contributions, benefits, and eligibility requirements are established by Hawaii Revised Statutes (HRS) Chapter 88 and can be amended by legislative action.

The ERS is composed of a contributory and hybrid contributory retirement plan. Prior to June 30, 1984, the plan consisted of only a contributory option. Effective July 1, 1984, legislation was enacted to create a noncontributory plan for members of the ERS who are also covered under Social Security. Persons employed in positions not covered by Social Security are precluded from the noncontributory plan. The noncontributory plan provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory plan or to elect the noncontributory plan and receive a refund of employee contributions.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2012

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

Defined Benefit Pension Plan (continued)

All benefits vest after five and ten years of credited service under the contributory and noncontributory plans, respectively. Both plans provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date and prior to January 1, 2003, is based on the three highest years of service, excluding the vacation payment. Effective January 1, 2003, the AFC is the highest three calendar years or highest five calendar years plus lump sum vacation payment, or last 36 credited months or last 60 credited months plus lump sum vacation payment.

Most covered employees under the contributory plan are required to contribute 7.8% of their salary. Prior to July 1, 2005, the funding method used to calculate the total employer contribution requirement was the Entry Age Normal Actuarial Cost Method. Under this method, employer contributions to the ERS were comprised of normal cost plus level annual payments required to liquidate the unfunded actuarial liability over the remaining period of 29 years from July 1, 2000. Effective July 1, 2008, employer contribution rates are a fixed percentage of compensation, generally 15% for most covered employees. HART's contribution to the ERS as of June 30, 2012 was \$809,516.

The 2004 State of Hawaii legislative sessions approved a hybrid retirement plan, which took effect on July 1, 2006. Employees who choose to be under this plan are required to contribute 6% of their salary and will receive pensions based on a 2% benefit formula instead of a 1.25% benefit formula under the current noncontributory plan. The hybrid plan does not affect HART's contributions to the ERS.

The ERS issues a Comprehensive Annual Financial Report (CAFR) that includes financial statements and required supplementary information, which may be obtained at the following address: Employees' Retirement System of the State of Hawaii, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State of Hawaii Employer-Union Health Benefits Trust Fund (EUTF), an agent multiple-employer plan provides certain health care (medical, prescription, vision, and dental) and life insurance benefits for retired City employees. Act 88 established the EUTF during the 2001 legislative session and is codified in HRS 87A. Contributions are based on negotiated collective bargaining agreements and are limited by State statute to the actual cost of benefit coverage.

For employees hired before July 1, 1996, the City pays 100% of the monthly health care premium for employees retiring with 10 or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than 10 years of credited service.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2012

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

Post-Retirement Health Care and Life Insurance Benefits (continued)

For employees hired after June 30, 1996 and retiring with 25 years or more of service, the City pays the entire health care premium. For employees retiring with at least 15 years of service but fewer than 25 years of service, the City pays 75% of the monthly Medicare or non-Medicare premium. For those retiring with at least 10 years but less than 15 years of service, the City pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For those retiring with less than 10 years of service, the City makes no contributions.

For employees hired after June 30, 2001 and retiring with over 25 years of service, the City will pay 100% of the monthly premium based on the self plan. For those who retire with at least 15 years but fewer than 25 years of service, the City will pay 75% of the retired employees' monthly Medicare or non-Medicare premium based on the self plan. For those retiring with at least 10 years but fewer than 15 years of service, the City pays 50% of the retired employees' monthly Medicare or non-Medicare premium based on the self plan. For those with fewer than 10 years of service, the City makes no contributions.

The City also reimburses 100% of Medicare premium costs for retirees and qualified dependents (through the State), who are at least 65 years of age and have at least 10 years of service.

Annual Other Postemployment Benefits (OPEB) Cost and Net OPEB Obligation

HART implemented Governmental Accounting Standards Board (GASB) Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions, prospectively beginning with the fiscal year ended June 30, 2012. HART is required to contribute the annual required contribution (ARC) of the employer, an actuarially determined amount. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The following table displays the components of the annual OPEB cost, the amount contributed to the plan, the changes to the net OPEB obligation, and the percentage of annual OPEB cost contributed:

| | |
|---|---------------------|
| Actuarial accrued liability | \$ 1,964,000 |
| Actuarial value of plan assets | <u>-</u> |
| Unfunded actuarial accrued liability (UAAL) | <u>\$ 1,964,000</u> |
| Funded ratio | 0.0% |
| Covered payroll (active plan members) | \$ 5,385,000 |
| UAAL as a percentage of covered payroll | 36.5% |

