

STATE OF CALIFORNIA  
**Budget Change Proposal - Cover Sheet**  
 DF-46 (REV 08/15)

Fiscal Year 2016-17	Business Unit 0950	Department State Treasurer's Office	Priority No. 1
Budget Request Name 0950-300-BCP-BR-2016-A1		Program 0740-State Treasurer's Office	Subprogram 0740028-Public Finance Division

Budget Request Description  
 Debt Management System (DMS) II Project

**Budget Request Summary**

The DMS II Special Project Report (SPR) 1 was approved in May 2015. The SPR 1 addressed the schedule slippage from the originally approved FSR and rebaselined the cost estimates for the DMS II Project. The expenditure and reimbursement authority amounts requested by this Finance Letter (FL) are based upon the proposed funding changes reflected in the SPR 2.

The STO is requesting \$6,265,000 in expenditure and reimbursement authority for FY16/17 to continue the DMS II Project. The DMS II Project was originally planned to be a replacement system for the STO's existing, obsolete and inflexible debt management system; however, following receipt of vendor feedback on the draft Request for Proposal (RFP) in March 2015, it was determined that the STO would be better served to modernize its current Oracle platform, leveraging the functional core of the existing DMS.

This request will not impact the General Fund. The STO has identified specific reimbursement funds as the sole funding source. The funding estimates in the FY 15/16 FL did not anticipate that the System Integrator (SI) would be engaged for the entire FY16/17. Given, the change in the procurement strategy we have reallocated the planned funding to account for the change in the project schedule and needs. The amount reflected in this FL includes all the necessary costs to fund the project for FY 16/17.

Requires Legislation <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	Code Section(s) to be Added/Amended/Repealed
---	--

Does this BCP contain information technology (IT) components? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No <i>If yes, departmental Chief Information Officer must sign.</i>	Department CIO <i>Jan Ross</i>	Date <i>3-10-16</i>
---	-----------------------------------	------------------------

For IT requests, specify the date a Special Project Report (SPR) or Feasibility Study Report (FSR) was approved by the Department of Technology, or previously by the Department of Finance.

FSR  SPR Project No. 0950-019 Date: 5/14/2015

If proposal affects another department, does other department concur with proposal?  Yes  No  
 Attach comments of affected department, signed and dated by the department director or designee.

Prepared By <i>MAISHA DOTTERY</i>	Date <i>3-10-16</i>	Reviewed By <i>Ruthie Mallon</i>	Date <i>3-10-16</i>
Department Director <i>Blake Fowler</i>	Date <i>3-10-16</i>	Agency Secretary <i>[Signature]</i>	Date <i>3/10/16</i>

**Department of Finance Use Only**

Additional Review:  Capital Outlay  ITCU  FSCU  OSAE  CALSTARS  Dept. of Technology

BCP Type:  Policy  Workload Budget per Government Code 13308.05

PPBA <i>Gregory R. Bruss</i>	Date submitted to the Legislature <i>4/1/2016</i>
---------------------------------	--

**Fiscal Summary**  
(Dollars in thousands)

BCP No.	Proposal Title	Program				
1	Debt Management System (DMS) II	0740-State Treasurer's Office				
Personal Services	Positions			Dollars		
	CY	BY	BY + 1	CY	BY	BY + 1
Total Salaries and Wages <sup>1</sup>		6.0	6.0		\$490	\$490
Total Staff Benefits <sup>2</sup>					<b>204</b>	<b>224</b>
<b>Total Personal Services</b>	0.0	6.0	6.0	\$0	\$694	\$714
<b>Operating Expenses and Equipment</b>						
General Expense					24	24
Printing					3	3
Communications					18	18
Postage					3	3
Travel-In State					6	6
Travel-Out of State						
Training					6	6
Facilities Operations					24	24
Utilities					6	6
Consulting & Professional Services: Interdepartmental <sup>3</sup>					113	113
Consulting & Professional Services: External <sup>3</sup>					4,627	4,621
Data Center Services					6	6
Information Technology						
Equipment <sup>3</sup>					640	114
Other/Special Items of Expense: <sup>4</sup>						
Agency Facilities					45	45
Other					50	50
<b>Total Operating Expenses and Equipment</b>				\$0	\$5,571	\$5,039
<b>Total State Operations Expenditures</b>				\$0	\$6,265	\$5,753
Fund Source	Item Number					
	Org	Ref	Fund			
General Fund						
Special Funds <sup>5</sup>						
Federal Funds						
Other Funds (Specify)						
Reimbursements	0950	001	0995		\$6,265	\$5,753
<b>Total Local Assistance Expenditures</b>				\$0	\$0	\$0
Fund Source	Item Number					
	Org	Ref	Fund			
General Fund						
Special Funds <sup>5</sup>						
Federal Funds						
Other Funds (Specify)						
Reimbursements						
<b>Grand Total, State Operations and Local Assistance</b>				\$0	\$6,265	\$5,753

