Deloitte.

State of Louisiana
Office of Information Technology

Financial Model

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Executive Summary

Current State

Future State

Operating Model: Agencies are independently funded through many means of finance and procure IT goods and services separately

Chargeback: Existing agencies are at varying levels of chargeback maturity; Rate setting is a manual process with time lags between cost determination and future rate setting

Supporting Tools and Resources: There are very few IT finance resources to manage the processes with a heavy reliance on Internal Agency Transfers (IAT) that obscures transparency into spending

Capital and Supplemental Funding: There is **a c**hallenge to create enough political capital to fund or complete the implementation of mission-critical large-scale systems (e.g., LAGov)

Operating Model: Central IT operates as an Ancillary Internal Service Fund agency (815); Authority over all IT spending is consolidated to 815 and the Division of Administration (DOA) becomes a single payer on behalf of other agencies; Maximize means of finance opportunities

Chargeback: Full direct charging model for all services acquired by agencies using dynamic and effective rate setting with supporting staff, processes and continuous improvement

Supporting Tools and Resources: An IT Finance team to support rate setting and cost modeling dynamically; Rates are developed for all services and overhead allocation; Reduction in use of IAT over time to increase transparency; Improved cost allocation in accordance with Federal guidelines
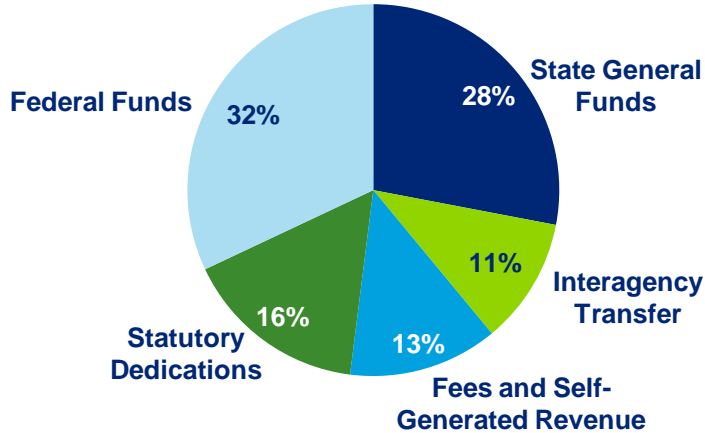
Capital and Supplemental Funding: Central IT has the ability to fund large transformative projects using Louisiana Technology Innovation Fund and other mechanisms (e.g., capital surcharge); Accounting processes to support carryover of capital fund balances (60 days) to allow for services spanning fiscal years
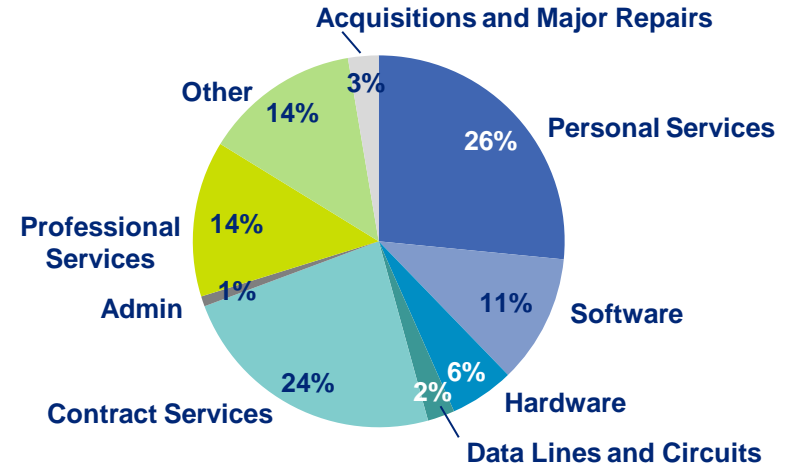
Current State Funding Approaches

