AGENDA

JOINT HEARING

ASSEMBLY BUDGET SUBCOMMITTEES NO. 4 ON STATE ADMINISTRATION

AND

NO. 5 ON TRANSPORTATION

ASSEMBLYMEMBER JUAN ARAMBULA, CHAIR
ASSEMBLYMEMBER BOB BLUMENFIELD, CHAIR

TUESDAY, MAY 12, 2009

STATE CAPITOL, ROOM 447
1:30 P.M.

VOTE ONLY

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VOTE ONLY ITEM

0750 OFFICE OF THE LIEUTENANT GOVERNOR

ISSUE 1: FUNDING FOR THE OFFICE OF THE LIEUTENANT GOVERNOR

BACKGROUND

The Governor vetoed the budget for the Lieutenant Governor's Office from $2.778 million to $1.044 million a reduction of $1.734 million or 62.4 percent. The budgets of other Constitutional Officers were also reduced, but the reductions were far less severe. The Department of Justice and the State Controller's Office were vetoed by an amount equal to 10 percent of their department personal services budget.

STAFF COMMENT

The vote-only action below would restore the Lieutenant Governor's budget to the previously-budgeted level, minus a 10 percent reduction to personal services. This reduction is the equivalent to the reduction level made to the Department of Justice and the State Controller's Office.

Vote-Only Action: Appropriate and additional $1.511 million for the Lieutenant Governor's budget

ITEMS TO BE HEARD

ITEM 0840 STATE CONTROLLER

ISSUE 1: 21ST CENTURY PROJECT—PICKING UP THE PIECES

The 21st Century Project is a major information technology project to develop and implement an integrated human resource management system to replace the state's existing payroll and benefits, employment history, position management, and leave accounting system. The project dates back to 2004, when the State Controller's Office (SCO) initiated a Business Case Benefits Study for replacement and integration of the state's human resources information systems.
In 2005, the Legislature approved the project with an estimated total cost of $130 million. However, the state recently terminated the contract of the primary vendor (the system integrator), and the project will be undergoing evaluation and analysis to determine how much of the prior work can be salvaged and the best way to proceed forward.

Placeholder Funding in Budget. The Governor's proposal for the 21st Century Project in 2009–10, which was included in the 2009 Budget Act, funds 80 one–year limited–term positions and $9.6 million (General Fund). This serves as a placeholder. The Department of Finance (DOF) indicates that it will submit a revised request in the May Revision.

History

Two–Phase Procurement. The SCO decided to pursue a two–phase or "unbundled" procurement approach. This meant the state would be looking for two vendors and undertaking two procurements. The first vendor would supply the software package (SAP was selected, and remains the software vendor), and the second vendor (the *primary* vendor) would integrate the software to the state's specific business requirements. BearingPoint was selected as the system integrator, partly on the basis of a bid that was lower than SCO had anticipated.

Early Problems Delayed Project Development. During 2006 and 2007, SCO experienced multiple problems with BearingPoint. The vendor asserted that issues with the software package and with SCO were the primary reasons for delays. Eventually, SCO issued the vendor a breach of contract notice in October 2007 after multiple schedule delays. After discussions, the vendor and SCO reached a plan to address project failures and work continued. These delays extended the planned schedule by two years and raised total costs to about $180 million.

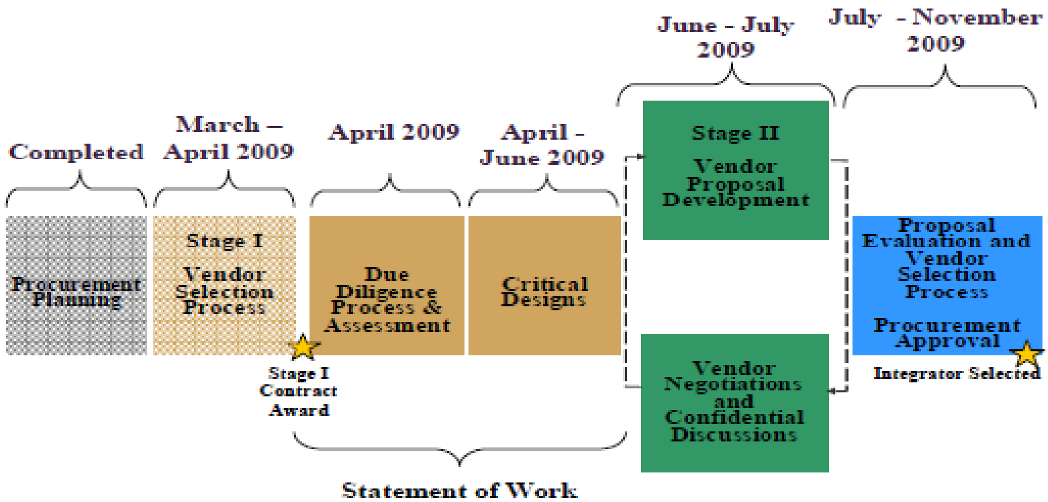
BearingPoint Contract Terminated. After several months, the vendor again fell behind schedule and failed to complete project activities and provide deliverables on time. With the project schedule and development in jeopardy, the Department of General Services (DGS) issued a default notice to the vendor on December 3, 2008. The notice stated that the vendor failed to (1) properly manage the project, (2) complete designs in a timely manner, and (3) make progress toward development. The vendor was given 30 days to respond and address the default but failed to do so. On January 6, 2009, SCO formally terminated the vendor from the contract and system integration work on the 21st Century project stopped. Currently, the vendor is in bankruptcy proceedings and considering suing the state—arguing the state has terminated the contract for "convenience," rather than good cause.

