

Elaine M. Howle
State Auditor
Doug Cordiner
Chief Deputy

CALIFORNIA STATE AUDITOR

Bureau of State Audits

555 Capitol Mall, Suite 300

Sacramento, CA 95814

916.445.0255

916.327.0019 fax

www.bsa.ca.gov

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The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

This letter report provides an update on recent events related to the Financial Information System for California (FI\$Cal) project. Pursuant to Government Code, Section 15849.22(e), the State Auditor's Office (state auditor) is required to independently monitor the FI\$Cal project throughout its development, as deemed appropriate by the state auditor. The independent monitoring shall include, but is not limited to, monitoring the contracts for independent project oversight (IPO) and independent verification and validation (IV&V) services; assessing whether concerns about the project raised by the IPO and IV&V contractors are appropriately addressed by the FI\$Cal steering committee and the FI\$Cal project office within the Department of Finance or its successor entity; and assessing whether the FI\$Cal project is progressing timely and within budget. This report is the fifth report we have issued since we began monitoring the FI\$Cal project in 2007.

Government Code, Section 15849.22(e)(2), requires that the state auditor report on the status of the FI\$Cal project at least annually before January 10. Accordingly, we are providing this summary of the events that have occurred since our last status update dated January 7, 2010. In that update, we summarized certain events including the project's awarding of a \$1.3 million contract to Cambria Solutions, Inc. for the purpose of documenting the current business processes and systems of 44 state entities in preparation for the "fit-gap" analysis phase of the project.¹ Since that time, the project moved forward on its plans to obtain three fit-gap vendors and, in June 2010, awarded the fit-gap contracts to Accenture plc, CGI Group, Inc., and International Business Machines Corporation. This letter report provides updates on our oversight activities, the status of the project's long-term funding strategy, the project's challenges in recruiting and retaining key staff, and revisions to the project's governance model. In addition, we discuss trailer bill language that requires the project to examine and report to the Legislature on the costs and benefits of alternative approaches to the implementation of FI\$Cal.

State Auditor's Monitoring and Project Oversight Activities

As part of our monitoring activities, we continue to attend monthly oversight meetings, steering committee meetings, and the newly established steering committee executive working group meetings, which we will discuss in a later section of this letter report. As we pointed out in our October 2009 status update, the Office of the State Chief Information Officer (OCIO)² took on the responsibility of contracting for a consultant to perform the IV&V services for the FI\$Cal project and engaged Eclipse Solutions for this purpose. Although its contract with Eclipse Solutions ended December 31, 2010, the OCIO again selected Eclipse Solutions to perform the IV&V services through calendar year 2011.

¹ The purpose of the "fit-gap" analysis was to have three bidders develop detailed technical and cost proposals for the project, which will become the basis for software and system integrator bids.

² Chapter 404, Statutes of 2010, which became effective January 1, 2011, renames the Office of the State Chief Information Officer as the California Technology Agency and the position of the State's chief information officer as the Secretary of California Technology.

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In our last two status updates, we also communicated a concern about the OCIO's plan to provide the IPO services for the project even though the State's chief information officer (CIO) serves as a voting member of the project's steering committee.³ We were concerned that this arrangement—the OCIO providing the IPO services and the CIO being a voting member of the steering committee—might, either in fact or appearance, create a conflict that undermines the purpose of the IPO, which is to provide an independent, unbiased perspective. Ultimately, the OCIO implemented this arrangement and hired an employee to perform the IPO services. As of this date, we have identified no actual conflicts or compromises in the integrity of the IPO services, despite our ongoing concerns.

