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October 29, 2009 2009-039

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capital
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$Cal) project. Pursuant to Government Code, Section 15849.22(f), the State Auditor's Office (state auditor) is required to independently monitor the FI$Cal project throughout the development of the FI$Cal system, as deemed appropriate by the state auditor. The independent monitoring shall include, but is not limited to, monitoring the contracts for independent project oversight (IPO) and independent verification and validation (IV&V) services; assessing whether concerns about the project raised by the IPO and IV&V contractors are addressed by the FI$Cal steering committee and the FI$Cal project office within the Department of Finance (Finance), or its successor entity; and assessing whether the FI$Cal project is progressing timely and within budget. In our January 2008 status update, we reported our concern related to Finance's decision to combine the IPO and IV&V services under the same contract. We also reported in January 2009 that the contract with the original independent oversight consultant engaged to perform both types of services expired in September 2008 and, as we recommended, the FI$Cal project indicated that it planned to split the IPO and IV&V services between two different consultants for the duration of the project. At this time, we believe it is appropriate to provide a brief status update as it relates to some concerns we have about the Office of the State Chief Information Officer's (OCIO) plans for providing the IPO services for the project and the project's current lack of long-term funding. Additionally, we provide an update on a recent decision related to a change in the project's procurement approach.

As the FI$Cal project has evolved and with the establishment of the new OCIO in January 2008, the OCIO has taken on a greater role as it relates to the project. For example, as we described in our January 2009 status letter, the project engaged Grant Thornton, LLP (consultant) in December 2008 to comment or make recommendations related to various aspects of the FI$Cal project. Based on its review, the consultant recommended that the state's chief information officer (CIO) become a voting member of the FI$Cal project's steering committee because of the project's prominence as a major statewide information technology (IT) investment. In March 2009 the steering committee adopted this recommendation. In another example, the OCIO took on the responsibility of contracting for a consultant to perform the IV&V services for the FI$Cal project and, in August 2009, engaged Eclipse Solutions to perform these services.

Recent OCIO Decision to Provide Independent Project Oversight Might Create a Conflict

In addition, the OCIO recently informed us that it intends to have its own staff provide the IPO services rather than contract with an outside consultant as it has done for the IV&V services. We are 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 very purpose of the IPO, which is to provide an independent, unbiased perspective. In its own California

Project Management Methodology Reference Manual, the OCIO defines a steering committee as consisting of executives and other participant stakeholders that have decision-making authority over the project. Thus, as a voting member of the steering committee, the state CIO has the ability to influence decisions related to the FI$Cal project. Further, according to Finance's Information Technology Project Oversight Framework (oversight framework), which provides the oversight framework for the State's IT projects, project oversight is an independent review and analysis of specific project activities and documentation to determine if the project is on track to be completed within the estimated schedule and cost. For example, according to the expert we engaged to assist in our monitoring of the FI$Cal project, one of the IPO's responsibilities is to raise issues related to decisions made by the steering committee. However, we are concerned as to whether the OCIO staff providing the oversight could remain independent and free to communicate issues to all stakeholders that may be critical of decisions made by the steering committee, when the CIO is a participant in those steering committee decisions. Finally, Finance's oversight framework requires a higher level of independence for high criticality projects, which the FI$Cal project surely is, and requires that oversight on these types of projects be conducted by consultants.

When we discussed our concerns with the OCIO, the OCIO provided several reasons why it believes that an independence problem does not exist. The OCIO explained that under the typical structure, the contractor providing the IPO services would report directly to the project, which makes the contractor somewhat connected to the project, and thereby susceptible to being swayed by the project manager and other staff. The OCIO explained that using a contractor to conduct IPO services would not necessarily provide greater independence because the contractor still has an incentive to continue to have a business relationship with the project. The OCIO believes that, by using its own staff to perform the IPO services, it is mitigating this risk. Additionally, the OCIO indicated that, although the CIO is a voting member of the steering committee, the CIO does not have ownership of the FI$Cal project as do the other members of the steering committee, but acts in the role of a technical advisor to the project. For these reasons, the OCIO does not believe the CIO's position on the steering committee compromises its ability to perform IPO services in an independent manner. While we appreciate the OCIO's perspective, it does not alleviate our concerns. Similar to its hiring of an independent IV&V contractor, we see no reason why the OCIO or some other entity could not hire an IPO contractor to assure that project oversight is unbiased and independent.

