

MEMORANDUM

TO: Joint Budget Committee

FROM: Amanda Bickel, JBC Staff

SUBJECT: COFRS Modernization Legislation Proposal

DATE: January 24, 2013

COFRS Modernization Project – Background

During the 2012 legislative session, the Capital Development Committee, the Joint Budget Committee, and the General Assembly approved a project to develop a replacement for the current COFRS state accounting system.

As approved, the project included:

- System development and customization for Colorado during FY 2012-13, FY 2013-14. The anticipated “go-live” date is July 1, 2014.
- Ongoing annual payments to the vendor to host and maintain the system “in the cloud”.
- Initial system development costs financed by the vendor, so that the overall new costs associated with the system, including both development and operating costs, will cost the State an estimated \$8.4 to \$8.7 million per year for the ten year period from FY 2012-13 through FY 2021-22.
- Allocation of annual costs spread across funding sources. The request reflected an estimated annual General Fund cost of about \$3.0 million. However, for FY 2012-13, final funding splits included \$3.8 million General Fund.
- Program funding for FY 2012-13 was provided through new line items in each Department’s operating budget and a reappropriated amount in the capital construction portion of the budget.

The chart below summarizes the appropriations included in the FY 2012-13 budget, including a supplemental adjustment in the Department of Public Health and Environment.

FY 2012-13 COFRS Modernization Funding Appropriations					
	General Fund	Cash Funds	Reappropriated Funds	Federal Funds	Total
Agriculture	9,783	56,487	-	7,536	73,806
Corrections	480,395	30,736	33,379	545	545,055
Education	61,100	89,496	47,318	-	197,914
Governor's Office of Info. Tech.*	25,375	555	25,371	-	51,301
Governor's Office	22,407	23,019	-	24,457	69,883
Health Care Policy and Financing	329,397	173,190	2,052	501,459	1,006,098
Higher Education	-	19,614	16,847	2,858	39,319
Human Services	814,729	251,033	-	512,069	1,577,831
Judicial	1,056,857	-	-	-	1,056,857
Labor and Employment	-	185,370	-	290,886	476,256
Law	-	-	46,431	-	46,431
Legislature	19,406	-	-	-	19,406
Local Affairs	104,883	-	52,620	-	157,503
Military and Veterans Affairs	1,034	231	153	40,780	42,198
Natural Resources	134,326	1,148,689	68,112	39,841	1,390,968
Personnel and Administration	128,128	16,396	143,537	-	288,061
Public Health and Environment	417,565	281,805	-	-	699,370
Public Safety	52,658	81,603	34,217	-	168,478
Regulatory Agencies	3,016	131,452	7,995	2,252	144,715
Revenue	80,654	246,122	-	-	326,776
Secretary of State	-	40,140	-	-	40,140
Transportation	-	67,699	473	39,137	107,309
Treasury	45,502	55,614	-	-	101,116
Total	3,787,215	2,899,251	478,505	1,461,820	8,626,791
Percent of Total	43.9%	33.6%	5.5%	16.9%	

*This amount does not appear in the Long Bill.

Problems Related to System Financing

On December 14, 2012, the Office of State Planning and Budgeting (OSPB) wrote a letter to the JBC identifying two technical challenges it had encountered with the project's financing and requesting that the JBC sponsor related legislation. The two problems identified:

Technical problem related to whether current appropriations clearly authorize a lease-purchase arrangement. Pursuant to Section 24-82-801(b), C.R.S., a lease-purchase agreement for the acquisition of real or personal property must be specifically authorized as such either via a separate bill or must be "specifically authorized by appropriation in the annual general appropriation act or a supplemental appropriation act". This is understood by OSPB and the Office of Legislative Legal Services to mean that, at a minimum, the line item for COFRS modernization would need to specify that the appropriation is for a lease-purchase.

Substantive problem related to cost of financing. The vendor's proposal to finance the implementation carried an implicit *interest rate of 5.25 percent*, which would add approximately \$5.7 million to the cost of the project. In addition, the State has determined that the *federal government will not permit it bill it for the capital costs* of a new information technology system while the system is being built. It may only bill the federal government for *depreciation* on the new system after it has been implemented. As a result, the effective appropriation available for

the program in FY 2012-13 is less than the \$8.6 million appropriated because the federal funds are not currently accessible.

