

High-Speed Rail Authority:

It Risks Delays or an Incomplete System Because of Inadequate Planning, Weak Oversight, and Lax Contract Management

April 2010 Report 2009-106



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April 29, 2010

2009-106

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the California State Auditor presents its audit report concerning the High-Speed Rail Authority's (Authority) readiness to manage funds authorized for building the high-speed rail network (program) in California, including the \$9 billion in general obligation bonds the voters authorized in November 2008.

This report concludes that the High-Speed Rail Authority has not adequately planned for the future development of the program. For example, in its 2009 business plan, the Authority outlined the sources from which it expected to receive the funds necessary to meet the estimated \$42.6 billion cost of the program. The Authority stated it would need \$17 billion to \$19 billion from the federal government; however, the Authority has received a federal commitment of only \$2.25 billion. In addition, the business plan does not make clear which government would be responsible for a revenue guarantee needed to attract private investors, or how much it might cost. The program risks significant delays without more well-developed plans for obtaining funds.

The Authority also needs to improve some administrative practices. State law requires the Authority to establish an independent peer review group (review group) to review the Authority's plans, but only five of the eight members have been appointed. Thus, the Authority cannot fully benefit from the expertise the review group would provide. Additionally, the Authority does not currently categorize and track expenditures for administration, which state law limits to 2.5 percent (\$225 million) of the \$9 billion in bond funds authorized. Unless it tracks these funds and develops long-range plans for spending them, it risks running out of them prematurely.

Finally, a primary tool for monitoring the program has been inadequate and the Authority has not implemented effective controls over invoice processing and in some cases has paid for work that was not part of contracts or work plans. Three recent monthly progress reports the contractor managing the program (Program Manager) submitted to the Authority contained inconsistent information and did not compare actions performed and products created to what contractors promised to complete in their work plans. Additionally, the Authority paid at least \$4 million of invoices for which it had no evidence from the Program Manager that the contractors had performed the work invoiced. The Authority also paid more than \$268,000 for work that was not included in contractors' work plans, impairing its ability to measure performance against those plans, and it misused public funds when it paid \$46,000 for furniture not covered in the contract with its Program Manager.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

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Summary

Results in Brief

The Legislature created the High-Speed Rail Authority (Authority) in 1996. State law charges the nine-member Authority with the development and implementation of intercity, high-speed rail service. According to state law, the entire network, from Sacramento to San Diego, is intended to be complete by 2020. In November 2008 voters approved the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century (Proposition 1A), providing \$9 billion for construction of a high-speed rail network (program).

Although the Authority's 2009 business plan contains the elements required by the Legislature, it lacks detail regarding how it proposes to finance the program. For example, the Authority estimates it needs \$17 billion to \$19 billion in federal grants. The business plan, however, specifies only \$4.7 billion in possible funds from the American Recovery and Reinvestment Act of 2009 (Recovery Act) and a few other small federal grants. According to its communications director, the Authority has no definite commitments from the federal government other than Recovery Act funding, which actually amounted to \$2.25 billion when awards were announced in January 2010. The program risks significant delays without more well-developed plans for obtaining or replacing federal funds.

Further, the Authority's plan relies heavily on federal funds to leverage state bond dollars through 2013. Proposition 1A bond funds may be used to support only up to 50 percent of the total cost of construction of each corridor of the program. The remaining 50 percent must come from other funding sources. Thus, the award of up to \$2.25 billion in Recovery Act funds allows for the use of an equal amount of state bond funds for construction, for a total of about \$4.5 billion. However, the Authority's spending plan includes almost \$12 billion in federal and state funds through 2013, more than 2.5 times what is now available. Additionally, creating a viable funding plan may be a challenge as matched funding for the least expensive corridor eligible for Recovery Act funds—Los Angeles to Anaheim—amounts to \$4.5 billion, while projected costs total \$5.5 billion. Barring additional non-Proposition 1A funding, the Authority may have to settle for a plan covering less than a complete corridor. The Authority must decide relatively quickly which corridors will receive federal funds. Its chief deputy director says it must prepare funding plans by spring 2011 in order to meet federal deadlines.

Audit Highlights . . .

Our review of the High-Speed Rail Authority (Authority) revealed the following.

- » *The Authority's 2009 business plan estimates it needs \$17 billion to \$19 billion in federal funds. However, the Authority has no federal commitments beyond \$2.25 billion from the American Recovery and Reinvestment Act of 2009 (Recovery Act), and other potential federal programs are small.*
- » *The Authority's plan for spending includes almost \$12 billion in federal and state funds through 2013, more than 2.5 times what is now available.*
- » *The Authority does not have a system in place to track expenditures according to categories established by the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century, its largest source of committed funding.*
- » *The Authority has not completed some systems needed to administer Recovery Act funds, for example, a system to track jobs created and saved.*
- » *Some monthly progress reports, issued by the Authority's contracted Program Manager to provide a summary of program status, contain inconsistent and inaccurate information.*
- » *Authority staff paid at least \$4 million of invoices from regional contractors received after December 2008, without having documented written notification that the Program Manager had reviewed and approved the invoices for payment.*

continued on next page . . .

» *The Authority paid contractors more than \$268,000 for services performed outside of the contractors' work plans and purchased \$46,000 in furniture for one of its contractor's use, based on an oral agreement contradicted by a later written contract.*

The Authority's plans for private financing include a revenue guarantee that needs further specification, but it is working to improve its approach to risk management. According to the 2009 business plan, the Authority expects private investors to supply \$10 billion to \$12 billion, but also indicates these investors will require a minimum revenue guarantee from a public entity. The Authority's financial planning consultant has addressed concerns raised by the Legislative Analyst's Office that this might be a prohibited operating subsidy; however, details on how much the revenue guarantee may cost or who might pay it are scant. Additionally, the 2009 business plan provided little detail on how the Authority would manage risk in general, but the Authority is planning to improve risk management for the program.

The Authority also needs to improve its oversight and administrative controls. State law creates a peer review group (review group) to assess the Authority's plans. Most significantly, the review group is to issue an analysis and evaluation of the viability of the Authority's funding plan for each corridor of the program. As of February 2010, however, only five of the group's eight members had been appointed, limiting the expertise available to the Authority. Moreover, according to our legal counsel, the review group is likely subject to the Bagley-Keene Open Meeting Act (Meeting Act), although the Authority has received informal advice to the contrary. Nevertheless, the review group's work could be voided if this issue is not resolved.

Additionally, the Authority lacks systems to comply with state law regarding bond funds. According to state law, only up to 2.5 percent (\$225 million) of its portion of bond funds from Proposition 1A may be used for administration and only 10 percent (\$900 million) may be used for planning, environmental review, and preliminary engineering (preconstruction tasks). According to its fiscal officer, the Authority is unsure how it will classify the expenditure of bond proceeds and does not have a system for tracking expenditures by category. Until such a process is in place, the authority cannot report accurately on its expenditures and risks running out of bond funds available for administration or preconstruction task costs. This is a serious problem because it is set to have spent \$168 million of the \$1.1 billion in bond proceeds authorized for these purposes by the end of fiscal year 2009–10.

Contractors accounted for 95 percent of the program's total expenditures over the past three fiscal years. Although the Authority generally followed state requirements for awarding contracts, its processes for monitoring the performance and accountability of its contractors—especially the entity that has been contracted to manage the program (Program Manager)—are inadequate. The Program Manager's monthly progress reports, a

primary document summarizing monthly progress on a regional and program level, have contained inaccurate and inconsistent information. For example, the July 2009 report indicated that the regional contractor working on the Los Angeles-to-Anaheim corridor had completed 81 percent of planned hours but had spent 230 percent of planned dollars. In addition, although the progress reports described actions taken or products created, they did not compare those actions and products to what the contractors promised to complete in their work plans. The work plan for a consultant the Authority recently hired to oversee the Program Manager does not include a review of the monthly reports.

The Authority does not generally ensure that invoices reflect work performed by contractors. According to the chief deputy director, the Program Manager should review each regional contractor's invoice to ensure that the work claimed actually has been performed and then notify Authority staff whether the invoice should be paid. The chief deputy director further stated that staff should not pay invoices without notifications. However, Authority staff paid at least \$4 million of invoices from regional contractors received after December 2008—when the Authority's fiscal officer says she was informed that such notifications were required—without documenting notification. The Authority only recently adopted written policies and procedures related to invoice payment. However, those policies and procedures do not adequately describe its controls or their implementation.

Finally, the Authority made some payments that did not reflect the terms of its agreements, risking its ability to hold contractors accountable for their performance. For example, it spent \$46,000 on furniture for its Program Manager's use based on an oral agreement, despite the fact that its written contract expressly states that oral agreements not incorporated in the written contract are not binding. The written contract requires the Program Manager to provide its own furniture, equipment, and systems. Additionally, the Authority paid a regional contractor more than \$194,000 to subcontract for tasks not included in the regional contractor's work plan and paid the Program Manager \$53,000 for work on Recovery Act applications, which was also outside the Program Manager's work plan.

Recommendations

To ensure that it can respond adequately to funding levels that may vary from its 2009 business plan, the Authority should develop and publish alternative funding scenarios that reflect the possibility of

reduced or delayed funding from planned sources. These scenarios should detail the implications of variations in the level or timing of funding for the program and its schedule.

To plan adequately for private investment, the Authority should further specify the potential cost of revenue guarantees and who would pay for them.

In order to respond effectively to circumstances that could significantly delay or halt the program, the Authority should ensure that it implements planned actions related to risk management.

To avert possible legal challenges, the Authority should ensure that the review group adheres to the Meeting Act or seek a formal opinion from the Office of the Attorney General regarding whether the review group is subject to this act.

To ensure that it does not run out of funds for administrative and preconstruction tasks prematurely, the Authority should track expenditures for these activities and develop a long-term spending plan for them.

To ensure that Authority staff receive relevant information on the program's status, they should amend the program management oversight consultant's work plan to include a critical review of progress reports for accuracy and consistency. Authority staff also should ensure that the Program Manager revises its progress reports to include information on the status of promised products and services.

To determine if it is paying invoices that accurately reflect work performed, the Authority should ensure that staff adhere to controls for processing invoices. For example, staff should not pay invoices from regional contractors until they receive notification from the Program Manager that the work billed has been performed, or until they have conducted an independent verification.

To ensure that it does not misuse public funds and can hold contractors accountable, the Authority should adhere to the conditions of its contracts and work plans, and make any amendments or modifications to contracts or work plans in writing.

Agency Comments

The Authority raised concerns about the report title but agreed with our recommendations and outlined actions it is taking or plans to take to address them.

Introduction

Background

The Legislature created the High-Speed Rail Authority (Authority) in 1996. Among other duties, state law charges it with the development and implementation of intercity, high-speed rail service that is fully integrated with existing intercity rail and bus networks. The Authority's nine members, described in the text box, have exclusive responsibility for the planning, construction, and implementation of a high-speed passenger train network, with trains traveling at speeds exceeding 125 miles per hour. In November 2008 voters approved the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century (Proposition 1A), which provides \$9 billion from the sale of general obligation bonds for construction of a high-speed rail network (program) and \$950 million from the sale of general obligation bonds for improvements to other rail systems connecting to it. According to the state law that placed Proposition 1A on the ballot, the entire network, from Sacramento to San Diego, is intended to be completed by 2020. Further, the law stipulates that a person using nonstop service will be able to travel between San Francisco and Los Angeles in two hours and 40 minutes, or less. According to the Authority's latest business plan, trains must travel at speeds up to 220 miles per hour during parts of the trip to reach this goal.

Beginning in 1996, the State issued several plans and reports to develop and construct the program in California. In 1996 the Authority's predecessor, the Intercity High-Speed Rail Commission, issued a summary report and action plan concluding that a high-speed rail system is feasible. In 2000 the Authority released its first business plan, and in 2004 it released a draft program-level environmental impact report and environmental impact statement to describe the proposed program's environmental effects on a statewide scale. In 2005 it certified¹ the program-level environmental impact report and statement.

The High-Speed Rail Authority's Membership

The High-Speed Rail Authority (Authority) consists of nine members appointed by the following:

- The governor—five
- The Senate on Rules Committee—two
- The Speaker of the Assembly—two

Authority members serve for terms of four years. There is no limit on the number of terms they may serve. The Authority elects a chair from among its members who serves for one year.

