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FINANCE AND AUDIT COMMITTEE MEETING MINUTES

March 25, 2021

Webcast at:

www.hsr.ca.gov

The meeting of the California High-Speed Rail Authority (Authority) Finance and Audit Committee Meeting was called to order on March 25th at 8:30 A.M. via webinar due to Governor Newsom's State of Emergency declaration regarding the COVID-19 outbreak and in accordance with Executive Order N-25-20 and the Guidance for Gatherings issued by the California Department of Public Health. The Meeting Minutes were prepared in the order items were presented during the meeting.

Committee Members Present:

Mr. Tom Richards, Committee Chair
Mr. Ernest Camacho, Committee Member
Mr. Jim Ghielmetti, Committee Member
Ms. Nancy Miller, Committee Member

Staff Present:

Mr. Brian Kelly, Chief Executive Officer
Mr. Brian Annis, Chief Financial Officer
Mr. Joseph Hedges, Chief Operating Officer
Ms. Teresa Draeger, Senior Management Auditor
Mr. Darin Kishiyama, Principal Transportation Engineer (RDP Contract Manager)
Mr. Daniel Horgan, Deputy Chief Operating Officer (RDP Project Manager)

Public Comment

An opportunity for public comment was made at the outset of the meeting.

Item #1 – February Meeting Minutes

The February 9, 2021 Meeting Minutes were moved for approval by F&A Committee Member Camacho and seconded by Committee Member Ghielmetti and approved unanimously by all members.

Item #2 – F&A Committee Chairman's Remarks, Initiatives, and Updates

Committee Chair Richards had no remarks, initiatives, or updates to present.

Item #3 – Audit Report 1 – Rail Delivery Partner Contract Compliance

Senior Management Auditor Teresa Draeger presented the Rail Delivery Partner Contract Compliance audit report to the F&A Committee Members. Responses to the report were then provided by Principal

Transportation Engineer, Darin Kishiyama (RDP Contract Manager) and Deputy Chief Operating Officer, Daniel Horgan (RDP Project Manager).

Question:

Member Camacho asked when one of the firms under review (Stephen J. Thoman Consulting, Inc) refused to participate in the audit, how was the issue addressed? Member Miller had the same question.

Response:

Mr. Hedges replied that we reviewed all the circumstances involving this contractor and verified receipt of services for the approximate amount invoiced. However, since we were unable to complete an audit of the firm, we reduced the invoiced amount of approximately one million dollars by two hundred thousand dollars to ensure appropriate coverage and flexibility. WSP agreed with this approach to the sub-contractor.

Question:

Member Miller asked how we were able to verify services from the firm for the amount invoiced?

Response:

Mr. Hedges responded that Mr. Kishiyama verified the deliverables received from the sub-contractor and a reasonableness factor with regards to services rendered.

Question:

Member Miller asked if this company was still under contract?

Response:

Mr. Hedges responded that the company is no longer under contract. We had very little leverage over the individual because it was a one-person type of firm, which is no longer in business.

Question:

Member Ghielmetti asked how these bills get paid without proper verification?

Response:

Mr. Kishiyama stated that these rates and overhead are established before they bill to the contracts, so we can determine their overhead is justifiable. The issue here is we were not able to go back and review their records to determine the appropriateness of the entirety of what they submitted. The auditor, Ms. Draeger, was unable to access the company's records which would help validate charges are appropriate and correct. Because of the failure to have access to the records after the fact; that is where the problem for this sub-consultant came into effect.

Question:

Member Ghielmetti asked Mr. Kishiyama if the problem has been fixed?

Response:

Mr. Kishiyama replied that we have engaged with the Rail Delivery Partner (RDP) for their education of their sub-consultants to make sure overhead rates are all substantiated, and they are providing the right information as far as a consistency of approach. We feel that we have better confidence in the data up front. However, it is not 100% fixed because he cannot guarantee that every sub-contractor will comply with the requirements of the contract. But the contract is the contract and WSP has been reminded of these facts.

Question:

Member Ghielmetti asked if the contracts include provisions to allow for audits?