<sup>1</sup> Itemize positions by classification on the Personal Services Detail worksheet.

<sup>2</sup> Provide benefit detail on the Personal Services Detail worksheet.

<sup>3</sup> Provide list on the Supplemental Information worksheet.

<sup>4</sup> Other/Special Items of Expense must be listed individually. Refer to the Uniform Codes Manual for a list of standard titles.

<sup>5</sup> Attach a Fund Condition Statement that reflects special fund or bond fund expenditures (or revenue) as proposed.



**Supplemental Information**

*(Dollars in thousands)*

BCP No. 1	Proposal Title Debt Management System (DMS) II
--------------	---

Equipment	CY	BY	BY +1
Standard Complement		20	
Hardware		120	14
Software		500	100
<b>Total</b>	\$0	\$640	\$114

**Consulting & Professional Services**

Project Management Support Vendor		449	449
IV&V Vendor		179	173
Prime Solution Vendor		3,999	3,999
Project Oversight (Ca Dept of Tech, IPOC)		113	113
<b>Total</b>	\$0	\$4,740	\$4,734

**Facility/Capital Costs**

<b>Total</b>	\$0	\$0	\$0

**One-Time/Limited-Term Costs**      Yes       No

Description	BY		BY +1		BY +2	
	Positions	Dollars	Positions	Dollars	Positions	Dollars
	0.0	\$0	0.0	\$0	0.0	\$0

**Full-Year Cost Adjustment**      Yes       No

*Provide the incremental change in dollars and positions by fiscal year.*

Item Number	BY		BY +1		BY +2	
	Positions	Dollars	Positions	Dollars	Positions	Dollars
<b>Total</b>	0.0	\$0	0.0	\$0	0.0	\$0

**Future Savings**      Yes       No

*Specify fiscal year and estimated savings, including any decrease in positions.*

Item Number	BY		BY +1		BY +2	
	Positions	Dollars	Positions	Dollars	Positions	Dollars
<b>Total</b>	0.0	\$0	0.0	\$0	0.0	\$0

# BCP Fiscal Detail Sheet

BCP Title: Debt Management System (DMS) II

DP Name: 0950-300-BCP-DP-2016-A1

## Budget Request Summary

	FY16					
	CY	BY	BY+1	BY+2	BY+3	BY+4
Positions - Permanent	0.0	6.0	0.0	0.0	0.0	0.0
<b>Total Positions</b>	<b>0.0</b>	<b>6.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Salaries and Wages						
Earnings - Permanent	0	490	0	0	0	0
<b>Total Salaries and Wages</b>	<b>\$0</b>	<b>\$490</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
Total Staff Benefits	0	204	0	0	0	0
<b>Total Personal Services</b>	<b>\$0</b>	<b>\$694</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
Operating Expenses and Equipment						
5301 - General Expense	0	24	0	0	0	0
5302 - Printing	0	3	0	0	0	0
5304 - Communications	0	18	0	0	0	0
5306 - Postage	0	3	0	0	0	0
5320 - Travel: In-State	0	6	0	0	0	0
5322 - Training	0	6	0	0	0	0
5324 - Facilities Operation	0	24	0	0	0	0
5326 - Utilities	0	6	0	0	0	0
5340 - Consulting and Professional Services - External	0	4,627	0	0	0	0
5340 - Consulting and Professional Services - Interdepartmental	0	113	0	0	0	0
5344 - Consolidated Data Centers	0	6	0	0	0	0
5368 - Non-Capital Asset Purchases - Equipment	0	640	0	0	0	0
54XX - Special Items of Expense	0	95	0	0	0	0
<b>Total Operating Expenses and Equipment</b>	<b>\$0</b>	<b>\$5,571</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
<b>Total Budget Request</b>	<b>\$0</b>	<b>\$6,265</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
<b>Fund Summary</b>						
Fund Source - State Operations						
0001 - General Fund	0	0	0	0	0	0
0995 - Reimbursements	0	6,265	0	0	0	0
<b>Total State Operations Expenditures</b>	<b>\$0</b>	<b>\$6,265</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
<b>Total All Funds</b>	<b>\$0</b>	<b>\$6,265</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

