



January 16, 2024

The Honorable Nancy Skinner, Chair  
Joint Legislative Budget Committee  
1020 N Street, CA 95814

Dear Senator Skinner:

This letter summarizes a review conducted by the Office of the Inspector General, High-Speed Rail (OIG-HSR) of the California High-Speed Rail Authority's (Authority) March 2023 Project Update Report (project update report). In Senate Bill 198, one of the conditions necessary for the Authority to request access to the remaining \$2.2 billion in Proposition 1A funding for the High-Speed Rail project (project) is an OIG-HSR review of the project update report.<sup>1</sup> As described below, the OIG-HSR has completed a risk-based review of this report and has found that the Authority generally included all statutorily required elements in the report and appears to have a reasonable basis for the project plans, cost estimates, and other information provided in the report. Thus, we concluded that the Authority met its objective in issuing a credible update of the status of the project. Despite the overall credibility of the project update report, we found that the Authority could make some improvements to future project update reports and business plans, as well as the policies associated with these annual publications.

### **State Law Required the OIG-HSR to Review the Authority's March 2023 Project Update Report**

In 2023, following a process established in state law, the Legislature and Governor's Office appointed California's first Inspector General for High-Speed Rail. The stated purpose of establishing the OIG-HSR, which began its operations on September 1, 2023, is to better ensure the success of the project and meet the expectations of taxpayers by ensuring that information state decisionmakers have about the project is accurate, current, and impartial. In addition to establishing ongoing duties and responsibilities for the OIG-HSR, Senate Bill 198 required that, at least 60 days prior to the Authority requesting access to \$2.2 billion in project funds, the OIG-HSR must review the Authority's project update report.<sup>2</sup>

For two important reasons, the OIG-HSR prioritized completing its review of the project update report as close to the end of December 2023 as was possible. First, based on its

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<sup>1</sup> Senate Bill 198: Statutes of 2022, Chapter 71, Section 16 (b)(3)(A).

<sup>2</sup> Senate Bill 198 provided one other option that would allow the Authority to request project funds—the OIG-HSR could publish a statutorily defined annual report that summarizes its reviews and resulting recommendations and Authority actions. However, given the timing of when the Authority believes it needs to access these project funds, which is Spring 2024, exercising this annual report option would not have led to any meaningful information for state lawmakers. Thus, the OIG-HSR prioritized reviewing the project update report.

analysis of when it will likely need additional project funds, the Authority requested that the OIG-HSR complete its review by the end of December 2023 if possible. Second, starting in January 2024, the OIG-HSR will need to focus its currently limited resources on its planned review of the Authority's 2024 business plan, which state law requires to be published May 1 of each even-numbered calendar year. Thus, constrained by limited time and staff resources, the OIG-HSR used a risk-based approach in which we exercised our professional judgment to select—and confirm the reasonableness of—key information and assertions provided by the Authority in its project update report.

### **The 2023 Project Update Report Generally Included All Statutorily Required Elements**

The project update report generally included all elements required by state law, including new reporting requirements added by Senate Bill 198. In prior project update reports, which the Authority must publish during odd-numbered calendar years, state law required relatively less detailed information than what state law required of the Authority's business plans. However, as summarized in the text box, Senate Bill 198 added new requirements for the 2023 project update report, as well as all subsequent business plans and project update reports (annual reports). To satisfy these new requirements, and to fulfill commitments it made in its 2022 business plan, the Authority provided a project update report in 2023 that is similar in size and scope to its biennial business plans.

In March 2023, following the publication of the project update report, both the Legislative Analyst's Office (LAO) and the Peer Review Group—a statutorily created group of experts with experience in transportation and other project-related fields—presented evaluations of the project update report to the Legislature. Although neither specifically stated that the report contained all information required by Senate Bill 198, the evaluations also did not allude to any required information that appeared to be missing, and the Peer Review Group specifically complimented the completeness of the project update report.

The Authority has implemented management controls to ensure that its annual reports fulfill all statutory requirements. Specifically, in its annual reports, the Authority provides an appendix in which it lists relevant reporting requirements and indicates where in the report these requirements are met. The Authority has also

#### **Additional Reporting Elements Required by Senate Bill 198**

The Authority shall develop schedules related to the delivery of the following tasks:

- Completion of the 119-mile segment.
- Completion of right-of-way, planning, and advance engineering for Merced and Bakersfield extensions.
- Completion of key agreements between the state and regional rail authorities for construction and operation of the Merced-to-Bakersfield segment.
- Provision of an updated cost estimate to complete the Merced-to-Bakersfield segment extensions.
- Completion of a funding plan that includes any federal awards for the Merced-to-Bakersfield segment.

Source: Senate Bill 198: Statutes of 2022, Chapter 71, Section 8.

established procedures for preparing annual reports which communicate the roles of staff and executives in ensuring that annual reports provide statutorily required information, as well as any information the Authority otherwise committed to providing in a previous report. The results of the external evaluations described above and the existence of the Authority’s reporting controls informed our risk-based approach to reviewing the project update report. We also met with various stakeholders and Authority personnel, and no one with whom we spoke had found any omission or other error in the project update report.