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2012

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

Annual Other Postemployment Benefits (OPEB) Cost and Net OPEB Obligation (continued)

Funded Status and Funding Progress

The following is the schedule of the funded status and funding progress of the plan as of the most recent actuarial valuation date, that is, July 1, 2011:

| | |
|---|--------------------------|
| Annual required contribution | \$ 208,000 |
| Interest on net OPEB obligation | - |
| Adjustment to annual required contribution | <u>-</u> |
| Annual OPEB cost | 208,000 |
| Contributions made | <u>-</u> |
| Increase in net OPEB obligation | 208,000 |
| Net OPEB obligation at beginning of fiscal year | <u>-</u> |
| Net OPEB obligation at end of fiscal year | <u><u>\$ 208,000</u></u> |
| Percentage of annual OPEB cost contributed | 0% |

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2012

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

Annual Other Postemployment Benefits (OPEB) Cost and Net OPEB Obligation (continued)

In the most recent actuarial valuation, dated as of July 1, 2011, the entry age normal actuarial cost method was used. The actuarial assumptions included a discount rate of 7.0%, which was based on EUTF's anticipated asset investment return and the HART's anticipated funding level. Actuarial assumptions also included an annual health cost trend rate of 9.25% for 2012, reduced by decrements to an ultimate rate of 5% after 8 years, expected payroll increases of 3.5% to amortize unfunded liabilities, projected salary increases based on the ERS July 1, 2011 assumptions to determine the actuarial accrued liability, and an inflation rate of 3.0%. The unfunded actuarial accrued liability is being amortized over a 30 year closed period as a level percentage of projected payrolls.

The EUTF issues a stand-alone financial report that includes financial statements and required supplementary information, which may be obtained at the following address: State of Hawaii Employer-Union Health Benefits Trust Fund, 201 Merchant Street, Suite 1520, Honolulu, Hawaii 96813.

NOTE H – LITIGATION AND SUBSEQUENT EVENTS

HART is party to various legal proceedings arising in the normal course of business. The outcome of individual matters is not predictable. However, management believes that the ultimate resolution of all such matters will not have a material adverse effect on HART's financial position, results of operations, or liquidity.

HonoluluTraffic.com, et. al. v. Federal Transit Administration, et. al.

In May 2011, a lawsuit was filed against the Federal Transit Administration (FTA) and the City alleging violations of federal law in approving the City's rail transit project. Among other claims, the allegations were that the defendants improperly studied only the first 20 miles of the project and not the full route, that alternatives to the project were not properly considered, that potential native Hawaiian burial sites were not studied prior to the approval of the project and that defendants failed to comply with the federal Department of Transportation Act.

On November 1, 2012, the United States District Court for the District of Hawaii ruled in favor of the plaintiffs with regard to three matters, and ruled in favor of the defendants in all other respects. The three matters were that the defendants did not adequately analyze above ground traditional cultural properties, they did not adequately support their rejection of an alternative route involving a tunnel underneath Beretania Street and they did not adequately support their determinations regarding the impact of the rail project on Mother Waldron Park. A hearing has been scheduled for December 2012 for this case.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2012

NOTE H – LITIGATION AND SUBSEQUENT EVENTS (continued)

Bombardier v. Department of Budget and Fiscal Services, et. al.

Following the disqualification of its Core Systems Design-Build-Operate Maintain Contract proposal as nonresponsive, Bombardier filed a bid protest with the City Chief Procurement Officer. This bid protest was denied, and Bombardier then appealed to the Office of Administrative Hearings, State Department of Commerce and Consumer Affairs. The Hearings Officer ruled against Bombardier, which then appealed to the First Circuit Court, where the Circuit Court judge affirmed the decision of the Hearings Officer. Bombardier then appealed to the Intermediate Court of Appeals (ICA). On October 17, 2012, the ICA issued a decision affirming the decisions of the Circuit Court and the Hearings Officer in their entirety.

Kaleikini v. Yoshioka et al.

On January 31, 2011, Plaintiff filed a lawsuit in the First Circuit Court, challenging the approval of the Final Environmental Impact Statement (FEIS) as well as other approvals for the City's rail transit project that HART is now responsible for developing, operating, maintaining and expanding. Plaintiff alleged various State law violations but primarily alleged that an archaeological inventory survey (AIS) had not first been completed for the entire 20-mile project alignment, in violation of State law. Instead, the project was proposed to be built in four sections, with an AIS to be completed for each section prior to any construction taking place in that section. The case involves both City and State of Hawaii defendants.