## Program Summary

Program Funding

0740028 - Public Finance

**Total All Programs**

0	6,265	0	0	0	0
<b>\$0</b>	<b>\$6,265</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

**Personal Services Details**

**Salary Information**

Positions	Min	Mid	Max	<u>CY</u>	<u>BY</u>	<u>BY+1</u>	<u>BY+2</u>	<u>BY+3</u>	<u>BY+4</u>
1337 - Sr Info Sys Analyst (Spec) (Eff. 07-01-2016)				0.0	1.0	0.0	0.0	0.0	0.0
1373 - Sys Software Spec II (Tech) (Eff. 07-01-2016)				0.0	1.0	0.0	0.0	0.0	0.0
1393 - Dp Mgr III (Eff. 07-01-2016)				0.0	1.0	0.0	0.0	0.0	0.0
1470 - Assoc Info Sys Analyst (Spec) (Eff. 07-01-2016)				0.0	1.0	0.0	0.0	0.0	0.0
1583 - Sr Programmer Analyst (Spec) (Eff. 07-01-2016)				0.0	1.0	0.0	0.0	0.0	0.0
4225 - Treasury Program Mgr II (Eff. 07-01-2016)				0.0	1.0	0.0	0.0	0.0	0.0
<b>Total Positions</b>				<b>0.0</b>	<b>6.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Salaries and Wages	<u>CY</u>	<u>BY</u>	<u>BY+1</u>	<u>BY+2</u>	<u>BY+3</u>	<u>BY+4</u>
1337 - Sr Info Sys Analyst (Spec) (Eff. 07-01-2016)	0	81	0	0	0	0
1373 - Sys Software Spec II (Tech) (Eff. 07-01-2016)	0	81	0	0	0	0
1393 - Dp Mgr III (Eff. 07-01-2016)	0	98	0	0	0	0
1470 - Assoc Info Sys Analyst (Spec) (Eff. 07-01-2016)	0	67	0	0	0	0
1583 - Sr Programmer Analyst (Spec) (Eff. 07-01-2016)	0	81	0	0	0	0
4225 - Treasury Program Mgr II (Eff. 07-01-2016)	0	82	0	0	0	0
<b>Total Salaries and Wages</b>	<b>\$0</b>	<b>\$490</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

Staff Benefits	<u>CY</u>	<u>BY</u>	<u>BY+1</u>	<u>BY+2</u>	<u>BY+3</u>	<u>BY+4</u>
5150350 - Health Insurance	0	40	0	0	0	0
5150500 - OASDI	0	30	0	0	0	0
5150600 - Retirement - General	0	123	0	0	0	0
5150800 - Workers' Compensation	0	4	0	0	0	0
5150900 - Staff Benefits - Other	0	7	0	0	0	0
<b>Total Staff Benefits</b>	<b>\$0</b>	<b>\$204</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

Total Personal Services

\$0

\$694

\$0

\$0

\$0

\$0

## Analysis of Problem

### A. Budget Request Summary

On May 14, 2015, the SPR 1 was approved by CalTech; the SPR 1 was submitted to account for the schedule slippage from the DMS II Project FSR to January 2015. The SPR 1 also provided cost estimates for the DMS II Project through the planned project deployment of March 2020.

