

# CALIFORNIA STATE AUDITOR

## Senate Committee on Transportation and Housing

Status of High-Speed Rail Authority's Implementation  
of Recommendations

Room 112, State Capitol  
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Presentation by  
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### 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



Independent NONPARTISAN  
TRANSPARENT Accountability



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Elaine M. Howle, State Auditor

## BUREAU OF STATE AUDITS

## BACKGROUND

In 1996 the Legislature created the High-Speed Rail Authority (Authority) to develop and implement intercity, high-speed rail services. The Authority's nine members—five appointed by the Governor, two by the Senate Rules Committee, and two by the Speaker of the Assembly—serve four-year terms with no limit on the number of terms they may serve. The Authority has operated with a very small staff. Between fiscal years 2000–01 and 2006–07 it had 3 to 5 staff members including the executive director. Staffing was increased to 7 in fiscal years 2007–08 and 9 in 2008–09. In June 2009 the Authority contracted for an organizational assessment. The resulting organizational chart proposes 37 staff plus administrative/office technician positions.

In November 2008 voters approved the Safe, Reliable High-Speed Passenger Train Bond Act for the 21<sup>st</sup> Century (Proposition 1A), which provides \$9 billion from the sale of general obligation bonds that the Authority will administer for construction of a high-speed rail network and \$950 million the California Transportation Commission will allocate for improvements to other rail systems connecting to it. The proposition set limits on how the Authority can spend its bond funds, which includes a cap of 2.5 percent on administrative costs (which the Legislature can increase up to 5 percent); 10 percent on environmental studies, planning, and preliminary engineering activities; and no more than 50 percent on the total cost of construction for each corridor or usable segment of the program. The remaining 50 percent must come from other funding sources. As of March 1, 2010, the State had issued \$258.4 million in Proposition 1A bonds.

The proposed rail network would run from Sacramento and San Francisco in the north to San Diego in the south. 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. Phase one is made up of the following 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 and Los Angeles to Anaheim. Estimated total cost for phase one: \$42.6 billion

As the Authority's staff grew, so did its expenditure—from \$6 million in fiscal year 2000–01 to \$139.1 million by fiscal year 2009–10. At the time of the audit, proposed spending for fiscal year 2010–11 was \$958.2 million with Proposition 1A funds covering \$583.2 million and federal funds covering \$375 million. Of the \$583.2 million, \$50.4 million would be for administrative costs and \$532.8 million for capital costs.

In recent years most of the Authority's cash expenditures were related to contracts for architectural and engineering services. For fiscal years 2006–07 through 2008–09 cash expenditures were \$75 million with \$65 million (87 percent) related to payments to private firms with contracts exceeding \$20 million. The largest contract was \$199 million extending more than 6 years for a contractor that serves as the Authority's program manager, providing day-to-day management and directing the contractors working on specific corridors. In January 2010 the Authority contracted with another consultant for program management oversight. This consultant is to review and monitor the program manager's work to ensure it is proceeding on schedule and conforming to approved work plans.

## AUDIT SCOPE

As requested by the Joint Legislative Audit Committee, the California State Auditor performed an audit of the High-Speed Rail Authority and its readiness to manage funds for the program. The scope of the audit included:

- Determining 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.
- Identifying and assessing the steps the Authority's governing board has taken to establish a process for strong program oversight.
- Reviewing and evaluating the Authority's strategic plan to determine if its goals and objectives are reasonable.
- Identifying the Authority's funding sources for all major contracts over the past three years.
- Evaluating the Authority's contracting procedures and practices for awarding, managing, and monitoring contracts and determining the Authority's controls to ensure the appropriateness and accuracy of contract payments.
- Reviewing a sample of contracts and paid invoices to ensure that they comply with applicable policies, procedures, and controls and determining if Authority expenditures were reasonable and aligned with its goals and objectives.

## AUDIT HIGHLIGHTS

During our audit of the Authority, to determine its readiness to manage funds for the program, we noted the following:

- The Authority's Business Plan lacks details regarding how it proposes to finance the program. For example, the Authority estimates that it needs \$17 billion to \$19 billion in federal funds. However, the Authority has no federal commitments beyond the \$2.25 billion from the American Recovery and Reinvestment Act.
- 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 expects between \$10 billion and \$12 billion from private investors, but also indicates that these investors will require a revenue guarantee from a public entity.
- The Authority's 2009 Business Plan provided little detail on how it would manage risk in general, but the Authority is planning to improve its approach to risk management.
- The Authority lacks systems to comply with state law regarding bond funds.
- Although the Authority generally followed state requirements for awarding contracts, its processes for monitoring the performance and accountability of its contractors are inadequate.
- 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 \$6.9 million in invoices from regional contractors without gaining assurance that the invoices reflected work performed.
- The Authority paid contractors more than \$268,000 for services performed outside of the contractors' work plans and purchased \$46,000 in furniture for its program manager based on an oral agreement.