Authority members receive \$100 for each day they attend to Authority business, up to \$500 per month, plus actual travel expenses.

Source: California Public Utilities Code.

¹ An agency certifies a final environmental impact report by confirming that the report complies with the California Environmental Quality Act, was reviewed by the agency's decision-making body before approving the project, and reflects the agency's independent judgment and analysis.

In 2008 the Authority certified an additional environmental impact report and statement focused on the section of the program linking the San Francisco Bay Area and the Central Valley. However, in August 2009 a court determined that the Authority needed to make changes to the 2008 report in several areas and to recirculate it. Areas needing revision include a description of the track alignment between San Jose and Gilroy and the Authority's finding on vibration impacts. Consequently, the Authority rescinded its certification in December 2009 and in March 2010 circulated a revised environmental impact report. The Authority released revised business plans in November 2008 and December 2009.

Until recently, the Authority operated with a very small staff. State law requires it to appoint an executive director to administer its affairs. The executive director may hire staff as allowed by the Authority. Between fiscal years 2000–01 and 2006–07, the Authority operated with three to five staff members, including the executive director. The Authority gained additional positions and increased its staff to seven in fiscal year 2007–08 and nine in fiscal year 2008–09. As of January 2010, it has nine full-time staff members and one half-time staff member.

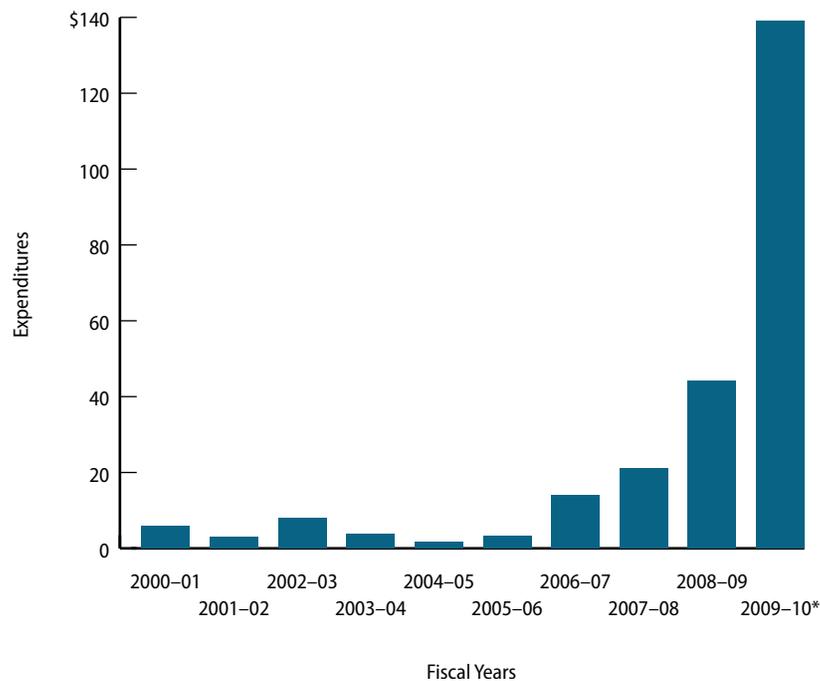
In June 2009 the Authority contracted for an organizational assessment. The assessment, published in December 2009, was conducted to facilitate the Authority's shift from a planning entity to one focused on implementation. The assessment includes an organizational chart proposing 37 total staff plus administrative/office tech positions. According to the chief deputy director, in September 2009 the Authority requested funding for 35 new positions. The proposed 2010–11 Governor's Budget includes an additional 27 positions for the Authority. New proposed staff include a chief financial officer, a chief program manager, regional directors, and transportation and environmental planners.

As part of increasing the size of its staff, the Authority hired a deputy director for communications, policy, and public outreach (communications director) in 2009 to bring outreach activities under its direct control, to streamline the outreach program, and to increase the quantity and quality of outreach activities. An additional goal, according to the communications director, is to keep the Authority's members more informed of staff activities. Consequently, at the request of the Authority chair, the communications director initiated a weekly report issued to Authority members in August 2009 that provides high-level information on the staff's progress and is posted to the Authority's Web site. The Authority has made a number of other documents available on its Web site, including agendas, minutes, and other materials related to meetings, business plans, economic studies, and information relevant to specific sections of the program—for

example, the corridor between Los Angeles and Anaheim. In addition, the Authority posts its budget appropriation on the main page of its Web site and a detailed budget within the meeting materials on its Web site. Finally, the Authority is using electronic and social media to communicate with the public, specifically an e-mail list, Twitter, and Posterous.

As the Authority's staff has grown, so have its expenditures. As Figure 1 demonstrates, it spent \$6 million in fiscal year 2000–01. In contrast, its appropriated budget for fiscal year 2009–10 is \$139.1 million, and the 2010–11 Governor's Budget proposes expenditures totaling \$958.2 million as of January 2010. Proposition 1A funds would cover \$583.2 million of this amount—\$50.4 million for administration and \$532.8 million for capital costs—and federal funds would provide \$375 million for capital costs.

Figure 1
High-Speed Rail Authority Expenditures
Fiscal Years 2000–01 to 2009–10
(In Millions)



Sources: Governor's budgets for fiscal years 2002–03 through 2010–11, State Controller's Office expenditure reports, and High-Speed Rail Authority (Authority) payment logs.

Note: The fiscal year 2010–11 Governor's Budget proposes \$958.2 million for the Authority as of January 2010.

* Estimated expenditures.

Proposition 1A

In 2008 California voters approved Proposition 1A, which provides funding for development of the program. Proposition 1A authorizes the State to sell \$9 billion in general obligation bonds for planning, engineering, and construction of the network and an additional \$950 million in general obligation bonds for capital improvements to intercity, urban, and commuter rail systems connecting to it. The Authority is to administer the \$9 billion, while the California Transportation Commission is to allocate the \$950 million for connecting systems.

The proposition sets additional limits on how the Authority can request and spend its bond funds. These include a 2.5 percent (\$225 million) cap on administrative costs—which the Legislature may increase up to 5 percent (\$450 million). The proposition also limits the overall amount of funds the Authority may spend on environmental studies, planning, and preliminary engineering activities to 10 percent of its total bond funds (\$900 million). The Authority also must submit a detailed funding plan to a peer review group, the director of the Department of Finance (Finance), the policy committees with jurisdiction over transportation, and the fiscal committees in both houses of the Legislature, no later than 90 days before submitting initial appropriation requests for capital costs for each corridor. Further, before committing funding for expenditures on construction and real property and equipment acquisition on each corridor or portion of a corridor, the Authority must submit a detailed funding plan—separate from the funding plan described earlier—to the director of Finance and the Joint Legislative Budget Committee. The director of Finance must determine whether the plan is likely to be successfully implemented as proposed.² Bond proceeds may not be used to support more than 50 percent of the total cost of construction for each corridor or usable segment of the program; the remainder must come from other funding sources.³ However, the Authority need not submit either funding plan before using up to 7.5 percent (\$675 million) for environmental studies, planning, and preliminary engineering activities, as well as for acquisition of rights-of-way, improvements to rights-of-way, and relocation assistance. These costs are also not subject to the 50 percent limitation. As of March 1, 2010, the State had issued \$258.4 million in Proposition 1A bonds.

² State law requires two different funding plans, one before requesting appropriation of certain bond funds and one before committing those funds for expenditure. Although the requirements for both plans are similar in most respects, state law requires that the plan submitted before committing bond funds for expenditure include one or more reports, prepared by independent firms, that indicate, among other things, that construction can be completed as proposed and that planned train service will not require an operating subsidy.

³ According to state law, a corridor is a portion of the high-speed rail system, and a usable segment is a portion of a corridor that includes at least two stations.

The High-Speed Rail Network

The proposed program would run from Sacramento and San Francisco in the north to San Diego in the south. Figure 2 on the following page depicts the proposed routes for the program. According to the Authority's 2009 business plan, phase one comprises six corridors between San Francisco and Anaheim:

- San Francisco to San Jose
- San Jose to Merced
- Merced to Bakersfield
- Bakersfield to Palmdale
- Palmdale to Los Angeles
- Los Angeles to Anaheim

Although state law sets 2020 as the intended date to complete the entire system between Sacramento and San Diego, the Authority says that ideally it plans to complete phase one of the program by 2020. Figure 3 on page 11 shows the Authority's timeline, as presented in its 2009 business plan. According to the timeline, the Authority plans to complete environmental and preliminary engineering work on the Los Angeles-to-Anaheim corridor by the end of fiscal year 2010–11 and expects to complete construction of phase one by the beginning of fiscal year 2019–20. Later in the report, we discuss several issues that raise doubts about the Authority's ability to meet these goals.

Projected Costs and Committed Funding

In December 2009 the Authority estimated that the total cost for phase one of the program would be \$35.7 billion in 2009 dollars. This represents an increase of \$2.1 billion over the costs it projected in 2008. The increase is almost entirely attributable to an increase in estimated costs for the Los Angeles-to-Anaheim corridor, which jumped from \$2.2 billion in 2008 to \$4.6 billion in 2009.⁴ The Authority also estimated phase one would cost \$42.6 billion in "year-of-expenditure" dollars. It calculates year-of-expenditure dollars by distributing and escalating costs based on the year of planned expenditure. In this way, it incorporates inflation, which

⁴ The Authority estimates that the Los Angeles-to-Anaheim corridor will cost \$5.5 billion in year-of-expenditure dollars.

makes up about 80 percent of the difference in costs, into its projections. The Authority believes this method provides a more credible view of program costs and therefore uses it throughout its discussion of expenditures and revenues.

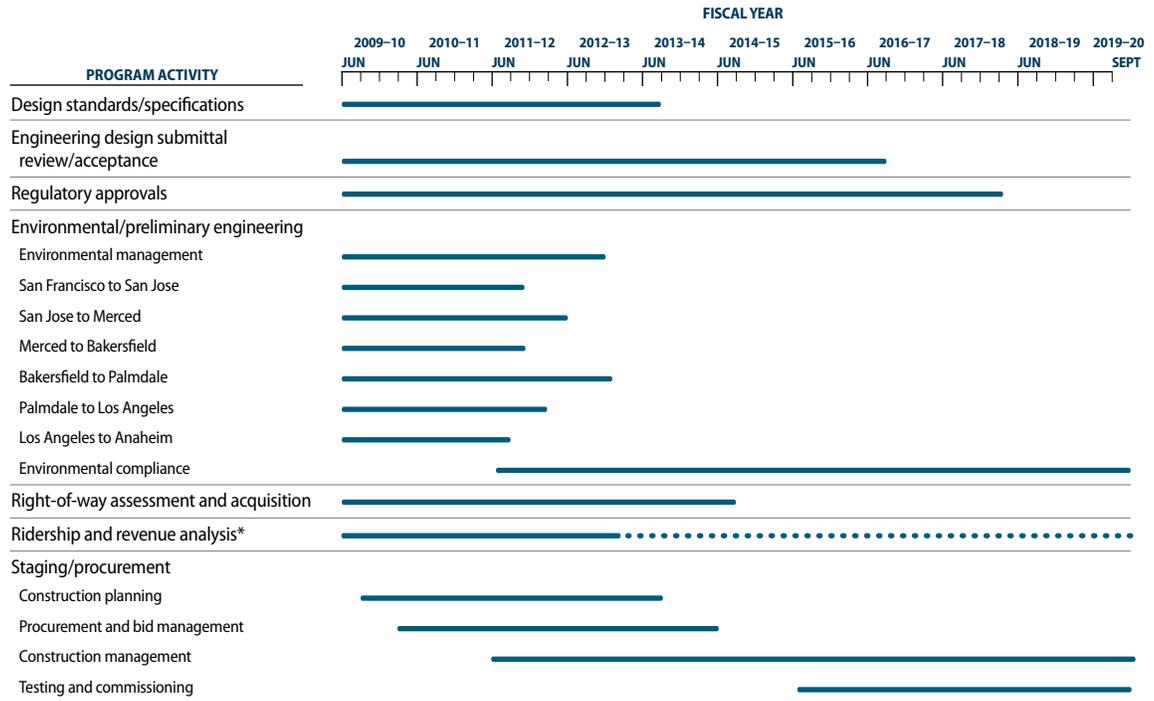
Figure 2
Proposed Routes for the High-Speed Rail Network



Source: High-Speed Rail Authority (Authority).

