December 17, 2019
2019-039

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 highlights several urgent concerns with the project to implement the Financial Information System for California (FI$Cal). Among our concerns is the manner in which the 2019 project plan update sets a formal end date for the project even though the FI$Cal project will not have implemented promised functionality. Specifically, the updated project plan continues the project's trend of removing key features from the project's scope, increasing the budget, and developing unrealistic schedules, resulting in a product that will lack crucial features, such as bond and loan accounting tools, and will not include the transition of the State's annual financial reporting to FI$Cal. In addition, the 2019 project plan update also does not guarantee that oversight will continue until the delivery of these features—described as key functionalities in project documentation—and it requires an aggressive schedule that is already proving unrealistic. Finally, the project's financial documentation understates the true cost of FI$Cal. It omits some costs that the governing entities have deferred until after they have declared the project complete, and the 2019 project plan update does not reflect the significant contract and staffing costs that entities incurred when trying to transition from their legacy systems to FI$Cal. As such, the reported cost of FI$Cal will be understated.

In addition to these concerns, challenges during FI$Cal's implementation may affect the State's credit rating and increase borrowing costs. Several entities using FI$Cal submitted late financial information to the State Controller's Office (State Controller) in preparation for assembling the State's fiscal year 2017–18 annual financial statements. Of those, the State Controller found that 17 submitted only estimated statements. As of October 2019, the State Controller has reported that even more entities are submitting late financial information for fiscal year 2018–19, which may ultimately damage the State's credibility among investors. Additionally,

FI$Cal Background

In 2005 the State initiated an information technology project to replace existing budget systems. In 2006 the State transformed the scope of the project to combine the State's accounting, budgeting, cash management, and procurement operations into a single, modernized system. After a series of project plan updates, the most recent of which we analyze in this report, the FI$Cal project is currently projected to cost $1.06 billion with an official end date of June 30, 2020.

Multiple state agencies—which we refer to collectively as the project's *governing entities*—play important roles in developing FI$Cal:

- A *steering committee* provides governance to the project. The committee includes representatives from the following:
  - Department of Finance (Finance)
  - Department of General Services (DGS)
  - State Controller
  - State Treasurer's Office (State Treasurer)
- The California Department of Technology (CDT) approves project plan updates.
- The Department of FI$Cal (project office) implements, maintains, and operates the system.

CDT and the project office have failed to fully implement several of our recommendations from previous reports, which could have mitigated ongoing concerns such as late financial reporting from entities newly transitioning to FI$Cal, and lack of transparency in total project costs. Appendix A summarizes our prior recommendations and their status.