Project Expenditures. SCO has indicated that the state had spent about $70 million on project development, $25 million of which were primary vendor costs. The total amount expended constitutes nearly 40 percent of the estimated total cost for the project. However, SCO also indicates that significant amounts of past encumbrances are available for reversion--$20.6 million from 2007-08 and an about $7.5 million in 2008-09—and these savings have not yet been reflected in the budget.

Going Forward

SCO Re-Procurement Plan. SCO is in the process of selecting two contractors who will enter into a two stage process culminating with the selection of one of the contractors as the new system integrator. In Stage I the two contractors each review and evaluate project artifacts (work done by BearingPoint), including critical designs and implementation approaches. During Stage II, contractors will develop and submit a final proposal, based on the due diligence performed under the Stage I contracts. Stage II will result in a single contract award to complete the project solution for the civil service employee population. Only those Bidders selected for contract award in Stage I are eligible to participate in Stage II. Negotiations will be held in Stage II, if necessary, with the Bidders to arrive at their final proposed solution and cost for the Stage II contract.

A schematic of this procurement process and timeline is shown below:



LAO Options for Legislative Consideration

LAO notes that the project has terminated its contract with the primary vendor and has expended about $70 million with few tangible deliverables to show for this. Given the problems the project has faced and the money that has been expended thus far, the Legislature may feel that continuing the project would be "throwing good money after bad." However, the Legislature must also weigh the state's need for an updated human resources management system. Below, LAO presents options that the Legislature could pursue, including halting the project, pursuing SCO's current plan, and restarting software integration from the beginning.

Halting the Project Not Advised. Halting the project would lead to immediate General Fund savings. However, the state's need for an updated and integrated human resources management system would be unmet. Additionally, several IT projects are depending on 21st Century implementation for aspects of their own development. For example, the Business Information System (BIS), currently being rolled out by California Department of Corrections and Rehabilitation, planned to interface with 21st Century to handle its human resource management needs. Due to SCO's delays, BIS now requires an interim solution and is planning around 21st Century for the short–term. Total project costs for BIS have increased. Other IT projects planning to interface with 21st Century could incur increased costs as well.

Concerns With SCO Approach. As described above, the SCO proposes to have a new vendor finish configuration of the software package partially completed by the prior vendor. We find this option holds potentially large risks for the project. There may not be enough vendors interested in or, more importantly, able to complete this project. A lack of vendors could lead to a situation where there are no competitive bids and could drive up the cost of the bid. Vendors may only be interested in submitting a bid if the state guarantees or holds harmless the new vendor for any bugs in the work already completed. Such a guarantee could also be costly and drive up state costs. Accountability issues could arise if the new vendor points to the original vendor as the cause of future failures in the system. This could create further delays and/or lead to litigation.

California has no track record of a vendor successfully completing an IT project begun by another vendor. Though this does not mean it cannot be done successfully, the fact that it has not been done points to the difficulty of such an approach.

Clean Start on Software Configuration. Given the potential risks noted above, it may be more prudent to look for a new system integrator to begin configuration from the start. While the SCO approach could attract only a small number of qualified vendors, more vendors would likely be interested in a new integration contract when they would not need to rely on the partial work of the failed vendor. A bigger pool of vendors would lead to increased competition for the bid, ultimately giving the state more flexibility to choose a quality vendor and possibly bringing down the total vendor costs as well. Although this approach is less risky, it would probably cost more since the work of the initial vendor has to be redone.

