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**FINANCE AND AUDIT SUBCOMMITTEE MEETING MINUTES
January 16, 2018**

**California Secretary of State Building
1500 11th Street
First Floor Multi-Purpose Room
Sacramento, CA 95814**

The Finance and Audit Subcommittee of the California High-Speed Rail Authority (Authority) Board met on January 16, 2018 at 8:30am

Committee Board Members Present:

Mr. Michael Rossi, Chair
Mr. Tom Richards

Authority Staff Present:

Mr. Tom Fellenz, Interim CEO
Mr. Russell Fong, CFO
Mr. Scott Jarvis, Chief Engineer
Ms. Paula Rivera, Chief Auditor
Mr. Mark McLoughlin, Director of Environmental Services
Mr. Paul Engstrom, Third Party Manager
Ms. Patty Nisonger, CIO
Mr. John McMillan, Acting Director of Real Property

Rail Delivery Partner Staff Present:

Mr. Roy Hill, Chief Program Officer
Mr. Joe Cazares, Acting Director of Infrastructure Delivery

Minutes prepared in the order items were presented during the meeting.

Agenda Item: October 19, 2017 Meeting Minutes

- Reviewed and discussed at this meeting.

Agenda Item: Action Items from Previous Finance and Audit Committee Meeting

Mr. Rossi welcomed everyone. Mr. Rossi started the meeting by stating that if you read the minutes there are a series of things that were requested from the last meeting to go through and find out the status of all of those items. Mr. Rossi stated that before we do that he would like Mr. Fong to do the Executive Summary.

Agenda Item: Financial Reports

Mr. Fong started with the Accounts Payable Aging Report and announced that we still have zero aged invoices. Mr. Fong reported that starting next month, we are going to start reporting on the status of where we are at on disputes, which have been growing.

Mr. Fong moved onto the Admin Budget. At 42% of the year completed, we have spent 33%, which is consistent with where we were last year. A little area of concern is our vacancy rate. In the last month it went from 15.5% up to 16.8%. More concerning is our Program area. It went from 16.8% last month to 18.9%. Mr. Rossi commented that was one of the issues that he would like to talk about. Mr. Rossi asked Mr. Hill regarding getting through his analysis and getting staffing right-sized. Mr. Rossi asked when are we going to fix that problem? Mr. Hill stated we are going through that process now and from process discussions we should have that done within the next six weeks. Mr. Rossi asked if that was a commitment? Mr. Hill replied yes. Mr. Rossi asked that this be noted in the minutes.

Mr. Fong moved onto the Capital Outlay Budget Report. Again at 42% of the year completed, we have spent 27%. The Project Development budget is at 38% spent and construction is at 31% spent.

Mr. Fong moved onto the Total Projects Expenditures Report. Mr. Fong stated he would like to report that the report states \$733.2 million in matched funds. This is matched funds for the ARRA agreement. As of today, he reported that we have \$899 million matched already.

Mr. Fong moved onto the Contracts and Expenditures Report. Mr. Fong stated we have over 300 contracts that are active, totaling about \$5.6 billion.

Mr. Fong moved onto the Projects and Initiative Report. Mr. Fong stated we are reporting on thirty-six projects and initiatives. The good news is that we are down to just five red. All five of those are in the IT area. Mr. Rossi asked where do we stand with IT? Ms. Nisonger replied we have begun making progress on several projects. It is slower than she would have liked. We do have a solid schedule for the Cost Management System. It came as part of the Corrective Action Plan. We have a couple of projects that we have completed in the last few months including Schedule Management, Risk Management, and Maximo implementation. Ms. Nisonger stated that we are on track now with the Contracts System, so we are starting to make some good progress. Mr. Rossi asked when are we going to get this done? Mr. Nisonger replied that the Go-Live date that was submitted to her with the Corrective Action Plan for the Cost Management System is May 24, 2018. Mr. Rossi asked that this be noted in the minutes to follow up. Mr. Rossi commented that the numbers of reds has been reducing. That is good work. Mr. Richards asked how many that was down from? Mr. Rossi replied fourteen.