The STO is requesting \$6,265,000 in expenditure and reimbursement authority for FY 16/17 to continue the DMS II Project that was originally authorized in the FY 13/14 Budget Act. The amount estimated in the SPR 1 for FY 16/17 and the revised amount requested in this FL and the SPR 2 for FY 16/17 consists of:

- \$120,000 for Hardware
- \$500,000 for Software/Licensing
- \$449,000 for the Project Management Support Services (PMSS) Consultant
- \$179,000 for the Independent Verification & Validation (IV&V) Consultant
- \$3,999,000 for the System Integrator (SI)
- \$113,000 for CalTech Independent Project Oversight (IPOC)
- \$45,000 for Agency Facilities
- \$50,000 for Other
- \$810,000 for continued state staff funding which includes four existing positions and two new positions, and their respective project roles:
  - Data Processing Manager III (DPM III) – Project Manager
  - Associate Information Systems Analyst (Specialist) – (new) Test Analyst
  - Systems Software Specialist (SSS) II – (new) Network Administrator
  - Senior Programmer Analyst (Sr. PA) – Technical Architect
  - Senior Information Systems Analyst (Sr. ISA, re-classed from System Software Specialist II) – Business/Data Architect
  - Treasury Program Manager II (TPM II) – Program Staff/SME

This project is supported by a combination of State staff and vendors. However, not all of the State staff positions are funded through the project. As identified in the chart below, only four critical State positions are currently funded by this project, and we are requesting two more positions be added. It should be noted that an additional nineteen State positions are also critical to the success of this project and are absorbing this workload along with their core responsibilities. The State resources that are funded through this project are denoted below with an asterisk.

<b>State Staff Summary</b>		
<b>Staff/Role</b>	<b># Staff</b>	<b>Staff Participation</b>
<b>Project Management</b>		
Project Manager (PM)*	1	Dedicated
Technical Architect*	1	Dedicated
Business/Data Architect*	1	Dedicated
PM Support Vendor	1.5	Dedicated
<b>Program/Business</b>		
Business Manager/Lead*	1	Dedicated
Program Staff/SME	1	Dedicated
Subject Matter Experts	12	25%

## Analysis of Problem

<b>State Staff Summary</b> <i>(continued)</i>		
<b>Staff/Role</b>	<b># Staff</b>	<b>Staff Participation</b>
<b>Technical</b>		
Senior Programmer	1	Dedicated
Staff Programmer	1	Dedicated
Information Systems Analyst* (new)	1	Dedicated
Systems Software Specialist* (new)	1	Dedicated
ITD Executive	1	50%
Subject Matter Experts	3	20%
<b>Oversight</b>		
Independent Verification and Validation Vendor	1-3	Dedicated
Independent Project Oversight Consultant (Department of Technology)	1	Dedicated

The two new positions were added following discussions with the Independent Project Oversight Director, from the Department of Technology. She suggested that STO consider the impact of new and emerging workloads arising as a result of having the Systems Integrator (SI) onboard and continuously deploying optimization initiatives.

The first new position is proposed to be the DMS II project's network administrator. The current Information Technology (IT) organization was analyzed as to the ability to redirect a full-time resource to the DMS II project's network administration responsibilities for the duration of the project. This is an emerging workload resulting from the modernization of the DMS II through the continuous deployment of optimization initiatives. The modernization approach requires STO assume the ongoing maintenance and operations within 90 days of each optimization deployment. This means the network administrator is responsible for managing and maintaining all of the infrastructure components and technology environment as the technology components are deployed and updated throughout the project lifecycle.

STO's Technical Support Section is responsible for network administration, but cannot redirect a full-time resource to the project. In fact, the Technical Support Section has been and remains so significantly understaffed that it is able only to maintain patching software and operating systems, but unable to devote staff to the design, analysis and workload associated with upgrading the STO's Oracle infrastructure (the platform on which DMS operates), resulting in the obsolete conditions as they currently exist. Furthermore, the legislature recognized the chronically understaffed needs in this section and approved the addition of one new staff to the Technical Support Section under the IT Staff Augmentation Finance Letter in the Spring of 2015. This position has been dedicated to supporting STO's current backup systems, storage area network and uptime optimization. The position can't be redirected without significant, negative impacts on the over-committed resources currently supporting STO's enterprise infrastructure.