After reviewing the project update report in detail, including the report appendix described above, we concluded that the project update report is generally complete.<sup>3</sup> In fact, for some report elements, the Authority technically exceeded the level of information required by state law. As indicated in the text box above, Senate Bill 198 directed the Authority to “develop schedules related to the delivery of” the various required elements. However, for two of those elements, the Authority provided the relevant information rather than simply stating when it would do so. To its credit, the Authority provided both an updated cost estimate and funding plan for the Merced-to-Bakersfield segment. Although we believe the Authority generally achieved, and in these two instances exceeded, overall compliance with statutory requirements, it is reasonable that project stakeholders should expect continued improvements to the Authority’s annual reports in general and to the Merced-to-Bakersfield segment funding plan specifically. Such improvements, which we discuss later in this letter, will become particularly important as the high-speed rail project continues to progress and the level of requested federal funding the Authority secures becomes clearer.

### **The Authority Appears to Have a Reasonable Basis and Adequate Support for the Information in the 2023 Project Update Report**

The OIG-HSR’s review of key elements of the project update report found that, in general, the Authority had a reasonable basis and adequate support for the information and projections it included in the report. As described above, constrained by time and resources, we took a risk-based approach informed by the status of the overall project, as well as by the emphasis that Senate Bill 198 placed on specific project components. Our review took steps to assess the Authority’s basis for 17 distinct components of the project update report that can be grouped into the five categories listed in the text box. Among these

**Categories of Project Update Report Components We Reviewed**

- Past Expenditures
- Updated Cost Estimates
- Prospective Funding
- Project Schedule and Progress
- Project Benefits

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<sup>3</sup> Although the project update report accounted for right-of-way acquisitions in the project schedule and total estimated costs for the Merced-to-Bakersfield segment, the report could have more clearly delineated when, and at what cost, right-of-way acquisitions will be completed on that segment. The Authority agreed to better highlight the anticipated timing and total cost of right-of-way acquisitions in future reports.

categories, we considered the focus of Senate Bill 198 on the Merced-to-Bakersfield segment where applicable, and we placed additional emphasis on early or prospective components of that segment. For example, our review of future cost estimates focused primarily on elements related to that segment, such as the Merced and Bakersfield extensions and the acquisition of rolling stock.

Through our review of these components, we obtained an understanding of the Authority's basis for the information it included in the project update report, such as the methods it used to estimate certain future costs. For example, we reviewed the Authority's approach to estimating the possible cost-related risks associated with acquiring rolling stock and determined that its methods were based in part on criteria from the Federal Transit Administration and Federal Railroad Administration. Similarly, we reviewed the Authority's approach to applying cost inputs used in its construction estimates as well as its accounting for the future inflationary factors it describes in the report. However, our review was neither as broad nor deep as may be warranted for future reviews during which the OIG-HSR is fully staffed. For example, we did not assess the reasonableness of judgmental decisions the Authority made when quantifying various risk factors, nor did we verify the accuracy of specific materials costs the Authority used to estimate the total dollars required to construct the segment extensions.

Notwithstanding the support the Authority provided for the information in the project update report, we noted that the specificity and conclusiveness of the underlying information we reviewed varied based, in part, on how far along a given aspect of the project was at the time. For example, we verified the overall amount and range of purposes of the federal funds the Authority described requesting in the project update report. However, although the Authority was awarded about \$3 billion of its total request in late 2023, the outcome of the remaining requested amount and what additional funding may be needed as a result remain uncertain. In addition, the Authority's scheduling documentation that supports prospective components of the 2030 timeframe for the Merced-to-Bakersfield segment is, perhaps understandably, less developed and subject to more uncertainty than the civil works projects already well underway in the Central Valley.

### **The Authority Could Improve the Usefulness of Its Annual Reports by Adding More Specificity to Its Funding Plans**

As indicated earlier, we found that the Merced-to-Bakersfield segment funding plan included in the project update report exceeded statutory requirements; to its credit, instead of simply including a schedule for when it would provide a funding plan, the Authority devoted approximately ten pages to discussing its planned approach for securing future project funding. Despite this significant effort, we concluded that project stakeholders, including the Governor's Office and the Legislature, would benefit from more detail in future versions of the funding plan. Specifically, those plans should more clearly describe when the multi-billion-dollar funding gap identified in the project update

report may begin to negatively affect the project schedule. In so doing, the plans would specify under what timeframe and circumstances state lawmakers may need—in order to keep the Merced-to-Bakersfield segment on schedule—to identify and provide additional state funds for the project.

The Authority's published funding plan is primarily focused on possible federal grants. Based on secured funding at the time of the project update report, including anticipated future cap-and-trade revenues through 2030, the Authority identified a remaining funding gap of more than \$8 billion to complete the segment.<sup>4</sup> In response, the Authority described goals and strategies for obtaining roughly \$8 billion in federal funding that could resolve a large portion of that gap. As part of that description, the project update report includes an exhibit showing which components of the segment were unfunded and the calendar years in which the Authority desired to receive federal funds for those components. For the time and circumstances in which the project update report was written, this level of detail and federal funding focus may have been entirely appropriate. However, recent success in obtaining over \$3 billion in federal funds for the project notwithstanding, there is still uncertainty regarding whether the Authority will reach its stated goal of obtaining the full \$8 billion in federal funds. Further, the Authority's contingency calculations for the segment indicate that the funding gap may well be as large as \$12 billion. Indeed, given existing uncertainties regarding both the segment's ultimate cost and the Authority's ability to obtain sufficient federal funding, the LAO concluded that the Legislature will likely need to identify billions in additional project funding within the next few years to help complete the segment.

The Legislature's ability to identify these funds could benefit from additional detail in future funding plans. Despite its strengths, the project update report's funding plan does not clearly specify at what point the funding gap will begin to affect the Merced-to-Bakersfield segment schedule or the specific amounts needed to prevent such delays. Therefore, as work on the project moves forward and the balance of actual costs and awarded federal funds becomes clearer, state lawmakers would benefit from a more robust analysis that includes a description of the following:

- Ideal dates by which the Authority should, to incur the fewest possible project-related adjustments and other schedule-mitigation efforts, have funding identified and committed for each currently unfunded segment component.
- Critical dates by which the Authority must, to keep the segment on its schedule, have funding identified and committed for each currently unfunded segment component.
- An assessment of the prospects and timing of obtaining federal funds for each currently unfunded segment component.
- The timing and amount of any residual need for state funding to keep the segment on schedule through its completion.

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<sup>4</sup> We calculated this reported funding gap by comparing the upper end of the Authority's total funding as reported in Table 3.0 to its projected segment costs at the 50<sup>th</sup> percentile confidence level in Table 3.3.

## **Recommendation**

Beginning with its 2024 business plan, the Authority should provide in its annual report funding plans greater specificity regarding when additional funds need to be identified and committed for any unfunded Merced-to-Bakersfield segment components. At a minimum, this additional detail should provide state lawmakers with a range of timeframes, spanning from ideal to critical, for additional funding that would help keep the Merced-to-Bakersfield segment on schedule, including an analysis of the prospects of receiving federal funds for unfunded components and the potential need for additional state funds.

## **Authority Response**

The Authority agrees with the Inspector General's recommendation and will work to incorporate the information requested into the 2024 Business Plan prior to the Board's final adoption in April 2024.

## **The Authority Should Convert a Key Reporting Practice into an Official, Board-Adopted Policy**

In its review of the project update report, the LAO highlighted that the Authority did not update existing cost estimates for segments of the high-speed rail project in Northern and Southern California. The Authority indicated to us that its practice in recent years has been to update cost estimates for unfunded segments of the high-speed rail project only after a significant design milestone, such as when an environmental clearance record of decision (record of decision) for a segment has been obtained. Those portions of the project for which the Authority did not update costs in the project update report were all outside the Merced-to-Bakersfield segment, and none had reached a record of decision in the time since the 2022 business plan. The Authority's Chief Financial Officer explained that this practice is intended to provide stakeholders with relevant updates to project cost estimates once the design of those segments has reached a level of maturity where associated cost updates benefit from meaningful new information, such as needed environmental mitigations, and not simply an inflation adjustment of past cost estimates.

The Authority's manual for developing its annual reports indicates that board adoption of a record of decision for a project segment will result in an updated cost estimate for that segment. However, the manual does not explicitly state that cost estimates for segments not yet reaching a record of decision will *not* be updated in the Authority's annual reports, nor does the manual explain the rationale for that practice. To more firmly establish and explain the reasons behind its cost estimation practice, and to allow external stakeholders to understand and comment on that practice, we believe the Authority should pursue a formal, board-adopted policy that establishes the conditions under which it will update cost estimates and explains why doing so in other

circumstances would not benefit the reports' users. Such a policy would not only help avoid or mitigate potential criticism from external stakeholders but would also communicate a consistent set of expectations for the internal experts involved in preparing cost estimates for the Authority's annual reports.

### **Recommendation**

Prior to publishing its 2024 business plan, the Authority should draft and seek board approval for a policy that describes the conditions under which it will update cost estimates in its annual reports. The policy should include a description of how the status of key design milestones—including records of decision—affects decisions to update cost estimates.

### **Authority Response**

The Authority appreciates and agrees with the recommendation of the Inspector General. Given the timing of the recommendation and the current schedule of board meetings, the Authority will incorporate an action item for Board consideration at the April 2024 board meeting, concurrent with the adoption of the 2024 Business Plan.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "B. Belnap". The signature is fluid and cursive, with the first and last letters of the first and second names being prominent.

Benjamin M. Belnap, CIA  
Inspector General, High-Speed Rail