Current Financial Landscape

Based on the current model, departments and OIT depend on different means of finance to support their IT operations.
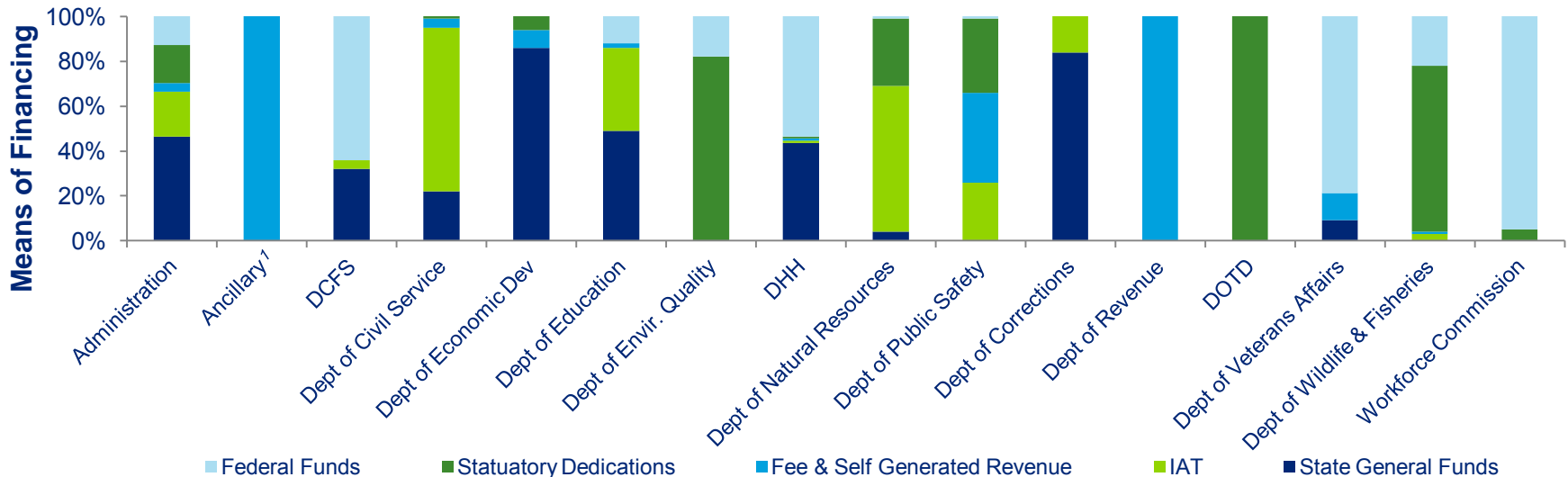
FY14 Means of Finance, All Departments

- State General Funds: 28%
- Federal Funds: 32%
- Statutory Dedications: 16%
- Fees and Self-Generated Revenue: 13%
- Interagency Transfer: 11%

Total Funding: $304.4M based on IT-0

FY14 Expenditures, All Departments

- Acquisitions and Major Repairs: 3%
- Personal Services: 26%
- Software: 11%
- Hardware: 6%
- Data Lines and Circuits: 2%
- Contract Services: 24%
- Admin: 1%
- Professional Services: 14%
- Other: 14%

FY14 Means of Finance, by Department

Vertical axis: Means of Financing (0% – 100%)

Departments: Administration, Ancillary[1], DCFS, Dept of Civil Service, Dept of Economic Dev, Dept of Education, Dept of Envir. Quality, DHH, Dept of Natural Resources, Dept of Public Safety, Dept of Corrections, Dept of Revenue, DOTD, Dept of Veterans Affairs, Dept of Wildlife & Fisheries, Workforce Commission

Legend: ■ Federal Funds ■ Statuatory Dedications ■ Fee & Self Generated Revenue ■ IAT ■ State General Funds

1 – Includes OTM, OGB, ORM, LPPA, FPPA and Flight Maintenance.