STATE AUDITOR'S ASSESSMENT OF IMPLEMENTATION STATUS

HIGH-SPEED RAIL AUTHORITY  
6-MONTH RESPONSE TO RECOMMENDATIONS  
OCTOBER 12, 2010

CALIFORNIA STATE AUDITOR  
RECOMMENDATIONS

<p>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.</p> <p>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.</p>	<p>The Authority states that it is currently in the process of hiring new financial consultants. It further reports that it expected that the new consultants should be approved at its October 20 meeting. In addition, the Authority stated that the new consultants will assist to develop the alternative funding scenarios. Finally, it plans to provide a full set of alternative scenarios in its one-year response to the audit.</p> <p>Authority states that it continues working with the financial and legal consultants to provide a discussion of revenue guarantees. In its 60-day response, dated June 28, 2010, the Authority's staff was working with a financial consultant and its bond counsel to provide a discussion of what constitutes a "revenue guarantee." It also planned to identify how much any such guarantees would cost and which government entities might be responsible for those guarantees. Finally, it expected to provide this information by the 6-month response.</p>	<p><b>Pending</b></p>
<p>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.</p>	<p>In its 60-day response, the Authority stated that it would seek authorization for a position of Manager, Project Control and Risk Management. The Authority also stated that its program manager has revised its risk register and development protocol to provide guidance to regional teams for preparation of lists of uncertain future events that have the potential to impact project objectives. In addition, the Authority stated that it was in the process of establishing an internal audit office that will report to the CEO and the audit committee of the Board.</p> <p>In its 6-month response, the Authority stated that on July 7, 2010, the Legislature added an additional management position designated by the Authority as Deputy Director, Risk Management. The Authority states that this position will assume responsibility for risk management for the entire project. Further, the Authority indicated that it will move forward with the steps necessary to fill the position once the state budget is approved.</p> <p>The Authority also states that it has developed a duty statement for one of two audit positions it plans to fill. However, due to a lack of a state budget and the current freeze on hiring, the Authority has not begun the hiring process.</p>	<p><b>Pending</b></p> <p><b>Pending</b></p> <p><b>Pending</b></p>

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RECOMMENDATIONS

HIGH-SPEED RAIL AUTHORITY  
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<p>To avert possible legal challenges, the Authority should ensure that the review group adheres to the Bagley-Keene Open Meeting Act or seek a formal opinion from the Office of the Attorney General (Attorney General) regarding whether the review group is subject to this act.</p>	<p><b>Pending</b></p>
<p>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 and Reinvestment Act of 2009 (Recovery Act) requirements.</p>	<p><b>Pending</b></p> <p>In its 60-day response, the Authority stated that obtaining a formal opinion of the Attorney General is both costly and time consuming. In its 6-month response, the Authority reports that its staff is working with legislative contacts to obtain clarification of the law. It asserts that it will obtain adequate clarification in time for the final audit response.</p> <p>As it stated in its 60-day response, the Authority has enhanced its computer system to include systems for tracking administrative versus project expenditures. However, while the system enhancements went online on May 28, the Authority is working with the contractor to resolve issues with the system. In addition, the Authority states that it has not been able to provide sufficient policy guidance to staff regarding key elements of the system.</p> <p>Finally, the Authority expects full system operability by the time it submits its final response to the audit in April 2011. (Note: in its 60-day response, the Authority asserted that the system would be fully operational on or before it submitted its 6-month response to us.)</p> <p>The Authority stated that California's Inspector General for the Recovery Act programs was evaluating the Authority's readiness for receipt of Recovery Act funds.</p> <p>In its report issued October 27, 2010, the Inspector General concluded that the Authority is not fully prepared to distribute and monitor Recovery Act funds.</p>
<p>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.</p>	<p><b>Completed</b></p> <p>The Authority reports that on July 1, 2010, the Authority submitted to its governing board a recommendation that it adopt as its key policy documents the Business Plan and the Strategic Plan. According to the Authority, on August 5, 2010, the Board adopted that recommendation within its amended policies and procedures.</p> <p>In addition, the Authority added language to its policies and procedures stating that the Authority [meaning the appointed members of its governing board] is responsible for developing key policy documents, including approving business plans and strategic plans.</p> <p>The Authority added language to its policies and procedures requiring that its governing board members communicate with contractors through the CEO.</p>

<p>CALIFORNIA STATE AUDITOR RECOMMENDATIONS</p>	<p>HIGH-SPEED RAIL AUTHORITY 6-MONTH RESPONSE TO RECOMMENDATIONS OCTOBER 12, 2010</p>	<p>STATE AUDITOR'S ASSESSMENT OF IMPLEMENTATION STATUS</p>
<p>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.</p>	<p>The Authority advised its project management oversight consultant to amend its work plan to include provisions requiring the critical review of the program manager's progress reports. The Authority's program manager revised its progress report format to ensure the reports accurately reflect project status. However, the project management oversight consultant said it does not have sufficient information to assess the Earned Value Analyses in the reports. These analyses are designed to express the value of work produced for the cost paid. The consultant stated that it would prefer to focus on physical deliverables and their actual level of completion.</p>	<p><b>Completed</b></p> <p><b>Partially Complete</b></p>
<p>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.</p>	<p>The Authority asserts that it developed an invoice review, verification, and approval process. In addition, it provided evidence showing that invoices now include cover sheets requiring signatures from both the program manager and the Authority. Furthermore, this process is detailed in the Authority's <i>Contract Administration Manual</i>.</p>	<p><b>Completed</b> However, we have not conducted follow-up work to determine whether the Authority is now following the process it has established.</p>
<p>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.</p>	<p>The Authority amended its contract with AECOM to include Vision California work.  The Authority amended its contract with Parsons-Brinkerhoff (PB) requiring an audit-adjusted field rate for staff co-located with the Authority and using authority facilities. An "audit-adjusted field rate" is a discounted overhead rate used when consultants use client facilities. The Authority indicates that Ernst &amp; Young audited PB's overhead rates.</p>	<p><b>Completed:</b> Amendment to AECOM contract was finalized on June 22, 2010.  Amendment was approved on September 10, 2010.</p>
<p>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.</p>	<p>The Authority amended its <i>Contract Administration Manual</i> to include detailed procedures for implementation of invoice review and documentation of invoice controls.</p>	<p><b>Completed</b></p>