* This corridor relates to a rail project separate from the high-speed rail network that the Authority is pursuing with local and regional transit agencies.

Figure 3
Projected Timeline of Program Activities for Phase One of the High-Speed Rail Network



Source: High-Speed Rail Authority, 2009 business plan.

Note: The following program activities extend through the entire length of the program:

- Program management and controls
- Public education and communication
- Engineering criteria and design management
- Risk management

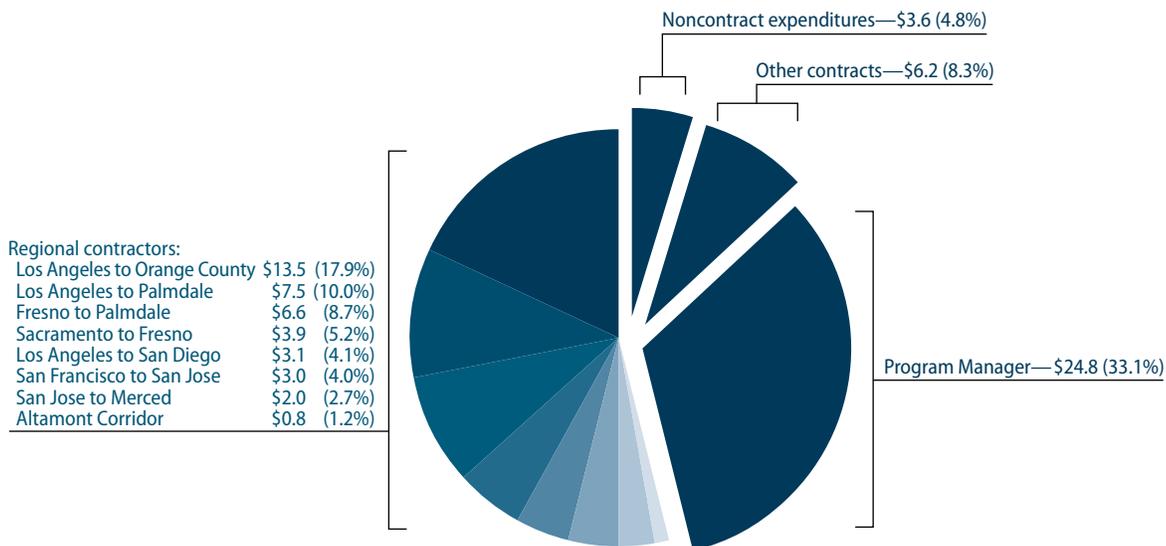
* According to the director of the Authority's program management team, the solid line represents planned work for updating relevant ridership and revenue projections; the dotted line represents likely ongoing review of these projections.

As of February 2010, the Authority had about \$11.6 billion of funding committed for the program: \$9 billion in state bond funds, \$2.25 billion in federal funds from the American Recovery and Reinvestment Act of 2009 (Recovery Act), and \$336 million in other public funding. Although not required to, the Authority stated in its Recovery Act applications that the State would match federal participation on a dollar-for-dollar basis, using state, local, and private funds. The Authority submitted seven applications to the Federal Railroad Administration (Railroad Administration)—three for planning and four for construction—for a total of \$4.7 billion in Recovery Act funds. In January 2010 the Railroad Administration announced that it had approved five of the Authority's applications: one for planning and four for construction, totaling \$2.25 billion. As of March 2010, the chief deputy director said the Authority expected to receive \$194 million

in planning funds but is continuing to work with the Railroad Administration to determine how to distribute the remainder of the Recovery Act grant among the four approved construction applications. We further discuss issues related to the program's funding plan in the Audit Results section of this report.

In recent years, most of the Authority's cash expenditures were related to contracts for architectural and engineering services. As Figure 4 demonstrates, for fiscal years 2006–07 through 2008–09, about 87 percent of its \$75 million in cash expenditures related to payments to private firms with contracts exceeding \$20 million (major contracts). The largest single recipient of Authority funds, with a \$199 million contract extending more than six years, was the contractor that serves as the Authority's program management team (Program Manager). It provides day-to-day management and directs the contractors working on specific corridors.

Figure 4
Payments Made by the High-Speed Rail Authority by Type and Region
Fiscal Years 2006–07 Through 2008–09
(Dollars in Millions)



Sources: High-Speed Rail Authority payment logs.

Note: The total value of each of the regional contracts and the Program Manager's contract is more than \$20 million. These are multiyear contracts that extend beyond fiscal year 2008–09.

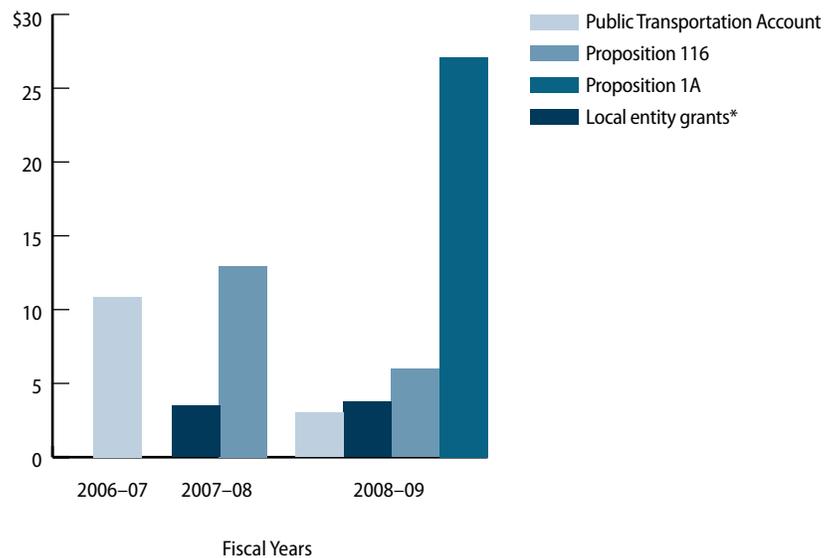
An additional 8.3 percent of the Authority's cash expenditures between fiscal years 2006–07 and 2008–09 went to other contracts, including those for financial planning, legal assistance, and visual simulations of the train system. Only 4.8 percent of the Authority's

cash expenditures during these three years were for other costs such as those for facilities, travel, interdepartmental agreements, and compensation of Authority staff.

The Authority recently contracted with a consultant for program management oversight. This consultant is to review and monitor the Program Manager’s work to ensure that it is proceeding on schedule and in conformance with approved work plans. This structure, one contractor reviewing the work of another contractor, is not unique to the Authority. The California Department of Transportation and the Federal Transit Administration have used similar structures.

Between fiscal years 2006–07 and 2008–09, the Authority paid its major contractors from three state funds and two local grants. Figure 5 outlines the amount of funding from each source. State funds came from the Public Transportation Account, which receives its funding from retail sales and use taxes on gasoline; the Clean Air and Transportation Improvement Fund, which receives its funding from the sale of general obligation bonds approved by voters in 1990; and Proposition 1A funds, discussed previously. The two local grants reimbursed costs originally paid by the Public Transportation Account.

Figure 5
Funding Sources for Major Contracts
Fiscal Years 2006–07 Through 2008–09
(In Millions)



Sources: High-Speed Rail Authority contract files.

Note: “Major contracts” are multiyear contracts with a total value greater than \$20 million. This graph represents total amounts provided for these contracts by each source. The nine contracts were entered into between 2006 and 2008 and end between 2012 and 2014.

* Local entity grants come from the Orange County Transportation Authority (\$7 million) and the Fresno Area Council of Governments (\$250,000 in fiscal year 2008–09).

Scope and Methodology

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits to assess the Authority's readiness to manage funds authorized for building the high-speed rail network. Specifically, the audit committee asked us to determine if the Authority is structured to administer its funding in compliance with laws and regulations and whether its processes and controls are transparent, provide accountability, and ensure the cost-effective use of public resources. The audit committee also asked us to identify and assess the steps the Authority's governing board⁵ has taken to establish a process for strong program oversight and to review and evaluate the Authority's strategic plan to determine if its goals and objectives are reasonable.

In addition, the audit committee requested that we identify the Authority's funding sources for all major contracts over the past three years. It also asked us to evaluate the Authority's contracting procedures and practices for awarding, managing, and monitoring contracts and to determine the Authority's controls to ensure the appropriateness and accuracy of contract payments. Finally, we were asked to review a sample of contracts and paid invoices to ensure that they comply with applicable policies, procedures, and controls, and to determine if Authority expenditures were reasonable and aligned with its goals and objectives.

To determine if the Authority is structured to administer its funding in compliance with laws and regulations, we identified key aspects of state law related to Proposition 1A bond proceeds, reviewed records pertaining to the peer review group, interviewed Authority staff responsible for accounting, assessed accounting processes, and reviewed the Authority's efforts to prepare for receiving Recovery Act funds. We also assessed its efforts to monitor potential conflicts of interest. The Authority's business plan is a key document that describes the Authority's vision for the program, so we also assessed whether it contains required elements and provides a clear path going forward, focusing on those sections related to program financing and risk management. Further, we assessed whether the Authority's processes and controls are transparent, provide accountability, and ensure the cost-effective use of public resources in conjunction with other audit procedures. For example, we assessed transparency by reviewing the Authority's business plan and we assessed accountability and cost-effectiveness by reviewing the Authority's process for awarding contracts and its controls over invoice payments.

⁵ According to state law, the "High-Speed Rail Authority" is comprised of the nine members of its "governing board." In this report, we refer to the governing board as "the Authority."

To identify the steps the Authority's governing board has taken to establish a process for strong program oversight, we interviewed the former executive director,⁶ chief deputy director, communications director, and Authority chair. We also assessed the communications the Authority receives from its staff and the access Authority members have to information regarding the program. Further, we reviewed the Authority's policies and procedures.

To review and evaluate its strategic plan, we interviewed Authority staff responsible for the plan, the Authority chair, and a consultant hired to develop the plan. The Authority had not finalized its strategic plan at the time of our fieldwork, so we limited our review to determining whether the draft plan includes the necessary elements of a strategic plan as described by Finance.

To identify the Authority's funding sources for major contracts, we reviewed contracts in effect at the end of 2009 and decided that we would classify contracts with a total value greater than \$20 million as major. Nine major contracts totaled \$757.9 million and accounted for 98.6 percent of the value of Authority contracts active as of December 31, 2009. The remaining eight contracts totaled \$10.8 million. Further, all the major contracts are for architectural and engineering services. We totaled funding for fiscal years 2006–07 through 2008–09, by source, for each major contract.

To evaluate contracting procedures and practices for awarding, managing, and monitoring contracts, we focused our review on architectural and engineering contracts, as those account for the overwhelming majority of contracts in terms of aggregate dollar value. We interviewed Authority staff and reviewed state law and the Authority's policies regarding awarding of architectural and engineering contracts. Also, we identified key criteria for awarding contracts and compared the Authority's process in awarding three contracts to these key criteria.

To determine the Authority's controls to ensure the appropriateness and accuracy of contract payments, we interviewed its chief deputy director, fiscal officer, and other staff involved with processing contract payments. We also reviewed its contract administration manual. To review a sample of contracts and paid invoices to ensure that they comply with applicable policies, procedures, and controls, we judgmentally selected 30 invoices related to major contracts and paid with funds appropriated in fiscal years 2006–07 through 2008–09. Our selection reflected the distribution of expenditures across fiscal years and also among the

⁶ The Authority's executive director resigned effective March 31, 2010. We refer to him as the "former executive director" throughout this report.

major contracts. We determined whether the Authority followed its internal control procedures when paying the invoices. To select our sample, we used electronic logs of invoice payments maintained by the Authority. We reconciled payment totals on the logs, for each year and funding source, to accounting records of the Authority and to records from the State Controller's Office and determined that the logs were materially complete. Our testing also found the amounts in the logs to be accurate.