The Project Is Still Considering Its Long-Term Funding Options

In our last two status updates, we reported our concern about the fact that the FI\$Cal project lost its source of long-term funding and that it was exploring various other funding options. In its second Special Project Report (SPR) issued in November 2007, the cost of the project was estimated to be approximately \$1.6 billion spread over 12 years. The project did not update this estimate in its third SPR released in November 2009. Instead, according to the third SPR, the project planned to re-estimate its overall costs and to address its long-term funding and financing plans in the fourth SPR. The FI\$Cal project indicated that it will complete a fourth SPR and, as required by a trailer bill to the Budget Act of 2010, submit a written report to the Legislature on its selection of the winning system integrator before it awards the contract. Based on the project's last schedule, which we discuss in a later section, the SPR and the legislative report would be due in 2011. Thus, until the project completes its fourth SPR, the total cost of the project and the long-term funding solutions are uncertain.

As we explained in greater detail in our October 2009 status update, originally, trailer bill language to the Budget Act of 2008 allowed FI\$Cal to sell bonds to finance the project. However, the FI\$Cal project indicated that because of the State's economic situation and a law that prohibits the use of bonds to finance a budget deficit, it determined that it could not rely on the sale of bonds to fund the project as it had initially planned. The project used some of the remaining funds from a \$38 million State General Fund loan it received in fiscal year 2008–09 to fund the \$12.2 million it reported spending during fiscal year 2009–10. For fiscal year 2010–11, the project estimates it will spend \$42.6 million, which includes the costs associated with the three fit-gap vendors. To fund these expenditures, the project is continuing to use \$19.2 million remaining from the fiscal year 2008–09 loan. In addition, it received an appropriation of \$16 million from the General Fund and \$7.4 million from various special and nongovernmental cost funds to support the remaining expenditures not covered by the loan.

Although the project believed it could not rely on bonds as a source of funds, a budget trailer bill for fiscal year 2010–11 continued to include language authorizing the project to issue bonds. In fact, the project is working with the Department of Finance to identify other avenues that might allow it to use

³ The State's CIO has since taken a position with the federal government. Thus, the former governor appointed an acting CIO, who has been sending a designee to attend the steering committee meetings.

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bond funds to pay for FI\$Cal, while at the same time avoiding a conflict with the law that prohibits the use of bonds to finance a budget deficit. In addition, the project anticipates that the federal government will approve a request to recover some of its planning costs through the Statewide Cost Allocation Plan, which distributes the State's central services costs to departments and to work performed under federal grants and contracts. Thus, if it receives this approval, it appears that the federal government will participate in the planning costs of the project moving forward.

As another possible financing alternative, the project reported that it is coordinating with the Department of Finance's legal counsel to negotiate with the California Infrastructure and Economic Development Bank—also known as the I-Bank—to determine the extent to which the project may obtain loans from the I-Bank as a means to help address its funding needs. The I-Bank is a state agency that generally provides financing to public agencies, nonprofit organizations, and other eligible entities for public infrastructure and private development. However, the project indicated that its ability to take advantage of this type of financing would require legislative changes. Finally, the project is also exploring the possibility of using vendor financing as the project works with the three fit-gap vendors. As previously mentioned, the project plans to present its final long-term funding strategy in its fourth SPR.

Difficulties in Hiring and the Loss of Key Staff Could Delay the Project

As was also mentioned in our last two status updates, because of the uncertainty surrounding its future funding, we are concerned that the FI\$Cal project may have difficulty attracting and retaining qualified staff. In various steering committee meetings we have recently attended, project representatives have reported having difficulty hiring and retaining enough staff to perform the project's scheduled tasks. For example, the project reported that its annual staff turnover rate is currently approaching 30 percent and, as of December 15, 2010, 75 full-time positions of a total 165 full-time budgeted positions (45 percent) were vacant.

Although the project has identified some factors that contributed to the difficulties in hiring and retaining staff, the project recently reported that the former governor's hiring freeze has exacerbated the project's staffing problem. Specifically, the former governor issued a directive dated August 31, 2010, to all state agencies and departments to cease hiring, which included the FI\$Cal project. The project indicated that it requested an exemption from the hiring freeze and, in October 2010, was granted an exemption to recruit for certain key positions, including the hiring of a new project director. However, the project reported that the hiring freeze has already negatively affected its schedule. As of December 31, 2010, the project is still in the process of determining how much the delay in hiring staff will affect the project's ability to meet the completion dates shown in the text box.