The Circuit Court granted the City defendants' Motion to Dismiss Complaint and/or for Summary Judgment, and denied the Plaintiff's Motion for Preliminary Injunction and Motion for Reconsideration. In doing so, the Circuit Court determined that the phased approach for AIS completion proposed for the rail project met applicable State law requirements.

Plaintiff then filed an appeal in the ICA, where the matter was fully briefed by all parties. The case was then transferred to the Hawaii Supreme Court. Shortly after the transfer, the Plaintiff-Appellant filed a motion for injunctive relief pending appeal, which the court denied. Oral argument before the Hawaii Supreme Court occurred on May 24, 2012.

On August 24, 2012, the Supreme Court of the State of Hawaii in the case of Kaleikini v. Yoshioka et al. vacated the circuit court's judgment in favor of the City and State, ruling that the administrative rules implementing HRS §§ 6E-8 and 6E-42 do not permit the State Historic Preservation Division (SHPD) of the Department of Land and Natural Resources to concur in the rail project absent a complete Archaeological Inventory Survey (AIS) for the entire project. The project had received SHPD approval to conduct separate AISs for each of the four construction phases, with construction proceeding in each phase after completion of the AIS for that phase. The case will now be remanded to the State Circuit Court.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2012

NOTE H – LITIGATION AND SUBSEQUENT EVENTS (continued)

Kaleikini v. Yoshioka et al. (continued)

On September 4, 2012, the City Defendants filed a motion to reconsider, modify and/or clarify the Supreme Court's opinion of August 4, 2012. On September 27, 2012, the Supreme Court denied the motion. On October 5, 2012, the Plaintiffs filed a request for attorney's fees and costs with the Supreme Court. The State and City Defendants filed oppositions to this request, and the request is pending decision of the court.

Based on the Hawaii Supreme Court's decision, ground disturbing construction activities related to the project have been halted pending completion of all AIS work or further court rulings. HART is continuing with property acquisitions, AIS work and other non-ground disturbing construction activities.

Management estimates that the remaining AIS work for the entire 20-mile guideway will be completed in 9 to 12 months.

HART estimates that delay expenses will cost the project approximately \$63-\$84 million.

PART II
SUPPLEMENTARY INFORMATION

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

SCHEDULE OF FUNDING PROGRESS

June 30, 2012

| <u>Actuarial Valuation Date</u> | <u>Actuarial Value of Assets</u> | <u>Actuarial Accrued Liability (AAL)</u> | <u>Unfunded AAL (UAAL)</u> | <u>Funded Ratio</u> | <u>Covered Payroll</u> | <u>UAAL as a Percentage of Covered Payroll</u> |
|---|--|--|------------------------------------|-------------------------|----------------------------|--|
| July 1, 2011 | - | 1,964,000 | 1,964,000 | 0% | 5,385,000 | 36.50% |

PART III
REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

To the Directors
Honolulu Authority for Rapid Transportation
City and County of Honolulu

We have audited the accompanying statement of net assets and the related statements of revenues, expenses and change in net assets and cash flows of the Honolulu Authority for Rapid Transportation (a component unit of the City and County of Honolulu) ("HART"), as of and for the year ended June 30, 2012, and have issued our report thereon dated November 19, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of HART is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered HART's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of HART's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of HART's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined previously. However, we identified a deficiency in internal control over financial reporting, described in the accompanying schedule of findings as 2012-01 that we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether HART's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.



To the Directors
Honolulu Authority for Rapid Transportation
City and County of Honolulu

HART's response to the finding identified in our audit is described in the accompanying response of the affected agency. We did not audit HART's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management of HART, and others within the entity, and is not intended to be and should not be used by anyone other than these specified parties.

PKF PACIFIC HAWAII LLP

Honolulu, Hawaii
November 19, 2012

PART IV
SCHEDULE OF FINDINGS

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

SCHEDULE OF FINDINGS

June 30, 2012

FINDING 2012-01 – FINANCIAL STATEMENT REPORTING

Criteria

Management of HART is responsible for maintaining a complete set of financial records that accurately reflects their financial position and results of their operations in accordance with accounting principles generally accepted in the United States of America (US GAAP).

Condition

During our audit we received 29 post-closing adjustments to the trial balance from management. These adjustments were recorded to reflect the correction of certain assets, liabilities, revenues and expenses. In addition, the following items were not properly presented on the financial statements:

- \$518,674,109 of unrestricted net assets on the statement of net assets.
- \$447,284,490 of net assets of the City's Transit Fund as of June 30, 2011 and \$190,664,993 from the GET county surcharge in the statement of revenues, expenses, and change in net assets, as well as the related effects on the statement of cash flows.
- \$6,189,065 of additional intergovernmental revenues, as well as the related effects on the statement of cash flows.
- \$602,212 of operating expenses consisting of amounts paid to the City for Central Administrative Services Expenses in the statement of revenues, expenses and change in net assets, as well as the related effects on the statement of cash flows.