To determine if the Authority's expenditures were reasonable and aligned with its goals and objectives, we used our sample of contract payments, as described earlier, because major contracts represented the vast majority—87 percent—of payments made by the Authority from appropriations for fiscal years 2006–07 through 2008–09. We compared tasks billed on each invoice to those outlined in contractors' annual work plans. Further, we analyzed the Authority's accounting reports between July 2006 and June 2009 to identify other-than-major contract costs that were unusual and could indicate nonalignment with the Authority's goals and objectives. Related to this analysis, we reviewed 10 travel claims in detail. Finally, we determined whether a number of foreign trips by Authority staff and board members met state guidelines and were for purposes that aligned with Authority goals. We found no exceptions related to other-than-major contract costs.

Audit Results

The High-Speed Rail Authority's Planning Lacks Details

The December 2009 business plan of the High-Speed Rail Authority (Authority) lacks detail regarding how it proposes to finance the high-speed rail network (program) and mitigate associated risks. Further, the Authority has not yet completed a strategic plan. According to its 2009 business plan, it anticipates needing \$17 billion to \$19 billion from the federal government to finance the program, but the business plan provides detail on only a small portion of this. Plan details include \$4.7 billion in anticipated grants from the American Recovery and Reinvestment Act of 2009 (Recovery Act), which the Authority has since learned will amount to only \$2.25 billion. Further, the Authority estimates it will need \$10 billion to \$12 billion in private investment. Although it claims private interest is high, the Authority has not received any commitments from private investors. Additionally, a revenue guarantee, without which the private investors are unlikely to participate, lacks specifics. Also, the Authority has identified a number of risks that could affect the program and is working to improve its approach to risk management. Finally, the draft strategic plan, which Authority staff anticipate completing in April 2010, includes all the elements it should, but the Authority itself has been involved in its creation to only a limited extent.

The Authority's 2009 Business Plan Contains the Elements Required by the Legislature

The Authority published its first business plan in 2000 and revised plans in 2008 and 2009. In November 2008, three days after voters approved the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century (Proposition 1A) bond measure, the Authority released its second business plan. In March 2009 the Legislative Analyst's Office (Legislative Analyst) stated that the revised plan lacked many details and recommended that the Legislature require the Authority to provide additional information. In amendments to the 2009 Budget Act, the Legislature required a revised business plan by December 15, 2009, that would include various details about the program, as described in the text box. Further, the Legislature made almost \$70 million—or half of the Authority's funding for fiscal year 2009–10—contingent on receiving the business plan. The Authority released its revised business plan on December 14, 2009.

Amendments to the 2009 Budget Act required the High-Speed Rail Authority (Authority) to prepare a revised business plan that includes the following:

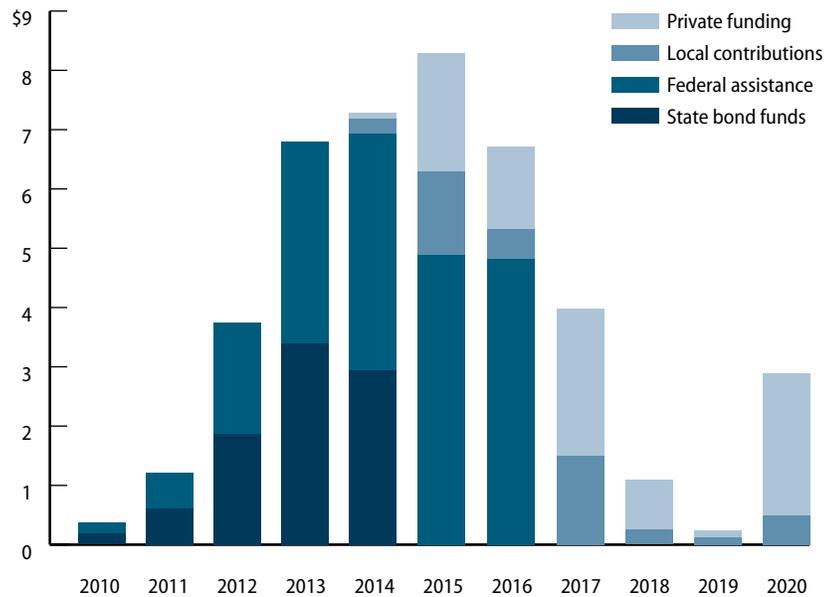
- A thorough discussion describing steps being pursued to secure financing.
- A working timeline with specific, achievable milestones.
- Strategies the Authority will pursue to mitigate different risks and threats.
- Additional information related to ridership, capacity, cost, and private investment strategies.
- System details such as route selection and alternative alignment considerations.

Source: Chapter 1, Statutes of 2009 (ABX4 1), Fourth Extraordinary Session.

The Authority's 2009 business plan contains information related to each element the Legislature requested. For example, it contains program details such as updated cost estimates, general route selection and alternative alignments, and a working timeline with specific milestones related to environmental work. In addition, the 2009 business plan includes a description of the funding the Authority needs to complete phase one—the portion between San Francisco and Anaheim.

The Authority's financial plan includes federal funding, such as that available from the Recovery Act, state bond funds from Proposition 1A, private investment primarily backed by projected operating surpluses of the high-speed rail system, and local funding in the form of such things as naming rights and development around stations. Figure 6 shows the revenues the Authority indicates it will need from each source over the next 11 years. According to the business plan, phase one is projected to cost \$42.6 billion in year-of-expenditure dollars⁷ and has an estimated completion date of 2020.

Figure 6
High-Speed Rail Authority Projected Sources of Funds
2010 Through 2020
(In Billions)



Sources: High-Speed Rail Authority's 2009 business plan.

Note: Projected amounts for federal assistance and private funding in this graph are somewhat different from those reported in the text of the business plan. Funding for federal assistance is \$751 million more than the upper range of the Authority's projections, and private funding is \$674 million less than the lower range of its projections in the text of the business plan.

⁷ The Authority calculated year-of-expenditure dollars by distributing and escalating costs for each corridor based on the year of planned expenditure.

The Authority's Financial Projections Indicate Almost Total Reliance on State and Federal Funds Through 2014

The business plan provides little detail on how the Authority expects to obtain a total of \$17 billion to \$19 billion in federal grants. As the federal government is by far the largest funding source in the plan, we expected to find concrete details indicating how the Authority expects to secure this money; however, the plan provides detail for only a portion of the total. The plan includes \$4.7 billion in Recovery Act funds for which the Authority already had applied. The plan also mentions the Passenger Rail Investment and Improvement Act, which created a mechanism for distributing \$1.5 billion in grants for California and 10 other federally designated high-speed rail corridors in other states over five years beginning in 2009. Further, the plan notes a \$1 billion per year proposed federal commitment for high-speed rails nationally over a five-year period. After the plan was published, Congress appropriated \$2.5 billion for the 2010 federal fiscal year for high-speed rail, intercity passenger rail, and congestion relief grants.

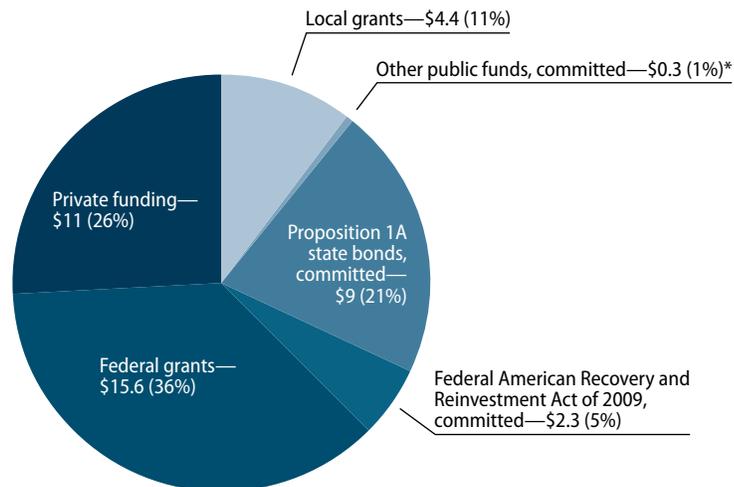
The program risks significant delays because the Authority's plan depends almost exclusively on federal and state funds through 2014 and does not include specific steps for obtaining or replacing federal funds. Further, the Authority's plan includes its request for \$4.7 billion in anticipated Recovery Act funds. Paired with state dollars, these funds would be sufficient to support development of the program into 2013, according to the data in Figure 6. However, according to a U.S. Department of Transportation announcement in January 2010, the Authority will receive only up to \$2.25 billion of the \$4.7 billion Recovery Act funding for which it applied, which is 28 percent of the \$8 billion in grants awarded nationwide. With only \$2.25 billion committed, the Authority will fall far short of the amount it indicates it needs to meet spending goals in the next few years, barring significant new grants or appropriations of state funds outside of Proposition 1A. According to its communications director, the Authority has no definite commitments from the federal government other than Recovery Act funding.

The Authority's assumptions regarding federal funding are optimistic. According to the business plan, the estimate of federal participation in the program is based on the federal government's historically high participation in large transportation infrastructure programs such as highway, transit, and aviation projects. However, the Highway Trust Fund is a dedicated source for highway and transit programs and has its own revenue source—the federal tax on motor fuels. The U.S. Government Accountability Office, in a 2009 report on the future development of high-speed rail, noted that no such dedicated federal revenue source exists for projects for this mode of transportation, so high-speed rail projects must

With only \$2.25 billion in committed federal funds, the Authority will fall far short of the amount it indicates it needs to meet spending goals in the next few years.

compete with other non-transportation demands on federal funds. Further, the Federal Railroad Administration (Railroad Administration) received more than \$57 billion in applications for the \$8 billion of available Recovery Act grants. This suggests that competition for any additional federal dollars will be strong and that California can expect to receive only a fraction of the total. However, the Authority's plan for financing the program depends heavily on federal funding, as Figure 7 illustrates.

Figure 7
Phase One Program Funding by Source
(Year-of-Expenditure Dollars in Billions)



Sources: High-Speed Rail Authority (Authority), 2009 business plan.

Note: The Authority estimated its funding in ranges. For the purpose of this graph we used the average of low and high estimates. Plan ranges were \$17 billion to \$19 billion for federal grants (including federal American Recovery and Reinvestment Act of 2009 funds), \$10 billion to \$12 billion for private funding, and \$4 billion to \$5 billion for local grants.

* Other public funds are specific to the San Francisco-to-San Jose corridor and mostly relate to local grants.

Through 2013 the Authority's plans also depend on federal funding to leverage state bond dollars. As noted in the Introduction, Proposition 1A bond funds may be used to support only up to 50 percent of the total cost of construction of each corridor or usable segment of the program. The remaining 50 percent must come from other funding sources. Thus, the award of up to \$2.25 billion in Recovery Act funds allows for the use of an equal amount of state bond funds for construction, for a total of about \$4.5 billion.⁸

⁸ The Railroad Administration approved a total of five applications submitted by the Authority—one for planning and four for construction. The construction applications represent about 91 percent of the total dollar amount for all five applications.

However, the Authority's spending plan includes almost \$12 billion in exclusively federal and state funds through 2013, more than 2.5 times what is now available.

Unless it can raise additional federal funds or funds from other sources, the Authority will not be able to leverage adequate state funds to meet its spending goals for specific parts of the program. Before it may commit funds from Proposition 1A for expenditures for construction on a corridor or usable segment, state law requires that the Authority have a plan that estimates the full cost of construction and identifies the sources of all funds and the anticipated time of receipt based on offered commitments or assurances from potential funding sources. State law also requires that the director of the Department of Finance (Finance) determine whether the plan is likely to be successfully implemented as proposed.