Mr. Rossi stated that some of the items that we spoke about at the last meeting, looking at the most recent ROW report, that he is still not comfortable that we are on top of ROW the way we were before. Mr. Rossi asked who would like to speak to him regarding ROW? Mr. Jarvis replied, stating that he would like to take the opportunity to introduce, Mr. John McMillan. Mr. McMillan is the Acting Right-of-Way Director. Mr. McMillan retired from the State after thirty-five years of project delivery experience. He is very experienced in project delivery overall and understands where ROW fits into that picture. Mr. Richards asked how long he been here? Mr. Jarvis replied that Mr. McMillan has been acting in this role since the first of the year. Mr. McMillan said this is day eight.

Mr. Rossi asked what has to happen to get this thing moved faster? Mr. Jarvis replied that the real key with ROW is to continue to focus on the critical parcels, working closely with our design-builders and our construction package teams. This is something that we have been focusing on and determining what the critical parcels are on all three projects and making sure that communication is

flowing so that we can manage our resources. Mr. Rossi asked how long we have had these three projects? Mr. Jarvis replied that CP 1 was executed in August 2013 and the others in 2014 and 2015. Mr. Rossi asked if we know what the critical parcels are? Mr. Jarvis replied that we do know. Mr. Rossi stated so it is not an issue of getting them identified. Mr. Rossi asked when are we going to get them delivered? Mr. Jarvis replied that we do have a ROW acquisition plan that has all of the dates written for delivery. We do have a plan for when to deliver. Mr. Rossi stated that looking at the Operations Report it does not look like we are making any progress. Mr. Richards asked if you are also having problems with critical parcels, is it because they change? Once you have defined them as critical parcels, are you having any design-build problems? Mr. Jarvis replied that the challenges is the identification part as the contractor develops their design, we have a very narrow footprint. Sometimes it is necessary to obtain additional ROW for room for utilities, relocation, and design changes. It is a dynamic situation as far as determining the key parcels but generally we have a pretty good handle on what the critical path items are on the project and those are parcels we have been focusing on so far.

Mr. Richards asked if you are not struggling because of the design-builder and you have come to an agreement that these are critical and somehow they end up not being critical so basically you have been working on them and all of the sudden they are not critical and you have a new list of critical parcels. Mr. Jarvis replied that is an element to a degree. The critical path in any construction project is there is some change to that. That is a factor but I think one of the biggest factors right now is that most of the parcels that have not been acquired are in the eminent domain process so we don't have a lot of direct control once it gets into that process. We continue negotiating and working with the parcel owners. We have acquired over two-thirds of the parcels in the Central Valley, over 1200 parcels. The remaining parcels are part of the eminent domain process. Mr. Richards asked if he had a schedule or spreadsheet that he could send to Mr. Rossi and himself? Mr. Jarvis replied yes, we have a ROW acquisition plan. Mr. Fellenz commented that the focus of eminent domain is to get the Order of Possession. As the top priority, getting into court, getting that despite the fact that we might not meet a resolution on compensation to get our possession first. That is definitely a focus.

Mr. Camacho asked if any of these parcels are being impacted by Third Party Agreements? Mr. Jarvis replied yes. Mr. Camacho asked to what extent? Mr. McMillan replied he was not comfortable answering but on the Order of Possession, one of the challenges is the time we need to relocate and do cost evaluation before we can transfer that parcel over to the design-builder. That has been a challenge. We have brought on a property management consultant to deal with demolition work, clearance work. We have actually been fast-tracking a lot of these parcels over to the design-builders. Mr. Rossi stated that from reading the reports that is not happening. There needs to be a plan that tell us how you are going to accelerate that exercise by how much and by when. Mr. Jarvis stated he understood.

Mr. Rossi asked for a status update on Dragados/Flatiron. Mr. Hill replied that we had discussions with them prior to the holiday season and we came to an agreement regarding the settlement for the delays up until August 31, 2017. That takes off the table all those delays. That settlement was in place and we are working with them now. Part of that settlement was to mobilize more sites beginning this year. They were on four sites in December. They are on nine sites as of today and they will be on twelve working sites by February. There is an improvement and we are working jointly to produce a new delivery schedule and have that produced by the end of February. Mr. Rossi replied ok. Mr. Hill replied that the intention of that is to reduce forecast delay to the CP 2-3 contract. The intent of that, working jointly, is we just talked about ROW, Environmental and Third Party to see how we can mitigate that program to the earliest completion date.

