Elaine M. Howle *State Auditor*

January 7, 2021
2020-039

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

Dear Governor and Legislative Leaders:

This letter report follows up on significant concerns raised in our previous assessments on the development and implementation of the Financial Information System for California (FI$Cal). In August 2018, we issued a letter report that discussed how agencies using FI$Cal struggled to submit critical financial reports to the State Controller's Office (State Controller) on time. In December 2019, we issued another letter report, in which we identified several issues with a 2019 project plan update, including a misleading timeline that deferred some development and costs associated with that development until after the project's formal conclusion. This letter report highlights the following concerns with the FI$Cal project and provides an update on the status of recommendations we made in prior reports:

- The project missed its June 2020 completion date despite removing features from the project scope in 2019. The project's governing entities—composed of the steering committee members, the California Department of Technology (CDT), and the Department of FI$Cal (project office), which we discuss in the text box—have issued a project plan update that extends the project timeline by two years, uses a new budget methodology, and reflects a reduced project scope. The budget methodology the governing entities used does not describe the full cost of the project and deviates from the information they presented in previous project plan updates because it excludes certain development costs.
- State agencies using FI$Cal still struggle to complete required financial reports on time. Consequently, the State released its annual audited financial statements months late for the second year in a row. A late release of critical financial information increases the risk to the State of a lower credit rating, which could result in increased costs to taxpayers.

Background on FI$CAL

In 2005 the State initiated an information technology project to develop a comprehensive budget system that would connect to other state financial systems, including the information technology systems used by the State Controller and other departments. In 2006 the State transformed the scope of the project to combine the State's accounting, budgeting, cash management, procurement, and other operations into a single, modernized system. The State subsequently issued a series of project plan updates that further modified the project's scope, schedule, and budget. The most current of these updates, issued in September 2020, extends the project's official end date to June 2022 with a cost of more than $960 million.

Multiple state agencies have roles in developing FI$Cal:

- The steering committee acts as the approval body for key project decisions and includes representatives from the Department of Finance (Finance), the Department of General Services, the State Controller, and the State Treasurer's Office (State Treasurer).
- CDT approves project plan updates and provides oversight on areas such as project governance, time management, and resource management.
- The project office implements, maintains, and operates FI$Cal.

Source: State law, various Special Project Reports, and other department information.

- The project office and CDT have not addressed some of our recommendations to ensure that agencies using FI$Cal produce timely financial reports and to improve oversight and transparency of the project.

The Project Office Missed Its Completion Deadline and Its Updated Plan Extends the Project Schedule, Uses a New Budget Methodology, and Reflects Some Scope Reductions

The project office was unable to complete the project by its June 2020 deadline, further delaying a project that has extended years beyond previous estimates. The governing entities set this deadline in an August 2019 project plan update after the project office missed its July 2019 completion target. However, shortly after approving the new schedule, CDT called the timetable "aggressive" and noted there was little room for error if the project office was to complete the project as planned. We reported in December 2019 that this tight schedule, as well as CDT identifying months of delays in development and testing, posed risks to the project office meeting its new June 2020 deadline.

Development and testing delays led the governing entities to issue a ninth project plan update in September 2020. In that plan, the governing entities estimate a much longer timeline in order to complete the project's remaining tasks. The governing entities now propose to complete the project in June 2022. As Figure 1 shows, the project office has missed many project completion dates and has extended the current completion date by two years. According to the project plan update, extending the project completion date will give the project office one more year to develop FI$Cal and to perform time-intensive tests of system features; specifically, developing and then testing FI$Cal's report production functions for the State Controller's use.

Figure 1
The Project Office Has Missed Many Target Completion Dates for FI$Cal

Source: Analysis of five Special Project Reports: numbers 4, 5, 6, 8, and 9.

Our first concern with the updated project plan is that the reported budget changes the way the project reports its costs and further obscures the real cost of FI$Cal. The project plan update shows that the current total cost for the FI$Cal project is slightly less than $1 billion. However, the total project cost for July 2020 and onward presented in the project plan update includes only estimated costs for the specific project tasks described in the document—development and testing of features that allow the State Controller to transition to FI$Cal—and excludes development costs for other project activities such as implementing features related to bond and loan accounting. The differences in costs due to this exclusion are significant. For example, the 2020 project plan update reports $14 million in project costs for fiscal year 2020–21, whereas the previous project plan budget showed $100 million in the same year. The project plan update does not indicate how the project will save $86 million; rather, it notes only that the project office's $115 million non-project departmental budget will cover costs outside the reported $14 million.