LAO Approach: Require Project to Submit Cost–Benefit Analysis. Given that project staff cannot immediately assess the quality and value of the work completed by the first vendor, we recommend that the Legislature require the project to conduct a detailed cost–benefit analysis of two approaches: (1) hiring a vendor to complete configuration work of the first vendor or (2) starting configuration work from the beginning. This analysis should be part of a special project report available for discussion at budget hearings no later than May 1, 2009.

COMMENTS

1. SCO should update the Subcommittee on project expenditures and savings through 2008-09.

2. SCO should explain exactly where it is in the re-procurement process.

3. LAO should summarize their view of the SCO's approach and any recommendations for legislative action in light of that approach.

4. DOF and SCO should inform the Subcommittee about their plans for a May Revision budget proposal.

5. SCO indicates that one problem that led to the failure of the previous project approach was that too much reliance was place on the system integrator, and state staff were not involved closely enough in managing the project to detect and resolve the problems that were occurring at an early enough stage and to ensure that actions to resolve problems really were taking place. SCO indicates that it has put together a more expert team, with broader experience, to evaluate this procurement. However, staff notes that the evaluation committee will all be SCO employees or SCO contract staff. While other agencies are on the project steering committee, it may be helpful to include several experts on the evaluation committee who do not report to the SCO in order to better ensure objectivity, as well as perspective.

Staff Recommendation: Informational, pending May Revision.

ITEM 9655 STATEWIDE ACCOUNTS RECEIVABLE MANAGEMENT ENHANCEMENTS

ISSUE 1: IMPLEMENTATION OF NEW PROGRAM

This is a new budget item that is included in the 2009 Budget Act-10 budget to provide centralized budget authority for statewide accounts-receivable management enhancements. Accounts Receivable (AR) are outstanding obligations owed to the State including taxes, fees, penalties and other payments. The new funding in the budget is $8.3 million ($3.3 million General Fund) and the Department of Finance (DOF) estimates the gross revenue gain at $32.5 million ($13.8 million General Fund). The budget funding in this item supports two efforts: (1) $197,000 for two new positions (two-year limited-term) at the State Controllers Office (SCO) to centrally track statewide AR and (2) $8.1 million to pay for private collection agency fees or departmental costs for collections work. This proposal would affect both revenue and non-revenue departments – i.e., it would affect the Board of Equalization (BOE) and the Franchise Tax Board (FTB), but also departments such as the Department of Motor Vehicles, the California Highway Patrol, and the State Lands Commission.

Trailer Bill Action Needed. Although the 2009 Budget Act included funding for this item, bull implementation also requires the adoption of statutory changes in trailer bill language.

Administration Accounts Receivable Proposal for 2009-10. The AR proposal includes the following main components:

1. Establish 2.0 new limited-term positions at the SCO and $197,000 to collect and analyze AR data from departments and to periodically report on the results of this effort for policy considerations and for management action.

2. Establish a new mechanism to pay for private collection agencies fees, which could generate a net gain of up to $19.8 million (up to $7.8 million General Fund).

3. Establish general statutory authority to allow all departments to charge a fee for their costs of collecting delinquent ARs, potentially increasing revenues up to $1.4 million. Amend existing statute to allow the Board of Equalization (BOE) to add the contingency fee for in-state private collection agencies' fees to tax liabilities, potentially increasing revenues up to $3.2 million.

4. Revise statute to increase the size of ARs departments can internally discharge from $250 to $500.

Current Practice. The State Administrative Manual (SAM) provides direction to departments for collection of ARs. Departments are generally directed to send three letters in an attempt to collect ARs and then can turn the debt over for collection by private collection agencies. However, the tax agencies have additional powers and employ more extensive collection efforts. Initial surveys by the Administration indicate that over $6.3 billion in ARs are outstanding. Few departments, only 9 out of 40 in a recent review, use private collections agencies. For those that do use private collectors, collection rates range from 1 percent to 40 percent. Under current practice, private collectors receive a share of any collections – the Administration indicates it would explore another option of the sale of ARs, such that the purchaser assumes all risk of collection, but keeps 100 percent of debt collected.

Another option for some departments is to turn over non-tax collections to the Franchise Tax Board. Statute defines certain non-tax collection activity for FTB such as collection of child support and court-ordered debt. Departments can also turn debts over to FTB, and if the debtor has a tax refund due, the refund is instead redirected to debt payment.