Mr. Richards asked is that what we contemplated in November at the meeting with their staff and RDP

and HSR staff actively working on a regular basis? Mr. Hill replied yes. It is with all of these situations. They all take two or three months to get embedded going forward. He has no doubt at this stage that is not the case.

Mr. Fellenz commented that we have some new personnel in CP 2-3 that Mr. Hill might want to mention. Mr. Hill replied yes. We have a Program Director on CP 2-3. We have a new Program Director on CP 1. A new Commercial contracts person in the Central Valley. We are changing our team to reflect the requirements. Mr. Fellenz commented that for CP 2-3, the new Program Director came from Skanska. He has worked for a contractor essentially his whole career. Mr. Richards asked who he is working for? Mr. Fellenz replied for RDP. Mr. Rossi asked when he was coming onboard? Mr. Fellenz and Mr. Hill both replied he is already here, before Christmas.

Mr. Rossi moved onto the October 19 meeting minutes, page 4. In those minutes, we talk about ROW and that there was going to be an analysis. Mr. Rossi asked when are we going to get that analysis? Mr. Jarvis commented that you will get that this month. Mr. Rossi stated this meeting was done in October and you don't have an analysis, in basically three months, who is running ROW? Mr. Rossi asked again to have the analysis. Mr. Jarvis replied yes.

Mr. Rossi moved onto the Environmental Reports. Mr. Rossi asked Mr. McLoughlin if he changed the dates? Mr. McLoughlin replied those dates are changed and they have priorities. Mr. Rossi replied ok. Mr. McLoughlin added that on page 61-62 (four-month look ahead) he did not prioritize those. Mr. Rossi asked if those would be prioritized next month? Mr. McLoughlin replied yes, those will be prioritized for next month and will reflect the same schedule. Mr. Fellenz commented that these are consistent with FRA's schedules.

Mr. Richards asked that you take a look, every time well in advance of when we have the next meeting, look at the minutes from the previous meeting and make sure you are being responsive to what we have asked for so we can blast through this and move the process forward. Mr. Fellenz replied ok. Mr. Richards stated so we can move the process forward and we can ask different questions. Mr. Fellenz replied ok.

Mr. Rossi asked where are we on the risk analysis, listed on page 6 of the previous meeting's minutes? Who is working on that now that Mr. Tapping is gone? Mr. Fellenz commented that Mr. Fong is managing the analysis. Mr. Fong replied that we will have the CP 1 analysis done in a week, it is connected to the baseline. Mr. Noel Berry, Risk Manager, replied that for the rest of them (CP 2-3 and CP 4) they will follow in the next six to eight weeks. Mr. Fellenz reaffirmed that.

Mr. Richards commented that there were a number of other things in the minutes that we could address but I think rather than badger you through all of that, when we get to the next meeting minutes if you could go back and look at these and what has not be responded to so we can deal with those at the February meeting. Mr. Fellenz replied ok.

Mr. Richards asked Mr. Fong if he had anything on Cash Management. Mr. Fong replied that we have \$1.2 billion in Prop 1A and \$945 million in Cap and Trade cash. Mr. Rossi agreed with what Mr. Richards said about the minutes. The minutes are here and if there are questions, you need to respond to them at the next session. Mr. Fellenz replied yes.

Mr. Rossi commented that as you look at the projections, I just want to leave you with a thought. If you look at the Operations Report, clearly they don't mean anything today because you have rebase-lined the project. So we are going to have to change those. As we move forward, what I don't want to have happen again is when we ask for something we have to be brutally honest about where we are

so we can deal with the problems. Trying to play catch-up is unbelievably expensive. We all need to understand in this room today going forward with the new baseline that these are great reports. I'm not talking about the Operations Report, but all of the other reports are spot on financially and are accurate and fine. But the Operations Report and the projections, we can't pretend whether x or y is going to happen. It takes too long to figure it out. Fix it. Mr. McLoughlin and I have had this conversation now for two years about the projected delivery dates on the environmental side. Holding onto stuff that we know is incorrect is unfair to the tax payers of the State of California. You are all sitting in this room. We are not doing that any more. Let's be clear, all right? If it is bad news, bring it forward so we can deal with it. Stop holding on to fantasies. That is just not acceptable.