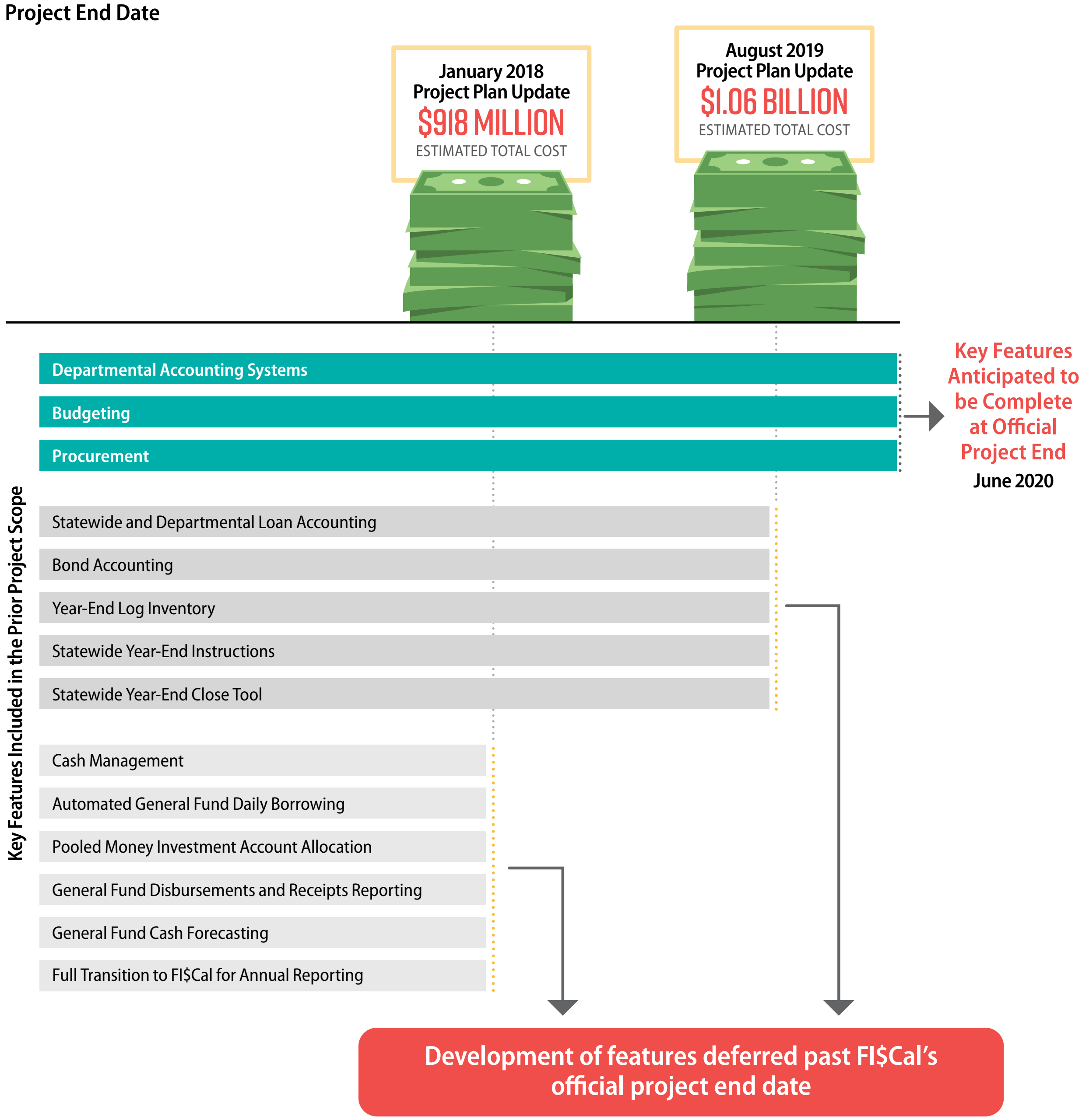
These issues increase the risk that the FI$Cal project will be unable to deliver many of its envisioned benefits. The State created the FI$Cal project with the intent to replace diverse financial systems and unite the State's accounting, budgeting, and cash management operations into a single system. However, the project in its current form will not fully accomplish this goal by its 2020 end date. Without action from the Legislature and the project office, as of the 2020 end date, the FI$Cal project will result in reduced functionality, obscured project costs, and a misleading timeline that inaccurately portrays the project as having ended successfully.

The Revised Project Plan Will Result in the Premature End of the FI$Cal Project Before the System Is Fully Established and Operational

The most recent update to the FI$Cal project plan states that the project will end on June 30, 2020. This will mark the formal conclusion of the project even though there are key system features that will not be implemented until after that date. The entities that govern the FI$Cal project have submitted eight special project reports, which are update documents to modify the project plan, since 2006. In a 2018 project plan update, the governing entities reduced the number of features the system will have available when the project is complete. These features included tools for the State to manage and forecast its cash flow and to allocate investment revenue to agencies. As Figure 1 shows, the most recent project plan update in August 2019 continues this trend by identifying a list of key features that will not be complete by the formal conclusion of the project. The governing entities redefined the status of these features as system maintenance activities to be performed at a later date. Because maintenance and operations activities are not included as formal components of the FI$Cal project scope, there is no obligation for the governing entities to publish the cost of these activities or report on the schedule for completing them. In fact, the current project plan does not provide any assurance that they will ever be implemented.

The project will not have fully achieved one of its central purposes—modernizing the State's accounting functionality—by the time the governing entities have declared the project complete. The Legislature intended FI$Cal to replace the State's aging financial systems, implement standardization across all departments, and maintain a central source for financial data. Instead, the State—with the fifth largest economy in the world—will continue to rely on aging technology to ensure accountability and develop key financial statements. Though individual state departments perform accounting tasks, the State Controller ultimately compiles and publishes the State's annual financial statements. However, since the project's 2018 project plan update, the governing entities have not confirmed that the FI$Cal system will be ready to perform this central activity on its own by 2020. Instead, the State Controller intends to run its legacy system in parallel with FI$Cal for the next several years. According to the governing entities, this approach will give the State Controller the opportunity to validate data in the FI$Cal system prior to turning off its legacy system. Given the complexity of this arrangement, we would have expected the project to develop robust procedures to run both systems simultaneously. However, it did not do so, and the project's outside technical consultant (oversight contractor) concluded that the lack of adequately defined processes and requirements for the use of these parallel systems poses a significant risk, which could lead to the project's failure to run these two systems successfully in parallel. This plan to run parallel systems, coupled with the official end of the project in 2020, is troubling as the 2019 project plan update indicates that the State Controller will not rely on FI$Cal exclusively until 2022 or later. The plan could negatively impact the State for years, as the State Controller has already noted significant operational inefficiencies related to transferring and duplicating data between the two systems.

