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January 9, 2009 2008-039

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

Dear Governor and Legislative Leaders:

As required by a trailer bill to the Budget Act of 2007 (see Section 65, Chapter 172, Statutes of 2007), the Bureau of State Audits (bureau) took over the administration of the Department of Finance's (Finance) contract for independent oversight of the Financial Information System for California (FI$Cal) project beginning in September 2007. The budget trailer bill, which amended the Budget Act of 2007, required the bureau to monitor the contract, including assessing whether the concerns of the contractor were being addressed, and to periodically report to the Legislature on the contract. It also required Finance to submit to the Legislature, no later than April 1, 2008, a Special Project Report (SPR) for FI$Cal that describes four project alternatives for the Legislature's consideration. Finance completed the SPR several months before the April deadline and, shortly thereafter, we provided a brief status update on our monitoring of the contract to the governor and the Legislature on January 31, 2008.

Since January 2008 we have continued to monitor the contract for independent oversight of the FI$Cal project. In June 2008 the FI$Cal project informed the independent oversight contractor that it was to complete the work that was agreed to for fiscal year 2007–08. The oversight contractor completed its work related to fiscal year 2007–08 activities and was told by the FI$Cal project not to perform any of the work outlined in the contract for the period of July 1, 2008, through September 30, 2008, the end of the contract term, because of uncertainties surrounding the project's budget.

Ultimately, on September 23, 2008, the Legislature and the governor approved the Budget Act of 2008 as well as a supplement to the Budget Act. On September 30, 2008, they also approved a related trailer bill that codified certain aspects of the FI$Cal project and set forth specific duties for various parties including the bureau. All of the relevant bills were urgency statutes and took effect immediately. Thus, pursuant to Government Code, Section 15849.22(f), the bureau is required to independently monitor the FI$Cal project, throughout the development of the FI$Cal system, 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

Steering Committee Membership

Business Title	Role
Staff to the Steering Committee:	FI$Cal Project Director FI$Cal Project Executive
Department of Finance:	
Chief Operating Officer	Project Sponsor
Program Budget Manager	Committee member
Program Budget Manager	Committee member
State Controller's Office:	
Chief Operating Officer	Committee member
Chief Administrative Officer	Committee member
Department of General Services:	
Deputy Director, Procurement Division	Committee member
Deputy Director, Real Estate Services Division	Committee member
State Treasurer's Office:	
Director, Cash Management Division	Committee member
Department of Social Services:*	
Chief Deputy Director	Committee member
Employment Development Department:*	
Deputy Director, Administration	Committee member
Department of Personnel Administration:	
Director	Committee member
Office of the Chief Information Officer:	
State Chief Information Officer	Nonvoting committee member

Sources: FI$Cal Project Charter as of January 11, 2008, and updated information provided by FI$Cal staff.

Note: According to the FI$Cal Project Charter, the steering committee performs a variety of activities that generally provide statewide leadership and support for the project.

*According to the FI$Cal Project Charter, these departments may be rotated through the life of the project.

independent verification and validation (IV&V) services; assessing whether concerns about the project raised by the IPO and IV&V contractors are addressed by the steering committee (see the textbox) and the FI$Cal project office with Finance (or its successor entity); and assessing whether the FI$Cal project is progressing timely and within budget. Additionally, the bureau is required to report on the status of the FI$Cal project at least annually before January 10. Thus, with the completion of the work by the original independent oversight contractor and passage of the fiscal year 2008–09 budget and the related trailer bill, we believe it is appropriate to provide a status update on our monitoring of the completed contract and an update on the activities that have occurred since the budget bills were enacted.

BACKGROUND

During 2005 Finance completed a feasibility study report to formally initiate the Budget Information System (BIS) project, which was to replace Finance's existing legacy budget systems. However, according to Finance, as work proceeded and workshops were held, project stakeholders identified a need to consolidate and modernize other financial business systems of the State, such as the current budgeting and accounting systems, rather than simply developing a statewide budget system. As a result, Finance developed an SPR during 2006 that expanded the scope of the BIS project to more broadly address other financial management areas, such as accounting, financial reporting, and grant and human resources management. The new project was given the name FI$Cal.

In April 2007 Finance awarded a contract to a consultant—Visionary Integration Professionals (VIP)—to provide both IPO and IV&V services for the procurement phase and activities of the FI$Cal project. The contract term extended from April 2007 through September 2008. As part of its contract, VIP was responsible for verifying that project deliverables were satisfied; validating that delivered solutions met the accepted requirements; verifying that the approach and deliverables produced the desired outcomes; and reporting to the project executives and steering committee on the risks and overall project health, including the status of the schedule, cost, scope, and quality. VIP began providing services covering project activities during May and June 2007; however, the contractor's oversight work was suspended pending enactment of the fiscal year 2007–08 budget.