During our audit we also noted the following missing or erroneous disclosures:

- Beginning cash on the statement of cash flows was overstated by \$420,319,695.
- \$303,390,475 of capital contributions was excluded from non-cash investing, capital related financing activities in the statement of cash flows.
- Supplementary schedule of funding status on post-retirement health care and life insurance benefits was excluded.
- Disclosure of total future minimum lease payments on HART's leases was understated by approximately \$738,000.

Cause

The above finding was caused primarily by lack of sufficient staff resources allocated to preparing for the audit and the detailed review of the information prepared.

Effect

Post-closing adjustments causes delays in the audit timing and increases the cost of the audit process. As a result of our audit procedures, adjustments and disclosures for the conditions noted in the previous section were proposed and accepted by management, to present HART's financial statements and related notes in accordance with US GAAP.

Honolulu Authority for Rapid Transportation
(a component unit of the City and County of Honolulu)

SCHEDULE OF FINDINGS

June 30, 2012

Recommendation

We recommend that management of HART consider the amount of resources needed in order to satisfy its external reporting requirements. In addition, we recommend that HART implement a more formal review process for financial reporting, which would include a detail review of the financial statements and related financial statement disclosures to ensure that the financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. This review would also include the completion of a US GAAP disclosure checklist.

In addition, accounting tasks such as monthly reconciliations play a key role in proving the accuracy of accounting data and information included in interim financial statements. Therefore, in order to provide more accurate and timely accounting information, we recommend that HART consider establishing more effective review and reconciliation policies and procedures as a customary part of the accounting process. This would involve monthly reconciliations of accounts, making adjustments throughout the year that have typically been made at year-end only, and performing more frequent reviews of the general ledger throughout the year, including making any necessary adjustments.

PART V
RESPONSE OF THE AFFECTED AGENCY



IN REPLY REFER TO:
CMS-AP00-00367

HONOLULU AUTHORITY for RAPID TRANSPORTATION

Daniel A. Grabauskas
EXECUTIVE DIRECTOR AND CEO

BOARD OF DIRECTORS

Carrie K.S. Okinaga, Esq.
CHAIR

Ivan M. Lui-Kwan, Esq.
VICE CHAIR

Robert Bunda
William "Buzz" Hong

Donald G. Horner

Keslie W. K. Hui

Damien T. K. Kim

Glenn M. Okimoto, Ph.D.

David K. Tanoue

Wayne Y. Yoshioka

November 21, 2012

PKF Pacific Hawaii LLP
1132 Bishop Street
Suite 2500
Honolulu, Hawaii 96813

Dear Sir or Madam:

Subject: Finding 2012-01 – Financial Statement Reporting Response

We thank our auditors for their highly professional and dedicated services on HART's first financial audit.

While HART became a semi-autonomous agency of the City and County of Honolulu, it did not have its own accounting staff in Fiscal Year (FY) 2011-12. HART relied upon borrowed staff resources from the Department of Budget and Fiscal Services and other HART staff in order to prepare its financial statements using the City's financial system.

Several identified items in the financial statements related to presentation errors for one-time transfers of the City's Department of Transportation Services (DTS) Transit Fund net assets to HART. These one-time transfers were required upon establishment of HART's 1st year and, therefore, should not reoccur in future years.

As a newly formed agency, HART acknowledges its lack of accounting and financial reporting resources, and has placed a high priority on developing a qualified and experienced accounting staff in FY 2012-2013.

Several specific corrective measures have been identified and have been or will be implemented as follows:

With the hiring of HART's CFO in August 2012, HART has assessed its accounting and financial reporting resource needs, determined that additional accounting staff resources are needed, and is in the process of recruiting, and hiring for these positions.

This will result in appropriately experienced accounting staff and management preparing the financial statements, and a higher level review process implemented in order to reduce presentation errors including utilization of disclosure checklists.

PKF Pacific Hawaii LLP
Page 2
November 21, 2012

Again, we extend our thanks to our auditors, PKF Pacific Hawaii LLP, namely Dwayne Takeno and Charles Goodin, for their professionalism and comprehensive understanding of HART's unique start-up challenges.

Sincerely,

A handwritten signature in black ink, appearing to read "Diane R. Arakaki". The signature is fluid and cursive, with a large initial "D" and "A".

Diane R. Arakaki
Chief Financial Officer