Figure 1
Despite Increasing Costs, the FI$Cal Project Will Not Complete Certain Key Features Until After the Official Project End Date



Source: Analysis of FI$Cal project documentation.

The project plan update adopted in 2019 also defers many other important FI$Cal features to dates after the governing entities plan to formally end the project. This project plan update describes “key” system features that the project office will not implement until after the project ends. These features, detailed in Figure 1, include statewide and departmental loan and bond accounting, which are tools required to track, manage, and record certain transactions in FI$Cal. According to project documentation, a delay in the implementation of these key features was necessary because other deliverables required more work than expected. Without assurance that FI$Cal will provide the State with its promised functionality, it remains unclear whether or when the project will actually complete its original goal of providing to the State a comprehensive, integrated financial management system.

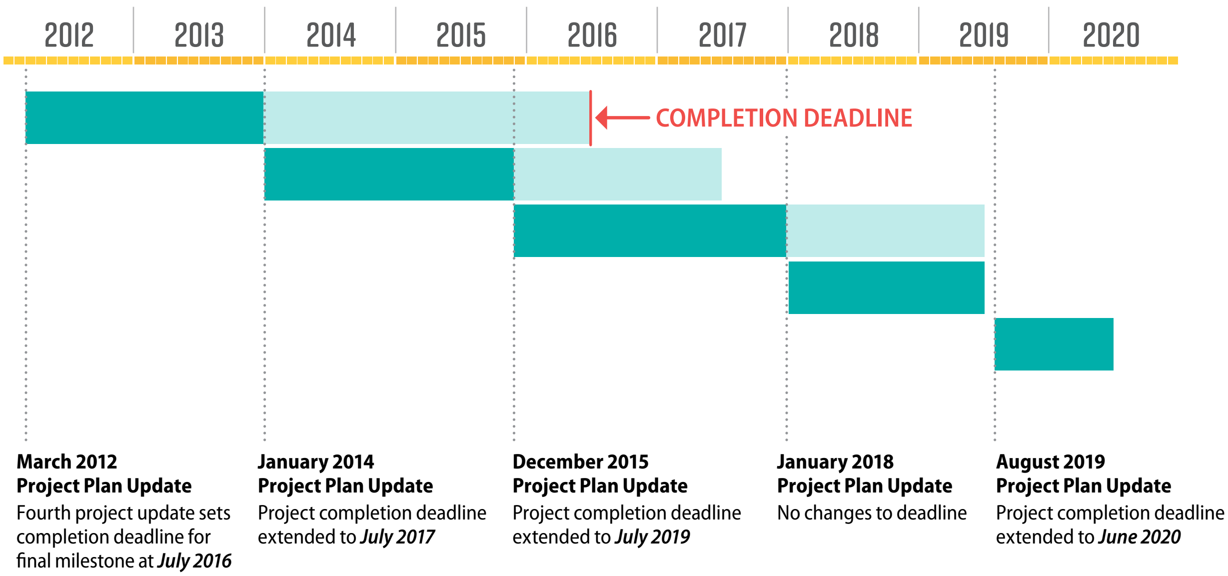
The Aggressive Project Schedule Continues the Pattern of Unrealistic Timelines That Encourages Compromises in the Development Process

Although the governing entities updated the project’s goals in 2019 in part to make the scope of the project more manageable, the project may not achieve those revised expectations. After not completing the project by the previously estimated end date of July 2019, the governing entities revised the project’s estimated end date to June 2020. However, CDT immediately noted that the schedule was “aggressive,” and that there was “no slack to recover the schedule if delays occur.”

In fact, the project is already falling behind its diminished expectations. For example, CDT reported in September 2019 that the project was experiencing schedule delays, specifically identifying one feature related to the transfer of payment information from a legacy system into FI$Cal that was nine months behind schedule, and another two-month delay related to user testing. As Figure 2 illustrates, the project has historically not achieved its target deadlines. This pattern suggests that the governing entities have consistently created unrealistic schedules that do not adequately convey to the Legislature and the public the true progress or timeline for completion. Consequently, the project’s 2020 end date is likely to represent yet another unrealistic deadline.

Additionally, oversight reports have identified several quality issues during FI$Cal’s development, some of which may be related to the project’s aggressive schedule. For example, the project’s oversight contractor identified system failures due to the project not following best practices to validate user-entered data. Similarly, in August 2019, CDT reported that tight deadlines, a lack of adequate testing, and a lack of methods to stop new users from entering incorrect information have affected project quality during implementation. CDT further noted in multiple reports in 2019 that staff have had to correct some information directly in FI$Cal’s database—as opposed to correctly reentering transactions through FI$Cal’s normal data entry process—which CDT describes as a “risk-prone approach” to using systems such as FI$Cal. According to our IT consultant, such findings indicate that the project is experiencing quality problems due to inadequate or rushed development procedures. While our office did not identify any material errors in the State’s fiscal year 2017–18 annual financial statements, the issues identified above may cost the State resources to correct and will negatively affect the project as it struggles to meet its deadlines.