Problems with Current Practice. The four components of the request (listed above) seek to address the following issues:

1. Centralized data on department ARs is not compiled – records are only kept at the department level. This hampers transparency, but also reduces the opportunity of the state to package and sell ARs.

2. No flexible mechanism exists to pay private collectors when they are successful in collecting ARs – departments must fund this out of their base budget or request additional funds through the annual budget process.

3. No general statutory authority exists for departments to charge a fee for the cost of collection for delinquent ARs.

4. Current statue limits the amount that departments can internally discharge (or drop from the books as uncollectible) to $250. The Administration argues this should be increase to $500 to focus department efforts on more cost-effective AR collection.

Recent SCO Audit Report. In April, the SCO released audit findings that indicate that three state agencies-- the Highway Patrol, the Public Utilities Commission, and the Department of Industrial Relations—fail to give high priority to collecting fines and penalties and that tens of millions of dollars have gone uncollected.

COMMENTS

DOF should present this proposal to the Subcommittee. The BOE and FTB should comment on this proposal relative to their collection experience and explain how this proposal might affect their work. Additionally, the Administration should speak to the use of private collectors, versus the option of State staff, such as additional positions at FTB.

Since existing statute allows for use of private collections agencies in most cases, this proposal seems to more facilitate existing departmental use of private collections agencies, than to chart a new direction in state policy. At the same time, it would be helpful to understand the cost and effectiveness of private collectors versus state employees, and the Administration indicated no such analysis has been performed.

The Subcommittee may wish to adopt placeholder trailer bill language and reporting language to ensure that the results of this effort are tracked and reported to the legislature.

Staff Recommendation: Adopt placeholder language (Trailer Bill and reporting language)

8880 FI$CAL

ISSUE 1: FI$CAL

BACKGROUND

The Financial Information System for California (FI$Cal Project) is an automation project to replace the State's existing budgeting, accounting, and procurement computer systems with a state-of-the-art Enterprise Resource Planning (ERP) system. The project is sponsored by collaboration of the Department of Finance, the State Controller's Office, the State Treasurer's Office, and the Department of General Services.

The new ERP system is intended to have the following benefits to the State:

- Standardizes and streamlines government operations and gives managers, end-users, and stakeholder's access to timely and accurate information.
- Standardizes and modernizes technology, which will reduce the wide variety of programming languages, tools, and databases used in the state.
- Increases transparency to provide a better basis for decision making and knowledge sharing to the public and the state's business partners. Utilizes best practices for handling and processing data
- Increases fiscal accountability and control at all levels of an organization, including statewide.

FI$Cal is governed by a steering committee that is in the process of developing the procurement and implementation strategy. Although no final commitment has been made, the discussion have focused on using a two-stage procurement for awarding the contract for the FI$Cal project to a vendor. The first step would be to select and retain two firms to conduct a fit-gap analysis and design. This analysis involves the two vendors evaluating software solutions and developing a project plan and cost estimate for FI$Cal. After the fit gap analysis is completed by both vendors, the state would then award the final contract to one of the two proposals. The fit gap analysis would be conducted in 2010, with the state awarding the full contract for FI$Cal in 2011.

FI$CAL BOND FINANCING

The Fiscal Year (FY) 2008-09 budget includes $40 million ($2 million General Fund) and the FY 2009-10 includes $82 million ($2 million General Fund) for the FI$Cal system. These expenses are funded with expected future proceeds of a bond that is expected to be issued to fund the FI$Cal system.

The FI$Cal bonds would be repaid over 10 years, with about 55 percent of the costs recovered by federal and special fund sources.

STAFF COMMENT

Staff has requested that LAO, DOF, and OCIO develop placeholder trailer bill language to requiring the project to report on the outcomes of the fit-gap analysis prior to the award of the final RFP

Staff Recommendation: Adopt Placeholder Trailer Bill Language

0860 BOARD OF EQUALIZATION

ISSUE 1: DATA WAREHOUSE

BACKGROUND

The Board of Equalization will discuss technological changes they have made to improve their ability to identify non-compliant taxpayers. One of these options will be to develop a data warehouse. A data warehouse provides a common data model for all data of interest regardless of the data's source. This makes it easier to report and analyze information than it would be if multiple data models were used to retrieve information. In the case of the BOE, a data warehouse allows the BOE to match its tax records with records from customs and EDD to look for inconsistencies in data that would suggest and underreporting or failure to report taxes.

STAFF COMMENT

Other states have used private companies to construct proprietary data warehouse to identify non-compliant taxpayers.

Staff Recommendation: None. Informational Item