Without additional funding commitments, the Authority jeopardizes its ability to create a viable funding plan for the first corridor slated to be done with environmental work. According to Authority estimates, the 30-mile corridor between Los Angeles and Anaheim—the least expensive of the corridors approved by the Railroad Administration—will cost \$5.5 billion. However, with the \$2.25 billion Recovery Act grant and an equal amount of Proposition 1A funds, the Authority has only \$4.5 billion potentially available. State law requires the Authority to identify funding sources and timing of receipts before funds from Proposition 1A can be used for construction on any portion of the program. Thus, even if all the \$4.5 billion in federal and state funds were used on this corridor, the Authority would need to identify at least an additional \$1 billion, or plan to build a segment that costs up to \$4.5 billion and does not cover the entire corridor.⁹ As described in the Introduction, the Authority may be able to use some Proposition 1A funds available outside of funding plan requirements; however, if it did so the Authority would need to spend most of these funds, leaving little or none of them available for other corridors. Further, according to the chief deputy director, the Authority is working with the Railroad Administration to determine which corridors will receive federal funding. However, they will need to decide quickly. She said the Authority must prepare funding plans by spring 2011 to meet the Railroad Administration's deadline to obligate federal funds in fall 2011.

According to the communications director, the Authority presented the data in Figure 6 on page 18 to illustrate that public funding will be used up-front and that private funding likely will be used toward

Without additional funding commitments, the Authority jeopardizes its ability to create a viable funding plan for the first corridor slated to be done with environmental work.

⁹ State law allows the Authority to submit a funding plan for a corridor or a "usable segment," which is the portion of a corridor between at least two stations.

the end of construction. We based our analysis on this presentation, as it was the only funding scenario the Authority included in its 2009 business plan and was aligned with expected yearly capital costs also presented in the plan. In its April 2010 draft addendum to the 2009 business plan, the Authority presented another scenario that reflects similar funding needs in each year and still relies heavily on federal and state dollars up-front. The key difference between this scenario and that in the 2009 business plan is the use of some local grant funds in earlier years. The alternative scenario still relies heavily on federal funding through 2013 and indicates no new local grant commitments, so we believe our concerns remain valid.

The Authority's Plans for Private Funding Are Vague

Private investors have expressed interest in the program, but they have made no commitments and the Authority expects they will require a revenue guarantee to participate. The business plan describes the interest of private investors as strong and diverse, and indicates the Authority plans to rely on them to supply \$10 billion to \$12 billion, primarily backed by projected future operating surpluses. As Figure 6 on page 18 illustrates, however, it does not expect to begin using significant funds from this second-largest proposed source until 2015. In spring 2008, in an effort to better understand private interest in the program, the Authority issued a Request for Expressions of Interest to potential investors. According to the consultant contracted to prepare the Authority's financial plan, the consultant communicates regularly with about 50 parties who responded to the spring 2008 request and others who have approached the consultant or the Authority since then. The consultant said the general consensus from these communications is that private investors will require a minimum revenue guarantee from a public entity in the event that ridership projections, and thus operating surplus projections, are not met. This viewpoint is also expressed in the 2009 business plan.

The Legislative Analyst expressed concern that a revenue guarantee might violate state law prohibiting an operating subsidy for the program. In a February 2010 memo, the Authority's financial consultant provided clarification, indicating that the revenue guarantee would not be used as an operating subsidy but would be a limited-term contingent liability used to support up-front capital investment. Additionally, he said that such guarantees with capital cost-only limitations have been employed in both federal and state highway and transit projects. The consultant also stated that the guarantee would be of a limited duration, from five to 10 years. Therefore, a guarantee could increase costs to

The Authority does not expect to begin using significant funds from private investors until 2015.

the public sector. The business plan does not make clear which government would be responsible for the guarantee or how much it might cost.

The Authority has addressed a number of concerns surrounding the model it uses to project ridership, which is fundamental to operating revenue projections, and thus to private investors' interest in supporting the program. In memos released together in March 2010 and published on its Web site, the Authority's former executive director¹⁰ and the consultant responsible for developing the ridership model responded to concerns from the public regarding ridership and revenue projections. For example, an advocacy group alleged that the Metropolitan Transportation Commission, which contracted for the study, made drastic changes to the model, yet did not include these changes in the public documentation or the final project report. The consultant responded that the model development team adjusted coefficients and constants to address peer review comments, that these coefficients and constants were in the final model, and that they were not later changed. The consultant also explained that the final coefficients, constants, and related details were not included in the final report but were in the model itself, part of a package that also included the final report and a user's guide.

The Authority addressed additional concerns in its April 2010 draft addendum to the 2009 business plan. For example, in a background document for a joint hearing in January 2010, the Senate Transportation and Housing Committee and a Senate budget and fiscal review subcommittee quoted Authority projections indicating that more passengers traveling between regions would board in Merced or Palmdale (5,300 and 5,200 per day, respectively) than would board in Los Angeles (3,700), a much larger city.¹¹ According to the addendum, these apparent discrepancies are due to several factors. For example, it explained that Merced and Palmdale do not have frequent, inexpensive air service available to travelers, as does Los Angeles. Further, many riders from Merced and Palmdale count as "inter-regional" travelers because of the way regional boundaries are drawn.

More significantly, the Authority is working to review and revise the ridership model. According to the draft addendum, the contractor responsible for the model is working with the University of

The business plan does not make clear which government would be responsible for a revenue guarantee to private investors or how much it might cost.

¹⁰ The Authority's executive director resigned effective March 31, 2010. We refer to him as the "former executive director" throughout this report.

¹¹ According to the background document, the Program Manager gave revised figures to the legislative committees subsequent to the release of the 2009 business plan. These figures were slightly different from those in the business plan, which estimated that daily inter-regional boardings would be 5,600 and 5,500 in Merced and Palmdale, respectively, and 3,800 in Los Angeles.

The Authority says it has entered into a contract to peer review its past and current ridership models and forecasts.

California, Davis to refine the current forecasting models, develop independent forecasts, and conduct a risk analysis. This effort is to involve an independent peer review panel to assess the resulting products. In addition, the draft addendum stated that the Authority entered into a contract with the University of California, Berkeley's Institute of Transportation Studies in March 2010—at the request of the Senate Transportation and Housing Committee—to peer review the Authority's past and current ridership models and forecasts.

The Authority Is Working to Improve Its Approach to Risk Management

The Authority's 2009 business plan identifies a number of risks associated with the program, but it provides little detail on how it will manage those risks. The Project Management Institute, recognized for its development of standards for the practice of project management, publishes the *Guide to the Project Management Body of Knowledge*, which identifies and describes generally accepted project management practices. According to the guide, project risk management includes the processes of conducting risk management planning, identification, analysis, response planning, and monitoring and control on a project.

Risks identified in the business plan include those associated with government funding, ridership projections, and construction costs. The plan notes that estimated cost projections generally include a 30 percent contingency reserve, with a 20 percent contingency reserve being assigned to items such as track, systems, and electrification. However, the plan does little otherwise to describe its processes for monitoring and controlling risk. According to the communications director, the Authority acknowledges that risk management will be an organizational weakness if it remains as is moving forward.

The Authority has taken steps toward improving its approach. In March 2010 the Program Manager completed a major revision to its risk management process to include a "Risk Register Development Protocol." This protocol details how the Program Manager, regional contractors, and Authority staff will collaborate to identify, assess, analyze, manage, and monitor risk. The protocol also includes a description of a process for developing broadly accurate estimates of potential impact and probability of risks, and expectations for personnel assigned risk management responsibilities. Further, its consultant providing program management oversight, hired in January, will review the risk management plan. Also, the Authority's risk insurance manager, hired in February 2010, will provide services aimed at reducing exposure to project liabilities. The

Authority must ensure that these actions for managing risk are fully implemented so it can respond effectively to circumstances that could significantly delay or even halt the program.

The Authority Anticipates Completing a Strategic Plan in Spring 2010

Although state law no longer requires development of strategic plans, the *State Administrative Manual* says agencies must have strategic plans before Finance will consider budget change proposals for capital outlay.¹² The chief deputy director said the Authority made such a request in September 2009. According to Finance, strategic planning is a long-term, future-oriented process of assessment, goal setting, and strategy building that maps an explicit path between the present and a vision of the future. A strategic plan is an agency's comprehensive guide for carrying out its mission.

According to Finance, the key elements of a strategic plan are an internal and external assessment, mission statement, principles, vision, goals and objectives, performance measures, and action plans. The Authority's strategic plan is not yet complete; however, a draft includes all these elements except for action plans. For example, it presents a mission to "plan, design, build, and operate a high-speed train system that provides an efficient, safe, sustainable, and reliable transportation option for the people of California." The draft plan also identifies two goals: to "ensure that the Authority's organizational infrastructure fully supports its mission," and to "advance California's high-speed rail system through effective planning and construction." According to the consultant working on developing the strategic plan, completion is expected in April 2010, when it will go before the Authority for approval. She expects action plans and other implementation tasks to be completed by June 2010.

Finance's guidelines also state that strategic planning involves all levels and functional units of an agency; boards play an important policy-making role and can assist in developing the mission, principles, and vision of an agency. However, according to the chief deputy director, the Authority's participation in the strategic planning process has been limited to an invitation to take part in an initial survey about the organization's issues. The Authority bears ultimate responsibility for the program's success or failure, so we expected it to be a more active participant in the strategic planning process. Without such participation, the program could operate with plans that do not fully reflect the Authority's outlook.

The Authority's participation in the strategic planning process has been limited to an invitation to take part in an initial survey about the organization's issues.

¹² Capital outlay includes the acquisition of real property, major construction, and improvements.

The Authority Needs to Improve Oversight and Administrative Controls

The Authority has not put in place some structures it needs to provide adequate oversight and administrative control of the program. For example, state law requires the Authority to establish an eight-member peer review group (review group) to review its plans; however, only five of the eight members had been appointed as of March 2010. Further, state law limits the amount of bond funds the Authority may spend on administration, as well as planning, environmental studies, and preliminary engineering (preconstruction tasks), but it does not have a system in place to track expenses in these categories; nor has it determined which expenses should be classified as administrative. In addition, the Authority has taken some steps to prepare for Recovery Act funds, but it still must establish procedures to track jobs created and it must better document its policies and procedures. Finally, the Authority's governing board, which is ultimately responsible for the program's success or failure, is expanding its oversight role.

Required Qualifications for Peer Review Group Members

According to state law, the peer review group shall include the following individuals:

- Two with experience in the construction or operation of high-speed trains, designated by the State Treasurer's Office.
- One with experience in engineering and construction of high-speed trains, designated by the State Controller's Office (Controller).
- One with experience in project finance, designated by the Controller.
- One from a financial services or consulting firm, designated by the director of the Department of Finance.
- One with experience in environmental planning, designated by the secretary of the Business, Transportation and Housing Agency.
- Two from agencies providing intercity or commuter passenger train services, designated by the secretary of the Business, Transportation and Housing Agency.

Source: California Public Utilities Code.

Selection of the Peer Review Group Has Not Been Completed

Three of the members of a statutorily defined advisory group have not yet been appointed, reducing the Authority's access to important input. State law requires it to establish an independent review group, as described in the text box, that is to assess various plans the Authority may develop. The review group is also to issue independent judgments as to the feasibility of funding plans and the appropriateness of the Authority's related assumptions. State law directs the Authority to establish this group, but it leaves appointment of the group's members to four other agencies. As of March 2010, only five of the eight members had been appointed—one by the State Treasurer's Office (Treasurer), one by the State Controller's Office (Controller), one by Finance, and two by the Business, Transportation and Housing Agency. The Treasurer, Controller, and the Business, Transportation and Housing Agency each have one more appointment to make.

Without a complete review group, the Authority cannot benefit fully from its expertise. As the text box describes, review group members must be familiar with high-speed rail construction,

finance, and planning. Those members already appointed include the former director of the California Department of Transportation and an individual who has been involved with high-speed rail programs in the United Kingdom and Korea. Further, the three members appointed in 2009 gave detailed feedback on the organizational structure recommended in the December 2009 assessment to the Authority mentioned in the Introduction. They also commented on issues related to federal funding and risk management. According to the chief deputy director, the Authority considered the comments and incorporated the letter from the partial review group into the report on the organizational assessment.

According to representatives of the Treasurer and the Controller, the positions have been challenging to fill, given the necessary qualifications for appointees. However, representatives for all three agencies that still must make appointments stated they are actively pursuing qualified candidates, and two said they intend to make their appointments in April 2010.

The Bagley-Keene Open Meeting Act (Meeting Act)¹³ prohibits a majority of members of a state body (five, in this case) from discussing, deliberating, or taking action on items of business outside of an open meeting. Thus, according to our legal counsel, the review group must hold a meeting that is properly announced and open to the public when it analyzes and evaluates the Authority's plans. The Authority received informal advice from its legal counsel, a lawyer with the Office of the Attorney General, stating that the review group is not subject to the Meeting Act because it is not similar to a board or commission in that it is not expected to make collective decisions. State law, however, requires the review "group" to analyze and evaluate the Authority's plans and to report to the Legislature. Therefore, our legal counsel does not see any basis in law to conclude that the review group is not expected to make collective decisions. Moreover, the Meeting Act is explicit in applying to multimember bodies created by state law and allowing for very specific exceptions, which do not apply to the review group. Without clarity on whether the review group is subject to the Meeting Act, the Authority risks having the group act in a manner contrary to state law, potentially voiding its analyses, such as those related to the viability of the Authority's funding plans.

Without clarity on whether the review group is subject to the Bagley-Keene Open Meeting Act, the Authority risks having the group act in a manner contrary to state law, potentially voiding its analyses.

¹³ The Meeting Act establishes open-meeting requirements for every state board, commission, or similar multimember body. It generally requires such bodies to publicly announce their meetings, prepare agendas, accept public testimony, and conduct their meetings in public unless specifically authorized by the Meeting Act to meet in closed session.

The Authority Lacks Systems to Comply With State Law and Federal Grant Requirements

The Authority does not have a system in place to track expenditures funded by Proposition 1A to ensure compliance with statutory limitations on administrative and preconstruction task costs. As noted in the Introduction, only 2.5 percent (\$225 million) of the Authority's portion of Proposition 1A bond funds may be used for administration (the Legislature may increase this to 5 percent), and only 10 percent (\$900 million) may be used for preconstruction tasks. As Authority staff began spending funds from Proposition 1A in 2009, we expected them to have defined the types of costs falling in these categories and to have established systems for recording, reporting, and planning for these costs, but that was not the case.

According to its fiscal officer, the Authority is unsure how to classify the expenditure of bond proceeds, although it has a general idea of what should be considered administrative costs. The fiscal officer further stated that the Authority does not have a tracking system in place, but it is working with its information technology consultant to develop a database to keep track of costs by category. Until such a process is in place, the Authority cannot accurately report on its expenditures in each category, cannot create an accurate long-term spending plan, and risks not knowing when or whether it has run out of bond funds available for administration or preconstruction task costs. This is of particular concern because the Authority is set to have spent about \$168 million in bond proceeds by the end of fiscal year 2009–10, and the proposed 2010–11 Governor's Budget includes spending an additional \$583 million, for a total of about \$751 million. If these amounts were all spent on administration and preconstruction task costs, the Authority would use about two-thirds of all the money authorized by Proposition 1A for these cost categories.

American Recovery and Reinvestment Act of 2009 Selected Information Required in Recipient Reports

- Total amount of funds received
- Amount of funds expended or obligated
- Detailed list of projects and activities funded
- Estimated jobs created and retained by funded projects
- Rationale for infrastructure investments

Source: American Recovery and Reinvestment Act of 2009.

Furthermore, the Authority still needs to develop some systems to track and report on the use of Recovery Act funds. Because of its \$2.25 billion federal award, the Authority will be required to comply with both the Recovery Act reporting requirements, some of which are described in the text box, and with the readiness requirements of the California Recovery Task Force (task force). The Authority has fulfilled some requirements to prepare for Recovery Act funds; for example, it has established an accounting code to track the funds separately from other funds. Additionally, the Authority satisfied the task force's oversight and fraud prevention requirements by completing a risk assessment as part of its review of internal

controls and sending an employee to fraud prevention training. Further, the fiscal officer stated the Authority is developing a database to track all expenditures and automatically indicate the correct funding source. The database also will help fulfill the task force's transparency and reporting requirements.

However, the Authority has yet to develop some systems. For example, the proposed database does not allow the Authority to track the number of jobs created or saved, as the Recovery Act requires; nor has the Authority developed an alternative mechanism to track this information. In addition, we recently issued a report on the State's system for administering Recovery Act funds, which includes a recommendation that agencies incorporate Recovery Act provisions into their policies and procedures. According to its December 2009 Financial Integrity and State Manager's Accountability Act report, the Authority has not developed basic operational policies and procedures to which Recovery Act provisions could be added.

According to its chief deputy director, the Authority has lacked the staff necessary to implement all Recovery Act requirements. She further stated that it still has time to act, as it does not expect to receive the award funds until late in 2010. Nevertheless, the longer the Authority takes to ready itself to track and report on Recovery Act funds, the more it risks being unprepared to actually meet federal requirements. Noncompliance with grant provisions could jeopardize its ability to receive those funds and to compete for future grants—both of which are essential, given its heavy planned reliance on federal funds.

The Authority Is Working to Increase Its Involvement

Until recently, Authority members had not provided significant oversight to the program. As described in the text box on the following page, state law requires this group of nine appointees to direct the development and implementation of high-speed rail service. We expected the Authority to be engaged in activities in a manner reflecting its legislated responsibilities and powers. However, the Authority's involvement thus far has been limited. For example, it did not have an opportunity, as a body, to discuss or approve the revised business plan issued in December 2009. In fact, members received a copy of the plan only two days before staff submitted it to the Legislature. However, according to the communications director, some members received a draft of the business plan and discussed it with him. Also, as discussed earlier, the Authority has been only minimally involved in creating the strategic plan. Its chair stated that the Authority is ultimately

The Authority has yet to develop some systems needed to meet Recovery Act requirements.

Responsibilities and Powers of the High-Speed Rail Authority

Responsibilities include:

- Directing the development and implementation of intercity high-speed rail service.
- Appointing an executive director to administer the affairs of the High-Speed Rail Authority (Authority), as directed by the Authority.
- Establishing an independent peer review group to review the Authority's plans.

Powers include:

- Periodically submitting business plans.
- Entering into contracts for design, construction, and operation of high-speed trains.
- Acquiring rights-of-way.
- Issuing debt.
- Setting fares and schedules.

Source: California Public Utilities Code.

responsible for the program's success or failure. Unless it exercises oversight of plans and activities, however, it risks being unaware of significant issues that could disrupt or delay the program.

The Authority is taking some steps to increase oversight of its staff and the program. For example, according to its chair, he requested that staff begin providing members with weekly, written reports on the program's status. Although the chair said these reports have met his expectations, he acknowledges that they are only weekly "snapshots" of staff progress and do not contain detailed information on the program's budget and schedule. Further, in the 29-week period between the first weekly report on August 17, 2009, and March 6, 2010, staff issued only 12 weekly reports.

Additionally, the Authority created three committees—operations, finance, and executive/administrative. Members have participated in three workshops on issues pertinent to each committee. However, only the executive/administrative committee held its first four scheduled meetings. The operations

committee held two of its first four scheduled meetings, and the finance committee canceled its first meeting, scheduled for March 2010. According to the chair, the committees have had difficulties meeting regularly because members have not always been available.

In addition, the Authority has not always followed the policies and procedures it develops. In June 2009 it adopted policies and procedures related to its members' communications with Authority staff and contractors. For example, the policies and procedures require Authority members to communicate with contractors only through the executive or deputy director. However, the Authority's former executive director claims that member-to-contractor contact has occurred often and provided us with documentation showing that subsequent to the policy adoption, a board member met directly with a contractor to receive an update on program issues. According to the former executive director, when individual members express opinions to contractors, the contractors may be unsure if they should consider the opinions to be direction from the Authority or just comments. He indicated that if contractors ignore these communications, the Authority member later might criticize their work. Such conduct also might affect the public's

perception of openness and accountability, and create expectations for contractors to respond directly to Authority members' requests that staff may not know about.

Contract Monitoring and Internal Controls Do Not Provide Sufficient Accountability

Although the Authority's process for awarding architectural and engineering contracts generally meets state requirements, its monitoring of these contracts has been lax. For example, the Program Manager provides a monthly report of the program's overall progress—including the progress of regional contractors working on specific corridors—to staff. However, some recent progress reports have contained inconsistent information regarding the program's status and inadequate information on services provided by the various contractors. Also, the Authority is not consistently implementing its internal controls over contract payments and has paid for tasks not included in contractors' work plans.

The Authority's Process for Awarding Architectural and Engineering Contracts Generally Meets Requirements

Under state law, architectural and engineering contracts are subject to different requirements from other types of contracts. For example, before an architectural and engineering contract can be awarded, state law requires the agency to conduct discussions with at least three firms regarding concepts and methods of approach for furnishing the required services. Additionally, state law requires that architectural and engineering service contracts be awarded to the most qualified firm rather than to the lowest responsible bidder, as is generally the case for other service contracts. State agencies using such contracts must develop regulations to ensure that architectural and engineering services are engaged on the basis of demonstrated competence and at reasonable prices. Finally, in addition to being advertised in the *State Contracts Register*, architectural and engineering projects must be announced in the publications of professional societies. Architectural and engineering contracts have been very significant, accounting for about 87 percent of all the Authority's payments for fiscal years 2006–07 through 2008–09.

Our testing of three architectural and engineering contracts found that the Authority generally followed state requirements for awarding them. For example, in each case it conducted discussions with at least three firms regarding the proposed project. It also evaluated and ranked each proposal and selected and contracted

The Authority generally followed state requirements for awarding architectural and engineering contracts.

with the firm it deemed to be the most qualified from a pool of no fewer than three firms. Further, the Authority advertised each project in the *State Contracts Register*. However, in one instance it did not comply with the requirement to advertise through professional society publications. In this case, the staff member who advertised the contract said she believed that using the Department of General Services' e-procurement system to electronically post the project's advertisement to the *State Contracts Register* met advertising requirements. This electronic format, however, posts advertisements only in the *State Contracts Register* and does not cover other media. This appears to be an inadvertent mistake; nevertheless, without proper advertising through various required media, the Authority risks not reaching the widest pool of potential contractors.

A Primary Tool for Communicating the Status of the Program Contains Inaccurate and Inconsistent Information

The contract with the Program Manager requires it to submit a progress report to the Authority at least once a month. According to the Program Manager's director, this report is the primary document summarizing monthly progress on both a regional and overall level. The Authority's chief deputy director said the report is one of its primary monitoring tools. According to the Program Manager's director, the progress report is essentially a snapshot of the program at the end of a given period. As such it is designed to provide the reader with a summary look at the status of current work, planned work versus work progress, budgeted versus actual costs, budgeted versus actual labor hours, identification of critical issues that have or will affect the program's progress, and remediation measures to address areas of concern. The Authority's contract with the Program Manager requires the progress report to be sufficiently detailed for the executive director to determine if the Program Manager and regional contractors are performing to expectations and are on schedule, and to air difficulties so remedies can be developed.

Some monthly reports, however, contain information that is inconsistent and inaccurate. For example, in the June 2009 progress report, the program schedule, which graphically displays the program's progress by task, indicates that the Program Manager had completed its fiscal year 2008-09 regional contractor oversight activities for all corridors. However, elsewhere in the same document, in a table that provides further detail on the level of task completion, the hours worked and dollars spent for the same activities shows an average rate of completion of about 70 percent. Furthermore, according to the same report, the regional contractor for the Los Angeles-to-Anaheim corridor had planned to

finish 65 percent of its technical reports but actually completed only 7 percent by June 30, 2009. Likewise, it planned to finish 60 percent of its design submittals but actually completed only 20 percent. However, the “issues and areas of concern” section of the report does not discuss the delay in this work.

Also, the July 2009 report indicates that the regional contractor for the Los Angeles-to-Anaheim corridor—the corridor expected to have environmental and preliminary engineering tasks finished the earliest according to the 2009 business plan—had worked 81 percent of the hours planned for the month, but had incurred expenditures that were 230 percent of those planned. The Program Manager’s director provided us a statement from the regional contractor for the Los Angeles-to-Anaheim corridor explaining that the error was due to a discrepancy in the reporting periods for the monthly report and the contractor’s payroll. The regional contractor further stated it fixed the problem in December 2009. According to the chief deputy director, the Authority was unaware of the problem. The Program Manager’s director acknowledged he did not inform the Authority of this issue.