Figure 2
FI$Cal Has Historically Not Met Target Completion Deadlines



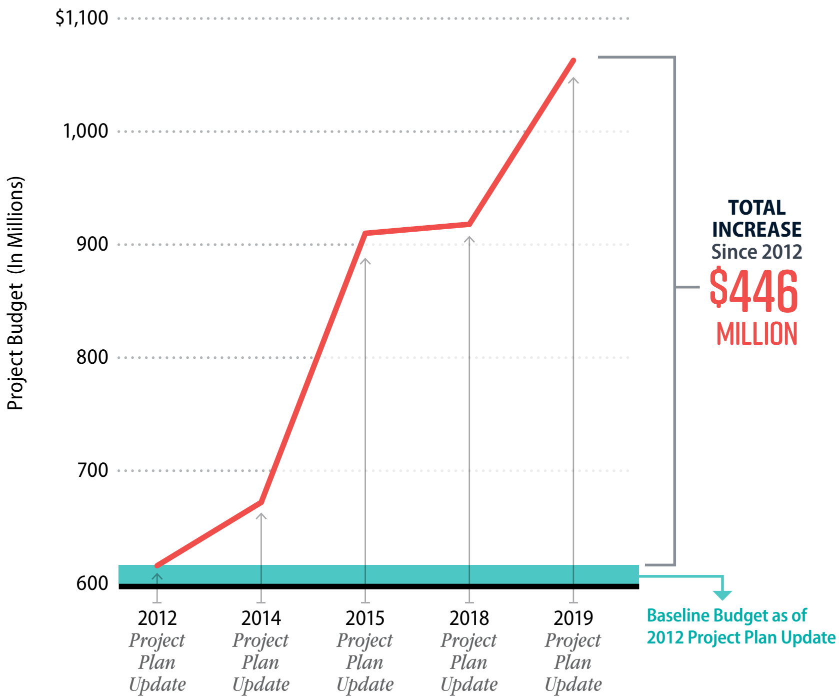
Source: Analysis of FI$Cal project documentation.

FI$Cal's Current Project Plan Update Obscures the True Cost of the System's Development and Adoption

The 2019 project plan update reports a budget increase of more than $140 million, resulting in a current projected cost of $1.06 billion; however, the project continues to exclude numerous related costs from its budget. Figure 3 demonstrates how the project's budget has increased by more than $400 million since 2012. However, the current budget, which runs only until the end of fiscal year 2020–21, does not include all costs for features redefined as maintenance and operations activities in recent project plan updates, such as cash management. Specifically, the 2019 project plan update does not contain any estimates of costs deferred beyond June 2021. As the project's budget has grown by more than $400 million since 2012, it is likely that if the unimplemented features are completed, it will result in higher costs that are not currently being reported.

In addition, the FI$Cal project has also resulted in additional costs that state agencies have incurred, such as expenses related to staffing increases required for implementation. Further contributing to increased workload, the project office reported that some entities that have transitioned to FI$Cal continued to use their legacy systems to address certain critical tasks. We discuss legacy system use in Appendix B. Our August 2018 monitoring report identified more than $10.5 million in contractor costs state agencies incurred when transitioning to FI$Cal. For example, the California Natural Resources Agency hired a consultant to help entities such as the Department of Parks and Recreation redesign their business processes related to FI$Cal. Since that report, we have identified an additional $28.5 million in anticipated costs, including expenses for contracts and staffing

Figure 3
The Reported Project Budget Has Increased By More Than $400 Million Since 2012