The Executive calculates that the total amount that must be financed (the capital portion of the project not covered by existing FY 2012-13 appropriations) is \$31,094,715. In FY 2012-13 alone, it is estimated that the vendor will complete system work valued at \$16.5 million, although only about \$7.0 million in appropriations are thus far available.

The vendor is continuing work on the project at a rapid pace. In light of the legal problems identified, the State negotiated *contingency provisions* in the contract that provide for termination of the contract and work on the system if the State is unable to secure the authority to finance the system during the 2013 legislative session.

Options Identified

The Governor's Office indicated that the project could be more cheaply financed through one of two options:

- **Borrowing from the Treasury pool:** Use an internal loan from the State Treasury cash pool. The loan would reduce the Treasury's externally invested balance, but the payments from projected appropriations would make the Treasury pool whole. The loan would carry an interest rate equivalent to the Treasurer's pooled investment earnings. The Treasurer's Office indicated to staff that the estimated cost of such a loan would be about 3 percent.
- **Lease-purchase financing arranged by Treasurer:** The Treasurer could directly arrange lease-purchase financing for the project (*e.g.*, Certificates of Participation), guided by the Attorney General's approval of the financing structure.

Recent Communication: Treasury Preferred Option and OLLS Questions

In response to the letter from the Governor's Office, *the JBC voted to draft a bill to address the financing problems*. In order to determine the structure of this bill, staff has pressed for further information on which financing option is preferred by the Treasurer and the Governor's Office. Staff also requested input from the Attorney General's Office and the Office of Legislative Legal Services on the proposals. Over the last two days, staff received statements from the Attorney General and the Treasurer's Office (attached).

- The Treasury anticipates that it will be able to finance a capital lease for the project at a rate of 2 percent or less, making a capital lease most attractive from a financing perspective.
- The Attorney General indicates that it is "comfortable that the proposed lease purchase financing can be structured in ways that do not violate the Colorado Constitutional prohibitions against multiple year fiscal obligations".
- The Office of Legislative Legal Services has raised questions about this project in light of some differences between this proposed project and other State Certificates of Participation and Lease-Purchase agreements.

A meeting with the Office of Legislative Legal Services and the Attorney General's Office has been scheduled today to discuss the legal issues surrounding the financing options.

Additional Option for the JBC's Consideration

All of the options thus far put forth by the Executive involve financing this project. However, **the JBC could consider paying for the capital costs of this project up-front and then requiring the General Fund (or the State Education Fund, if preferred) to be reimbursed for the portion of the project that can be charged to cash and federal funds.** Based on spreadsheets provided by the Executive Branch, this would require, the following additional appropriations in FY 2012-13 through FY 2014-15 (or the appropriation of the full \$31.1 million in FY 2012-13 for use in the subsequent years).

COFRS Modernization - Capital Development Phase			
	Available/Planned Appropriations		Additional
	Total	GF portion	Capital Cost
FY 2012-13	6,833,667	3,787,215	11,877,639
FY 2013-14	6,696,241	3,787,215	17,888,676
FY 2014-15			1,328,400
Total	\$13,529,908	\$7,574,430	\$31,094,715

Based on the fund splits included in the original Executive Request, **it is assumed that the General Fund would ultimately be reimbursed for about 65 percent of this amount (approximately \$20 million) by federal and cash funds over the subsequent 8 years, although the exact reimbursement is still uncertain and could be less than this.** This approach would eliminate any legal concerns or interest payments related to the project.



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January 22, 2013

Amanda Bickel
Joint Budget Committee
Colorado General Assembly

RE: Financing for COFRS rewrite

Dear Ms. Bickel:

We have reviewed the proposed lease purchase financing of approximately \$33,000,000 of the cost of the COFRS financial modernization project. We have also reviewed various other methodologies for funding this amount as necessary to complete the upgrade and installation of the system.

We are comfortable that the proposed lease purchase financing can be structured in ways that do not violate the Colorado Constitutional prohibitions against multiple fiscal year obligations.