Current Financial Model Details

Operating Model	▪ Current centralized service agencies are organized as both auxiliary (OCS and OIS) and ancillary (OTM) ▪ Agencies' budgets come from a variety of funding models ranging from majority federal to majority fee funded ▪ There is limited transparency into IT budgeting, spending, forecasting and financial operations across IT groups ▪ Pooling agency funds for common needs / collaborating on purchasing is cumbersome and limits resource sharing ▪ Departments request IT budgets independently and report through the IT-0 process to inform Office of Information Technology (OIT) of annual budgets
Chargeback	▪ Chargeback is at various levels of maturity ranging from use of basic flat rates to activity based costing ▪ Rate setting is a manual estimating process, supported only by part-time resources for some agencies ▪ Next years' rates are based on previous year's usage and cost, resulting in up to a two year lag in data and estimates ▪ Few services use real time information to set chargeback rates ▪ Rates for introductory offerings can sometimes be prohibitively high to cover the overhead and implementation
Supporting Tools and Resources	▪ IT Tables of Organization (T.O.) are not the only resources supporting administration of IT ▪ There are few staff resources familiar with details of rate setting and chargeback methodology to support the function ▪ Heavy use of IATs which obscures visibility into purchasing and spending patterns ▪ Costs of enterprise systems are not always allocated enterprise wide; often allocated only to direct / immediate users ▪ There is no requirement to buy services centrally or use central systems
Capital and Supplemental Funding	▪ The Louisiana Technology Innovation Fund (LTIF) was established to drive investments in IT; though the last reported funding for an LTIF project was in 2006 ▪ The State currently has a challenging time creating enough political capital to fund, or complete implementation of mission-critical large scale systems so systems are often implemented and then under utilized (e.g., LAGov) ▪ The capital budget is sometimes but not consistently used to fund capital projects for IT

Funding Model Considerations

Strategic Elements of a Financial Model

There are five key _influencers' in determining the funding model. Funding mechanisms can be viewed along a continuum of visibility into costs.

Influencers

← Management Philosophy →	Cost efficiency balance with improved service and quality	→
← Org. Maturity →	Implementation phase, stabilization phase, operations phase	→
← Type of Services →	Transactional, consultative, strategic	→
← Level of Effort →	Time/effort to develop, complexity of administration	→
← Performance Management →	Planning and budgeting, cost management, performance reporting	→

Less Detail/Effort — **Cost Detail Visibility / Level of Effort** — **More Detail/Effort**

	No Charge	Allocation	Cost Related Price
OVERVIEW	▪ The cost of providing service is included as a component of —entral" or overhead and no attempt is made to recover costs	▪ The total cost of service (budget or actual) is allocated to customers based on a driver (e.g., revenue, headcount, number of transactions) that is intended to approximate usage	▪ Customers are charged a price (based on budget, actual, or market) per transaction/event or actual activity
PROS	▪ The easiest mechanism to administer and communicate ▪ Minimal conflict with customers	▪ Increased visibility into cost of providing service ▪ Some ability to influence cost, behavior, and accountability	▪ Greater visibility and understanding of underlying cost of providing service ▪ Greater ability to predict and control chargeback / behavior and budget needs
CONS	▪ Cost may not match the value of the services delivered ▪ Budget may not be flexible to change as demands change	▪ The customer may have difficulty predicting the amount of the chargeback ▪ The method of allocation may result in perceived inequality	▪ More time and resources may be required to administer ▪ Requires high quality data and information about costs

	1. No Allocation	2. Flat Rate	3. Budgeted Rate	4. Budgeted Rate w/ Penalties	5. Activity Based Costing	6. Full Direct Charging	7. Market Based
DESCRIPTION	No allocation to business units, with costs recorded below the operating margin	Based upon one metric (e.g., revenue or headcount) but not necessarily the cost driver	Based upon a metric that approximates the distribution of cost	Similar to Budgeted Rate allocation, but includes penalties to drive behavior	Based on per-unit pricing of services developed for aggregation of associated costs (labor, systems, overhead, etc.)	Directly identified at time of use and charged to each business unit per transaction	Market rate based allocation Costs defined for service time and actual volumes

Key Financial Model Design Questions

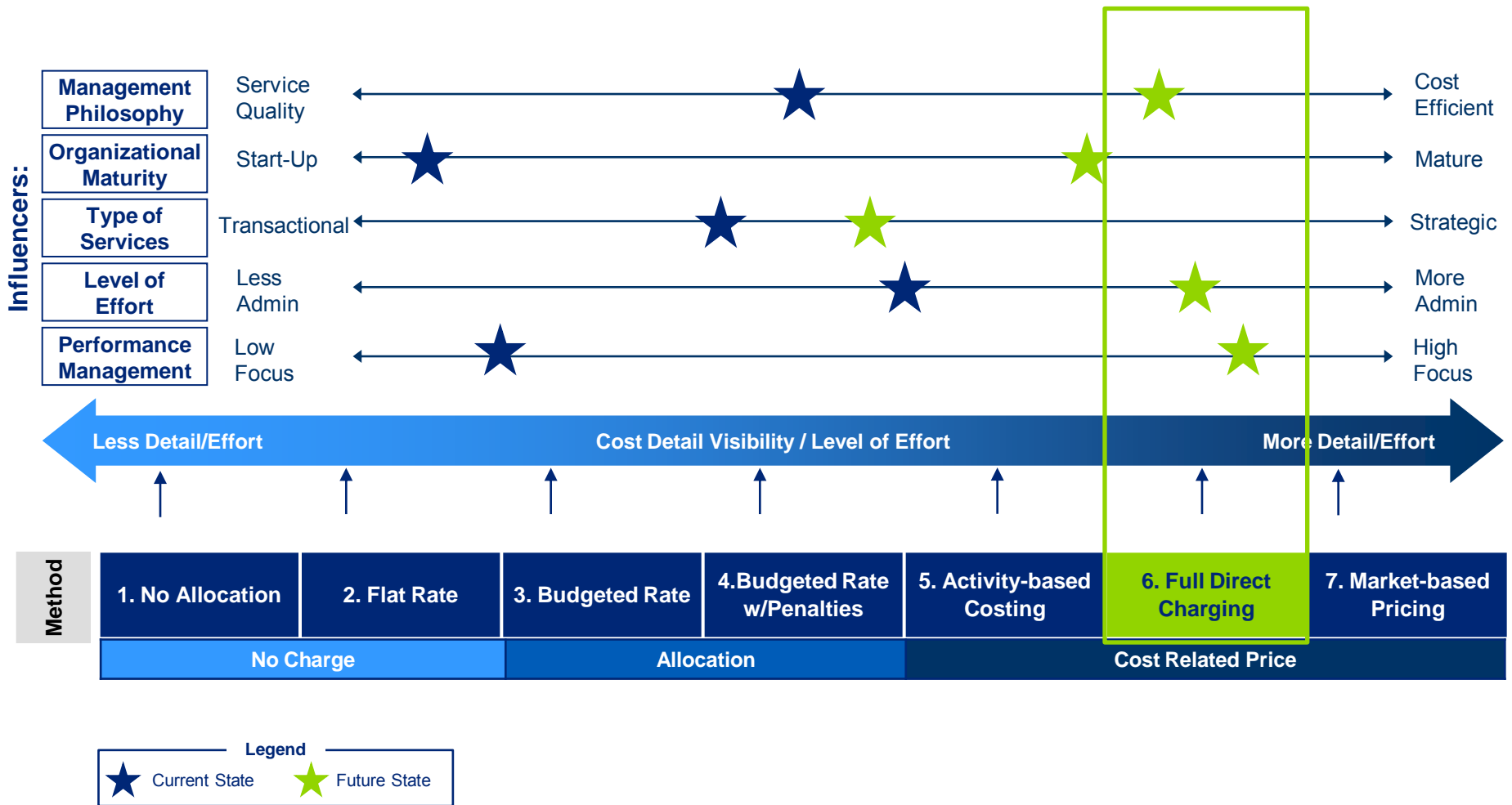Once the strategy is defined, 10 essential questions can help define the funding model:

	Key Questions
1	How can the model encourage the use of and movement towards **common systems** and **services**?
2	What **IT functions**, **positions** and **assets** will be transferred? Where will the budget come from to pay for them?
3	Is there **control** and **accuracy** of information to determine budgets and costs?
4	Is the **link** between **costs** and **prices** well-defined and communicated?
5	What are the **accounting implications** (per OMB A-87) when **consolidating assets**?
6	Should rates / pricing be **fixed** or **variable**?
7	Can the pricing model **link to cost** and **demand** drivers, and is it higher level and more generic?
8	Should **shared overhead** and/or **development and investment costs** factor into pricing?
9	Are the policies around **cross-subsidization** and **strategic pricing** clearly defined?
10	Does IT allow for **visibility** and **transparency** into the pricing model to develop rates?
11	How will departments know **spend** is congruent with **usage**?