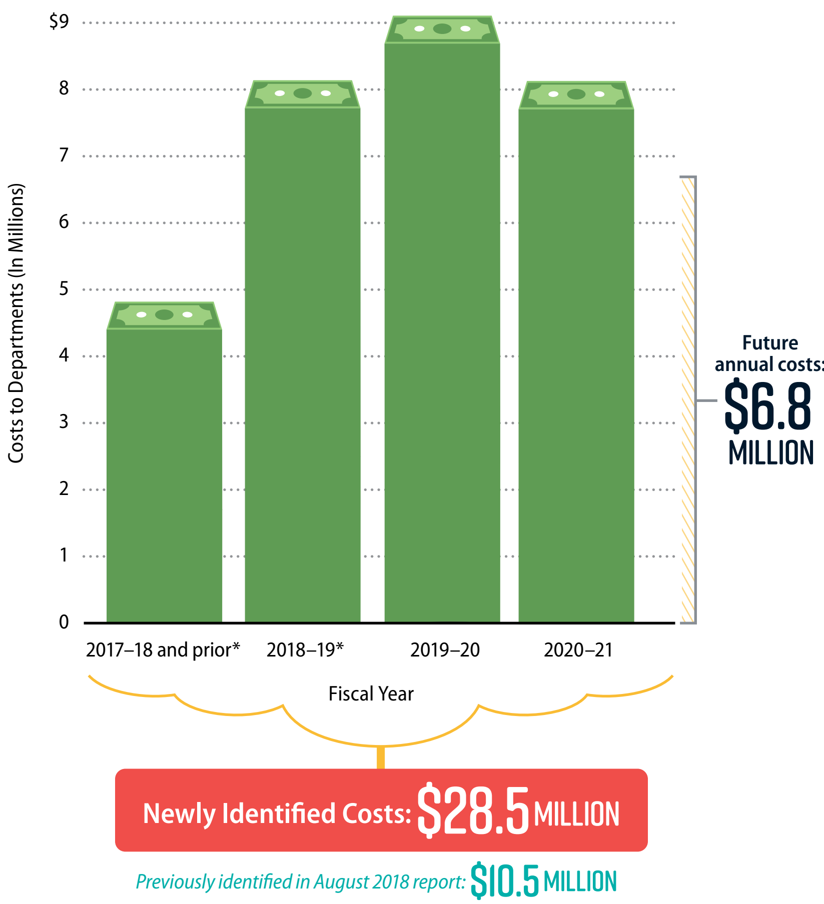
Source: Auditor-generated based on project documentation.

increases for agencies we reviewed, for a total increase of more than $39 million. Figure 4 shows the costs we identified at several such agencies, which include $6.8 million in ongoing future annual costs that state entities anticipate incurring. As these costs reflect only a selection of state agencies that we reviewed, other agencies are also likely bearing unreported costs. These costs further support our concern that the project's documentation does not reflect the true cost of implementing the FI$Cal system. Such discrepancies cast uncertainty over whether the Legislature is receiving adequate information about the project.

The Newest FI$Cal Project Plan Update Prematurely Eliminates Key Oversight Components

The 2019 project plan update in its current state prematurely eliminates oversight by CDT and the project's oversight contractor. The FI$Cal project's oversight consists primarily of independent project oversight by CDT—which produces monthly oversight reports addressing factors such as timelines and budget—and additional technical oversight provided by the oversight contractor. However, CDT staff stated that CDT has not yet determined whether it will issue reports after the June 2020 deadline. Further, the 2019 project plan update does not include a budget for CDT's oversight or retain the oversight contractor past the project end date, and the oversight contractor's current contract will expire in January 2020. When we discussed these issues with the project office, the chief deputy stated that he would prefer oversight to continue in the maintenance and operations phase until July 2021 due to the important work that would occur during that time period. The project office further indicated that it would discuss continuing oversight with CDT, and it expected to arrange for technical oversight beyond 2020. However, as of August 2019, the project's budget for both CDT's and the oversight contractor's work was zero for fiscal year 2020–21. Without the full range of structured oversight, the project may lose opportunities to proactively identify and mitigate risks that could result in further delays or unimplemented functionality.

Figure 4
State Entities We Reviewed Could Incur More than $39 million in Unreported Costs Due to FI$Cal Implementation



Source: Auditor-generated based on discussions with two departments moving to FI$Cal, contract documentation, and Finance documentation.

* Includes contract costs identified during earlier monitoring work but not included among the examples in our August 2018 report.

Though continuing oversight is important, the State also has opportunities to improve its existing oversight. Our review of CDT's oversight reports noted inconsistencies in how it described the overall status of the project. For example, we identified instances where CDT improved its rating of the FI$Cal project immediately after it approved a project plan update, only to subsequently give the project lower ratings again a few months later. We identified this most recent discrepancy after the 2019 project plan update, when CDT assessed the overall health of the project with its highest rating of "satisfactory" in an oversight report—only a month after having assigned the project its lowest rating—based primarily on the fact that the 2019 project plan updated the project's schedule, scope, and budget to make the project more manageable. Despite the overall positive rating in the oversight report, CDT identified numerous issues in the same report—many of which existed prior to the 2019 project plan update and supported the previous negative rating. These issues included incomplete testing that caused stability issues; poor system performance that, according to our consultant, impacts the system's ability to complete a day's work within a 24-hour window; and high vacancy rates for staff working on the project that may impact the governing entities' ability to meet the aggressive schedule for completing the project by 2020. CDT also noted in the same oversight report that it was uncertain whether the project was on track to satisfy the State's business objectives on time and within budget. Given such issues, we are concerned that CDT's recent satisfactory rating does not accurately describe the project's status.