The OCIO pointed out that it had an additional concern related to whether it could contract with an outside consultant for the IPO services as the result of a recent State Personnel Board decision. Specifically, in June 2009, the State Personnel Board disapproved a department's contract with a private IPO consultant because the department failed to demonstrate that the state workforce did not have employees with the skills necessary to perform these services as required by state civil service law. However, in reviewing the State Personnel Board's decision, we observed that footnote 3 expressly noted the department had not relied upon and, accordingly, the State Personnel Board did not analyze the justification for, a decision to contract out based on Government Code, Section, 19130(b)(5). This section permits state agencies to contract for services to, among other things, "insure independent and unbiased findings in cases where there is a clear need for a different, outside perspective." Given that the project's consultant described FI$Cal as one of the largest IT investments ever undertaken by the State,

combined with its estimated cost of more than $1.6 billion, it would seem that the FI$Cal project would meet the criteria for requiring a greater level of independence. Thus, the State Personnel Board's decision does not appear to limit either the OCIO's or some other entity's ability to hire a contractor to perform IPO services for this project.

Finally, the OCIO also pointed out that it does not believe it is necessary for a private consultant to provide IPO services for the FI$Cal project "at this time given the stage of the project." The OCIO indicated that it will regularly assess whether the IPO function should be carried out by a state employee or by a consultant based on several factors, including the quality of the deliverable and project management practices, adherence to project management standards and processes, and effectiveness of risk and issue management practices. In addition, the OCIO stated that it will be assessing the ability of the state employees who will be providing the IPO services to effectively identify emerging risks and issues, quantify trends, and recommend necessary corrective action. However, this does not alleviate our earlier concern that, during the time OCIO staff are providing the IPO services, the CIO is a voting member of the steering committee, which could, either in fact or appearance, create a conflict that undermines the very purpose of the IPO.

Future Funding for the FI$Cal Project Is Uncertain

We also are concerned about the fact that the FI$Cal project has lost its source of long-term funding and is considering what other funding options are available. For fiscal year 2009–10, the FI$Cal project is using the remaining funds from a loan it received in fiscal year 2008–09 from the State's General Fund to support its operations. The project believes that these funds are sufficient to complete the tasks scheduled for this fiscal year, which includes the preparation of the third Special Project Report that it plans to complete by December 2009. However, the FI$Cal project indicated that without additional funding it will not be able to pay for its activities for fiscal year 2010–11. Originally, trailer bill language allowed the project to sell bonds to finance the project. However, the FI$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 is unable to rely on the sale of bonds to fund the project as it initially planned. The FI$Cal project stated that it is exploring various funding options, such as using special funds that receive revenue from non-General Fund and non-federal sources or obtaining loans from vendors to finance vendor costs. It anticipates including its funding plan as part of the Governor's budget for fiscal year 2010–11. Nevertheless, with the level of uncertainty surrounding its future funding, we are concerned that the FI$Cal project may have difficulty attracting and retaining qualified staff.

Recent Change to Procurement Process

Finally, the steering committee recently approved a change in the project's approach to the first stage of procuring a system integrator. The project originally planned to execute its procurement in two stages, with the first stage resulting in contracts with two bidders to conduct a "fit-gap" analysis. The purpose of the "fit-gap" analysis is to have the two bidders develop detailed technical and cost proposals for the

project, which would become the basis for software and implementation bids. However, according to the FI$Cal project, as the result of discussions with the project director of the State Controller's Office 21st Century project regarding its "fit-gap" experience and vendor competition concerns expressed by the Department of General Services, the project decided to propose to the steering committee a modification to the first stage to select three bidders instead of two to perform the "fit-gap" analysis. In September 2009 the steering committee approved the proposal. The FI$Cal project also indicated that it originally intended on paying each bidder $6 million to complete the "fit-gap" analysis; however, with the addition of a third bidder, the project decided to reduce the amount paid to each bidder to $3.5 million, which will decrease the overall cost of the "fit-gap" stage by $1.5 million, although additional space at an unknown cost will be needed to house the third bidder. The FI$Cal project offered several justifications for this change, including the benefits realized from greater competition—both in terms of product selection and to provide negotiation leverage in selecting the final vendor—which it believes outweigh the relatively small costs associated with the additional space required to house the third vendor's staff.

We believe it is important to communicate our concerns at this time regarding recent decisions and events related to the FI$Cal project. As the statutes require, 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,

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