Completion Dates for Major Milestones*

<u>Milestone</u>	<u>Completion Date</u>
Fit-Gap	January 2011
Special Project Report	August 2011
Award Contract	September 2011

*The project provided a schedule containing the above dates to the steering committee on October 20, 2010, along with the following note: This schedule summary does not include the impact of the governor's directive issued on August 31, 2010.

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Moreover, the project recently lost several staff in key positions including the project director, a deputy director, and, most recently, the project executive. The FI\$Cal project executive resigned in mid-December 2010 after holding the position for more than two years. In early December 2010 the deputy director of the Project Management Office also announced he would be leaving the project. Only three months earlier, in September 2010, the project director resigned after serving in that position for 16 months. The loss of the project director will create a challenge for the project to hire an individual that has the combination of technical and business experience to deal with a project of this size, complexity, and scope. At this time, the project has appointed the deputy director of its business team as interim project director until it can fill the position. The project recently issued exam bulletins for both the project director and project executive positions, which contained final filing dates of December 10, 2010, for the project director's position and a final filing date of December 28, 2010, for the project executive position. Additionally, the project issued a bulletin advertising the deputy director's position indicating that it will accept applications until the position is filled. The OCIO staff performing the IPO services reported that the challenges the project faces due to the hiring freeze and the lack of a permanent project director could result in project delays if these issues are not resolved soon. This loss of the day-to-day leadership in such a short period of time is a concern, raising issues of continuity and consistency of the vision for and execution of the project.

The Project Has Implemented a New Governance Model

In October 2010 the steering committee approved a new governance model that included creating a new steering committee executive working group (working group). Additionally, the project is continuing to work on a decision matrix that assigns certain decision-making authority to various stakeholders or groups, such as the steering committee, the change control board, the project executive, and the project director. Both the former project executive and former project director were concerned that the decision-making structure, as it existed, could result in schedule delays when the project needed to quickly make significant decisions, but stakeholders were unable to reach a consensus. The IPO and IV&V reiterated this concern in their oversight reports. Ultimately, under the new governance model, the steering committee intends decisions to be made at the lowest level possible to ensure that decision-making involving critical issues does not impede the project's progress toward successful implementation.

As part of the change in the governance structure, the project established a new working group that plans to meet monthly. The working group is composed of the steering committee members, including the project sponsor, the designees representing the CIO, and those representing the State Controller's Office, the State Treasurer's Office, and the Department of General Services. Additionally, once the positions are filled, the project executive and project director will attend the monthly working group meetings as support and representatives from the State Auditor's Office and the Legislative Analyst's Office will attend as observers.⁴ The working group agreed that its primary role is to be an action-oriented, decision-making group whose purpose is to keep controversial issues within the project from materially

⁴ Currently, the interim project director is attending the monthly working group meetings.

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impeding progress toward successful implementation. The working group meetings differ from the steering committee meetings in that they do not include all of the participants who typically attend the steering committee meetings, such as the partner business executives from each of the partner agencies and various FI\$Cal staff. Further, the project sponsor indicated that he intends the working group meetings to provide a place for the project executives to talk freely and openly about emerging project risks and problems before they are ready to be formally presented to the steering committee.

The Project Is Considering a Scaled Down FI\$Cal Option

In May 2010 the Legislative Analyst's Office issued a report on the FI\$Cal project that recommended the project require the fit-gap vendors to develop, in addition to a plan for a fully functional system, a scaled-back plan for the project. As such, trailer bill language to the Budget Act of 2010 required the project to examine and report to the Legislature on the costs and benefits of alternative approaches to the implementation of the FI\$Cal system, including, but not limited to, a scaled back version of the system. The project indicated that it has requested the fit-gap vendors' assistance in identifying alternative approaches. The vendors are scheduled to present their analyses to FI\$Cal on February 4, 2011.

We will continue to monitor and report on these topics in addition to others that come to our attention, at a minimum, before January 10 each year.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor