



January 8, 2019
2018-039

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

Dear Governor and Legislative Leaders:

In August 2018, our office issued Letter Report 2017-039.1, which assessed the issues we had previously identified related to the Financial Information System for California (FI\$Cal). This letter provides you with an update on the status of the recommendations we made in that report. In August, we reported that many state entities that had implemented FI\$Cal before fiscal year 2018–19 struggled to produce on-time financial statements from within FI\$Cal and were dissatisfied with system performance, training and documentation, and technical support. We also reported that some of the 64 entities that were scheduled to begin using FI\$Cal in fiscal year 2018–19 could face similar challenges. Of these 64, many are entities with large budgets such as the Employment Development Department and the Department of Health Care Services, which are of material importance to the State’s overall financial reporting. We are concerned that some of our previous recommendations to the FI\$Cal project office (project office) and the California Department of Technology (CDT) remain unaddressed and that the State is at risk for delayed, and incomplete or inaccurate financial reporting, which may have serious statewide consequences.

Background

Beginning in 2005, the State initiated one of its largest-ever information technology projects. Initially intended to replace existing legacy budget systems, the project scope expanded to combine the State’s accounting, budgeting, cash management, and procurement operations into a single unified financial management system. This new project intended to replace hundreds of older data systems was given the name Fi\$Cal. Following a series of changes to FI\$Cal’s implementation approach, the state awarded the contract for the system integrator to Accenture in 2012 when the project had an estimated overall cost of \$600 million over six years. The project cost has since grown to an estimated \$918 million, and the project is currently scheduled for completion in July 2019.

The FI\$Cal project office manages and oversees the FI\$Cal system implementation, and CDT is responsible for overseeing, among other things, whether the project is properly managed and on track to be completed within the estimated schedule and budget and for ensuring that FI\$Cal will provide the functionality the State requires. The FI\$Cal project is further governed by a steering committee comprising stakeholders from the Department of Finance (DOF), the Department of General Services (DGS), the State Controller’s Office (State Controller), and the State Treasurer’s Office (STO). The steering committee also includes the chair of the Customer Impact Committee, who acts as the primary customer representative for all entities, and a representative of CDT as a nonvoting participant. State law requires the California State Auditor (State Auditor) to independently monitor the FI\$Cal project throughout its development and to report at least annually on issues we deem appropriate, such as whether the FI\$Cal project is progressing on schedule and within its budget.

The Project Office and CDT Have Not Adequately Addressed the Concerns We Reported in August

We are concerned with the lack of progress on some of our recommendations. We also continue to be concerned with entities' abilities to produce timely monthly and year-end financial statements and the risks any delays pose to the State's Comprehensive Annual Financial Report (CAFR). The CAFR issued by the State Controller is the State's year-end financial statement that informs stakeholders—such as credit agencies that rate the State's bonds—of California's financial activities. According to the project office, it met with representatives from DOF, DGS, the State Controller, and STO to discuss the status of delinquent entity financial statements. Further, the project office coordinated with the State Controller and DOF on a new policy for entities to submit financial statements—or estimated statements, if necessary—if the entities were unable to prepare financial reports using FISCAL by the State Controller's July and August 2018 deadlines. This new policy also allows entities to forgo the submission of some financial reports to the State Controller prior to publication of the CAFR that would better ensure the completeness and accuracy of any estimated year-end financial statements.

State Controller records indicate that as of November 2018 there were 90 entities covered by this new policy and 48 of them submitted late financial statements for fiscal year 2017–18. Of those 48 entities, several were more than two months late with their submissions and 20 entities had to submit estimated, rather than actual, financial statements. Late financial statements increase the risk of the State producing a late CAFR. Similarly, if entities find it increasingly necessary to rely more heavily on estimates, the risk to the State's CAFR increases. Specifically, any estimates not based on sound methodologies or complete or accurate information could result in the CAFR receiving a modified audit opinion indicating that material accounting misstatements have or may have occurred. In addition, California's general obligation bonds require the State to submit an annual report, which must include audited financial statements, if available, by April 1 of each year. Ultimately, a CAFR that is published late or with a modified audit opinion could erode stakeholder and investor confidence in the State's financial condition and potentially affect the State's borrowing costs.

In our August 2018 report we stated that a number of entities implementing FISCAL in the 2018–19 fiscal year may face similar challenges, only on a larger scale. Recently the project office reported that as of November 2018, 107 of the 156 entities that are a part of the FISCAL implementation had not completed financial statements for the first month of fiscal year 2018–19. If entities cannot produce timely monthly financial statements, it increases the risk that they will also have trouble producing timely year-end financial statements for the State Controller. Therefore, the problems that entities encounter when using FISCAL to produce year-end financial statements could strain the State's ability to publish a timely fiscal year 2018–19 CAFR to an even greater degree.

To understand how it is possible for the project office to report having implemented the system's accounting function for an entity, yet for that entity to be unable to use it to produce financial statements, one must consider what the project office considers implemented to mean. According to the project office, implemented means that the system is ready to use and

the entity has a starting point for recording transactions. Implemented does not mean that those entities have necessarily transitioned from their legacy systems to FI\$Cal nor that users within those entities are necessarily fully transacting or conducting the State's business with FI\$Cal. This gap between the enabling of the system for an entity's use and that entity actually transacting the State's business exclusively with the system creates uncertainty as to the extent entities are using FI\$Cal.

For instance, of the 64 entities for whom FI\$Cal made services available in fiscal year 2018–19, many have postponed a full transition to FI\$Cal because of their concerns with using the system for critical tasks. Specifically, in June 2018, 21 out of 64 entities had requested to postpone exclusively operating in FI\$Cal and planned to continue using their legacy systems. However, in November 2018, the project office reported that number had increased to 43 out of 64 of those entities.

We described in our August report the reason that some of these newly implemented entities are hesitant to transition from their legacy systems. Specifically, some of those entities in the July 2018 FI\$Cal release that receive billions of dollars in federal funding are concerned that their potential inability to produce accurate and timely financial information and meet various federal requirements may threaten their access to mission-critical federal funds. In part because of these concerns, a number of entities in the July 2018 release—including those with large public programs such as the California Department of Social Services and the California Department of Education—intend to continue to use their legacy systems after implementing FI\$Cal. However, entities continuing to use their legacy systems in addition to using FI\$Cal results in an increased workload for staff to post entries in two different systems. Additionally, entities continuing to operate solely in their legacy systems may have a large backlog of transactions that they will later need to input into FI\$Cal, which will consume additional staff time, particularly for those entities that process a high volume of transactions. The project office asserted that it has assigned additional resources and is working towards resolving all critical issues necessary to transition all entities onto the FI\$Cal system as soon as possible. However, it is unclear whether or when the entities' concerns with making a full transition from their legacy systems will be resolved.

Consequently, the FI\$Cal project will take more time and resources than originally planned to be fully implemented, which led to our August recommendation for a new Special Project Report (SPR). SPRs describe key elements of the project office's plan so that stakeholders can assess the overall status of the project, and they provide detail on the project's cost, schedule, and scope. CDT may require the project to submit a new SPR under certain circumstances such as a significant increase in the project's costs or failure to meet a critical milestone. As Table 1 shows, CDT will require the project office to submit a new SPR or another similar document disclosing a new implementation plan, cost estimates, and a timeline for FI\$Cal in 2019. Without this information, the transparency of the project's full cost, scope, and schedule diminishes, and project stakeholders cannot make informed decisions that fully account for all potential risks with the project's schedule and the associated costs to the State.

The Project Office and CDT Should Implement Our Recommendations

In our August report, we made a number of recommendations to the project office and CDT to address the issues that we had raised. Table 1 summarizes those recommendations, their current status, and our assessment of the status of each recommendation.

Table 1
The Project Office and CDT Have Not Fully Implemented Our August 2018 Recommendations

RECOMMENDATION	STATUS	STATE AUDITOR'S ASSESSMENT OF STATUS
FI\$Cal project office		
1 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.	The project office stated that it will include the new metrics in its annual report to the Legislature.	Pending
2 Within 30 days, the project office should consider postponing to the following fiscal year state entities whose migration to FI\$Cal in fiscal year 2018–19 could cause a loss of federal funding or a delay in publishing the State's CAFR.	According to the project office, it decided to move forward with the implementation of all 64 entities. However, some of these entities continue to transact in their legacy systems to mitigate risks with meeting federal reporting requirements or with preparing year-end financial statements.	Not implemented
3 The State Controller, DOF, 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 CAFR is produced with timeliness and accuracy.	Although the project office stated it did not hold a meeting in September to specifically address this recommendation, it participated in weekly leadership meetings with DOF, DGS, State Controller, and STO representatives where this topic was discussed. Further, the project office indicated it coordinated with the State Controller and DOF on a new policy for preparing year-end financial statements and with DOF on user training. As we discuss in the text however, entities have continued to submit late financial statements and there are some risks related to this new policy.	Pending
Department of Technology		
1 To ensure transparency of the total project costs, within 30 days, CDT should require the project office to submit a new SPR that includes, at a minimum, changes in cost, scope, and schedule for the following: <ul style="list-style-type: none"> • Ensuring that all entities are able to use FI\$Cal to meet all of their accounting and reporting needs. • Fully implementing the 2018 release entities that may not be successfully transacting in FI\$Cal by June 2019. 	According to CDT, it will require the project office to submit a new SPR or another similar document disclosing the project office's new implementation plan, cost estimates, and timeline in 2019.	Pending
2 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.	CDT stated it has been speaking up more by reiterating major concerns at steering committee meetings as well as by continuously discussing issues with the project office and representatives from DOF, State Controller, STO, and DGS on a regular basis. However, we have not observed CDT sharing significant risks or issues in recent steering committee meetings.	Not implemented
3 To ensure that stakeholders receive timely information regarding project risks and issues, CDT should ensure that it meets the <i>Statewide Information Management Manual</i> deadline for publishing the monthly oversight reports within 10 working days of the subsequent month.	CDT indicated that it is still working toward meeting this deadline, however there is a large amount of information that it carefully verifies for accuracy every month. Since we last reported on this issue in August, CDT has submitted late reports for four out of six months.	Not implemented

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The FI\$Cal system is a critical project deserving of the highest level of oversight. Given that entities continue to experience difficulties that we presented in our last report, and that the associated risks to the State remain high, the project office should prioritize including our recommended metrics in its annual report to the Legislature. For example, the project office's reporting metrics should include, among other items, the status of month-end close for all entities, the number of entities continuing to operate their legacy systems, and the number of entities reporting concerns with using FI\$Cal to meet federal requirements. The Legislature relies on the project office's annual report to ensure that the project office adequately manages risks and ensures the successful implementation of the project.

Pursuant to Government Code section 11864, we will continue to monitor these risks and to report at least annually on issues we deem appropriate.

Respectfully submitted,

A handwritten signature in black ink that reads "Elaine M. Howle". The signature is written in a cursive, flowing style.

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.