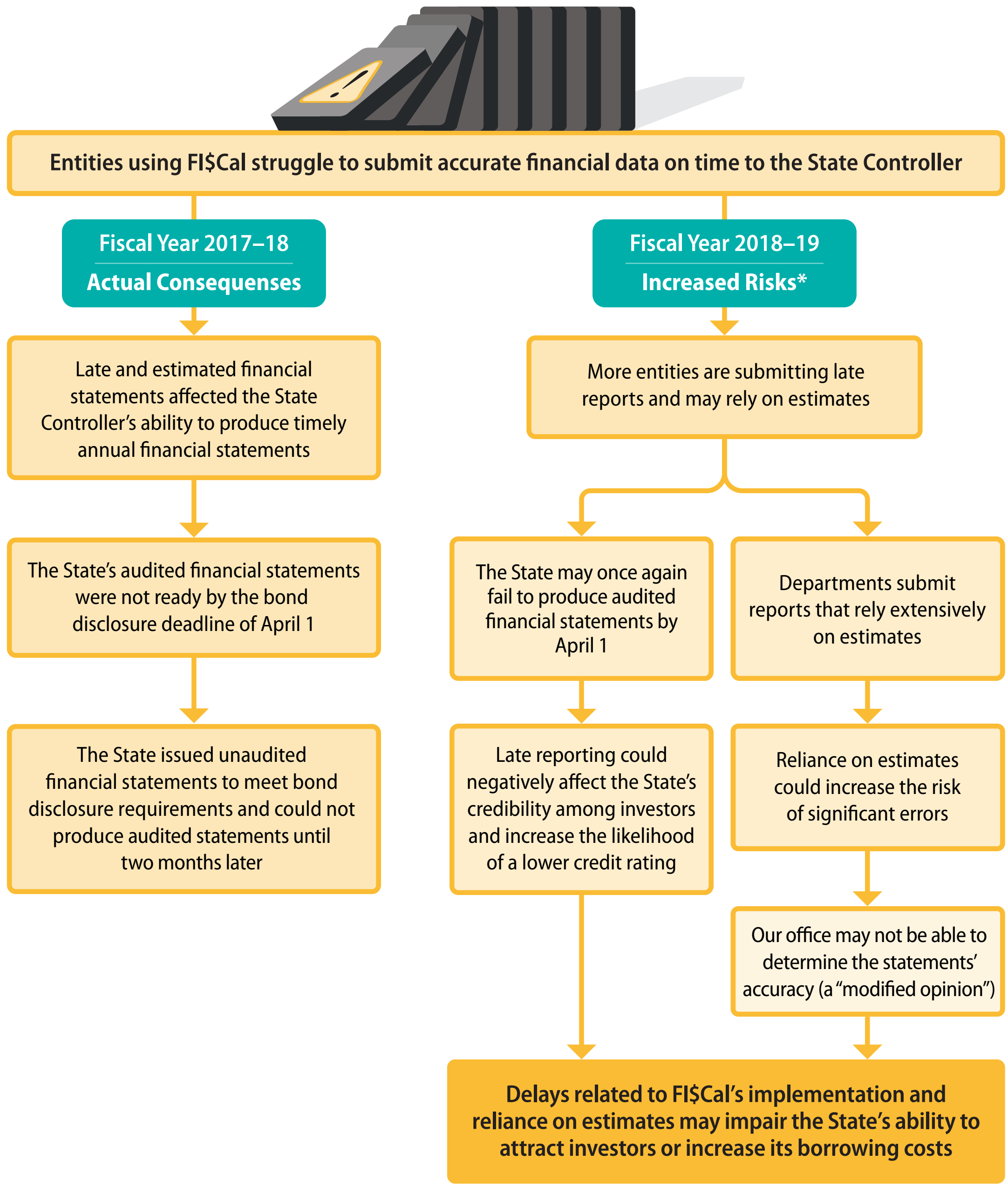
The State's Inability to Use FI$Cal as a Reliable Financial Reporting Tool May Lead to Increased Borrowing Costs

The State depends on a functional financial system to inform stakeholders about its financial position and to obtain funding for critical infrastructure. The State's General Fund supported general obligation bonds—which represent the majority of the State's debt and generally finance infrastructure projects such as roads, levees, and schools—require the State to publish an annual financial report including audited financial statements, if available, by April 1st of each year. Information from this report is then available for credit rating agencies and potential lenders to use in evaluating the State's financial health and risk. If the State cannot consistently produce its financial reports by this deadline, it may prompt credit rating agencies to lower the State's credit rating, leading to increased borrowing costs—a risk the governing entities acknowledged in 2007. In 2016 the State Treasurer reported that improvement in credit ratings between 2009 and 2016 resulted in a reduction of about $180 million in borrowing costs for every $1 billion of borrowing.[1] Thus, if the State's credit rating were reduced, it is reasonable to assume that the State would incur additional borrowing costs. These additional costs could affect the State's ability to plan for important projects that rely on billions of dollars in bond sales each year.