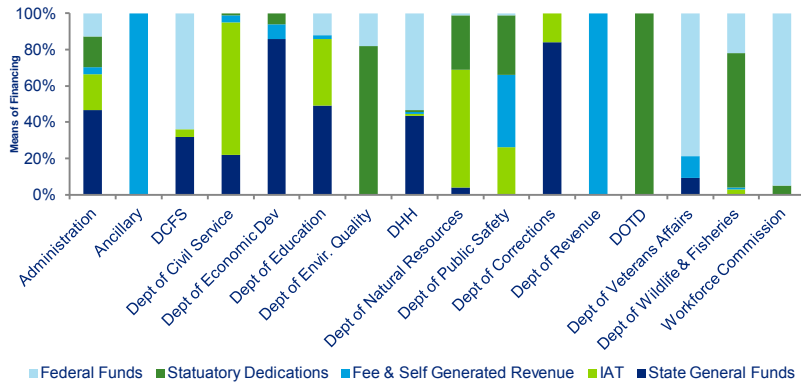# Future State Recommendations

Future State Financial Model Strategic Elements

The figure below provides insights into the role of each influencer on the future state financial model. Based on the results, the recommended method for funding becomes 6. Full Direct Charging. This cannot be accomplished overnight but through certain supports will be achievable in the medium term.
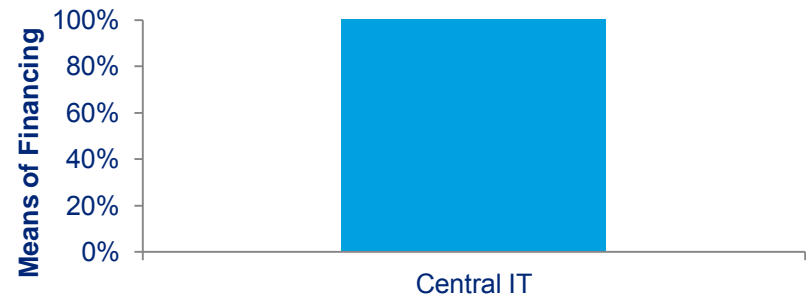
Influencers:

Management Philosophy	Service Quality		Cost Efficient
Organizational Maturity	Start-Up		Mature
Type of Services	Transactional		Strategic
Level of Effort	Less Admin		More Admin
Performance Management	Low Focus		High Focus

Less Detail/Effort — Cost Detail Visibility / Level of Effort — **More Detail/Effort**

Method

1. No Allocation	2. Flat Rate	3. Budgeted Rate	4.Budgeted Rate w/Penalties	5. Activity-based Costing	6. Full Direct Charging	7. Market-based Pricing
No Charge		**Allocation**		**Cost Related Price**		

Legend

★ Current State   ★ Future State

Recommended Future State Financial Model

Current State: Department Level Funding

Legend: Federal Funds · Statutory Dedications · Fee & Self Generated Revenue · IAT · State General Funds

Future State: Fees & Self Generated Revenue

Central IT

Legend: Federal Funds · Statutory Dedications · Fee & Self Generated Revenue · IAT · State General Funds

Actions to Move to the Future State

Operating Model	▪ Create an ancillary agency using an internal service fund — 815; with an direct appropriation for the CIOs salary ▪ Consolidate general fund spend, making the DOA a single payer on behalf of other agencies and enabling greater control over IT spending now and in the future ▪ Maximize non-general fund means of finance to leverage external sources of funding and funding allocations from different agencies and match sources ▪ Consolidate all IT spending under 815 and communicate approach to the Federal government
Chargeback	▪ Centralize all IT assets and services to a new IT organization and funded primarily through direct charging ▪ Build out modeling analytics and IT finance function to enable effective rate development ▪ Publish detailed rates for services, using a full direct charging model
Supporting Tools and Resources	▪ Fund salaries and FTE expenditures using 815 chargeback and interagency transfers (Year 1) ▪ Define the future state funding model that reduces the use of IATs ▪ Develop rate cards for specific services and redefine roles and responsibilities to reduce non-IT related work (e.g., training, administration) to most accurately bill back to departments; Define overhead rates to allocate pooled costs ▪ Define which contracts move to become centrally managed vs. remain with the agency (see slide on Contract Migration) ▪ Consider supporting advanced chargeback capabilities with an IT financial management tool (see appendix for examples)
Capital and Supplemental Funding	▪ Add capital fund surcharge to raise initial capital for major acquisition ▪ Examine consolidation impacts on existing depreciation in CAFR ▪ Build depreciation into rates after initial capital fund outlay ▪ Plan capital fund retention approach to retain capital fund balance for 60 days ▪ Statutory dedication for Louisiana Technology Innovation Fund (or similar) to fund large strategic or high cost projects

Future State Answers to Critical Financial Model Questions

The future state funding model addresses the key questions for consideration.