Mr. Rossi stated that he knows that the intent was all positive but it turns out that the result is not, because we need to deal with the problems quickly and efficiently. That is how you build projects. That is how you execute. Every project is going to have problems. We just can't do this again. I'm not going to go through these numbers because they are going to just change by the end of the day. What I want to have change is the culture about how we present this. Where I used to work, we had a simple rule - never shoot the messenger unless he/she was late because stuff happens. We are all human. Mistakes happen. It is not about that kind of stuff. It is about holding onto something that we all know will not turn out right, by what we say, what we tell people. We need to deal with it efficiently and quickly. Unless Mr. Fong or Mr. Fellenz have anything else, now that we are finally getting to a cost to complete number we are going to talk about that has some real delivery numbers, I don't see any need to go through the numbers that are going to be changing pretty quickly.

Ms. Schenk commented she wanted to say something. Ms. Schenk commented she has been sitting in on the Finance and Audit Committee Meetings and that she has heard Mr. Rossi give that speech a number of times. Ms. Schenk stated she is frankly impressed that with the equanimity in which he was delivering it because I have heard you deliver it no less than four or five times and yet you have to deliver it again.

Ms. Schenk asked what do we do to make your message be heard? Mr. Rossi commented that one of the things is, we have changed management significantly. You have to rethink what we are doing. I am a great believer in the inherent goodness of people. I don't think anyone wanted to do anything foolish or incorrect or costly. But you have got to get your focus right here. You've got a set of numbers, the Board has signed off, talked to people about them, we support it. You cannot not change assumptions when the world changes. It just is what it is and I think Ms. Schenk agrees with me, if it happens again that is what brooms are for. Ms. Schenk agreed. Mr. Rossi stated he knows everyone's hearts are in the right place. We can't even un-intentionally do stuff that is misleading and incorrect. We have a huge fiduciary responsibility to the tax payers of the State of California and to the Governor, who is supporting this project. And with all due respect to all you guys, to the Board because we are out there going, yeah this is right, this is going on. Not going to happen anymore. There is nothing wrong with bad news other than it is a weight or there is a refusal to admit that it is bad news and we think everything is fine. I would like you to remember, if you did not see it, pull it up on YouTube where every president of a tobacco company said they did not think nicotine was addictive. I don't want to be one of those guys. I also don't want to be the guys who stood up for Enron and said we did not do anything wrong, so this stuff stops now. Irrational exuberance does not work. Focus, discipline, rational thought process, willing to admit when you are wrong you are wrong. There is nothing wrong with being wrong. Stuff happens. Now if you are foolish about being wrong, that is a different issue. Stuff happens and when you look at the re-baseline, a whole lot of stuff is missing. Not great planning. It's not bad execution. You can't fix bad planning, by pretending the execution is good. Even if the execution is good, you can't fix bad planning. It is almost impossible if you start in a hole and try to climb out of it.

So as we move into the New Year, there are a couple of things that I think we need to do here. One is, when you get asked the question and it is in the minutes, come prepared to answer that question at the next meeting, even if it is to say, hey Mike and Tom, you guys are wrong. It has to be this way. We are ok with that. The other thing is no one in this place gets shot for bad news. No one. It is only for if you are late. So if you want to disagree with those principals of account as we go forward, that is what is going to be expected. Mr. Rossi asked if anyone wanted to digress on that thought process?

Mr. Richards commented that he only wanted to add one thing, to be absolutely clear, nobody should assume what you are doing is trying to answer any of the questions that we have asked with what you think we want to hear. And secondly, we look at each of you around the table and those that are behind you as being the experts in what you are doing. We are not and have never suggested that we are. So since you are the experts, what you need to do is give us your best information, your best thoughts and recommendations. But not for you to present to us things that you don't begin to believe to begin with. There are times we have sat around this table, where it has been clear, to us at least, some people may not be fully supportive of what they believe they have been directed to say. You are not being directed to say anything. You are being directed to give us your very best information and estimates and we need to deal with those. You cannot provide what you think we want to hear or what you think anyone else wants to hear. It has to be absolutely supported with the very best thinking, the experience you bring to the table. Mr. Rossi asked if anyone else had anything they wanted to say?