A trailer bill to the Budget Act of 2007 required the project to develop additional planning documents. Specifically, it required Finance to submit to the Legislature by April 1, 2008, an SPR that discussed four project alternatives as shown in the textbox. It also required the SPR to include a plan of funding that evaluated alternative financing options and included the use of special funds and federal funds; the formalization of roles and responsibilities through the execution of a memorandum of understanding by the various control agencies that are the project partners; and a revised project management plan addressing project leadership, succession planning, and vendor accountability through the management of contracts. After the budget trailer bill was enacted, as previously mentioned, the bureau took over the administration of the VIP contract, and in September 2007, authorized VIP to resume providing its oversight services. Subsequently, Finance completed the SPR and, shortly thereafter, we provided a brief status update on our monitoring of the contract to the governor and the Legislature on January 31, 2008.

Four project alternatives as outlined in the Special Project Report (SPR):

- Continuing with the project as proposed and approved in the December 15, 2006, SPR.
- Continuing with the design, development, and implementation of the Budget Information System as described in the Feasibility Study Report dated July 14, 2005.
- Developing and implementing a proof of concept, including the statewide functions of the control agencies and a few select departments.
- Taking no action.

BUREAU CONTRACT MONITORING ACTIVITIES

As part of our monitoring of the contract, we attended weekly oversight meetings, steering committee meetings, and other relevant project meetings that included the VIP consultants and other project stakeholders. We reported in January 2008 that we had attended 17 weekly oversight meetings through mid-January that generally included VIP staff; staff from FI$Cal and

Finance's Office of Technology Review, Oversight, and Security (OTROS)[1], as well as other FI$Cal partner representatives from the State Controller's Office (State Controller) and the Department of General Services (General Services). Since that time through mid-July 2008, we attended an additional 20 oversight meetings. These weekly meetings were used to discuss the project status, any emerging issues, oversight recommendations, and mitigation strategies. We generally observed that these meetings were well attended and that all the parties provided input. In January 2008 we also reported having attended six steering committee meetings and, since then, we have attended another 12 meetings.

We also reported in January 2008 that we had reviewed a number of VIP's deliverables that were required under its contract once it resumed providing services in September 2007. For example, one key deliverable for the IPO services that VIP provided was the monthly independent project oversight report (IPOR). Briefly, the IPOR was typically made up of three components: a project health assessment; an independent risk assessment; and a checklist evaluating project management processes for completeness, adequacy, and consistency. From January 2008 through July 2008, VIP continued to provide monthly IPOR's, generally by the 10th of each month, for the prior month, as required by the contract. The contract also required VIP to provide a quarterly comprehensive status report and a mid-quarter interim status report related to the IV&V services it provided. Essentially, these reports presented findings and observations from a technical standpoint as well as a checklist evaluating the project's performance and documentation. Since January 2008 VIP continued to provide these reports by the established deadlines. Further, based on discussions that took place at oversight meetings we attended, FI$Cal project staff worked to address any concerns that VIP identified in these two types of reports.

In January 2008 we also reported our concern related to the combining of the IPO and IV&V services under the same contract. Originally, Finance had made the decision to combine these services under the same contract, which it awarded to VIP in April 2007, several months before we were charged with taking over the administration of the VIP contract. However, as we reported in January 2008, we believe that these two functions should reside with separate contractors because it is not unusual for the IPO contractor to find fault with the activities of the IV&V contractor on a given project. We believed that the then current contract arrangements could diminish the IPO's ability to be independent regarding the IV&V activities for the FI$Cal project. We also reported that during the early phase of the project, this may not be of as great a concern as it would be later in the FI$Cal project's lifecycle. Currently, according to the FI$Cal project's most recent schedule, the project plans to split the IPO and IV&V services between two

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[1] Chapter 183, Statutes of 2007, which became effective January 1, 2008, requires the Office of the State Chief Information Officer (OCIO) to, among other things, approve and oversee information technology projects and establish and enforce state information technology strategic plans, policies, standards, and enterprise architecture. Thus, OCIO replaced OTROS as one of the oversight entities.

different consultants for the duration of the FI$Cal project as we advocated in our January 2008 status update. The project estimates that it will complete the procurement process for these two contracts by May 2009.