The progress reports also did not provide the status of contractor promised goods and services. Each fiscal year the Program Manager and regional contractors submit work plans for acceptance by the Authority’s executive director. Within each work plan, contractors detail the scope of planned activities, including promised services and due dates. Therefore, we expected progress reports to include a discussion of which services in the work plans contractors had or had not completed. The three progress reports we reviewed—June, July, and September 2009—each described actions taken or products created, but they did not compare those actions and products to what the contractors promised in their work plans. The Legislative Analyst had similar concerns about the information reported in the November 2009 progress report. In its March 2010 report, the Legislative Analyst noted that the progress report updated the status on only about half of the tasks identified in the Program Manager’s work plan, with the remaining tasks deleted or missing. The Program Manager’s director acknowledged to us that the monthly reports did not contain information on promised goods and services and stated that his team is changing the reports to include such a discussion.

Finally, the progress reports did not indicate the significant amount of work the Program Manager performed outside of its work plan. According to the Program Manager’s director, Authority staff have made ongoing requests to his team to perform tasks in addition to the planned scope of work. For example, according to the Authority’s chief deputy director, in June 2009 staff asked the Program Manager to assist in the preparation of Recovery Act

Monthly progress reports from the Program Manager to the Authority did not compare actions taken and products produced to what contractors had promised in their work plans.

applications. The Program Manager's director provided us with a list totaling 700 hours that detailed the time his team worked on Recovery Act tasks, broken down by employee. Additionally, according to him, his team provided support for the development of the Authority's 2009 business plan but did not separately track the hours it worked on this task, which was also outside of the work plan. As a result, work on other aspects of the program may have been delayed or curtailed.

For example, according to the September 2009 progress report, the Program Manager had planned to spend about 2,700 hours overseeing regional contractors in the month reported on, but it worked only about 1,400 hours, or about 53 percent, of the planned level. At the same time, the progress report indicated that for the month reported on, all regional contractors logged about 32,100 hours, or 72 percent of their planned activity. These results suggest that while the Program Manager worked on tasks outside its work plan, it may have reduced its oversight of regional contractors, increasing the risk that their work was not done correctly or according to plan.

Problems with the monthly reports appear to stem in part from the lack of attention Authority staff have paid to them. According to the former executive director, he and the chief deputy director received the reports but did not have any policies in place for their review; they performed reviews as time allowed. The contractor who acts as the Authority's chief engineer said the former executive director assigned him the task of reviewing progress reports around August 2009. He reviewed the September 2009 report and sent a memo to the former executive director and the Program Manager's director highlighting issues needing management action, specifically various tasks that were behind schedule. His memo did not point out inaccuracies and inconsistencies such as those previously mentioned, although it did ask the Program Manager's director to further address actions to mitigate highlighted problems.

The hiring of an oversight consultant may help resolve problems with progress reports.

The hiring of an oversight consultant may help resolve problems with progress reports. The duties of this consultant, hired in January 2010, include reviewing some of the data underlying the progress reports. For instance, the oversight consultant is to review certain promised services, audit work in progress, and review the Project Manager's invoices for compliance with annual work plans. The oversight consultant's duties do not specifically require it to review the progress reports; however, according to the Authority's project delivery director, staff could ask the consultant to do so as part of its overall scope of work. Until they resolve issues with the progress reports, Authority staff cannot ensure that this key monitoring document provides accurate and consistent information on the program's status.

The Authority Paid Invoices Without Ensuring They Accurately Reflected Work Performed

The Authority has not consistently implemented its controls regarding paying contractor invoices and has not documented execution of some controls, risking that it will pay for work outside the scope of the program or for items not allowed by state rules. For example, of 22 regional contractor invoices we reviewed, the Authority paid 20, totaling \$6.9 million, without documenting that the Program Manager had performed a required review and notified the Authority that payment was appropriate. Further, it made some payments to contractors that constituted a misuse of public funds because the items paid for were not included in written contracts. Finally, the Authority's written policies and procedures for invoice payment were adopted only recently and do not accurately describe significant controls staff say they are to follow.

The Authority Paid Invoices Without Assuring They Accurately Reflected Work Performed

The Authority paid invoices from regional contractors without gaining assurance that the invoices reflected work performed. According to the chief deputy director, the Program Manager should review each regional contractor's invoice to ensure that the work claimed has been performed, and then notify Authority staff whether the invoice should be paid. She further stated that staff should not pay invoices without notifications. However, for a sample of 22 invoices from regional contractors, the Authority had a record of the Program Manager's review for only two. According to the chief deputy director, when she processed regional contractor invoices, the Authority received only oral notification from the Program Manager that the invoices should be paid. Therefore, it has no record of such notifications during the period of her review. She further stated that when the Authority's current fiscal officer took over invoice review in spring 2007, she instructed the fiscal officer to get written notification from the Program Manager before payment. However, the fiscal officer says she was not told to obtain such notifications, nor did she receive any. The fiscal officer stated that, before December 2008, she was unaware of the expectation that the Program Manager would send notifications and knew of no formal policy requiring receipt of notifications before invoice payment. Of the 22 invoices we tested from regional contractors, the Authority received 12 before January 2009—totaling \$2.9 million—for which it has no evidence that the Program Manager performed a review. The Authority also has no documentation that the Program Manager reviewed eight invoices—totaling \$4 million—of the 10 received after

Out of 22 invoices from regional contractors, the Authority had a record of the Program Manager's review for only two.

We found that Authority staff paid the Program Manager's invoices without reviewing them to ensure they reflected work performed.

December 2008. Unless staff implement controls related to written notifications from the Program Manager, the Authority risks paying regional contractor invoices that are inaccurate or do not reflect services performed.

Unlike the system for controlling payments to regional contractors, Authority staff have needed to rely entirely on themselves to oversee payments to the Program Manager. However, we found that Authority staff paid the Program Manager's invoices without reviewing them to ensure they reflected work performed. According to the chief deputy director, until recently there were no staff members available to conduct such work. However, the Authority has long recognized problems in this area. In July 2006, as it sought a program manager, the Authority expressed concerns about whether this manager would receive adequate oversight. At that time, it directed staff to contract with a program management oversight consultant (oversight consultant). The oversight consultant was to ensure that the Program Manager was performing its duties with due diligence. The Authority has experienced difficulties hiring and retaining such a contractor. It brought on an oversight consultant in September 2007 but terminated the contract in December 2008 after multiple discussions. Authority staff then sought a new consultant and recommended one that was approved in June 2009. However, this effort fell through when the selected consultant's firm was bought by one of the Authority's regional contractors, creating a conflict of interest. In January 2010 the Authority executed a contract with a third oversight consultant that began work immediately.

Also, Authority staff did not keep a record of their own review of the regional contractors' and Program Manager's invoices. According to the fiscal officer, staff should review each invoice to ensure arithmetic accuracy, correct calculation of overhead amounts based on the rates in work plans, and compliance with state guidelines of other costs, such as those for travel. She stated that the Authority does not, however, maintain a record of this review. Without an adequate record of staff review, the Authority cannot ensure that invoice controls have been implemented, increasing the risk that it has paid for items not allowed by state guidelines or authorized in contractors' work plans. However, a review of 30 invoices revealed that contractors generally have reported and documented expenses appropriately, with minor errors involving some business meals.

The Authority Made Some Payments That Did Not Reflect the Terms of Its Agreements

In several instances, the Authority paid for items or work not included in contracts or work plans. The Authority purchased \$46,000 of furniture for its Program Manager's use based on an oral agreement. State law prohibits a state employee from permitting others to use public resources, including equipment, for any purposes not authorized by law. According to its fiscal officer, the Authority currently provides office space for a number of employees working for the Program Manager. However, the Authority's written contract with the Program Manager requires the Authority to provide office space and telephone service for the program manager, and requires the Program Manager to furnish the office equipment and systems necessary to conduct business.

The fiscal officer stated that Program Manager staff currently occupy desks and use equipment purchased by the Authority. The Authority has spent at least \$46,000 for furniture in office space currently occupied exclusively by contract staff. The chief deputy director explained that this arrangement resulted from an oral agreement between the Program Manager and the Authority. However, the written contract was executed after the oral agreement, and this written contract expressly states that oral agreements not incorporated in the written contract are not binding. Therefore, the newer written agreement effectively supersedes the oral agreement. Unlike the oral agreement, the written contract requires the Program Manager to provide its own furniture, equipment, and systems. Authority staff did not incorporate the oral agreement into the written contract, so they spent \$46,000 in a manner that constitutes an unauthorized use of public resources. According to the chief deputy director, the Program Manager reduced the overhead rate it charges for staff working in Authority facilities. Nevertheless, oral amendments reduce the transparency of the Authority's operations, as persons reviewing its contracts would not necessarily know such provisions exist.

The Authority also paid more than \$268,000 for services outside of contractors' work plans. In the most significant example, a regional contractor charged more than \$194,000 for tasks not included in its work plan. Specifically, the Authority asked a regional contractor to retain a consultant to perform work on "Vision California," an effort to explore the role of land use and transportation investments in meeting environmental and fiscal challenges facing California. According to a draft of the consultant's scope of work, the Authority has committed \$1 million to this effort over two fiscal years. However, this work was not reflected in the regional contractor's work plan. In another example, as discussed

The Authority purchased \$46,000 of furniture for its Program Manager's use based on an oral agreement, but the written contract says the Program Manager will furnish the office equipment and systems necessary to conduct business.

earlier, the Program Manager conducted work on Recovery Act applications that was outside its work plan. In September 2009 the Program Manager charged almost \$53,000 for work on Recovery Act applications. According to the chief deputy director, the Authority asked the Program Manager to perform this work. Nevertheless, if the Authority does not amend contracts or work plans to reflect additional tasks it wants performed, its ability to measure performance against those contracts and plans, and thus ensure accountability, is impaired, and established timelines may be jeopardized.

The Authority Lacks Adequate Written Policies and Procedures for Invoice Review

The Authority only recently adopted written policies and procedures related to invoice payment; however, they do not adequately describe its controls or their implementation.

Finally, the Authority only recently adopted written policies and procedures related to invoice payment; however, they do not adequately describe its controls or their implementation. In December 2008 the Authority's Financial Integrity and State Manager's Accountability Act of 1983 report¹⁴ identified its need to ensure that contract payments are accurate and to develop adequate control procedures. The report indicated that the Authority would immediately start developing policy directives and procedures, including those for controlling the review and approval of contractor invoices, and that it would complete a policies and procedures manual by June 2009. The Authority completed a contract administration manual (contract manual) in September 2009, which includes a description of the process for reviewing and paying invoices, but it does not reflect all the controls Authority staff say are in place. For example, the contract manual states that a contract manager must conduct a technical evaluation of each invoice, based on promised goods and services, to determine the reasonableness of charges; however, it does not discuss the review the Program Manager is to perform on regional contractors' invoices or the need for Authority staff to hold payments until they receive written notification from the Program Manager.

The Authority's 2009 Accountability Act report, issued December 2009, noted that, although it had performed some work on standardized policies and procedures, it had not yet developed basic operational policies and procedures. Without adequate

¹⁴ The Financial Integrity and State Manager's Accountability Act of 1983 (Accountability Act) requires each state agency to maintain effective systems of internal accounting and administrative control. The Accountability Act also requires agencies to conduct internal reviews and prepare reports on the adequacy of their systems of internal accounting and administrative controls.

written policies and procedures, the Authority cannot ensure that its staff understand how to implement internal controls over payments or guarantee that they implement them consistently.

Recommendations

To ensure that it can respond adequately to funding levels that may vary from its business plan, the Authority should develop and publish alternative funding scenarios that reflect the possibility of reduced or delayed funding from the planned sources. These scenarios should detail the implications of variations in the level or timing of funding on the program and its schedule.

In order to plan adequately for private investment, the Authority should further specify the potential costs of planned revenue guarantees and who would pay for them.

In order to respond effectively to circumstances that could significantly delay or halt the program, the Authority should ensure that it implements planned actions related to managing risk.

To avert possible legal challenges, the Authority should ensure that the review group adheres to the Meeting Act or seek a formal opinion from the Office of the Attorney General regarding whether the review group is subject to this act.

