

December 22, 2017

Brian Kelly, Secretary
California Transportation Agency
915 Capitol Mall, Suite 350-B
Sacramento, CA 95814

Dear Mr. Brian Kelly,

In accordance with the State Leadership Accountability Act (SLAA), the High-Speed Rail Authority submits this report on the review of our internal control and monitoring systems for the biennial period ending December 31, 2017.

Should you have any questions please contact Russell Fong, Chief Financial Officer, at (916) 431-2929, Russell.fong@hsr.ca.gov.

BACKGROUND

The Authority is responsible for planning, designing, building and operation of the first high-speed rail system in the nation. California high-speed rail will connect the mega-regions of the state, contribute to economic development and a cleaner environment, create jobs and preserve agricultural and protected lands. The system will run from San Francisco to the Los Angeles basin in under three hours at speeds capable of over 200 miles per hour. The system will eventually extend to Sacramento and San Diego, totaling 800 miles with up to 24 stations. In addition, the Authority is working with regional partners to implement a state-wide rail modernization plan that will invest billions of dollars in local and regional rail lines to meet the state's 21st century transportation needs.

In November 2008, the voters of California passed Proposition 1A, the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century which provided \$9.95 billion in general obligation bond funds for planning, design and construction of the system. Those funds are to be used in conjunction with \$3.3 billion in federal stimulus funds provided primarily under the American Recovery and Reinvestment Act. In addition, Senate Bill 862 provided an annual appropriation of 25% of the annual Cap and Trade proceeds for planning and construction of the system.

With more than 119-miles of active construction in the Central Valley underway, initial passenger service is planned for high-speed rail between the Silicon Valley and Central Valley.

ONGOING MONITORING

As the head of High-Speed Rail Authority, Brian P. Kelly, Chief Executive Officer, is responsible for the overall establishment and maintenance of the internal control and monitoring systems.

EXECUTIVE MONITORING SPONSOR(S)

The executive monitoring sponsor responsibilities include facilitating and verifying that the High-Speed Rail Authority internal control monitoring practices are implemented and functioning as intended. The responsibilities as the executive monitoring sponsor(s) have been given to:

Russell Fong, Chief Financial Officer.

MONITORING ACTIVITIES

The Authority has deployed a performance process utilizing performance criteria from the National Institute of Standards and Technology. The Authority Quality Management Team is trained as performance examiners. The Quality Management Team has a work plan that involves engaging each functional area over the course of each year to enhance individual performance scores and of the entire high-speed rail program. The Risk Management Team monitors identified risks and reports to the Authority's Board of Directors and the Board's Finance and Audit Committee in public meetings on a regular basis. The Quality Management Team monitors organizational performance with the performance evaluation process and reports annually. Throughout the year, the Quality Management Team engages each functional area to discuss strengths and Opportunities for Development (OFI) to develop action plans.

ADDRESSING VULNERABILITIES

Dashboard metrics support data-driven decisions by managers and for accountability by staff, managers and as an organization. When a dashboard metric changes, the manager is alerted and will address the change in a timely manner. Positive changes are worthy of note for potential continuous improvements and best practices. Negative changes are worthy of note for investigation, corrective actions, and additional resources. Dashboard metrics are the primary topics for management meetings and support effective and timely reporting. Dashboard metrics are reported to all levels of the organization and broad availability of the data supports accountability.

COMMUNICATION

The performance evaluation process involves meeting with the integrated functional area teams facilitated by the Quality Management Team to develop a response to performance excellence criteria of the National Institute of Standards and Technology (NIST). The Quality Management Team scores the responses according to the NIST methodology and compiles all scores into an annual Performance Evaluation Report. The identified risks are incorporated into the discussion to ensure that results are achieved, lessons are learned and improvements are made when necessary. The NIST performance criteria are focused on results and effective metrics. As metrics are developed by each functional area, they will be added to an organizational dashboard for display.

ONGOING MONITORING COMPLIANCE

The High-Speed Rail Authority is in the process of implementing and documenting the ongoing monitoring processes as outlined in the monitoring requirements of California Government Code sections 13400-13407. These processes include reviews, evaluations, and improvements to the High-Speed Rail Authority systems of controls and monitoring.

RISK ASSESSMENT PROCESS

The following personnel were involved in the High-Speed Rail Authority risk assessment process: Executive Management.

RISK IDENTIFICATION

Management performed an organization-wide risk assessment, with the assistance of the Authority's Audit Office, to identify potential issues that might impede the Authority's progress in achieving its goals and mission.

Executive management held a brainstorming session to discuss the risk assessment process. Individual interviews were conducted with executive management to identify administrative risks that face the Authority. The Audit Office grouped risks together based on areas of focus.

The risk assessment performed by executive management was focused on administrative risks. Program and project risk assessment is performed by the Risk Management and Project Controls Office. The Authority has a robust Risk Management Program, which provides the Authority with a formal, systematic approach to identifying, assessing, evaluating, documenting and managing risks that could jeopardize the success of construction, organizational, stakeholder, budget and schedule risk, or any other potential inability to deliver the required results. The Risk Management Program's objectives are to:

- Systematize the process by which the Authority responds to circumstances that could increase the cost or significantly delay or halt the Program,
- Increase transparency regarding challenges to project plans and objectives,
- Capture project opportunities,
- Satisfy legal and regulatory requirements and meet the needs and expectations of other stakeholders, and
- Rationalize allocation of resources including cost and schedule contingencies.