The project office's chief deputy asserted that this method of reporting costs better differentiates the project office's yearly departmental costs from those of the actual work on the project. We agree that this calculation may be useful for determining the cost of work the project office is currently performing to support the State Controller's transition. However, it is incomplete in describing the full cost of the project and deviates from the information previous project plan updates have provided about total project costs. Without complete cost information prepared using consistent methods, the Legislature and other stakeholders lack an important tool for evaluating whether the project is further exceeding its planned expenditures.

We are additionally concerned that the governing entities continue to exclude important tasks from the formal project scope. In our 2019 report, we noted that the 2019 project plan update classified the implementation of certain features—including FI$Cal's ability to produce the State's key financial reports on its own—as a form of system maintenance that the project office would undertake after the project's official end date. The 2020 project plan update continues this trend and reflects that the project office will defer developing several more FI$Cal features, such as automating certain cash transfers for departments, until the maintenance phase. Regardless of progress on deferred tasks, when the items within the formal project scope are finished, the governing entities will be able to declare the project *complete* in 2022. Thus, we remain concerned that the project office will not complete deferred tasks and all promised features promptly, or at all, once the project is declared complete.

The Project Office Should Continue Independent Oversight Through to Project Completion and Promptly Address the Concerns That Oversight Raises

The plan update does budget for independent project oversight, but until the project office issues a contract for continuing oversight, we remain concerned about it maintaining oversight for the duration of the project. The FI$Cal project's oversight includes two principal mechanisms: CDT's reports on the project's status and technical reports a consultant (oversight contractor) prepares. In December 2019, we recommended to the project office that it arrange for both oversight mechanisms to continue until the State Controller publishes the State's annual financial statements exclusively using FI$Cal. The project plan update reflects that the State Controller will finish its transition and produce reports exclusively in FI$Cal in spring 2023 or later and, accordingly, the plan includes an oversight budget through June 2023. However, the oversight contractor's current contract will expire six months earlier, in January 2023. Thus, there is a risk that full project oversight will end before the State Controller is exclusively using FI$Cal. According to the project office's chief deputy, the project office will secure a new contract for technical oversight at a date closer to 2023. We believe that the project office should do so to ensure the oversight contractor will be able to continue to monitor risks to the project while the project office supports the State Controller's final transition. In Appendix A, we summarize the status of our past recommendations the project office and CDT have not yet fully implemented.

In addition to ensuring that oversight continues, the project office should work to promptly address risks that the oversight entities identify. Although the latest project plan update represents a significant time extension to accomplish scheduled work, there is still a risk that the project office will not deliver a quality product by the new deadline. CDT and the oversight contractor released oversight reports in 2020 identifying ongoing difficulties the project office has with addressing risks promptly. For example, CDT reported in January 2020 that the project office was behind in tasks to build, test, and validate all of the remaining project milestones. At that time CDT also found that the project office had trouble managing the project scope including by adding unanticipated features to make FI$Cal usable. The logical result of CDT's finding is that the added tasks are increasing the project staff's remaining work. In its September 2020 report CDT indicated that the project office had not resolved either of these issues. For example, CDT reported that many added features were still in draft or development stages and that in the future the project office may need to add scope to the project. CDT's ongoing concerns indicate that the project office may face difficulties in meeting even its new, extended deadlines.

Similarly, the oversight contractor has repeatedly reported that the project office has not developed adequate processes and requirements for FI$Cal and the State Controller's existing system to run in parallel. The project plan update identifies the parallel operation of these two systems as a key project goal because this operation will allow the State Controller to verify the accuracy of data in FI$Cal and prepare for a final transition to using FI$Cal exclusively. However, as of September 2020, the oversight contractor repeated its finding that the project office lacked processes to ensure that parallel operations run smoothly. The oversight contractor tempered its report by noting that the issue had shown some improvement. For example, the contractor observed improvements in test procedures and related error resolution that allowed staff to more efficiently perform testing tasks. Yet, at the same time, the contractor identified areas where the project office should continue working to improve these processes. Lack of proper processes and procedures could ultimately introduce inefficiencies for State Controller staff as they attempt to reconcile these complex, interconnected systems.

The chief deputy of the project office stated that the project faces inherent risks of delays because of the complicated process to release new features for the State Controller when other departments are already using FI$Cal, and because there are a limited number of knowledgeable State Controller staff available to perform system testing. He also explained that the project office agreed to better communicate to CDT its plans to modify the project's scope and agreed that having robust documentation on running the parallel systems was important. The chief deputy noted that many of the current discrepancies identified when reconciling data between the two systems have to do with system settings such as transactions posting at different times.