Response:

Mr. Kishiyama replied yes, these are all roll-down provisions for any contract greater than \$25,000.

Question:

Member Ghielmetti asked Mr. Kishiyama when he became the contract manager for the RDP contract?

Response:

Mr. Kishiyama replied October 2018 is when he became the RDP Contract Manager.

Question:

Member Ghielmetti asked Mr. Kishiyama to confirm the audit covers 2015 through 2018, when he was not the contract manager?

Response:

Mr. Kishiyama replied correct, most of the audits that are currently underway are for time periods when he was not responsible for the contract.

Question:

Member Ghielmetti asked if there were any audits prior to 2015?

Response:

Mr. Kishiyama replied there was an audit of the Parsons Brinckerhoff/Program Management Team (PMT) contract which was prior to 2015. That was the predecessor contract to the RDP contract.

Ms. Draeger agreed.

Question:

Member Ghielmetti asked how much of this over billing occurred prior to 2015?

Response:

Mr. Kishiyama replied he believes the PMT audit had findings with a recommendation for recovery of over one million dollars, but he cannot speak to the specifics.

Ms. Draeger confirmed that is correct, approximately a million dollars, but that audit was a little bit different because the period the audit covered was nine fiscal years. So, it was a bigger time period. She cannot confirm at this time exactly how many sub-consultants were audited but there were several sub-consultants and the dollar amount was a lot greater in the overall audited reimbursed costs.

Question:

Member Camacho asked if the contractor operated under a provisional rate or a defined rate?

Response:

Mr. Kishiyama replied he believes it was a defined rate.

Question:

Member Camacho asked if we were just looking for billable hours against the contract?

Response:

Ms. Draeger replied that Mr. Kishiyama and WSP reviewed the information that was submitted by the consultants to determine the reasonableness of the overhead rate. In an audit, we want to go back to verify the costs that are included in that rate. The audit is trying to verify those costs in the overhead rate. What happened, as Mr. Hedges mentioned, Mr. Thoman shut down his business and advised he had no records for the auditor to review.

Question:

Member Camacho mentioned Mr. Kishiyama stated that they had a defined rate not a provisional rate. So, you did audit that labor rate going in, which includes the overheard rate?

Response:

Ms. Draeger replied, so I don't know if there was an audit (of the labor rate), Mr. Kishiyama would not have done it because he was not the contract manager at that time. So, WSP, Mr. Horgan, can explain it more.

Mr. Horgan advised he was not on the contract at that time either, but I guess the background information is this particular person was a WSP employee who decided to set-up his own small business. The charge out rate was slightly less once he started his own business. So that is really the background.

Question:

Member Camacho stated we should have a record of a process that took place. He has heard two different answers. One where there was a defined rate and another where there was not a defined rate. This is a single individual firm with one individual billing hours so if we gave him either a provisional or defined rate, all we are looking for are the number of hours to ensure the work was done.

Response:

Mr. Kishiyama responded he was given a defined rate. He did substantiate his rate through overhead statements. So, part of the validation process for audits requires going back in to determine that the costs he is specifying in an overhead rate were correct and allocable to the contract. Some of the hours he billed to the contract whether it's whole or partial or not at all those costs are that construct is overhead are correct and true. Those are the aspects. So yes, to the substantiated rate and then the problem really was/is trying to go back and verify that everything that he was billing to the contract was appropriate.

Question:

Member Camacho stated because you're talking about pre-award was done, we audited that rate, so it's just misleading when the report says that he was not opening his books to anything. He did in fact do that initially. You audited a rate and you couldn't verify it post audit.

Response:

Mr. Kishiyama responded there is a fine point to the pre-award too because as Mr. Horgan said the pre-award would really be further back in time toward 2015 and so Mr. Thoman was not a sub-consultant at that point. I think probably that you're meaning is before he came under the contract that we review his information, yes?

Question:

Member Ghielmetti asked if Mr. Thoman was a sub-contractor for WSP, shouldn't WSP be responsible for any reimbursements?

Response:

Mr. Kishiyama responded correct.

Question:

Member Miller asked if Mr. Hedges looked at the invoices and determined that there was a value provided except to the extent of about \$200,000?

Response:

Mr. Hedges responded that they reviewed and determined about one million dollars of invoicing was in dispute. Mr. Kishiyama completed a comprehensive study to verify a range of rates for similar type of consultants. Then agreed that a reduction of \$200,000 of that million-dollar invoice was adequate protection to the Authority to ensure that we were able to validate his rates.

Question:

Member Miller asked why that was not noted in this audit report?

Response:

Ms. Draeger responded that the audit committee convened as a result of this audit report. The audit committee could not begin the process of addressing the issue until we provided a report of finding.

Question:

Member Miller stated she understands that but usually you have an audit and then you have management responses. Do we not follow that kind of a process in our audits?

Response:

Ms. Draeger responded we did receive a response. If it is not included in this report, we can provide that information to you.

Question:

Member Miller stated she likes to see responses included in the audit or at the end so that it's an easy way of answering; what did we do about this problem?

Response:

Mr. Kelly responded from my perspective I think your point is very well taken. I think in this case the response that the Authority did to this was correct and going through our checks and balances on this and a thorough review. And I think you're right that we will endeavor in future audits to make sure that those responses to these audits and these findings are clear and stated in the audits going forward.

Question:

Member Miller asked if we could issue a supplemental report for responses to the audit on the website?

Response:

Mr. Kelly responded you're precisely right. I think we should be clear on what the response has been and that must be part of the record. I also would just say that this is the exact reason we do these audits. It's why we do the back-end audits to find any issues like this and then put in place the proper responses, and so I think it's important that those proper responses are part of the record and we will endeavor to make sure that happens going forward.

Ms. Draeger added that we will do that, and we'll add that to our next report.

Question:

Chair Richards asked if the five consultants identified in the report was the total population of the audit?

Response:

Ms. Draeger responded no, we are doing an audit of 18 sub-consultants and then WSP, the prime. So, there will be a total of 19 separate audits performed. What was issued in this report was what was completed at the time of the report. Since the issuance of the report, we have completed three more and issued three memos. The rest are in process. We're hoping to complete them by the end of this fiscal year.

Question:

Chair Richards asked if we'll see a follow-up on this audit when that's all completed?

Response:

Ms. Draeger responded yes, we'll see a second report that will include the rest of the sub-consultants and WSP. We'll be sure to include the WSP response and I'll have to check with Ms. Rivera, who's out, on why the response was not attached and included to be posted.

Item #4 – Financial Reports Executive Summary

Chief Financial Officer Brian Annis presented the Financial Report Executive Summary to the F&A Committee Members.

Question:

Chair Richards asked with regards to change orders, are we paying any change orders for work that has not been done?

Response:

Mr. Annis responded no. Some of these are perhaps in a category where the contractor has incurred some expenses at risk, but we would not pay for work not completed nor would we pay for work that is not yet in an approved change order.

Question:

Chair Richards asked if they do work that's at risk and is later presented in a change order, if that change order was not approved by the Authority, the work they did at risk is on them. Is that correct?

Response:

Mr. Annis replied that is correct.

Question:

Member Camacho asked if we have paid for change order work that has not been done in the past?

Response:

Mr. Hedges replied we have not allowed CP 2-3 to accrue any work that has not been authorized by contract or supplemental change orders. The only work allowed to accrue against, is work that is by executed contract or change order. So, the answer is no.

Question:

Chair Richards asked if that also includes CP 1 and CP 4?

Response:

Mr. Hedges responded yes. There is a multiple tier process that starts in the field and works its way through the Finance Office and the Program Delivery Office to ensure that is the case.

Question:

Member Camacho asked if we have a schedule of when we anticipate completion of CP 1, CP 2-3, and CP 4?

Response:

Mr. Annis replied yes, the Business Plan has dates for substantial completion. CP 1 and CP 2-3 have estimated substantial completion dates in December 2023 and CP 4 in April 2022.

Mr. Hedges added that we have reworked the RBS schedules and they coincide to those dates.

