MINUTES

JOINT FINANCE-APPROPRIATIONS COMMITTEE

DATE: Thursday, January 15, 2015

TIME: 8:00 A.M.

ROOM: Room C310

MEMBERS PRESENT: Senators Co-chairman Cameron, Keough, Mortimer, Bair, Nuxoll, Johnson, Thayn, Guthrie, Schmidt, Lacey

Representatives Co-chairman Bell, Gibbs, Miller, Youngblood, Burtenshaw, Horman, Malek, Monks, King, Gannon

ABSENT/EXCUSED: None

CONVENED: Vice Chairman Keough called the meeting to order at 8:00 A.M. At 8:05 A.M. the gavel was passed to Chairman Cameron.

STAFF PRESENT: Lockett

SPECIAL HEARINGS

PRESENTATION: **Findings of a System Modernization Study – An Independent Analysis of Idaho's Current and Future Financial System Needs**

PRESENTER: **Brandon Woolf, Idaho State Controller**

Woolf said the 2014 Legislature appropriated $250,000 to undertake a study to assess Idaho's financial system needs. The Department of Health and Welfare provided additional funding for the statewide project. After speaking with counterparts in others states and obtaining additional information from the National Association of State Auditors, Comptrollers and Treasurers, an extensive search was done to evaluate and vet vendors. Ultimately the services of Information Services Group (ISG) Public Sector were retained. ISG is a competent, experienced and nationally respected expert on enterprise level financial, payroll, and human resource systems. It was determined that ISG was best positioned to give Idaho an independent and unbiased recommendation.

Idaho assumed that the replacement system would be a statewide Enterprise Resource Planning (ERP) system which is a suite of fully integrated software applications that perform administrative business functions such as accounting, procurement, human resources, and payroll. The new system would replace central systems, such as the Statewide Accounting and Reporting System (STARS) and the Employee Information System (EIS) as well as a significant number of other central and agency-specific administrative systems. ERP systems typically offer additional functionality that would expand the system capability beyond what is presently available to a majority of State agencies.

ISG's study captured an estimate of the true and total cost of modernizing Idaho's fiscal system. (ISG did not evaluate higher educations' systems in this study.) The study goes beyond identifying hardware and software costs. It detailed the costs that would be borne by the Controller's office and other state agencies to connect their business-specific software, programmatic systems, to a new statewide fiscal system. ISG also identified longer term operating costs for the state.

The Controller gave a brief history of Idaho's financial system. Electronic tabulation machines were used in the late 1960's, then in the 1970's those systems were replaced with mainframe computers. In the 1980's newer systems were installed and are still in use today: STARS for Accounting and EIS for payroll, still in the mainframe environment. In the early 2000's, the systems in use were patched with add-ons. The updates did not change core technology but they extended the system's useful life. The state has reached a point where it is time to develop a plan to modernize because the current financial system can no longer be supported and the needs of many state agencies are not being met or are at risk of not being met.

The Controller's Office employed sound project management principles to ensure the study was progressing on time, within scope, and on budget.

PRESENTER: **Nathan Frey, Managing Partner, Information Services Group, Inc.**

Information Services Group (ISG) Public Sector recently submitted their report documenting the results of the Business Case Analysis for the System Modernization Study and stated the company's report indicates substantial justification for the need to modernize the central administrative systems used by the State of Idaho. To view the presentation, please click on the following link Systems Modernization Study

ISG is an independent advisory to 18 states on statewide Enterprise Resource Planning (ERP) projects and has done ERP business case development for 11 states. The company is independent of all hardware, software and services vendors. The purpose of the study was to evaluate the condition of statewide and agency business systems; the scope of the project involved administrative functions, financial management, procurement, and human resources and payroll management.

The Controller's Office and ISG interviewed, surveyed, and reviewed available documentation. Their analysis encompassed 80% of the State's operating budget and 70% of the State's employees involving 20 of Idaho's agencies or departments. After establishing the scope of the project, ISG began an assessment with the purpose of obtaining a high level of understanding the State's financial management systems, including: strengths and weaknesses, functionality either provided or not provided by each system, potential process improvement opportunities, and the degree of the various systems interfacing/integration. At the outset ISG tried to identify agency-specific systems that would be eligible for retirement or replacement by ERP implementation as well as quantifiable and intangible process improvement benefits and risks associated with legacy systems. Approximately 20 agencies were interviewed as well as additional stakeholders; the company reviewed system and business process documentation and validated observations and findings with the agencies.