	Key Questions	Future State Answers
1	How can the model encourage the use of and movement towards **common systems** and **services**?	• Centralizing authority for all general fund IT spending drives strategy and enables central control over IT spending and lower risks of non standard purchases; Enterprise architecture and procurement standards for assets, systems and services
2	What **IT functions**, **positions** and **assets** will be transferred? Where will the budget come from to pay for them?	• IT functions and positions from all departments will move into the consolidated organizations. IT contracts and assets will be evaluated (see criteria Contract Migration slide) to determine whether or not they will be migrated. The consolidated organization will be an ancillary agency funded through an internal service fund; control over general fund IT spending will be consolidated
3	Is there **control** and **accuracy** of information to determine budgets and costs?	• Consolidating general fund allocations will create greater transparency into IT spending and can help enhance budgeting accuracy and planning • Financial analysis and modeling capabilities will be developed within the IT organization to allow for more flexible price setting
4	Is the **link** between **costs** and **prices** well-defined and communicated?	• Rate setting will mature over time as costs and services are better defined and understood • Detailed rate schedules will be published for each type of service as well as overhead allocations
5	What are the **accounting implications** (per OMB A-87) when **consolidating assets**?	• Assets brought under central control will have depreciation built into the service rates as appropriate; assets that remain with a department will be depreciated according to agency requirements
6	Should rates / pricing be **fixed** or **variable**?	• A full direct charging approach will be used to set pricing • Variability will be set based on service capabilities and may differ over time depending on rate elements and user pool
7	Can the pricing model **link to cost** and **demand** drivers, and is it higher level and more generic?	• As the organization matures, pricing can be set based on time of use and specifically charged to each agency based on demand
8	Should **shared overhead** and/or **development and investment costs** factor into pricing?	• Overhead costs will be allocated to departments based on approved rate structures. Investment costs for large capital projects can be funded through the Louisiana Technology Innovation Fund; CIO salary will be a direct appropriation to enable the individual to perform a full suite of duties
9	Are the policies around **cross-subsidization** and **strategic pricing** clearly defined?	• Rates will be developed without cross-subsidies. Central IT will analyze and adjust prices to stay competitive with the market; rates will be compliant with federal guidelines regarding allocation
10	Does IT allow for **visibility** and **transparency** into the pricing model to develop rates?	• Central IT will conduct an annual or regular audit of service prices and compare against other states and industry third-party providers. Customers will be informed of rate structures, pricing and other factors for costs
11	How will departments know **spend** is congruent with **usage**?	• As part of the billing process, metrics will be developed and provided to departments on a regular cadence (e.g., monthly) to show usage and rate info.

Supplemental Funding Options

To support investment in critical systems and services, other states use alternative funding models to supplement their financial models. Two such models are recommended to be part of the financial model and are detailed below.