It is not uncommon for large projects like FI$Cal to have unforeseen issues or limitations from resource constraints. We are encouraged that the project office acknowledges some of the issues facing the project and the importance of working to resolve them. However, our concern is that CDT and the oversight contractor documented the issues needing correction in multiple oversight reports, and noted that the issues remained outstanding months later. If the project office does not mitigate areas of ongoing risk, recurring issues in development and testing such as those described here may hinder its ability to complete development by project deadlines and support FI$Cal users.

The Transition to FI$Cal Has Caused Delays to Critical State Financial Reporting for the Second Consecutive Year

Agencies transitioning to FI$Cal continue to struggle to produce financial reports on time, a problem that may impact the State's ability to secure low-cost financing for important projects. For the fiscal year 2018–19 reporting cycle, 12 large entities using FI$Cal, including the California Department of Education and the Employment Development Department, did not submit timely reports to the State Controller because they had difficulties with FI$Cal. The departments' late submissions significantly delayed the State Controller's ability to publish the State's annual financial statements for fiscal year 2018–19. The financial statements are typically published by April 1, but in 2020 they were delayed 6 months to October 2020.

Fiscal year 2018–19 is the second reporting cycle in a row in which the State published untimely financial statements. Agencies' difficulties with FI$Cal previously contributed to a two-month delay in the State publishing its financial statements for fiscal year 2017–18. In addition, the number of large agencies that encountered difficulties using FI$Cal increased from one for the 2017–18 cycle to 12 for the 2018–19 cycle as more departments transitioned to FI$Cal. In the past, agencies reported to us that their difficulties with using FI$Cal included user error, insufficient training, and system limitations. For fiscal year 2018–19, agencies continued to report a need for staff training, as well as an unfamiliarity with FI$Cal and its complexity.

Financial reporting delays may ultimately prove costly for the State. Each year the State Controller prepares a comprehensive set of financial statements, which our office audits for accuracy and compliance with accounting standards. In accordance with bond agreements, the State Treasurer typically publishes an annual report by April 1 that includes these audited financial statements. The State's ability to publish accurate and timely financial statements is critical for the State to sustain the trust of financial markets and maintain a high credit rating. A high credit rating helps ensure access to low-interest debt. If the State suffers a downgraded credit rating, it could substantially increase borrowing costs, affecting the State's ability to pay for debt-financed projects such as schools and levees. The State maintaining low borrowing costs may be particularly important in upcoming years, as the Legislative Analyst's Office has projected multiple years of reduced state revenue growth from a potential recession related to COVID-19.

This second year of FI$Cal-related delays occurred despite governing entities reporting in 2019 that the project office was providing support for agencies to finalize their monthly and annual financial reports. Further, the chief deputy of the project office explained that the office is working with Finance and the State Controller to provide dedicated support for the largest agencies, and many of the agencies' issues from 2018–19 were about knowledge gaps and converting data from their old systems. The project office expects these to be less problematic in the future. However, we remain concerned about agencies' late reporting in the future, given that late reports increased over the last two reporting cycles and the project office has acknowledged that some large agencies are still experiencing delays. Multiple years of the State issuing its financial statements late increase the likelihood of a negative effect on future borrowing costs. Thus, the State's ability to use FI$Cal to produce timely financial statements remains a significant concern until agencies are able to submit their reports on schedule.

Agencies' struggles with implementing and using FI$Cal, in addition to ongoing concerns regarding project scope reductions and significant unreported costs, represent significant risk to the State. Thus, in January 2020 our office added the issue of state financial reporting and accountability to our State High Risk List, which documents agencies and issues facing major challenges associated with their efficiency or effectiveness. In our January 2020 High Risk update, Report 2019-601, we concluded that the issues surrounding the FI$Cal project represented increasing impediments to the State's ability to efficiently and accurately report on its finances, and that many of these issues could persist beyond the project's formal completion date. Further, reliable tracking of expenditures is an issue of increasing importance during the COVID-19 pandemic as it helps allow state agencies to take full advantage of federal relief funding. However, as we discussed in our August 2020 update to the State High Risk List, Report 2020-602, agencies' struggles with FI$Cal may impede the State's ability to produce information it needs to satisfy federal funding requirements. Finally, in our October 2020 Internal Controls report, Report 2019-001.1, we noted a material weakness because of a series of deficiencies in FI$Cal's safeguards. Those deficiencies increase the risk that the State may not be able to rely on the financial reports FI$Cal generates. Due to these significant concerns, we will continue to report on issues related to state financial reporting and the FI$Cal project as part of both our State High Risk program and our annual FI$Cal monitoring mandate.