Following are the key findings of the STARS and EIS systems in the areas of financial management, procurement, and HR/payroll systems: 1) the systems are more than 20 years old, do not provide needed functionality, and cannot be feasibly updated, 2) the systems lack vendor support and compatibility with newer systems as well as flexibility and scalability required to meet changing business requirements, 3) web-based add-ons have reached the limits of underlying technology, 4) limited integration capabilities and manual workarounds have led to inefficiencies and greater opportunities for error, 5) decision-makers have difficulty obtaining timely and accurate information, 6) in the absence of a statewide purchasing system integrated with STARS, agencies have their own systems to generate requisitions and purchase orders, to perform budget checking, and to enable receiving and approval processes which, in turn, makes it difficult to enforce agencies' use of statewide negotiated contracts.

Two alternatives were evaluated: maintain the State's existing system (status quo), or implement full ERP. Maintaining the existing system (STARS and EIS) has limitations and risks described in the preceding paragraph. Implementing a new ERP system would encompass a suite of fully integrated financial management, purchasing, and HR/payroll software modules to perform administrative business functions as well as budget preparation and data warehouse/business intelligence capabilities.

If the ERP system were implemented it would occur in two phases. Phase 1 would involve Finance/Procurement and would take about 24 months; Phase 2 for HR/Payroll would take 18 months. Implementation would be preceded by a 12 to 24 month preparation phase for planning and executing a formal procurement process. The estimated cost to acquire and implement full ERP would be $102.7 million. Ongoing operational costs would be approximately $97.5 million over ten years; there would be some offsets resulting in a net benefit of $11.7 million. ISG estimates the investment would reach the payback point in the ninth year following the Phase 2 go-live (Year 13).

PRESENTATION: **Service Audit of Idaho Education Network (IEN)**

PRESENTER: **April Renfro, Manager, Legislative Audits Division, Legislative Services**

To view the presentation, please click on the following link: Service Audit of Idaho Education Network (IEN)

Renfro explained during the 2014 Legislative session House Bill 650 passed and included legislative intent language which required the Department of Administration to collaborate with the Legislature in performing service audits to determine ownership of all equipment purchased or leased regarding the Idaho Education Network (IEN) contract. The legislation also required confirmation of the type and level of usage of IEN services by each school district receiving services under the contract.

Renfro's division contracted with Eide Bailly, LLP, in July of 2014 to complete a services audit for the years ended June 30, 2013 and 2014. The purpose of the report was to provide information to address questions raised during the budget process in the 2014 legislative session. The procedures included establishing an understanding of the IEN contract, determining who owned the assets related to the IEN and the video conferencing services provided through the IEN and testing a sample of those assets. The assets were in five broad categories: high definition cameras, flat screen televisions, projectors, document cameras, and video teleconferencing codecs. The State of Idaho had purchased a total of 1,043 IEN assets at a cost of $3.35 million.

The contractor selected a sample of 30 out of 217 high schools utilizing 133 of IEN video teleconferencing assets purchased for $441,624 to determine that assets were locatable and the extent to which they were utilized. The 30 schools were specifically selected to ensure a cross section of large, small, and geographical differentiated schools. The contractor inquired with each school representative to determine which pieces of equipment were being utilized in any capacity and noted that 62 of the 133 items or 47% of IEN assets were being utilized. Only 125 of the 133 items or 94% of the assets were located; the eight missing items were worth $13,682. The most under-utilized asset group was the video teleconferencing codecs which happened to be one of the most expensive assets and represented 38% of the assets and 42% of the dollars.

Over four semesters from Fall 2012 through Spring 2014 more than 600 classes were offered through the IEN with an enrollment of more than 6,000, cumulative; however, use has declined during that time period. In the Fall of 2012 there were 1,850 students enrolled in IEN classes; in the Spring of 2014 only 1,510 students were enrolled and that figure included 105 students enrolled from North Idaho College and 126 students from the College of Western Idaho.

Eide Bailly sent a survey to 147 school district technology directors and administrators focusing on three main topics: broadband usage, utilization of IEN services, and use of interactive classes. They received 48 responses or 32.7% of the survey's respondents (38 completed the entire survey and 10 completed only a portion of the survey). Results indicated that almost 81% of the districts responding offered 0-3 interactive classes during the 2013-14 school year and almost 50% of the respondents indicated they did not offer any interactive classes during that school year which correlates to approximately 50% of the respondents indicating that they had no students participating in interactive classes.