Contributing to our concerns in this area, several agencies using FI$Cal submitted late and in some cases estimated financial statements for fiscal year 2017–18, one of which contributed to a delay in the State's financial reporting. In our January 2019 monitoring report, we expressed concerns with entities' abilities to produce timely monthly and annual financial statements. Entities have reported issues with using FI$Cal to produce financial information for a variety of reasons, including user error, system limitations, and insufficient support and training from the project office. As of November 2018, the State Controller found that 48 entities using FI$Cal submitted late fiscal year 2017–18 financial statements. Further, according to the State Controller, 17 of these departments submitted estimated financial reports, a practice that increases the risk of incorrect amounts in financial statements. We noted this issue in Report 2018-001.1, in which we found that a policy from Finance allowing agencies to submit such "estimated financial reports" may have caused confusion over what type of reports were permissible for agencies to send to the State Controller. Though our office ultimately found that this issue did not cause a material error in the State's annual financial statements, the State published them two months later than its spring deadline. Figure 5 highlights the increased risks to financial reporting for the most recent fiscal year and demonstrates issues encountered during the fiscal year 2017–18 reporting cycle.

1 In 2009, the three major credit rating agencies gave the State's general obligation bonds ratings that the State Treasurer classifies as "medium grade." In 2016, the State received "high-grade" ratings. As of September 2019, the State has maintained high-grade ratings.

Figure 5
The State Faces Challenges Because of Weakened Financial Reporting Related to FI$Cal



Source: Documentation and guidance from financial institutions, bond disclosure agreements, and auditing standards.

* Although the State Treasurer indicated that credit ratings did not decrease after the State issued late financial statement for fiscal year 2017–18, we remain concerned about future downgrades as entities continue to struggle to prepare timely financial reports.

Issues that occurred with the fiscal year 2017–18 financial reporting may escalate as the State Controller completes the fiscal year 2018–19 financial statements. An increasing number of large and complex entities may be unable to produce timely financial information using FI$Cal for fiscal year 2018–19. As we specified in our previous monitoring reports, many of the State's largest agencies, such as the Employment Development Department and the California Department of Education, only began reporting their financial information in FI$Cal for fiscal year 2018–19, creating a risk that they too would submit late statements or rely more heavily on estimated information. State Controller records show that up to 62 agencies, including both the Employment Development Department and the California Department of Education, missed the October 2019 deadline to submit their financial statements. Although Finance issued a new policy in 2019 that allows agencies to submit financial reports containing estimates based on sound methodologies and the best available information, it remains to be seen whether agencies are able to fully comply with this policy based on their struggles using the FI$Cal system. Estimates that do not comply with this policy could hinder our office's ability to verify the underlying information, which, as shown in Figure 5, could lead to an eventual reduction in investor confidence, decreases in credit ratings, and increases in borrowing costs.

Recommendations

Legislature

To ensure delivery of key features and greater transparency of project costs, the Legislature should direct CDT and the project office to create a new, ninth project plan update. The update should include, at a minimum the following:

- A budget detailing additional time and costs for the remaining development and implementation of key features deferred beyond June 2020 currently classified in project documentation as "maintenance and operations".
- A project timeline allowing sufficient time to stabilize current system functionality and complete the transition from existing business processes.
- A budget that includes ongoing funding for oversight until the State Controller produces the State's annual financial statements exclusively using the FI$Cal system.

To capture the complete costs of the FI$Cal project, the Legislature should also require the project office—in coordination with entities implementing FI$Cal—to report to the Legislature on all unanticipated costs of the project, such as staffing.

FI$Cal Project Office

The project office should arrange for oversight to continue until the State Controller publishes the State's annual financial statements exclusively using the FI$Cal system.

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 916.445.025

Appendix A

STATUS OF PRIOR RECOMMENDATIONS

Our August 2018 report included several recommendations to the project office and CDT related to improving project transparency and oversight. In our January 2019 report, Report 2018-039, we noted that the project office and CDT had not fully implemented those recommendations. As Table A reflects, the project office and CDT still have not fully implemented our recommendations.