The second new position included in the DMS II FL is for a Test Analyst. STO has never had any resources to devote to software testing. The Franchise Tax Board, CalPERS and the Board of Equalization among other departments have long-ago adopted a best practices approach whereby analytical staff is dedicated to writing business requirements and performing structured, standardized testing on all application development efforts. However, due to the insufficient staffing structure of the STO's IT division, the application developers are responsible for wearing multiple hats. Not only are they responsible for writing code and promoting it to production, they are also tasked with wearing the hat of a business analyst to mediate the business language converting it to business requirements, and then system requirements from which they will develop the application code. Furthermore, after developing the code, they must wear the hat of a test analyst, conducting unit tests, system requirements tests and leading user acceptance testing. Application developers inherently lack objectivity when writing and executing test scripts for their own code. They approach testing from the

## Analysis of Problem

perspective of proving that it works, rather than seeking to exploit vulnerabilities. This is a critical gap in the STO's IT organization, as it is imperative to find and exploit vulnerabilities prior to promoting code to production where hidden vulnerabilities could jeopardize the integrity of the STO's operations. Furthermore, their professional testing expertise is home-grown and lacks industry standards for robust structured, methodical testing. For this reason, an Associate Information Systems Analyst is included in this FL to perform DMS II requirements testing and lead the business users in User Acceptance Testing, prior to the State accepting any products developed by the SI.

It is anticipated at the completion of the project that STO will seek permanent position authority for these two positions, in addition to two other previously existing DMS II project positions, specifically it is planned that the Senior Programmer Analyst will join the application development team for the ongoing support of the DMS II application, and the Senior ISA will join the Associate ISA Test Analyst, and the two of them will form the STO Requirements and Testing team, within the Project Management Office. There is no anticipated future role for the DPM III. Additionally, it is anticipated that the Treasury Program Manager II will be reabsorbed in the Public Finance Division.

The potential permanent staff augmentation is not the result of the alternative procurement proposed in SPR 2. On 12/10/15, CalTech's Deputy Director of Independent Project Oversight, Rebecca Stilling, requested STO consider adding "placeholder" language to the DMS II SPR 2 that a staffing augmentation may be necessary prior to project completion. Her recommendation was based on the history of California's IT deployments, whether new or modernization initiatives. Some examples include the post-deployment workloads of the CalPERS' MyCalPERS project, the pilot deployment of the SCO's MyCalPAYs project, and the Employment Development Department's deployment of the Unemployment Insurance Modernization Project. Furthermore, the FISCAL project has already realized the need to augment project staffing levels, well beyond original estimates, while the project is still in development.

STO agreed to include this language, and will revisit this discussion in 2017. At that time, the project will be sufficiently underway to make a qualified determination regarding the appropriate number of additional staff that may be needed.

Furthermore, STO will evaluate whether such a request is more appropriate in the form of a departmental Budget Change Proposal (BCP) or Finance Letter (FL) as the potential permanent staff will serve STO's departmental IT application development efforts, as described above, of which DMS II is only one application that will be supported. Or, if the DMS II project will submit SPR 3 to request the permanent staff augmentation in the context of this project. After a final determination has been made, the decision will be shared with CalTech, Department of Finance and the Legislative Analyst's Office.

The STO will continue to use specific reimbursement funds as the sole funding source for the project. Under Government Code Section 16724.6, proceeds of General Obligation (GO) bond sales are specifically authorized to be used by the STO in the administration of debt, including "special accounting systems" and other services necessary to "maintain the tax-exempt status of the bonds." Once GO bonds are issued, proceeds are deposited into the State's Surplus Money Investment Fund (SMIF) until the proceeds are disbursed by the State department who received the funds. While in SMIF, the undisbursed bond proceeds earn interest. These earnings are available to pay: (1) any arbitrage rebate owed to the federal government; (2) GO bond administrative costs of the STO, Department of Finance, and the State Controller's Office; and (3) eligible projects authorized by the bond act once the proceeds have been disbursed and no rebate is determined to be owed. The STO proposes to continue to use a portion of these interest earnings to pay for the costs associated with DMS II. Using only the interest earnings on bond funds will ensure that all bond proceeds that were designated for projects in each bond fund will remain available for such projects.

### **B. Background/History**

California Government Code Sections 12333, 5702, 16720 et. seq. gives the State Treasurer (Treasurer) fiduciary and trust powers in connection with State debt, designates the Treasurer as agent for sale on State bonds, and authorizes the Treasurer to issue and administer the GO Bond Program.

## Analysis of Problem

In carrying out these mandated responsibilities, the STO's core objectives are: (1) to borrow from capital markets at the lowest prudently available cost to taxpayers; (2) administer the State's debt as trustee, registrar and paying agent, which includes timely payment of debt service, and (3) provide essential disclosure and analysis regarding the State's debt to the Governor; Legislature, taxpayers, investors, rating agencies, and other interested parties. In fulfilling these objectives, the STO is governed by Federal tax laws and regulations, regulatory bodies for municipal securities, the State Constitution and laws, and various bond documents that contain the terms of each debt issuance.

