JBC Staff-initiated Supplemental Recommendation

JS1 – A COMMITTEE POLICY FOR DEFINING AND ANNUALIZING MINIMUM EXPECTED BASELINE OPERATING EFFICIENCIES FOR IT CAPITAL PROJECTS

Staff Recommendation: Staff recommends that the Committee adopt a policy for annualizing implied out-year operating efficiencies – personal services and operating expenses base reductions – for funded IT capital projects as follows:

1. In the second fiscal year of implementation (between 12 and 24 months), personal services will be offset by a base reduction equal to 10.0 percent of the IT project cost. Additionally, in the second fiscal year of implementation, operating expenses will be offset by an equivalent, ongoing base reduction for annual operating or maintenance costs associated with the IT system. (If operating or maintenance costs are expected to vary over out years, an average of those out year costs should be taken as the base reduction.)

2. For supplemental or additional appropriations made for the project which are considered necessary to complete the system as originally requested, the personal services base reduction will be equal to 15.0 percent of the supplemental or additional appropriations. Additionally, increases in the annual operating or maintenance costs associated with the IT system over original estimates will be assessed an additional 10.0 percent base reduction for the additional amount.

3. Actual project costs that are lower than appropriated will reduce the out-year base reduction annualization using the same formula.

Staff Analysis:

<u>IT Capital Requests Don't Identify Savings</u>

IT capital project requests from state agencies request funding for new IT systems that presumably either create operating efficiencies or enhance program operations but do not identify operating efficiencies or program enhancements specifically. Generally, staff is in favor of updating IT systems as a way of gaining operating efficiencies and improving program operations. However, the cost of IT systems are generally high and all come with the general expectation of delivering some form of operating efficiencies or program enhancements.

Staff had initially recommended that the Committee pursue legislation to require that IT capital projects specifically include cost-benefit analysis with the intention of identifying operating efficiencies. On this basis, projects that deliver more operating efficiencies would presumably have a greater likelihood of being funded.

However, there appears to be general resistance to this legislative recommendation based on responses from OSPB. And staff's sense is that even with a statutory requirement, the quantification of operating efficiencies would likely still not be addressed satisfactorily.

Legislative Authority over Appropriation

Rather than argue or disagree about the arbitrary nature of methodology and projections for identifying operating efficiencies for the purpose of *paying for* an IT capital project, this recommendation simply states that the value of operating efficiencies (or program enhancements) is going to be assumed or implied for every project according to this formula. State agencies can independently determine whether a particular project is worthwhile based on that formula or cost.

The base reduction formula of 10.0 percent is essentially equal to a 10-year capitalization or depreciation schedule, which is reasonable for most large IT systems. The ongoing or permanent 10.0 percent base reduction also assumes that efficiency gains from an IT system are essentially permanent.

The formula does two things:

1. It recaptures 100 percent of the cost of an IT capital project over 10 years; and
2. It establishes a penalty of an additional base reduction equal to 5.0 percent of supplemental or additional appropriations that are needed due to poor project planning or implementation; and a penalty of 10.0 percent for ongoing costs that are higher than originally estimated.

The goal with this recommendation is to fund essentially any project that state agencies request for funding with the caveat that the state agency will be paying for the project with base reductions to personal services and operating expenses accordingly. The state agency should determine prior to the request, that such a request is worth at least that cost. It also encourages state agencies to more completely plan and exercise due diligence prior to requesting a project, rather than knowing they can always come back for more, when the original appropriation has been spent due to poor planning or poor implementation.

It really is up to the state agency to deliver on the project, because they will be paying for it whether it works or not. This does not absolve the JBC or the General Assembly from doing its own due diligence in vetting IT capital project requests. However, staff's concern is that state agencies do not really have to deliver efficiencies once a project has been funded. If a project is worth funding – because of the benefits that a project is expected to deliver – then the state agency can determine whether the 'cost' is worth the project. This relieves the burden on the JTC, the JBC, and the General Assembly for approving projects that in hindsight did not deliver as proposed – the cost will be recovered, regardless. And state agencies will know the tradeoff or cost.