Question:

Member Camacho asked if we have sufficient dollars to complete all construction packages (CP1, 2-3, 4) and the civil work in preparation for a track system?

Response:

Mr. Annis replied that our current cash balances are not sufficient, which is why we have requested the Prop 1A appropriation of \$4.1 billion to finish the Central Valley work including the track and systems. If we obtain the additional Prop 1A appropriation, then we will have sufficient funding. Our analysis shows both Prop 1A and future Cap and Trade of at least \$500 million a year will be sufficient to finish that work.

Question:

Member Camacho asked why we need the Prop 1A appropriation of \$4.2 billion? He stated our current spend rate on CP's is around \$55 to \$70 million, so we are not projected spend \$4 billion by 2023.

Response:

Mr. Annis replied that the number of structures has increased from 19 to around 55 and the number of guideways miles is also up, so as additional structures are cleared for construction that will ramp up the monthly billing. So, we do expect a significant ramp up to occur as more structures are cleared for construction and get underway.

Question:

Member Camacho stated even at \$100 million a month he does not think we're going to spend \$4 billion dollars.

Response:

Mr. Annis replied our forecast is not that we would spend the entire \$4.1 billion in FY2021-22. We may run out of Cap and Trade in early 2022 based on our current projection, so the Prop 1A funds would meet our cash flow needs in the latter half of FY2021-22. It would also be used in FY2022-23 and FY2023-24, so those resources would be spent down over multiple years, but again are needed to fund the expected invoices as we get into next fiscal year.

Question:

Member Camacho asked if Cap and Trade is projected to increase, would that decrease our need on the \$4.2 billion from Prop 1A?

Response:

Mr. Annis replied we do project Cap and Trade will bring in at least \$500 million, but I think we have to recognize the volatility that is there in that revenue source. Proceeds could be lower, as we've seen over the last 12 months, so we have a number of factors and risks in the exact pace of expenditures and in the receipt of revenues going forward.

Question:

Member Miller asked if Mr. Annis is projecting the remaining fiscal year project contingency to go down to about \$282 million?

Response:

Mr. Annis replied yes, that is correct. We originally thought that \$484 million would be spent out of contingency but now we estimate \$282 million will be spent out of the contingency.

Question:

Member Miller asked when the report says remaining fiscal year project contingency, does that mean remaining to be spent for the fiscal year not remaining at the end of the fiscal year in the budget?

Response:

Mr. Annis replied that is correct. It is an expenditure of contingency, not an assignment of contingency.

Question:

Member Miller asked if we're assuming that is expended between now and the end of the year, because it is currently showing no expenditures?

Response:

Mr. Annis replied when we assign contingency through a change order it ceases being contingency and is moved to where it is assigned, so to the DB contract for example.

Question:

Member Miller stated she thought we were eating into our contingency more than we should be given our pace of construction, but it's the reverse with your explanation. Is that correct?

Response:

Mr. Annis replied I believe so if I understand your statement. In a couple slides we have a look at contingency specifically which is a little different than the expenditures. We assign contingency and this slide is trying to get at the expenditure piece of it.

Mr. Hedges added that most of the contingency that is being used right now is addressing the inclusion of new scope. In traditional construction you would assume that you would have this general drawdown of your contingency as work progresses but, in some cases, we're using large amounts of contingency with regards to this inclusion of scope that was not at time of execution of the contract.

Question:

Chair Richards asked Mr. Hedges for his take on the DB numbers for February.

Response:

Mr. Hedges responded that the decrease in the numbers is driven predominantly by right-of-way and some late third-party agreements. There were also delays due to weather as the data that you're seeing in this report is from January and February, which was winter. I'll explain that in detail as I go through my report.

Question:

Member Camacho asked if the Design Builder (DB) expenditures include any change orders?

Response:

Mr. Annis responded that this is invoiced amounts. So, if there was a prior change order that they are invoicing against it would include those change orders, but if it's an implemented change order that has not been billed against it would not show under the expenditures.

Question:

Member Camacho asked if the dollar amount that is reflected here is not necessarily forward progress on construction?