The STO utilizes the existing DMS to carry out the Treasurer's mandated responsibilities. DMS was developed over ten years ago to administer the State's outstanding debt, track and pay debt service and fees on outstanding debt, and track and validate the authority to issue new debt. It was developed in two phases. The first phase, implemented in 2002, replaced an aging legacy system, which provided basic debt service payment capabilities and tracking of the State's debt. The second phase, implemented in 2004, added further functionality to replace various ancillary systems that the STO maintained at that time.

Since 2004, the amount of State debt that is tracked by the STO has dramatically increased. Further, numerous changes in law and in the market have altered the makeup of the State's debt. These changes, combined with the current system's inflexibility and inability to handle change, has rendered DMS functionally incomplete and materially inadequate for current needs. Consequently, various ad hoc systems have been created in Excel and Access to address the system's inadequacies. Core functions, such as short-term and variable rate debt service are maintained in these ancillary systems. These additional systems supplement DMS to ensure that legal and contractual obligations of the STO are met. Maintaining these ancillary systems, as well as fixing DMS run-time and data integrity problems, have come to require a substantial amount of the STO staffs' time. Further, redundant data entry into multiple spreadsheets and databases has exposed the system to the potential for costly debt management mistakes. The risk of error increases as services continue to expand, transactions become more complex and the amount of the State's debt increases.

In FY 12/13, the STO began to develop a plan of action to mitigate the identified existing DMS specific risks. The STO drafted a FSR that gained approval from the California Technology Agency (now the California Department of Technology) in May of 2013. Subsequently, the DMS II Project was launched in the FY 13/14 and has been approved for project and expenditure reimbursement continuously since that time.

In 2013, the STO's FSR determined that replacing the existing DMS system with a solution-based procurement using a SI was in the State's best interest, as STO's in-house staff had neither the expertise, nor the capacity to overhaul the highly-complex Oracle environment.

The FSR estimated releasing the DMS II RFP in February 2014. However, the RFP took longer to develop due to a number of internal and external factors. The STO and CalTech then agreed to release a draft-RFP prior to the formal RFP to gather more-informed vendor feedback and assess the viability of the recommended solution-based procurement. Both the STO and CalTech acknowledged that the creation and release of a draft-RFP would introduce additional delays to the schedule, but believed the resulting procurement would be of a much greater quality and clarity. Thus the delay was accepted.

The STO developed the SPR 1 to account for the schedule delay. It was submitted to CalTech and approved in May 2015. Following the SPR 1 submission, the STO received valuable vendor feedback on the draft-RFP, and determined the STO needed to conduct additional analysis on the procurement strategy for the DMS II Project from the solution based procurement anticipated in SPR 1. Following more in-depth vendor conversations in April 2015, the STO retained expertise of third-party consultants to explore the possibility of identifying: (1) alternative procurement strategies to increase the vendor pool and lower implementation risks; (2) pursue a procurement that would enable the project to incrementally realize benefits from the system; and, (3) determine whether the DMS functional core could be leveraged as the foundation of the DMS II requirements.

The consultants determined the DMS functional core could be leveraged by expert-level technicians with competencies exceeding that of STO's in-house application developers.

## Analysis of Problem

The STO presented and gained approval of the revised DMS II procurement strategy to the Department of Technology, the Department of Finance, and the Legislature in May 2015. Accordingly, the STO committed to submitting the SPR 2, accompanied by this FY 16/17 BCP, which includes revised cost projections for future fiscal years. The STO will also submit reports to the Joint Legislative Budget Committee pursuant to the requirements detailed in the "Supplemental Report of the 2015-16 Budget Package."

### Resource History (Dollars in thousands)

Program Budget	2010-11	2011-12	2012-13	2013-14	2014-15
Authorized Expenditures	-	-	-	\$679	\$1,073
Actual Expenditures	-	-	-	\$658	\$617
Authorized Positions	-	-	-	1.0	4.0
Filled Positions	-	-	-	1.0	1.9
Vacancies	-	-	-	0.0	2.1

### C. State Level Considerations

#### General Fund Savings

As a constitutional office, the Treasurer has broad authority and responsibility for over \$100 billion in State debt (bonds, notes, and commercial paper). One of the Treasurer's mandated responsibilities is to borrow from capital markets at the lowest cost to the State. DMS II will allow the STO to more efficiently manage the State's debt to ensure optimal confidence from the capital markets. Since the General Fund is responsible for paying debt service on most GO bonds and LRBs, achieving the lowest market interest rates on bond offerings directly result in reduced General Fund costs for debt repayment.

