Memorandum

To: House Committee on Corrections and Institutions
        Senate Committee on Institutions

From: Jim Reardon, Commissioner of Finance and Management
        Richard Boes, Chief Information Officer
        Steve Wisloski, Deputy State Treasurer

Re: Report on Information Technology Financing Recommendations
        Required by Section 39 of Act 104 of 2012

This report reviews findings and recommendations toward satisfying Section 39 of Act 104 of 2012. Section 39 requires the Secretary of Administration, working with the State Treasurer, to review financing alternatives for information technology (IT) infrastructure needs that were presented in a January 2011 report, and recommend any statutory changes to your respective Committees by January 15, 2013:

> **No. 104. An act relating to capital construction and state bonding budget adjustment.**
>
> * * * Information Technology * * *
>
> Sec. 39. INFORMATION TECHNOLOGY INFRASTRUCTURE NEEDS
> In order for state government operations to be effective and efficient, timely and reasonable replacement and upgrading of information technology systems are appropriate and necessary. Over the last decade, capital funds have been used increasingly to pay for these important projects. However, there is not enough capital funding available to meet the existing uses of this fund. Therefore, the secretary of administration, working in collaboration with the state treasurer, shall review the options for funding these projects described in the administration's report titled "Information Technology Infrastructure Needs: A Study of Financing Options" published on January 13, 2011, including a base line appropriation or revolving loan fund. The secretary and treasurer shall present a recommendation of any required statutory changes to the house committee on corrections and institutions and the senate committee on institutions on or before January 15, 2013.

Last year, we provided an update stating that we did not yet have sufficient information to assess appropriately what the overall IT needs of the State are, nor to assess what the State as a whole

currently spends on IT. Over the past year, we have investigated total IT spending by the State and appropriate benchmarks that provide an indication of overall needs. FY 2012 was selected as the baseline year for this effort since it is the most recent year not affected by the current atypical level of IT spending for health information technology.

In FY 2012, the State spent $77,323,168 in information technology, of which $27,264,322 was salaries and benefits for 442.5 positions. This information was derived from an analysis of all FY 2012 vendor payments combined with data from a Dept. of Human Resources report on salaries and benefits for specified IT-related job codes (See attached Analysis of IT Spending).

The benchmarks we used can be found in Gartner's IT Key Metrics Data 2013 documents[1]:

- IT Spending as a Percentage of State Budget
  Average for State and Local Government is 3.6%. The average within our budget size range of $1B to $10B is 2.6%. For the State of Vermont, the metric is $77,323,168 / $4,933,887,343 or 1.57%. To achieve 2.6%, Vermont's IT spending would have to be $128,281,071. That is a gap of $51 million compared to our FY 2012 IT spending.

- IT FTEs as a Percentage of Total Employees
  Average for State and Local Government is 3.6%. The average within our budget size range of $1B to $10B is 3.3%. For the State of Vermont, this metric is 5.0%. The main reason our IT staffing is higher than this benchmark is that we have legacy systems that require a large staff for operations and development. This factor will be of reduced importance as our legacy systems are replaced over time.

It is important to note that these benchmarks are averages, not optimum levels. Judgment needs to be applied to proposed IT expenditures based on their merits. Nonetheless, it is clear that the State's IT spending is well below average levels and it is necessary to consider reasonable financing approaches to address the gap.

A key principle in finance is to match the term of financing to the asset lifetime. Most IT investments have too short a lifetime to be a good candidate for responsible borrowing. Funding for most IT systems should be level over their life cycle; development and implementation are followed by ongoing maintenance and, ideally, investment toward the next generation replacement system. In view of these factors, an ongoing funding source is a better match than one-time funding or bonding.

---

[1] Gartner report issued 2/1//2013; https://www.gartner.com/doc/2324316

For a variety of reasons, the capacity to use additional federal or special funds is exhausted. Therefore, the ongoing central funding source for IT spending will need to be General Fund. This does not exclude making use of specific federal grants or special funds for IT systems.

Specifically, we are proposing to use a general fund appropriation to address the State's IT funding gap. We hope to ramp up to $20 million annually, to be applied to an IT projects list approved by the CIO and prioritized in accordance with the State's Strategic Plan. A process will need to be developed to prioritize these projects.

An additional mechanism can be used to address shared services (to be provided at an enterprise level). These services are generally paid for with the DII allocation. These services could be improved by increasing the amount of General Fund provided to departments for their GF share of this allocation; our target is in the range of $2-3 million. This approach could draw down the limited federal and special funds that might be available.

We want to thank the respective committees for their interest in this very important topic. We are available for testimony and would be happy to respond to any questions.