RISK RANKING

The risks identified were evaluated by executive management as to their potential impact and the probability of occurrence. Based on the risk evaluation, current risk levels were assigned to each risk in order to prioritize the allocation of resources, ensure the mitigation of the highest risks and identify those risks that are outside of management's control. A meeting was held with executive management to obtain additional detail on the high-impact and high-probability risks identified.

The High-High list was discussed at the weekly Executive Leadership Meeting and a recommendation for advancing three of the risks was presented to the Executive Committee for final review. The Executive Committee concurred with the recommendation. The Board established an Executive Committee to act as a core leadership group such time as a permanent CEO is announced. The Executive Committee consists of Interim CEO Tom Fellenz, Chief Operating Officer (currently vacant), Chief Financial Officer Russ Fong and Chief Program Officer Roy Hill. The Executive Committee will ensure that the organization continues to move forward, establishes a clear sense of roles and responsibilities within the Authority, and maintains focus on the job at hand.

RISKS AND CONTROLS

RISK: OPERATIONS -EXTERNAL-SERVICE PROVIDER—INTERNAL CONTROL SYSTEM ADEQUACY

Contract management of staff augmentation type-contracts was identified as a risk to the Authority due to the potential for a lack of clearly defined roles and responsibilities and detailed deliverables.

Insufficient contract manager training and a lack of formalized policies and procedures are contributing factors.

This can result in the Authority not receiving efficient service from its contractors, confusion over roles and responsibilities reducing accountability, and potentially deliverables not being sufficient to achieve Authority objectives.

CONTROL A

The Authority implemented a Contract Administration Branch (CAB) to provide governance, develop Policies and procedures, in addition a Contract Management Support Unit (CMSU) and Contract Administration Support Unit (CASU) were also implemented to develop training, monitor compliance, provide support contract managers, mitigate risk and support Authority objectives. Nine Policies and Procedures have been developed. The formalized policies and procedures are the guidelines for contract managers in which roles and responsibilities are clearly identified. Additionally, the Contract Management Support Unit (CMSU) actively works with contract managers through training, contract manager forums and online support. All Authority contract managers have signed a formal acknowledgement that they understand and will adhere to all policies and procedures and roles and responsibilities.

CONTROL B

Through training and monitoring which is conducted weekly, the Authority proactively tracks and manages participation and performance metrics which is reported in both weekly leadership and executive staff meetings.

Training Modules:

- Document Management
- Invoicing and Payment
- Deliverables Management
- Risk, Change & Claims Management

Performance Monitoring and Contract Compliance

CONTROL C

The Authority implemented a Contract Administration Support Unit (CASU) to assist contract managers with the day to day administrative functions to increase overall efficiency by allowing the contract managers to focus on managing the intent of the contract and control scope, cost and schedule.

RISK: OPERATIONS -INTERNAL-ORGANIZATIONAL STRUCTURE

Lack of internal governance was identified as a risk.

This is caused by the rate at which the Authority has expanded in recent years.

It results in unclear decision-making processes that affect the efficiency of the Authority.

CONTROL A

The Authority has developed a committee structure to support efficient and effective decision making to reduce the risk. The committees and their interfaces are described below:

The Executive Committee makes key decisions, provides direction to staff, and prepares recommendations to the Board on all issues related to managing the High-Speed Rail Program.

The Program Delivery Committee is the forum for decision making for the integrated program team regarding proposals that impact the program baseline (scope, schedule, and budget). Proposals that are approved by the Program Delivery Committee move to the Business Oversight Committee for consideration.

The Business Oversight Committee is a forum for decision making on proposals that impact the program from a financial and commercial perspective. Only approved proposals from the Program Delivery Committee will be brought before the Business Oversight Committee. Only items approved by the Business Oversight Committee will be presented as recommendations to the Board of Directors.

RISK: OPERATIONS -EXTERNAL-POLITICAL, REPUTATION, MEDIA

Lack of external outreach and communications to the public about the status of the high-speed rail program was identified as a risk to the Authority.

This is caused by the rate in which the program has progressed and expanded over the years.

It results in lack of information for the public about the progress and benefits of the high-speed rail program.

CONTROL A

Over the last several months, the Authority has taken several steps to expand external outreach and communications to the public about the status of the high-speed rail program. They include:

- Establishment of External Affairs Office and appointment of a Deputy Director of External Affairs to develop and implement a comprehensive stakeholder outreach campaign to build broad support for the high-speed rail program and strengthening relationships with the communities surrounding the project's alignment.
- Launch of BuildHSR.com, a new interactive website.
- Distribution of a monthly construction report that provides the media, elected officials, external stakeholders and the public with the latest visuals and statistics.
- Increased social media presence that includes photos, videos and first-hand stories.
- Expansion of the speaker's bureau which provides high-speed rail staff to speak with groups, organizations, associations, etc.
- Inaugurated monthly and quarterly electronic newsletter updates to the media, elected officials, external stakeholders and the public that provide the latest information.

CONCLUSION

The High-Speed Rail Authority strives to reduce the risks inherent in our work and accepts the responsibility to continuously improve by addressing newly recognized risks and revising controls to prevent those risks from happening. I certify our internal control and monitoring systems are adequate to identify and address current and potential risks facing the organization.

Brian P. Kelly, Chief Executive Officer

CC: California Legislature [Senate (2), Assembly (1)]
California State Auditor
California State Library
California State Controller
Director of California Department of Finance
Secretary of California Government Operations Agency