#### Protection of State Credit Rating

The State's credit rating reflects, in large part, the State's commitment to pay its debt obligations in a timely manner. These obligations include not only the State's GO bonds and LRBs, but other "ancillary" debt which is secured by contractually required payments of various State departments. In 2012, a delay in the payment of an "ancillary" debt obligation caused a rating agency to downgrade the "ancillary" debt and contemplate downgrading the State's overall credit rating as well. As the rating report reflected, the downgrade on the "ancillary" debt was limited to one notch since the STO promptly stepped in and took responsibility for processing the contractual payments. The STO's strong historical record in managing the State's debt and ensuring timely debt service payments was viewed as a credit positive. Implementation of DMS II will ensure that the State's debt will continue to be properly managed.

#### Funding the State's Infrastructure Needs

State bonds fund critical infrastructure needs such as schools, transportation, clean water, and clean air. In order to obtain funds for these vital projects, the State requires access to the capital markets. A missed or late debt service payment would trigger a default on the bonds which could result in rating downgrades or, even worse, the inability to access the capital markets. During a large part of FY 2008-09, the State was effectively shut out from the capital markets as a result of State financial issues, and thousands of State projects ground to an immediate halt. While this lockout was not a result of debt management deficiencies, it is a clear example of the real life ramifications of not having access to the capital markets. DMS II will allow the STO to better manage the State's debt to avoid unintended consequences and continue to fund the State's vital infrastructure projects.

## Analysis of Problem

### D. Justification

To respond to market, legislative, and legal changes, the STO adjusts its policies, marketing practices, types and structures of State debt issuances. The significant changes, which have taken place in recent years, combined with the current system's inability to handle change and overall instability, have rendered DMS functionally incomplete, materially inadequate and unable to address current needs.

To maintain the State's credibility in the bond market, the STO must exhibit accuracy, diligence, and efficiency. This contributes to the market's perception of the State's ability to manage its debt and ultimately influences the State's borrowing costs (interest rates, issuance costs, and other related expenses). Any failure to timely or accurately make a required payment or perform required disclosure duties could result in severe penalties, a downgrade of the State's credit rating, and/or expose the State to significant legal costs. At a minimum, the State could expect higher borrowing costs, and under a worst case scenario, it could affect the State's ability to access the capital markets. Any inability or delay in issuing bonds would mean that vital governmental projects and services could not be funded.

Any downgrade to the State's credit rating would likely result in a significant increase in the interest rates demanded by investors for the State's debt. Furthermore, the State could be subject to substantially higher debt related costs such as: (1) additional issuance fees that would be charged to the State to issue debt; (2) additional fees on existing obligations such as credit enhancements; (3) increased debt service on existing variable rate demand obligations; (4) increased debt service on annual cash flow borrowings such as Revenue Anticipation Notes; (5) additional debt service on LRBs that are authorized in future annual budget acts; (6) additional debt service on GO bonds authorized by the voters in the future or (7) additional debt service on bonds for entities that rely upon the State's General Fund for debt repayment.

To ensure the State's debt is properly managed, in 2012 the STO performed a review of its current systems and business processes. The review concluded: 1) there is a need for a system with significantly improved functionality and usability over existing DMS; and 2) there is a need for efficiency improvements in the amount and technical level of staff effort that is currently required to maintain the State's debt. The current DMS creates a number of challenges for the STO, resulting in unnecessary, additional effort by staff to carry out their basic responsibilities. In addition, STO's programmatic needs have evolved over the years and the capabilities of the system have not been able to meet these needs. As a result, staff have implemented and used various manual workarounds and applications such as Excel, Word, and Access to ensure efficient and effective management of the State's debt.