We prepared this report pursuant to Government Code section 11864.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE, CPA
California State Auditor

For questions regarding the contents of this report, please contact
Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

Appendix A

Status of Prior Recommendations

Our August 2018 and December 2019 reports included recommendations to the project office and CDT about improving project transparency and oversight. In December 2019, we reported that the project office and CDT had partially implemented most of the 2018 recommendations. This report is the first update of the one recommendation we made to the project office in our December 2019 report. As the table reflects, the project office and CDT must do more work to implement the recommendations we have made because many remain only partially implemented.

The Project Office and CDT Have Failed to Fully Implement Some Recommendations for More Than Two Years

RECOMMENDATION	JANUARY 2019 ASSESSMENT	DECEMBER 2019 ASSESSMENT	CURRENT STATUS	ASSESSMENT UPDATE
The project office should include in its February 2019 Annual Report to the Legislature specific metrics that will help inform the Legislature as to the current risks associated with system implementation. The project office's reporting metrics should include, among other items, the status of month-end close for all entities, the number of entities that are operating their legacy systems, and the number of entities reporting concerns with using FI$Cal to meet federal requirements.	Pending	Partially Implemented	Since we made this recommendation, the Legislature updated the annual reporting requirements it placed on the project office, which differ from the metrics we recommended. Because the Legislature has clarified what information it expects in annual reports about FI$Cal, we consider this recommendation resolved.	Resolved
The State Controller, Finance, and the project office should meet in September 2018 to discuss the status of delinquent entity financial statements and develop corrective measures to ensure that the State's financial report is produced with timeliness and accuracy.	Pending	Partially Implemented	Stakeholders including Finance, the State Controller, and the project office coordinated in 2019 to provide technical support and training to agencies finalizing and submitting their financial reports. However, 12 large entities using FI$Cal that significantly affected the State's fiscal year 2018–19 financial statements ultimately were unable to produce key reports on time. Consequently, the State released its audited financial statements more than 6 months after its April 1, 2020 target release date.	Partially Implemented

RECOMMENDATION	JANUARY 2019 ASSESSMENT	DECEMBER 2019 ASSESSMENT	CURRENT STATUS	ASSESSMENT UPDATE
The project office should arrange for oversight to continue until the State Controller publishes the State's annual financial statements exclusively using FI$Cal.	NA—Recommendation issued in December 2019	NA—Recommendation issued in December 2019	The project office has reflected in its 2020 project plan update a budget for CDT's oversight through fiscal year 2022–23.The project office has also approved a technical oversight contract through January 2023, and it must secure a new contract to extend oversight after the State Controller is scheduled to publish the annual financial statements exclusively in FI$Cal in spring 2023.	Partially Implemented
To ensure transparency of the total project costs, within 30 days CDT should require the project office to submit a new special project report that includes, at a minimum, changes in cost, scope, and schedule for the following: • Ensuring that all entities are able to use FI$Cal to meet all of their accounting and reporting needs. • Fully transitioning to FI$Cal by June 2019 the entities originally scheduled for onboarding in 2018.	Pending	Partially Implemented	Since we made this recommendation, the project office has submitted and CDT has approved two project plan updates that modified the project's cost, scope, and schedule. Though the 2019 project plan update included information on the project office's efforts to transition agencies to FI$Cal, our 2019 monitoring report identified instances where the update did not fully reflect the cost and scope of the project. Meanwhile, the 2020 project plan update does not report on departmental transition activities.	Partially Implemented
To ensure that stakeholders are able to make informed decisions, CDT should formally communicate any significant concerns regarding the project at the monthly steering committee meetings.	Not Implemented	Partially Implemented	Since our last update in December 2019, we have continued to observe various instances in which CDT is not sharing significant risks or issues at meetings. For example, in a key meeting in June 2020, CDT staff did not discuss four out of the five significant concerns listed in their most recent monthly report.	Partially Implemented

Source: State Auditor's reports: 2017-039.1 *FI$Cal Report Letter*, 2018-039 *FI$Cal Report Letter,* 2019-039 *FI$Cal Report Letter*, and our analyses of project office and CDT status updates.

Note: All recommendations are from August 2018 unless otherwise noted.

NA = Not applicable.