CURRENT STATUS OF THE FI$CAL PROJECT

Over the past year, the FI$Cal project has experienced some delays primarily driven by uncertainties surrounding its approach for procuring vendor services and the project's budget. The SPR that the FI$Cal project completed in December 2007 indicated that the Legislature had specifically requested that it report on its planning and strategy to ensure appropriate and successful management in the area of vendor accountability. As such, FI$Cal reported in the SPR that one of its strategies would be to use a bundled procurement approach, which requires the vendor community to propose a total business-based solution (e.g. software, hardware, design, implementation, knowledge transfer, customer support, and other services). However, in May 2008, during a special meeting of which the bureau was unaware and an executive session of the steering committee to which bureau staff were not invited, the FI$Cal project reevaluated the procurement approach it had proposed in the SPR. According to the FI$Cal project sponsor, the project had inadvertently neglected to invite us to participate in these meetings. As an outcome of these meetings, the FI$Cal project decided for several reasons, including the belief that a bundled procurement might limit competition, to proceed with an unbundled approach. This change in approach meant the project now intended to procure various components of the "bundled" procurement as separate procurements. However, the Legislature was not informed of this proposed change until it received a copy of a letter sent to the Office of the State Chief Information Officer dated June 4, 2008. The FI$Cal project executive later described in greater detail the rationale for this change in approach in a June 14, 2008, letter to the chair of the Senate Budget and Fiscal Review Subcommittee Number 4. The letter's summary for choosing the unbundled approach identified the following:

- *Increases likelihood of selecting the "best" software*—Allows the State to select the "best" software solution to meet the State's business needs.
- *Own the outcome*—the State is more fully vested in the solution.
- *Reduces reliance on a single vendor*—the State retains more control over the solution, non-performing vendors are easier to replace.
- *Allows additional early training*—so staff learns the software and are able to participate more knowledgeably in modernizing the State and configuring the system.
- *Leverage purchasing power*—the State can leverage its purchasing power in two separate procurements and potentially benefit from competition in both the software and service procurement.

Further, FI$Cal's proposed change in its procurement approach was also discussed in a Budget Conference Committee hearing held on June 18, 2008. As a result of concerns raised by the Budget Conference Committee regarding this change, a budget was enacted that significantly reduced the funding for the FI$Cal project from the $39.8 million proposed to the fiscal year 2006–07 baseline of $2.2 million and it required the project to provide an updated SPR to the Legislature that would contain a complete analysis of the business case for, and a thorough risk assessment of, the preferred unbundled procurement approach, including any necessary revisions to the project schedule and cost. However, a supplemental budget bill restored funding to the $39.8 million as proposed for the project, removed the requirement for an updated SPR, and authorized Finance to continue approving and making expenditures in support of FI$Cal until the Legislature establishes a separate Office of the Financial Information System for California. Additionally, a trailer bill codified some of FI$Cal's roles and responsibilities, imposing on the project a number of duties and authorizing the State Public Works Board to initially issue bonds, notes, or certificates of up to $277 million as a means of financing the project, with such additional bonds, notes, or certificates not to exceed $1.36 billion in total financing for the project with subsequent legislative approval.

Subsequent to the passage of the budget act in September 2008 and as part of our role as outlined in the trailer bill to the budget act, we have attended four additional steering committee meetings. During a steering committee meeting held in September 2008 before passage of the budget act, FI$Cal was still moving towards an unbundled procurement approach. Additionally, during the November 5, 2008, steering committee meeting, staff for the FI$Cal project provided a status report on the project indicating that the project's scheduled activities had to shift due to the budget and funding delays and other outstanding issues. The minutes to the meeting indicated that the issues affecting the schedule in addition to the budget delay included a revised procurement schedule for an unbundled procurement, the participation and timing of the review process (stakeholders and partners), and documentation of new requirements that affect the project. However, later in the same November 5th meeting, the project executive revisited the issue of the procurement approach. According to the minutes of this meeting, the project executive indicated that if the project stayed with the unbundled approach, the project's first phase would plan to "go live" in July 2014 because of the need to complete two SPRs and two procurements. On the other hand, according to the project executive, if the project were to return to a bundled approach, the project could meet a July 2013 date because it would require the completion of only one SPR and one procurement. The project executive indicated that he wanted the project to move forward as close to schedule and cost as possible, so he recommended that the project return to the bundled approach. This led to some discussion as to why the FI$Cal project was reversing the earlier decision. Eventually, the project sponsor asked the steering committee members if they were comfortable in proceeding with the idea of the bundled procurement approach and asked that they voice any concerns. Since no concerns were expressed, the project sponsor indicated that the project executive should move forward with the bundled approach and prepare an analysis for review by the steering committee that would provide the foundation for the decision and ensure that the bundled approach is supported.