RFI for Annualizations

It is envisioned that most, if not all, IT capital projects will need to include a request for information that asks the state agency to identify the line items that will be annualized with base reductions in future fiscal years. Failure to provide this annualization allocation will necessitate that JBC staff analysts will independently make those annualization recommendations in figure setting without state agency input.

For projects associated with central service agencies like the Office of Information Technology (OIT) and the Department of Personnel, those base reductions would be allocated to all state agencies according to a reasonable allocation formula tied to the funded project. Base reductions for such central service IT systems should generally be assessed at the executive director's office level for personal services and operating expenses reductions, given their central service function; in some departments, central services provision may occur in division or program administration offices, which necessitates the RFI. For projects in a given department, agency, or program, reductions should be taken specific to the department, agency, or program that benefits from the IT system, and similarly necessitates the RFI to allow the department, agency, or program to best determine the location of base reductions.

Example

The following is an example of how this policy would work.

The JTC has approved and forwarded a supplemental request from OIT for the Department of Personnel's Human Resource Information System (HRIS). The supplemental is for an additional $15.2 million in state funds. The original appropriation was for $16.1 million in state funds. Additionally, the project will experience annual, ongoing maintenance costs of $3.04 million. The project has a planned "go live" date of May 2017.

In FY 2016-17, the project will begin to experience annual, ongoing maintenance costs of $3.04 million. The second fiscal year of implementation will be FY 2017-18 based on the "go live" date of May 2017.

In FY 2017-18, the following base reductions will be allocated and taken statewide:

- $3.04 million in operating expenses;
- $1.61 million in personal services for the primary appropriation;
- $2.28 million in personal services for the supplemental appropriation.

- $6.93 million in total base reductions.

Over 10 years, those base reduction savings total $69.3 million. The project cost was $31.3 million and experienced $30.4 million in annual maintenance costs, for a 10-year total cost of $61.7 million. The difference of $7.6 million is the supplemental "penalty" amount.

Based on an allocation equivalent to the CORE allocation requested for FY 2015-16, the following table outlines base reductions for the HRIS project in FY 2017-18. For purposes of comparison, the two columns on the right include total operating appropriations for FY 2014-15 and the percentage that the base reduction represents of that total department appropriation.

HRIS Base Reduction Allocation in FY 2017-18				
	FY 2015-16 Req. Core Allocation	FY 2017-18 Base Reduction	FY 2014-15 Total Appropriation	Base Reduction Percent of Total Appropriation
Agriculture	0.7%	$51,099	$44,184,405	0.12%
Corrections	5.9%	408,982	808,028,400	0.05%
Education	2.0%	139,004	5,251,199,806	0.00%
Governor	1.7%	116,916	284,943,658	0.04%
Health Care Policy	15.4%	1,069,545	7,876,855,463	0.01%
Higher Education	0.9%	64,059	3,442,742,629	0.00%
Human Services	16.1%	1,115,870	1,901,273,647	0.06%
Judicial	15.6%	1,083,771	614,943,426	0.18%
Labor and Employment	2.9%	203,595	167,437,131	0.12%
Law	0.6%	39,535	73,966,331	0.05%
Legislature	0.3%	18,771	42,029,278	0.04%
Local Affairs	3.9%	267,439	310,257,918	0.09%
Military Affairs	0.6%	43,647	225,304,185	0.02%
Natural Resources	16.6%	1,153,645	256,122,267	0.45%
Personnel	3.9%	268,554	173,354,939	0.15%
Public Health	3.4%	237,020	551,305,467	0.04%
Public Safety	2.5%	175,643	401,203,913	0.04%
Regulatory Agencies	1.8%	125,093	86,666,820	0.14%
Revenue	2.9%	198,961	327,080,067	0.06%
State	0.2%	11,398	22,136,875	0.05%
Transportation	1.2%	80,143	1,283,197,431	0.01%
Treasurer	0.8%	57,310	438,771,136	0.01%
Total Statewide Base Reduction		**$6,930,000**		