Sincerely,

FOR THE ATTORNEY GENERAL

Bernie Buescher, Deputy Attorney General

cc: Esther van Mourik
Todd Olson
Jack Finlaw
Henry Sobanet
Brett Johnson
David McDermott

AG File: DOCUMENT4

COFRS Modernization Project: Private Financing Viability Assessment

January 22, 2013

Initial background: The COFRS Modernization Project (CMP) is well underway to improve the State's accounting system. One of the immediate challenges of this project is the vendor's proposal to finance the implementation at an interest rate of 5.25% - a rate well above market – which would add approximately \$5.7 million to the cost of the project.

Proposed Solution: The Treasurer's office has worked to determine the viability and market interest for a privately financed COP transaction or similarly structured capital lease, using components of the license and the perpetual lease as collateral. We have determined this option is viable with respect to the capital market, at an interest rate at least 3% lower than the vendor's proposed terms.

While the AG's office is offering its own memo with respect to legal components of this option, the following is a summary that explains why a privately financed structure is viewed as viable by the Treasurer's office (or specifically capital markets):

- *Strength of the State's Credit:* In general, the credit strength of any issuer is more important than the collateral. With Colorado's strong, AA- rating, investors have a low assessment of risk related to the possibility of default on such a small transaction.
- *Essentiality of Collateral:* From an investor's perspective, a factor of essentiality is used to determine the value of any asset used as collateral. The COFRS system is incredibly essential to the State's daily business – and without it, it would take as long as two years to procure and configure a replacement system.
- *Historically low interest rates:* Current financial market conditions offer historically favorable rates for issuers. After contacting several financial institutions, we are confident that the \$31 million needed to finance CMP at a nine year term will be priced no higher than 2% based on current interest rates.

If you have any further questions, please contact Brett Johnson at 303.866.2441.