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

RECOMMENDATION	STATUS AS OF JANUARY 2019 REPORT	JANUARY 2019 STATE AUDITOR'S ASSESSMENT OF STATUS	STATUS AS OF DECEMBER 2019 REPORT	ASSESSMENT UPDATE
FI$Cal project office				
The project office should include in its February 2019 Annual Report to the Legislature specific metrics that will help inform the Legislature as to the current risks associated with system implementation. The project office's reporting metrics should include, among other items, the status of month end close for all entities, the number of entities that are operating their legacy systems, and the number of entities reporting concerns with using FI$Cal to meet federal requirements.	The project office stated that it will include the new metrics in its annual report to the Legislature.	*Pending*	The project office included some of the metrics we recommended, but not others. For example, the project office did not report on the volume of backlogged transactions that entities still need to input into FI$Cal.	*Partially Implemented*
The State Controller, Finance, and the project office should meet in September 2018 to discuss the status of delinquent entity financial statements and develop corrective measures to ensure that the State's financial report is produced with timeliness and accuracy.	Although the project office stated it did not hold a meeting in September to specifically address this recommendation, it participated in weekly leadership meetings with Finance, DGS, State Controller, and State Treasurer representatives where this topic was discussed. Further, the project office indicated it coordinated with the State Controller and Finance on a new policy for preparing year-end financial statements and with Finance on user training. As we discuss in the text however, entities have continued to submit late financial statements and there are some risks related to this new policy.	*Pending*	As noted in this report, we had concerns with the policy set by Finance in consultation with the State Controller for preparing the year-end financial statements for fiscal year 2017–18. In addition, it remains to be seen whether departments will submit timely and accurate financial information using FI$Cal for fiscal year 2018–19.	*Partially Implemented*

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RECOMMENDATION	STATUS AS OF JANUARY 2019 REPORT	JANUARY 2019 STATE AUDITOR'S ASSESSMENT OF STATUS	STATUS AS OF DECEMBER 2019 REPORT	ASSESSMENT UPDATE
CDT				
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$Cal to meet all of their accounting and reporting needs. • Fully implementing the 2018 release entities that may not be successfully transacting in FI$Cal by June 2019.	According to CDT, it will require the project office to submit a new special project report or another similar document disclosing the project office's new implementation plan, cost estimates, and timeline in 2019.	*Pending*	The project office did submit a new project plan update with changes to its cost, scope, and schedule; however, as we mention in this report, we question whether this new update accurately captures the true costs, scope, and schedule of the project.	*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.	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 Finance, the State Controller, the State Treasurer, and DGS on a regular basis. However, we have not observed CDT sharing significant risks or issues in recent steering committee meetings.	*Not Implemented*	CDT has improved at raising significant concerns at the steering committee meetings. However, we believe its important for it to continue its efforts over the remainder of the project.	*Partially Implemented*
To ensure that stakeholders receive timely information regarding project risks and issues, CDT should ensure that it meets the Statewide Information Management Manual 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*	Since we last reported on this issue in January, CDT has submitted timely oversight reports.	*Fully Implemented*

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

Appendix B

USE OF PREVIOUS SYSTEMS

More than 20 departments postponed a full transition to FI$Cal with Finance's approval and instead continued to use the CalSTARS system, one of FI$Cal's primary predecessors, well into fiscal year 2018–19.[2] According to project documents, extended use of CalSTARS was necessary due to various problems departments were encountering using FI$Cal for specific critical tasks and to allow these departments additional time to resolve some implementation-related obstacles. Issues preventing entities from fully transitioning to FI$Cal became particularly problematic for two state entities, the California Department of Social Services and the Franchise Tax Board, which implemented FI$Cal in July 2018, but are using CalSTARS to submit financial statements to the State Controller for fiscal year 2018–19. However, project documents also noted that no departments are transacting in CalSTARS for fiscal year 2019–20.

Table B
More Than Twenty Departments Continued Using CalSTARS Well Into Fiscal Year 2018–19

MONTH DEPARTMENTS FULLY TRANSITIONED TO FI$CAL FROM CALSTARS IN 2019	DEPARTMENTS
January	California Governor's Office of Emergency Services
	California State Transportation Agency
	Secretary of State's Office
February	California Environmental Protection Agency
	Department of State Hospitals
March	California Air Resources Board
	California Alternative Energy & Advanced Transportation Financing Authority
	California Department of Education
	California Department of Fish and Wildlife
	California Department of Public Health
	California Department of Veterans Affairs
	California Pollution Control Financing Authority
	Department of Parks and Recreation
	State Water Resources Control Board
April	State Council on Developmental Disabilities
May	California Department of Forestry and Fire Protection
	Department of Developmental Services
June	Department of Health Care Services
July or later	California Department of Social Services
	California Health Benefit Exchange
	Franchise Tax Board
	State Treasurer's Office

2 Two departments—the Employment Development Department and the Commission on Judicial Performance—indicated that they fully transitioned from non-CalSTARS legacy systems during fiscal year 2018–19. Three other departments—the California Department of Tax and Fee Administration, the State Board of Equalization, and the Judicial Council of California—indicated that they will fully transition during fiscal year 2019–20 or later.