At the December 2008 steering committee meeting, the FI$Cal project presented its report on "Bundled vs. Unbundled Procurement Approach." The report lays out FI$Cal's reasons for returning to a bundled approach. The report indicates that a key assumption in the decision last May to move to an unbundled procurement approach was that "the Project must stay within the approved project approach, scope, and cost and schedule constraints." In the subsequent months, according to the report, the FI$Cal project determined that the existing state processes coupled with the existing project parameters would impact the project's cost and schedule—it anticipated that the unbundled approach would add at least one year and up to $80 million to the project. Ultimately, the report concludes that, while the benefits of an unbundled procurement cannot be quantified, they do not appear to outweigh the cost and schedule impact, thus, FI$Cal recommends returning to a bundled procurement approach. The report also presents an analysis and assessment of the benefits it previously identified with the unbundled procurement approach that were included in the June 2008 letter to the chair of the Senate Budget and Fiscal Review Subcommittee Number 4. This assessment attempts to explain why certain of these benefits may contain more risks or may not be as advantageous as originally thought and it introduces some additional strategies that the project might employ to improve the outcome of a bundled procurement in those areas where an unbundled approach may be more advantageous. In short, there appear to be advantages, disadvantages, and differing risks associated with both procurement approaches. Going forward, it will be important for the FI$Cal project to continue identifying and implementing strategies to mitigate these risks.

Additionally, according to the FI$Cal project, the late budget together with the actions taken in the budget conference committee significantly delayed the project. More specifically, the SPR identified that the project would be implemented in phases, with the first phase consisting of the implementation of the system within the partner agencies: Finance, General Services, State Controller, and the State Treasurer's Office, in addition to four selected departments and their five client departments. Once this phase is complete, the trailer bill to the Budget Act of 2008 requires FI$Cal to prepare a report to the Legislature on the success, lessons learned, and corrections to be incorporated as a result of the first phase before the Legislature will give its approval for FI$Cal to move to the second phase of the project. According to the SPR, this first phase was scheduled to be completed by the end of fiscal year 2012–13. However, because of the delays mentioned previously, FI$Cal now estimates that the first phase will not be completed until fiscal year 2013–14. Moreover, FI$Cal pointed out that the latest schedule is built around several assumptions that include promptly filling the planned positions needed to complete the work scheduled for the next six months and that a facility is available to house the staff to allow them to perform their work. According to the FI$Cal project executive, the project has been working to select and secure a new facility since spring 2008. He also indicated that, when the project notified the Legislature in October 2008 of its intention to enter into a lease for a site in Rancho Cordova (Zinfandel site), the Joint Legislative Budget Committee and the Legislative Analyst's Office (LAO) raised some concerns about the lease terms based on expected schedule changes and staffing needs. Based on subsequent discussions that occurred during the two steering committee meetings held in December, the FI$Cal project decided to move forward on its plans to house the project at the Zinfandel site. According to the FI$Cal project executive, the project is working with General Services on a lease agreement for the facility and is committed to ensuring that the lease agreement addresses the concerns raised by the Joint Legislative Budget Committee and the LAO.

Finally, according to FI$Cal, the schedule is also somewhat dependent on the results of a review that will be performed by a consultant over the next few months. More specifically, during the November 5, 2008, steering committee meeting, the State's chief information officer proposed that the project bring in a consultant with expertise in consulting on a project of this size and type to perform an assessment of the FI$Cal project's implementation approach. Thus, FI$Cal released a Request for Offer (RFO) on December 5, 2008, which indicated that the services requested through the RFO are to assist the FI$Cal project and the OCIO in reviewing the feasibility of the FI$Cal project organization, objectives, proposed approach, business requirements, and validating that these elements are consistent with proven practices for a large Enterprise Resource Planning system implementation. The RFO indicates that the contractor will comment or make recommendations related to the project's current business objectives and requirements, the project's organization and approach, and its sourcing strategy. It also indicates that the contract will have a duration of approximately six months ending no later than June 30, 2009. Ultimately, FI$Cal awarded the contract in December 2008 to Grant Thornton, LLP. It will be important for the project to quickly react to the feedback obtained from this consultant so the project can move forward more consistently than has occurred over the past year.

Respectfully submitted,

Elaine M. Howle

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