When asked about district satisfaction with the services received through the IEN, 35 respondents answered the question and 51.4% ranked the services received at a 5 on a scale of 1 to 5, with 5 being the most satisfied. Overall, participating schools value the IEN in a broad sense (connectivity and ability to utilize it for a variety of purposes). Students enrolled in IEN classes utilizing the video teleconferencing are about 2% of the total number of students with access to the IEN (down from 2.2% in 2012). Students enrolled in Idaho Digital Learning Academy (IDLA) classes utilizing the IEN are approximately 23% of the total number of students with access to the IEN. While usage of the IEN classes provided through the video teleconferencing has declined over the two years of data supplied, IDLA enrollment has increased.

PRESENTATION: **Use of Salary Savings in State Government to Fund Employee Compensation**

PRESENTER: **Bryon Welch and Amanda Bartlett, Office of Performance Evaluations (OPE)**

To view the presentation, please click on the following link: Use of Salary Savings in State Government

Welch said the Office of Performance Evaluations was asked to study the use of salary savings to fund employee compensation for state employees. Salary savings is one of the tools agencies have available to reward employees with one-time or ongoing pay increases. Salary savings along with a Change in Employee Compensation (CEC) are the primary compensation tools agencies have available to increase employee pay. The report explored what factors influence an agency's ability to generate salary savings, the extent to which savings are available to agencies, and what impacts those savings have on employee compensation.

OPE worked closely with the Office of State Controller since that office maintains the statewide accounting and payroll systems. Data from the analysis came from those systems because they provided the most consistent estimate of salary savings; data was analyzed from FY2006-2014. The report excluded postsecondary institutions since they process payroll outside of the statewide system and then transfer a limited amount of data to the Controller.

Bartlett explained that salary savings is the difference between the personnel budget and actual personnel expenditures. For agencies in the evaluation sample in FY 2006-2014, 11% was the average salary savings of the total personnel appropriation; the majority of agencies' estimated savings varied from 3% to 25%. Of the three types of salary savings, 46% was used for personnel expenditures, 41% was reverted, and 13% was transferred to another expenditure category.

Salary savings can be generated in the following ways: overappropriation, turnover, vacant positions, or a position being filled at a lower rate of pay. A corresponding scenario that could reduce savings would be: an underappropriation, leave balance payouts, or a position filled at a higher pay rate. Significant factors for the amount of salary savings depended on turnover rate, dependence on the General Fund, the size of the agency, and the branch of government. Legislative and judicial branch agencies were more likely to transfer money into and out of personnel than executive branch agencies. Once OPE was able to quantify the amount of salary savings and identify factors that influenced the amount of salary savings an agency had available, the office wanted to measure the effect of salary savings on employee compensation. It found that agencies that used more salary savings for personnel expenditures were able to provide ongoing salary increases to more employees. Agencies with high salary savings used personnel expenditures on average awarded ongoing increases to 56% of employees and agencies with no estimated salary savings on average awarded ongoing increases to 18% of employees. OPE found when the Legislature appropriated a CEC, over five times more employees received an ongoing increase than when no CEC was appropriated. Leave balance payouts and overtime represented major personnel expenditures not incorporated into agency budgets.

Welch discussed the impacts of relying on salary savings and policy considerations. Agencies have considerable discretion on how to use salary savings, whether that is targeted increases to employee pay, used to pay for unexpected overtime or leave balance payouts, or transferring those savings into another spending category. As previously stated, agencies generate and use salary savings at different rates, thus distribution is inequitable based on variable turnover rates and the lack of uniformity in the way agencies budget for personnel costs. Agencies who adhere to their budgets have little or no salary savings resulting in a perverse incentive to deviate from personnel budget; therefore, these prudent agencies are punished in that they do not have money available for employee compensation. Another impact of relying on salary savings is that agencies cannot rely on salary savings for long-term planning.

Policy considerations for legislators include the following. 1) Should statewide data systems be integrated to precisely monitor and manage salary savings? Key data points necessary to precisely calculate salary savings are not captured in statewide systems. 2) Should paid overtime and leave balance payouts be uniformly incorporated into agency personnel budgets? Idaho currently does not uniformly budget for paid overtime and leave balance payouts. 3) Does the legislative intent in Idaho Code align with today's legislative priorities? Salary savings has not proven to be an adequate tool to close the gap between average pay rates and policy pay rates. 4) What other tools can be used to address unmet employee compensation needs? The data analyzed for OPE's report showed that salary savings and a CEC together have not substantially improved overall employee pay.

Because salary savings cannot fund all types of compensation increases, the Legislature may need to identify additional funding strategies to address these needs and, further, should provide clear direction on the intended purpose of a CEC and salary savings and any additional compensation tools.

ADJOURNED: There being no further business to come before the Committee, Chairman Cameron adjourned the meeting at 10:37 a.m.

Senator Cameron Chair	Peggy Moyer Secretary

Senator Keough
Vice Chair