

High-Speed Rail Authority

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

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High-Speed Rail Authority's response as of October 2010

The High-Speed Rail Authority (Authority), created in 1996, is charged with the development of intercity, high-speed rail service that is fully integrated with existing intercity rail and bus networks. In 2008 voters approved Proposition 1A, which authorized the State of California to sell \$9 billion in general obligation bonds for planning, engineering, and construction of a high-speed rail network. 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.

Finding #1: The Authority's financial plans indicate heavy reliance on federal funds but lack details.

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 two other small federal sources. 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.

We recommended that the Authority 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.

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.*

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» *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.*

Authority's Action: Pending.

The Authority stated that it is currently in the process of hiring new financial consultants. The Authority said that the new consultants will assist it in developing alternative funding scenarios and that it plans to provide a full set of alternative scenarios in its one-year response to the audit.

Finding #2: 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 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. 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 public sector. The business plan does not make clear which government would be responsible for the guarantee or how much it might cost.

We recommended that the Authority further specify the potential costs of planned revenue guarantees and who would pay for them.

Authority's Action: Pending.

The Authority stated that it continues to work with financial and legal consultants to provide a discussion of revenue guarantees.

Finding #3: 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. In March 2010 the contractor that serves as the Authority's program management team (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 2010, 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.

We recommended that the Authority ensure that it implements planned actions related to managing risk.

Authority's Action: Pending.

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 said 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. The Authority also stated 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 for these positions.

Finding #4: Selection of the peer review group has not been completed, and it may be subject to open meeting requirements.

State law requires the Authority to establish an eight-member, independent peer review group (review group) 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.

The Bagley-Keene Open Meeting Act (Meeting Act) prohibits a majority of members of a state body 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.

We recommended that the Authority 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.

Authority's Action: Pending.

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.

Finding #5: 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. 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. 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.

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 and with the readiness requirements of the California Recovery Task Force. Nevertheless, a 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 (Accountability Act) report, the Authority has not developed basic operational policies and procedures to which Recovery Act provisions could be added.

We recommended that the Authority track expenditures for administrative and preconstruction 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.

Authority's Action: Pending.

The Authority stated that it enhanced its computer system to include systems for tracking administrative versus project expenditures and for compliance with Recovery Act requirements. However, while the system enhancements went online on May 28, 2010, the Authority continues to work 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. The Authority expects full system operability by the time it submits its final response to the audit in April 2011.

Finding #6: The Authority is working to increase its involvement.

Until recently, Authority members had not provided significant oversight to the program. State law requires this group of nine appointees to direct the development and implementation of high-speed rail service. 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. Also, the Authority has been only minimally involved in creating the strategic plan. Unless the Authority exercises oversight of plans and activities, it risks being unaware of significant issues that could disrupt or delay the program.

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. 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.

We recommended that the Authority 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.

Authority's Action: Corrective action taken.

The Authority added language to its policies and procedures stating that it is responsible for developing key policy documents, including approving business plans and strategic plans. The Authority also added language to its policies and procedures requiring that its members communicate with contractors through the Authority's CEO.

Finding #7: A primary tool for communicating the status of the program contains inaccurate and inconsistent information.

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 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.

We recommended that the Authority 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.

Authority's Action: Partial corrective action taken.

The Authority stated that the Program Manager revised its progress report format to ensure that its reports accurately reflect project status. However, the program management oversight consultant said that it did not have sufficient information to assess the Earned Value Analyses in the Program Manager's 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.

Finding #8: The Authority paid invoices without ensuring that they accurately reflected work performed.

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.

We recommended that the Authority 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.

Authority's Action: Corrective action taken.

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 Authority staff. Furthermore, this process is detailed in the Authority's *Contract Administration Manual* (contract manual).

Finding #9: The Authority made some payments that did not reflect the terms of its agreements.

The Authority also 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.

We recommended that the Authority adhere to the conditions of its contracts and work plans, and make any amendments and modifications in writing.

Authority's Action: Corrective action taken.

The Authority amended its contract with the Program Manager to require use of an audit-adjusted field rate for staff co-located with the Authority and using Authority facilities. The "audit adjusted field rate" is a discounted overhead rate used when consultants use client facilities. The Authority also amended its contract with a regional contractor to include work that was not part of the original contract.

Finding #10: The Authority lacks adequate written policies and procedures for invoice review.

The Authority 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 Accountability Act report identified its need to ensure that contract payments are accurate and to develop adequate control procedures. The Authority completed a 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 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.

We recommended that the Authority 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.

Authority's Action: Corrective action taken.

The Authority amended its contract manual to include detailed procedures for implementation of invoice review and documentation of invoice controls.