Exhibit A COFRS Modernization Total Cost Worksheet



Personal Services Appropriation													\$	-	
Project manager - 2 FTE GP IV	Concentration on Business Requirements	\$ 180,355	\$ 181,667	\$ 32,938	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 394,960
Project Assistant - GP II	Overall support of project	\$ 66,581	\$ 67,056	\$ 14,442	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 148,079	
Business Analysis - 2 FTE ITP IV	Validation of all Business Requirements	\$ 216,513	\$ 218,100	\$ 216,570	\$ 216,570	\$ 216,570	\$ 216,570	\$ 216,570	\$ 216,570	\$ 216,570	\$ 216,570	\$ 216,570	\$ 216,570	\$ 2,167,173	
Trainer - CSC II - ongoing permanent	Training to business users	\$ 73,541	\$ 73,541	\$ 73,015	\$ 73,015	\$ 73,015	\$ 73,015	\$ 73,015	\$ 73,015	\$ 73,015	\$ 73,015	\$ 73,015	\$ 73,015	\$ 731,202	
Financial Analysis - 2 FTE Contoller II	Standardized Business Processes	\$ 235,864	\$ 237,599	\$ 237,599	\$ 237,599	\$ 237,599	\$ 237,599	\$ 237,599	\$ 237,599	\$ 237,599	\$ 237,599	\$ 237,599	\$ 237,599	\$ 2,374,255	
Security Analyst - .25 FTE ITP IV	Security design, review, & implementation	\$ 24,941	\$ 25,097	\$ 7,860	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 57,898	
Subtotal Personal Services		\$ 797,795	\$ 803,060	\$ 582,424	\$ 527,184	\$ 527,184	\$ 527,184	\$ 527,184	\$ 527,184	\$ 527,184	\$ 527,184	\$ 527,184	\$ 527,184	\$ 5,873,567	
Operating Appropriation													\$	-	
Operating Costs	Computers, travel, operating supplies	\$ 23,295	\$ 12,225	\$ 12,225	\$ 1,450	\$ 1,450	\$ 1,450	\$ 1,450	\$ 1,450	\$ 1,450	\$ 1,450	\$ 1,450	\$ 1,450	\$ 57,895	
Hosting and Support	Vendor development, hosting, and support	\$ 6,790,000	\$ 6,790,000	\$ 6,790,000	\$ 6,790,000	\$ 6,790,000	\$ 6,790,000	\$ 6,790,000	\$ 6,790,000	\$ 6,790,000	\$ 6,790,000	\$ 6,790,000	\$ 6,790,000	\$ 67,900,000	
Independent Validation and Verification	Third party review of project deliverables	\$ 100,000	\$ 100,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 200,000	
Software Maintenance (5% escalation)	Annual software maintenance	\$ 915,700	\$ 961,485	\$ 1,009,559	\$ 1,060,037	\$ 1,113,039	\$ 1,168,691	\$ 1,227,126	\$ 1,288,482	\$ 1,352,906	\$ 1,420,551	\$ 1,420,551	\$ 1,420,551	\$ 11,517,576	
Subtotal Operating		\$ 7,828,995	\$ 7,863,710	\$ 7,811,784	\$ 7,851,487	\$ 7,904,489	\$ 7,960,141	\$ 8,018,576	\$ 8,079,932	\$ 8,144,356	\$ 8,212,001	\$ 8,212,001	\$ 8,212,001	\$ 79,675,471	
Total New Operating Request		\$ 8,626,790	\$ 8,666,770	\$ 8,394,208	\$ 8,378,671	\$ 8,431,673	\$ 8,487,325	\$ 8,545,760	\$ 8,607,116	\$ 8,671,540	\$ 8,739,185	\$ 8,739,185	\$ 8,739,185	\$ 85,549,038	
													\$	(0)	
Existing System Cost Currently Budgeted													\$	-	
Personnel	Existing costs to run COFRS	\$ 700,245	\$ 700,245	\$ 421,332	\$ 421,332	\$ 421,332	\$ 421,332	\$ 421,332	\$ 421,332	\$ 421,332	\$ 421,332	\$ 421,332	\$ 421,332	\$ 4,771,146	
Operating	Staff support costs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	
Overhead	Mainframe support costs	\$ 214,525	\$ 220,961	\$ 132,950	\$ 132,950	\$ 132,950	\$ 132,950	\$ 132,950	\$ 132,950	\$ 132,950	\$ 132,950	\$ 132,950	\$ 132,950	\$ 1,499,089	
Total Costs to Run Existing System		\$ 914,770	\$ 921,206	\$ 554,282	\$ 554,282	\$ 554,282	\$ 554,282	\$ 554,282	\$ 554,282	\$ 554,282	\$ 554,282	\$ 554,282	\$ 554,282	\$ 6,270,235	
Total Cost of System Over Useful Life													\$	-	
Operating Request - New Budget Request		\$ 8,626,790	\$ 8,666,770	\$ 8,394,208	\$ 8,378,671	\$ 8,431,673	\$ 8,487,325	\$ 8,545,760	\$ 8,607,116	\$ 8,671,540	\$ 8,739,185	\$ 8,739,185	\$ 8,739,185	\$ 85,549,038	
Existing System Costs Currently Budgeted		\$ 914,770	\$ 921,206	\$ 554,282	\$ 554,282	\$ 554,282	\$ 554,282	\$ 554,282	\$ 554,282	\$ 554,282	\$ 554,282	\$ 554,282	\$ 554,282	\$ 6,270,235	
Total Cost of System Over 10 Years		\$ 9,541,560	\$ 9,587,976	\$ 8,948,490	\$ 8,932,953	\$ 8,985,955	\$ 9,041,607	\$ 9,100,042	\$ 9,161,398	\$ 9,225,822	\$ 9,293,467	\$ 9,293,467	\$ 9,293,467	\$ 91,819,273	

Project Phases		
Phase I	Discovery, architecture and planning	<div style="width: 15%; background-color: #92d050;"></div>
Phase II	Design, configuration, integration, creation and testing	<div style="width: 30%; background-color: #92d050;"></div>
Phase III	Implementation	<div style="width: 20%; background-color: #92d050;"></div>
Phase IV	Post-implementation	<div style="width: 65%; background-color: #92d050;"></div>
Phase V	Extension, retirement or replacement	