Response:

Mr. Annis responded that it's work, in this case for February, that we think is eligible for payment. It would be their billable work that would be based on implemented change orders-based contract work.

Mr. Hedges added it is for work that we were able to accrue during that month. If they worked at risk in a prior month and there was a change order issued that would allow them to accrue for that completed work, we accounted for it in this invoice. Which is reflective of only work performed or completed.

Question:

Chair Richards asked Mr. Hedges to clarify that the expenditures of \$41.2 million and \$30.5 million reflect actual money paid for work that's been accomplished?

Response:

Mr. Hedges responded yes, absolutely.

Mr. Annis mentioned on a technical point, with the February data we tend to get invoices by mid-February and pay within 45 days. Many of those invoices continue to be under review for final payments, so it is probably a mix of some of these have been paid and some may be paid in the next week or two.

Item #5 – Central Valley Update

Chief Operating Officer Joe Hedges presented the Central Valley Status Report to the F&A Committee Members.

Question:

Chair Richards asked when you're talking about being behind or ahead on structures or guideways, is that behind or ahead relative to the completion dates that are reflected in the new Business Plan or is it some other delivery date that has not been updated to what the Business Plan is stating?

Response:

Mr. Hedges responded this is revision number one of the Revised Baseline Schedules (RBS) which had us focusing on the completion towards ARRA (December 2022). As we disclosed in the Business Plan, the current ARRA deadline is probably not achievable. You will see this reporting for the next couple months because there is a lag, but in the June Report (April data) you will see this updated to the new RBS's. That will include new projections for guideway, structures, and right-of-way.

Question:

Chair Richards asked Mr. Hedges to clarify if the dates shown in the report are consistent with a December 31, 2022 delivery?

Response:

Mr. Hedges responded yes.

Member Miller added that it is important to note that because you have accounted for this delay in the new Business Plan.

Mr. Hedges replied that we have done the science that validates my engineering best guess at the time of the Business Plan, which are reflective of early fall projections. As I have stated before, the process that we now are in is a cycle that is continuously evolved and revolved. So, we have just completed updating all our right-of-way dates and used those dates to update our construction schedules. So now it allows us to reset it all again. I would like to present to the F&A committee the reset of the RBS's at your convenience.

Question:

Chair Richards asked if once there is an action on the Business Plan, will there be new delivery dates showing that we are not behind?

Response:

Mr. Hedges responded yes.

Mr. Kelly added that he thinks this is the right way to present the information until the Business Plan is adopted, but the other element will be settlement conversations with the FRA on delivery dates. That still needs to be finalized before we set the final delivery date. That is one more thing that will inform what this looks like as we present after we have updated.

Question:

Member Camacho stated that we know we're behind right now, and because we move the date out does not make us not behind. We're still behind. We're just moving the date.

Response:

Chair Richards responded the delivery date is going to be what's been agreed upon with FRA. It is not necessarily what we are showing in the new Business Plan.

Mr. Kelly added that we present to the F&A on where things are in a certain snapshot and that snapshot is in the midst of changing. We need to get to the new picture so we can present this properly. It doesn't

mean we're suddenly on schedule and on budget, but I will say we have acknowledged those challenges publicly already. We're in the midst of the reset on those challenges and we are through the execution of the Business Plan. I think a proper discussion with the Board moving forward, is what we need to settle and move forward on to see this work really advance.

Mr. Hedges also stated that the definition of what is on schedule is relative until we incorporate all the known risks. These known risks with regards to additional scope into the contracts. That has been the struggle in the last couple years is trying to get our hands around that. Now with the completion of the designs it allows us to do that, because with the completion of the designs it includes the inputs and the direction from all the third-parties to define that, to scope it, to negotiate it, then to executes it and include it.

Question:

Chair Richards asked where we stand on securing the right-of-way for where we must lay the track for the ARRA grant?

Response:

Mr. Hedges responded that we are around 480 parcels needed as we speak today. We have about 64 delinquent parcels.

Having no further business, the meeting was adjourned at 10:12 AM.

The Authority additionally posts on its website transcripts from F&A meetings, which detail the discussion, questions, and answers from the meeting.

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