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GOVERNOR

STATE OF MICHIGAN
STATE BUDGET OFFICE
LANSING

CHRIS KOLB
DIRECTOR

May 31, 2019

The Honorable Jim Stamas, Chair
Senate Appropriations Committee
Michigan State Senate
State Capitol
Lansing, Michigan 48909

The Honorable Shane Hernandez, Chair
House Appropriations Committee
Michigan State House of Representatives
State Capitol
Lansing, Michigan 48909

Dear Legislators:

Section 371 of the Management and Budget Act requires that the State Budget Director submit a report identifying those agencies that are spending at a rate that would exceed the level of appropriations for the fiscal year.¹ Based on information received from each Executive Branch agency, one agency has indicated it is spending at a rate that will exceed the appropriated level.

The Department of Health and Human Services (DHHS) has identified a projected General Fund/General Purpose (GF/GP) shortfall in its information technology spending. The amount of the GF/GP shortfall could be as high as \$45 million. No appropriations have been overspent at this point, but absent major adjustments to spending, this shortfall would result in overspending by the close of Fiscal Year 2019. Given the magnitude of this shortfall, a comprehensive summary of information obtained and actions taken to address the shortfall is provided below.

The existence of a structural IT budget shortfall in the DHHS budget has been known since early last year, with various budget actions taken to address the shortfall since that time. In early April, however, DHHS became aware of the much larger magnitude of this projected shortfall.

In response to the reported shortfall, the State Budget Office (SBO), DHHS, and the Department of Technology, Management and Budget (DTMB) initiated a wide-ranging series of actions. In particular, I instructed SBO's Office of Internal Audit Services (OIAS) to immediately commence a formal audit engagement with DHHS. This comprehensive engagement process consists of (a) short-term efforts to verify the amount of the shortfall, assess how the shortfall emerged, and identify potential solutions to help mitigate the shortfall and (b) medium-term efforts to establish new IT spending controls for DHHS projects and review DHHS and DTMB practices to determine long-term solutions for managing DHHS IT investments.

OIAS has nearly completed its shortfall validation process. While further analysis and accounting adjustments could ultimately lower the GF/GP shortfall amount, the administration is proceeding to identify solutions that would solve a high-end amount of \$45 million. These solutions include working

¹ "Not later than June 1 of each year, the director shall submit to the chairpersons of the appropriations committees and the fiscal agencies a report that provides estimates as to which departments are spending at a rate that would exceed the level of appropriation for the fiscal year. This report shall include recommendations as to actions that need to be taken to ensure that actual expenditures do not exceed the appropriation at the close of the fiscal year."

to obtain concessions from IT vendors with high contract amounts, prioritizing and stopping IT projects where it is determined this will not negatively impact service delivery and program clients, and identifying other available discretionary resources and savings that can be achieved in the department's budget to be transferred to help resolve the shortfall.

OIAS's review to date has identified the following major factors that led to the shortfall:

- Lack of a formal process and attention from DHHS leadership over a multi-year period to oversee IT spending and monitoring of progress on projects:
 - Using large, multi-year contracts to fund additional projects not authorized in appropriations (e.g., spending maintenance and operations (M&O) funds on development projects)
 - The use of change notices in lieu of additional competitive bids on technologies leveraged statewide may have resulted in higher vendor rates that contributed to the department's overspend on appropriated projects
 - Contractors working on projects prior to execution of signed statements of work
 - No direct linkage of project spending to approved appropriations
 - Failure to maximize matching federal contributions and lack of appropriate monitoring of changes in the federal participation rates such as the expiration of enhanced federal match for certain large projects (from 90/10 federal/state to 50/50 as of 1/1/19)
 - It appears that prior department leadership, that has since transitioned out of the department, fostered an arrangement to exclude proper oversight of IT budgets by the department's financial operations organization, resulting in an inability to perform critical financial management and oversight due to a lack of visibility and timely access to related fiscal information
- Previous leadership took steps to shift current shortfall amounts into subsequent fiscal years by:
 - Supplemental appropriations being used to bridge overspending on currently executing projects
 - Using funding from routine M&O contracts in advance of the intended contract budgets to fund projects outside of the intended M&O scope

In short, the previous administration pursued multiple major IT initiatives without correctly accounting for the long-term cost impacts. Short-term budget maneuvers were used for several years before the resulting shortfall reached this magnitude.

To avoid similar issues occurring going forward, additional controls and reporting on DHHS IT spending are being instituted by SBO and DTMB in the state's accounting and procurement systems: stronger quarterly allotment controls, biweekly spending reports that can be tracked against a planning budget, and a single point of final approval within DHHS for IT contracts, change

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orders, and other IT spending commitments. Also, DHHS IT financial staff were moved from the department's IT area into its Financial Operations area late last year, establishing more direct financial oversight of IT spending.


SBO and DHHS will present a comprehensive budget plan to the Legislature in conjunction with FY 2020 budget target setting to both resolve the FY 2019 shortfall and ensure a structurally balanced IT spending plan for FY 2020, while ensuring that services to DHHS program clients are not interrupted or compromised. In the future, any major IT projects creating new state obligations above budgeted levels will be brought to the Legislature in a fully transparent manner for approval of appropriation adjustments prior to moving forward.

In conjunction with the continuing OIAS audit engagement, the administration is also collectively working to identify and implement improvements to contracting, oversight, organizational, and financial management practices to ensure maximum value is obtained for taxpayer dollars.

Outside of DHHS, no other agency has indicated that it is spending at a rate that will cause it to exceed its spending authorization for the current fiscal year. The only exceptions to this statement would be if legislative transfers that will be transmitted to you shortly are not approved. Lack of approval would create general fund deficits for the applicable agencies within specific line items.

All Executive Branch agencies and my office will continue to monitor any unanticipated expenditure needs or declines in restricted revenues that could potentially arise later in the year and will alert you to any resulting shortfalls. In particular, we will inform you if it appears that year-end caseloads in DHHS will exceed the estimates adopted by the administration and legislative fiscal agencies as part of the May 2019 consensus revenue agreement.

If you have any questions about this report, please don't hesitate to contact me or Kyle Jen, Deputy State Budget Director.

Sincerely,

Chris Kolb
State Budget Director

cc: Senate Appropriations Committee
House Appropriations Committee
Senate Fiscal Agency
House Fiscal Agency
Executive Office
Departments
Internal SBO Distribution