In addition to the business improvements of DMS that are needed, the STO's Information Technology Division (ITD) maintains the current DMS and has found that DMS is becoming unstable. Simply maintaining DMS has necessitated an ever increasing amount of ITD staff time which has stretched ITD staff resources thin. This instability and the labor required to maintain the system has resulted in the deferral of system enhancements needed to keep DMS up to date with current market conventions and business processes. The risk of failure of DMS grows everyday while system capabilities fall behind. DMS II, the project currently underway to modernize DMS, is a high priority for the STO and since this project is expected to continue for a number of additional years, the risks associated with any delay to the DMS II Project are just too great.

The STO will continue to use specific reimbursement funds as the sole funding source. Under Government Code Section 16724.6, proceeds of GO bond sales are specifically authorized to be used by the STO in the administration of debt, including "special accounting systems" and other services necessary to "maintain the tax-exempt status of the bonds." Once GO bonds are issued, proceeds are deposited into the State's SMIF until the proceeds are disbursed by the State department who received the funds. While in SMIF, the undisbursed bond proceeds earn interest. These earnings are available to pay: (1) any arbitrage rebate owed to the federal government; (2) GO bond administrative costs of the STO, Department of Finance, and the State Controller's Office; and (3) eligible projects authorized by the bond act once the proceeds have been disbursed and no rebate is determined to be owed. The STO proposes to use a portion of these interest earnings to pay for the costs associated with DMS II. Using only the interest earnings on bond funds will ensure that all bond proceeds that were designated for projects in each bond fund will remain available for such projects.

## Analysis of Problem

### E. Outcomes and Accountability

The STO has consistently met all requirements related to its duty to manage the State's debt. DMS II will facilitate eliminating certain ancillary systems and will streamline certain processes. In the short term, this will provide savings in the staff time required to perform individual functions. Ultimately, these savings will allow each individual staff member to handle the increasing workload associated with the growth and complexity of the State's debt. Therefore, the true measurement of the success of DMS II will be measured by the STO's ability to continue to meet its mandated fiduciary duties.

### F. Analysis of All Feasible Alternatives

The STO proposes to continue to provide funds for the DMS II Project as the following alternatives have been deemed inadequate to meet the STO business objectives and are too risky to the State to pursue.

#### ALTERNATIVE 1: REDIRECT EXISTING FUNDING

Funding would be redirected to the DMS II Project from existing funding sources when/if funds become available. The STO has determined that it does not have the necessary resources available and the Project would ultimately fail thus leaving the current system in place with no fixes or enhancements. This alternative is not a viable option due to the risks and inadequacies of the current system.

#### ALTERNATIVE 2: DISCONTINUE PROJECT FUNDING

No action would be taken to replace the existing system. This alternative is not a viable option due to the risks and inadequacies of the current system.

### G. Implementation Plan

The STO is pursuing developing a Request for Offer (RFO), as described in the SPR 2 via the State's IT-Master Services Agreement (IT-MSA).

The STO is working with the Department of General Services (DGS) and California Department of Technology (CDT) Statewide Technology Procurement Division (STPD), on the IT-MSA procurement. Independent Project Oversight Consulting (IPOC) services are being performed by CalTech and the STO is continuing the services of the IV&V consultant hired to ensure that all project activities and deliverables are performed consistently with State policies and industry best practices.

#### Project Schedule

An updated project schedule has been included in the SPR 2. A final project plan and budget through project implementation will be provided upon completion of the procurement and may or may not necessitate a subsequent SPR 3.

### H. Supplemental Information

N/A

### I. Recommendation

As mandated through State law, the Treasurer is responsible for the issuance and administration of State debt. Funds derived from the sale of State bonds provide vital governmental services and fund critical infrastructure projects for the State. As such, it is in the best interest of the taxpayers for the State's debt to be administered in the most efficient manner and at the lowest cost possible. DMS II will facilitate the administration of the State's debt to ensure ongoing compliance with the Treasurer's mandated responsibilities.

The STO recommends approval of \$6,265,000 in expenditure and reimbursement authority for FY 16/17 to continue funding the DMS II Project. The unimproved DMS system is highly unstable and inadequate for current business needs. Any failure of the STO to meet its mandated, fiduciary responsibilities because of inadequacies of the existing DMS could result in severe penalties, a downgrade of the State's credit rating, and/or expose the State to significant legal costs. The risks associated with discontinuing funding authority thus delaying or ending the DMS II Project are just too great. The expenditure and reimbursement authority being requested will allow the STO to continue to fund the DMS II Project.