Mr. McLoughlin asked to make some clarifications on the Project and Initiatives Report, Administrative Record (kCura), page 7. Mr. McLoughlin commented that these bullets are red and they should be green now, as far as escalation. Ms. Nisonger commented that the system is now essentially complete and we just have documentation to tie up. Mr. Rossi said good job, that's great. Ms. Nisonger commented that from Mr. McLoughlin's perspective, he is trying to defend a red dot there. It did deliver late but is essentially complete now. Mr. Rossi replied ok.

Mr. McLoughlin moved onto the Operations Report, Executive Summary, page 6. Mr. McLoughlin commented regarding the last sentence that says, "the primary drivers are: lack of executed third party agreements at bid; lack of final environmental permits". This is a three year conversation with we disagree with what is in here. On the lack of permits, all bidders had their best professional judgment. They had the environmental documents. The construction people need to do what they do but at the same time everyone bid on the same thing using their best professional judgment such as Geotech information, preliminary Geotech, and they use their best judgment.

Mr. Rossi asked Mr. McLoughlin what he was referring to here? Mr. McLoughlin stated the last sentence, ROW, Environmental and Third Party responded to changes to the project. Whether it is the Authority approved or contractor approved changes, we respond to that to ensure environmental is clear, what the ROW is and purchased third party, we respond to those changes. Same with CP 2-3. The project has changed. The RDP and the Fresno group are doing a great job of getting the project to move but those re-examinations are very clear to uphold the Board's original NOD decision and the RODs and make sure those are done right. It is the contractor's responsibility to do that work correctly and within the same legal bounds as the original decisions. Mr. McLoughlin commented that he just wanted to note that not having permits is not a reason for a change order.

Mr. McLoughlin moved onto the Peer Review Group Report (Legislative Dashboard). Mr. McLoughlin commented that the report talks about the top five near-term risks and also the top five long-term risks. Mr. McLoughlin commented that that is the same conversation that he just mentioned about delays and clearances. The contractor is responsible for those re-examinations. Again, they

need to do those properly. We have identified that that is an issue, so I want to make sure our group is doing the best that we can to approve them but they have to provide the right quality documents and include the third party and ROW pieces of that to make sure that happens.

Mr. Rossi commented that he did not see anything inconsistent with how you would run that Mr. McLoughlin. Mr. Rossi asked Mr. McLoughlin if you were suggesting that their responsibility is not being executed? Are you being held responsible or just knowing they need to their job in order for you to do yours? Mr. McLoughlin replied both. They need to do their job best and we are subject to the project change or delays when we are not the ones re-evaluating these. I want to make sure they are done clearly, again to make sure that the Board decisions, the ROD decisions, especially with the NEPA assignment coming up. We have to hold them accountable for providing quality decision documents. If there is a delay in the project, risk is part of that. We are responding to those changes but we want to make sure the documents are quality to make those decisions.

Mr. Rossi asked if Mr. Hill was hearing that and in agreement with that? Mr. Hill replied yes. Mr. Rossi replied ok and noted.

Mr. Jarvis requested to say a few words regarding the Central Valley. Mr. Jarvis stated that there has been significant cost growth in the Central Valley and there are four main reasons for that. He could elaborate on that if Mr. Rossi wanted. Mr. Rossi stated he thought he knows what those are. Mr. Rossi stated he was clear on those so we are fine. Mr. Rossi thanked Mr. Jarvis.

Mr. Rossi commented that these series of reports, the financial reports and accounting reports, are exactly how they should be. They are accurate and you can follow what is happening. The operating reports, which I maintain that once you get your financial reports right, are the most important reports. Those are not any good and it is a shame. So as we re-baseline and re-do these reports, we need to stay on top of these in order to understand what is going on. If anyone has a disagreement with that statement, right now is the time to make it. Hearing no disagreement, Mr. Rossi thanked everyone for coming.

There were no further discussions and meeting adjourned at 9:05 a.m.