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ANALYSIS OF AUDIT REQUEST

2012-115

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I. AUDIT REQUEST

Assemblymember Harkey and Senator LaMalfa are requesting an audit to assess the adequacy of the California High-Speed Rail Authority's (Authority) oversight and management of the implementation of a high-speed rail network (program).

II. BACKGROUND

Since 1996 state law has charged the Authority with the development and implementation of intercity, high-speed rail service that is fully integrated with existing intercity rail and bus networks. When voters approved the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century (Proposition 1A) in November 2008, the Authority became responsible for managing the \$9 billion provided for the construction of the program. 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 no later than 2020. The law also mandated that nonstop service between San Francisco and Los Angeles take no longer than two hours and 40 minutes.

The Authority has a nine-member board, appointed by the Legislature and the governor, and a small core staff to support its operations and administration. Over the past several years, the Authority's cost estimates to build the program have fluctuated greatly and the timeline in which it has planned to complete the project has been extended. As a result, various parties, including the California State Auditor (state auditor), have raised concerns regarding the Authority's oversight and management of the project.

In 2009 the Joint Legislative Audit Committee asked the state auditor to assess the Authority's readiness to manage the funds authorized for the program, resulting in our April 2010 report titled *High-Speed Rail Authority: It Risks Delays or an Incomplete System Because of Inadequate Planning, Weak Oversight, and Lax Contract Management* (Report 2009-106). This report concluded that the Authority had not adequately planned for the future development of the program and made 10 recommendations to the Authority. In January 2012 the state auditor reported the results of a follow-up review concerning the Authority's efforts to implement recommendations from our April 2010 report. The state auditor's report titled *High-*

Speed Rail Authority Follow-Up: Although the Authority Addressed Some of Our Prior Concerns, Its Funding Situation Has Become Increasingly Risky and the Authority's Weak Oversight Persists (Report 2011-504) concluded that although the Authority had implemented some of the recommendations made in the prior report, significant problems continue to exist.

As part of this follow-up audit, the state auditor examined the Authority's 2012 draft business plan (draft plan), released on November 1, 2011, and concluded that the program's overall financial situation had become increasingly risky, in part, because it had not provided viable funding alternatives in the event that planned federal funding does not materialize. In its draft plan, the Authority more than doubled its previous cost estimates for phase one of the program, which would run from San Francisco to Los Angeles-Anaheim, from \$42.6 billion to between \$98.1 billion and \$117.6 billion. Further, it estimated that phase one would not be fully operational until 2034—14 years later than the estimated completion date shown in the Authority's 2009 business plan. The state auditor also reported that the draft plan lacked some key details about the program's costs and revenues. Additionally, the report identified a number of critical, ongoing problems involving the Authority's oversight of the program, including that it is significantly understaffed and had delegated significant control to its contractors—especially the entity that manages the program (program manager). As a result, it was noted that the Authority may not have the information necessary to make critical decisions about the program's future. The state auditor made several additional recommendations to the Authority, including that it clearly report total costs and disclose all assumptions in its funding and cost estimates and that it continue to fill positions to decrease its reliance on contractors, such as the program manager.

The draft plan was the focus of several legislative hearings and, after a wide array of input and further analysis by the Authority, it released a significantly revised business plan in April 2012. In particular, the Authority decreased its previous cost estimates for the program to \$68 billion and estimated the completion of phase one would occur by 2028. In its revised plan, the Authority attributes the cost and time savings, in part, to the adoption of a blended approach to building the program, which focuses new high-speed infrastructure development between the State's metropolitan regions while using, to the maximum extent possible, existing regional and commuter rail systems in urban areas. The plan also specifies that cap and trade funds are available, as needed, upon appropriation.

In July 2012 the Legislature approved and the governor signed Senate Bill 1029 (SB 1029), which appropriated more than \$7 billion to the Authority for the program's initial construction. In 2012 the Authority is scheduled to select design-build contractors. Assemblymember Harkey and Senator LaMalfa are requesting the audit because they believe that missteps during this early planning period, such as failure to adequately define and assign risk, could imperil the project for decades with massive **cost overruns and lengthy project delays**. Further, they emphasize that ensuring an

active role for the state auditor during these crucial months could ultimately save taxpayers billions of dollars.

III. AUDIT SCOPE AND OBJECTIVES

The audit by the California State Auditor (state auditor) will provide independently developed and verified information related to the California High-Speed Rail Authority's (Authority) oversight and management of the high-speed rail network (program) and will include, but not be limited to, the following:

1. Review and evaluate the laws, rules, and regulations significant to the audit objectives.
2. Review and evaluate the extent to which the Authority has implemented significant recommendations made in the state auditor's January 2012 report, such as recommendations regarding risk management, monitoring contractors, tracking expenditures, and identifying and mitigating potential conflicts of interest.
3. Evaluate the qualifications and experience of the Authority's management team to oversee a program of this magnitude.
4. Based on a review of invoices, expenditures, contract decisions and/or modifications, status of deliverables, and inflation data, determine whether cost and time projections presented in the 2012 revised business plan continue to appear reasonable and accurate. Additionally, identify any variations in the budget or schedule and determine whether these variations are adequately explained.
5. Identify the role of the program manager in making strategy and management decisions on behalf of the State and assess whether this role serves the State's best interest. In doing so, ensure that this assessment includes a determination of the appropriateness of the program manager's role in the decision-making process for selecting design-build contractors.
6. Determine whether the Authority's board members exercise appropriate oversight over staff decisions.
7. In accordance with SB 1029, which went into effect in July 2012, determine whether the Authority has completed the following:
 - a. Developed an accountability plan that establishes adequate criteria governing the expenditure of funds and includes detailed program descriptions and associated costs.

- b. Contracted with the Department of Finance's Office of State Audits and Evaluations to review expenditures.
 - c. Taken steps to prepare the Staff Management Report, Risk Management Plan, Project Update Report, and Greenhouse Gas Report, consistent with statutory requirements.
 - d. Taken reasonable steps to fill the positions of Risk Manager, Chief Program Manager, and Chief Financial Officer.
8. Review and assess any other issues that are significant to the Authority's oversight and management of the program.

IV. OTHER WORK IN THE GENERAL AREA

2011-504 High-Speed Rail Authority Follow-Up: Although the Authority Addressed Some of Our Prior Concerns, Its Funding Situation Has Become Increasingly Risky and the Authority's Weak Oversight Persists (January 2012)

2009-106 High-Speed Rail Authority: It Risks Delays or an Incomplete System Because of Inadequate Planning, Weak Oversight, and Lax Contract Management (April 2010)

V. RESOURCE REQUIREMENTS

We estimate that this audit would require approximately 2,319 hours of audit work at a cost of approximately \$231,900 plus travel and administrative expenses and the costs related to an outside consultant, if necessary. We will conduct this audit using our existing budget authority to the extent funding is available for audits approved by the Joint Legislative Audit Committee.

VI. REQUIRED DATE OF COMPLETION

Assemblymember Harkey and Senator LaMalfa did not specify a completion date for this audit.

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