To ensure that it does not run out of funds for administrative and preconstruction tasks prematurely, the Authority should track expenditures for these activities and develop a long-term spending plan for them. It also should develop procedures and systems to ensure that it complies with Recovery Act requirements.

The Authority should participate in the development of key policy documents, such as its business and strategic plans. Further, Authority members should adhere to their policies and procedures, including those outlining how they may communicate with contractors.

In order to ensure that staff receive relevant information on the program's status, the Authority should amend the oversight consultant's work plan to include a critical review of the progress reports for accuracy and consistency. Authority staff also should request that the Program Manager revise its progress reports to include information on the status of contract products and services in relationship to what was promised.

To determine if it is paying invoices that accurately reflect work performed, the Authority should ensure that staff adhere to controls for processing invoices. For example, staff should not pay invoices from regional contractors until they receive written notification from the Program Manager that the work billed has been performed, or until they have conducted an independent verification.

To ensure that it does not misuse public funds and can hold contractors accountable, the Authority should adhere to the conditions of its contracts and work plans, and make any amendments and modifications in writing.

To better determine if payment controls are implemented, the Authority should ensure that its written policies and procedures reflect intended controls over invoice processing and offer sufficient detail to guide staff. These procedures should include steps for documenting implementation of invoice controls.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of the report.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: April 29, 2010

Staff: Jim Sandberg-Larsen, CPA, CPFO, Project Manager
John Lewis, MPA
Sarah Bragonje, MPA
Ryan Grossi, JD
Timothy T. Jones

Legal Counsel: Scott A. Baxter, JD

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

(Agency response provided as text only.)

California High-Speed Rail Authority
925 L Street, Suite 1425
Sacramento, CA 95814

April 19, 2010

Elaine M. Howle*
State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

Thank you for the opportunity to review and comment on the draft audit report regarding the California High-Speed Rail Authority (Authority).

The Authority is committed to transparency and believes strongly that additional spotlight on our operations will ultimately make for a better high-speed train project for the state. So, the Authority appreciates the input and recommendations from the Bureau of State Audits, and agrees with its recommendations.

We believe the audit process has identified areas where the Authority can improve its administrative processes and project oversight. We note that many of the findings in your draft audit are similar to those outlined earlier by the Legislative Analyst's Office (LAO). As a result, in many instances the Authority has already taken action to address issues raised in your report. In particular, the Authority earlier this month approved an addendum to its 2009 Business Plan that clarified our efforts to address funding for system construction, risk management, and alternatives for securing the private capital investments necessary to bring this important project to fruition. We appreciate that in many cases the draft audit takes note that the Authority is already taking steps to improve its operations based on recommendations made earlier by the LAO, as well as on findings in your draft audit.

We do believe, however, that the report's inflammatory title is overly aggressive considering that the contents of the audit's findings are not equally scathing. While the Authority is appreciative that the report in its entirety reflects more objectively the challenges of a state entity in transition from a planning body to one responsible for implementing a large-scale public infrastructure project, we also appreciate that not all Californians are able to read each and every word in the audit report and therefore may be misled by the title and headlines contained within.

①

The audit report's detail correctly describes the enormity and complexity of the high-speed train project. It also correctly describes the organizational structure of the Authority and the recent budget changes that have occurred to supplement staffing. It's important to note that staffing levels have been a concern of the Authority Board for some time, and which it has therefore taken significant action to address. This includes contracting out for an organizational assessment and working quickly to hire a chief executive officer.

* California State Auditor's comments appear on page 47.

This is a historic project for California, which has the potential to bring tens of thousands of jobs to the state in the near term and bring improved mobility, increased economic strength, and environmental benefits in the long-term. The Authority is committed to building the high-speed train system in a responsible way that reflects the will of the people of the state, and in that task, we are grateful for the partnership and additional oversight of entities such as the Bureau of State Audits.

Our response to the draft audit report follows the recommendations presented at the end of the report. Our responses are contained in the attached document.

With appreciation,

(Signed by: Curt Pringle)

Curt Pringle, Chairman
California High-Speed Rail Authority

Attachment

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April 19, 2010

Attachment

General Response

- The Authority is committed to transparency and believes strongly that additional spotlight on our operations will ultimately make for a better high-speed train project for the state. The Authority appreciates the input and recommendations from the Bureau of State Audits, and agrees with its recommendations.
- We believe the audit process has identified areas where the Authority can improve its administrative processes and project oversight. We appreciate that in many cases the draft audit takes note that the Authority is already taking steps to improve its operations based on recommendations made earlier by the LAO, as well as on findings in your draft audit.
- We do believe, however, that the report's inflammatory title is overly aggressive considering that the contents of the audit's findings are not equally scathing. ①
- The draft audit report correctly describes the enormity and complexity of the high-speed train project. It also correctly describes the organizational structure of the Authority and the recent budget changes that have occurred to supplement staffing.
- This is a historic project for California, which has the potential to bring tens of thousands of jobs to the state in the near term and bring improved mobility, increased economic strength, and environmental benefits in the long-term. The Authority is committed to building the high-speed train system in a responsible way that reflects the will of the people of the state.

BSA Recommendations and Authority Responses

Recommendation: The Authority should develop and publish alternative funding scenarios that reflect the possibility of reduced or delayed funding from planned sources . . . should detail the implications of variations in the level or timing of funding for the program and its schedule.

Response: The Authority agrees that it is important to be aware and plan for funding scenarios that differ from the scenario we feel is most likely and have therefore presented those in our December 2009 Report to the Legislature. It is important to note that alternate scenarios would not vary in terms of the ratio of state to federal to private funding. Instead, alternate scenarios would be presented as lengthened timelines for construction and for bringing online revenue-based passenger service, which in turn would mean an increased project cost as inflation affects the cost of materials and labor.

Recommendation: Authority should further specify the potential cost of revenue guarantees and who would pay for them.

Response: The Authority agrees that, as we move from the environmental planning phase to an implementation phase, it will be important to further detail the concept of a minimum revenue guarantee, its cost and the entity we would propose to be responsible for such a guarantee. The Authority has already asked its financial consultant to address these issues within the context of the overall proposed procurement and risk-transfer strategy, which is scheduled to commence

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April 19, 2010

with a Request for Qualifications process late this year and with a Request for Proposals process in 2011. Additionally, we have been working with our legal counsel on this issue and will ask for a written opinion on the matter prior to bringing such a proposal before the Legislature.

Recommendation: Authority should assure that it implements planned actions related to managing risk.

Response: The Authority agrees that risk management is a top priority. Your report correctly notes that, to that end, the Authority in February 2010 hired a risk insurance manager, and that in March 2010 the Program Management Team revised its risk and mitigation development protocol. Additionally, in 2009, the Authority contracted for an independent organizational assessment, which was conducted by the firm KPMG. This assessment recommended an organizational structure that includes an office for "Project Controls & Risk Management," which would report directly to the Authority's chief executive officer. The Authority in November 2009 approved the recommended organizational chart and has been working, within the state hiring process, toward putting the staffing plan in place. One element of that is establishing an auditing office, which is an element of the Authority's 2010-11 annual budget request.

Recommendation: Authority should ensure that the review group adheres to the Meeting Act of seek a formal opinion from the Office of the Attorney General regarding whether the review group is subject to this act.

Response: The report correctly states that the Authority has received legal advice suggesting that the Independent Peer Review Group was not intended to be set up as a public entity operating within the structure required by Bagley-Keene. But we agree that this is a topic that merits clarity. To that end, the Authority will continue to work on this issue with its lead legal counsel (a deputy attorney general from the Office of the Attorney General). Additionally, the Authority will approach the Legislature with the Bureau of State Audits' question pertaining to its intent, in that the Independent Peer Review Group is a legislatively created entity. The Authority welcomes working with the Peer Review Group, and respects its independence.

Recommendation: Authority should track expenditures for [administrative and preconstruction] activities and develop a long-term spending plan for them. It should also develop procedures and systems to ensure it complies with Recovery Act requirements.

Response: The Authority thanks the Bureau of State Audits for its recommendation to develop a long-term spending plan for preconstruction activities and will do so. The Authority has already begun to bring online a database for tracking expenditures, which will include detailed provisions for monitoring expenditures by source and mechanisms to alert staff to potential problems. This database system is scheduled to be in place in May 2010. Regarding the Recovery Act, the Authority has already reached out to and begun working in cooperation with the Governor's Recovery Act Task Force, and will review all Recovery Act requirements and implement procedures to track compliance.

Recommendation: Should amend the program management oversight consultant's work plan to include a critical review of progress reports for accuracy and consistency. Authority staff should also assure that the Program Manager revises its progress reports to include information on the status of promised products and services.

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Response: We agree that critical review of the Program Manager's monthly progress reports should be included within the Program Management Oversight consultant's scope of work. In fact, we already believed the consultant's scope of work to be inclusive of this task, and the Program Management Oversight consultant is already engaged in the process of reviewing and assisting the Program Manager in revamping these important reports. Additionally, the reports have been the subject of two public meetings before the Authority's Operations Committee, the result of which is that a new reporting procedure has been put in place by the Board Committee. To provide greater clarity that this task is already underway and is a part of the Program Management Oversight team's scope of work, the Authority will explore explicitly calling out in writing this element of the consultant's work.

Recommendation: *Should ensure that staff adhere to controls for processing invoices . . . should not pay invoices from regional contractors until they receive notification from the Program Manager that the work billed has been performed, or until they have conducted an independent verification.*

Response: The Authority thanks the Bureau of State Audits for identifying this weakness in our protocols. While this verification and notification has indeed been occurring, it has often been informal and/or verbal. And though no improprieties have occurred as a result of the current process, the Authority agrees that this is a process that must be improved by being documented in writing. The Authority will formalize this process such that verification and notification is made routinely in written and therefore easily documented form. ②

Recommendation: *Authority should adhere to the conditions of its contracts and work plans, and make any amendments or modifications to work plans in writing.*

Response: The Authority agrees and will review all contracts and work plans to identify any that require modifications or amendments. Additionally, it should be noted that in January 2010, the Authority brought aboard a state employee assigned as contract manager to the Authority's regional engineering consultants with the responsibility to audit, oversee, and correct instances such as those described in the report.

Recommendation: *Authority should participate in the development of key policy documents, such as the Authority's business and strategic plans. Further, Authority members should adhere to their policies and procedures, including those outlining how they may communicate with contractors.*

Response: The Authority strongly agrees and appreciates that the Bureau of State Audits recognized in its report the Authority's increased participation in the project's development and details over the past eight months. The report notes that Board members were involved in the development of the strategic plan and the business plan, but that involvement has already increased, with the Board Executive/Administrative Committee giving significant input into the strategic plan during an April 7 public meeting and the entire Board reviewing and unanimously approving an addendum to the business plan at an April 8 meeting. Additionally, in light of this draft audit report, the Board has been re-advised on its approved method for communicating with contractors, which is one subject of a revision/addition to the Authority's Board Policies & Procedures, which was discussed April 7 in a Board Committee meeting and will be brought back to a May or June Board meeting.

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Recommendation: Authority should ensure its written policies and procedures reflect intended controls over invoice processing and offer sufficient detail to guide staff. These procedures should include steps for documenting implementation of invoice controls.

Response: The Authority will review its contract administration manual and will identify areas, such as controls over invoice processing, to make certain that policies and procedures are adequately detailed in a manner that ensures effective controls are in place. For deficient or missing policies, staff will prepare them and communicate them to staff responsible for invoice payments.

Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE HIGH-SPEED RAIL AUTHORITY

To provide clarity and perspective, we are commenting on the response to our audit report from the High-Speed Rail Authority (Authority). The numbers below correspond to the numbers we placed in the margins of the Authority's response.

We disagree. The title accurately characterizes the risks the Authority faces, given our findings. In fact, in responding to our recommendation to develop alternate funding scenarios, the Authority states that such scenarios would be presented as lengthened timelines, which in turn would mean an increased project cost. Such language suggests the potential for delays in the high-speed rail program. Further, we discuss the risk of an incomplete system on pages 19 through 21 of the report.

This is the Authority's observation. We did not make a determination whether work billed has been performed, as Authority staff only documented two notifications for 22 invoices we tested.

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cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State
Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press