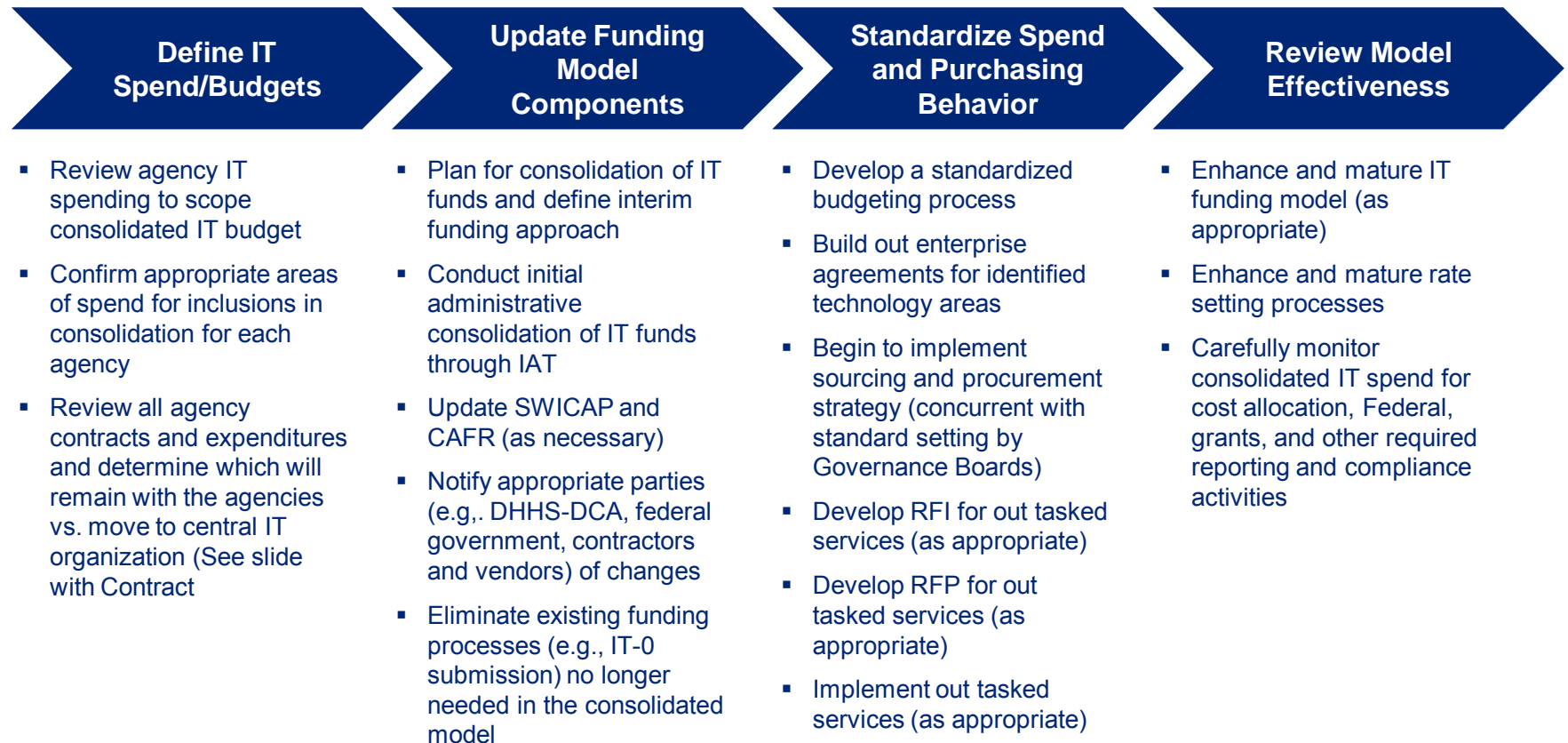| Alternative Models	Description	Example(s)
Investment Funds	Pools of money established for funding pilot programs, trying new technologies or supporting projects with short pay-back periods. Savings generated from funded projects can be used to replenish the investment fund	▪ Enterprise ―venture capital" seed money ▪ Accumulation of funds for replacement of systems over the period of their life cycle ▪ State of Michigan has an IT investment fund (OpenMichigan) as part of its overall IT funding ($47M over 5 years)
User-fee Revenue	Adding fees to a citizen for state transactions (e.g., court, licensing)	▪ State of Iowa charges convenience fees for a number of e-government applications available through the state's web portal ▪ State of New Jersey adds a surcharge to telephone bills to fund the statewide 9-1-1 system
Bond Funding	Issuing project bonds through the state's bond authority to fund IT procurements	▪ General obligation bonds ▪ Revenue bonds ▪ State of Oklahoma used bond funds to finance a new data center ▪ Commonwealth of Virginia used bond funds to rebuild its statewide emergency radio system
Flexible Budgeting and Appropriations Strategies	Gain additional funding for IT projects or increase flexibility in the use of existing IT funds[1]	▪ Using uncommitted year-end funds for technology projects ▪ Reallocating savings realized from previously implemented technology projects to fund other technology projects ▪ State of Maryland established Major IT Development Fund for IT development projects as a non-lapsing, interest bearing fund ($16M in FY14)

- - - Recommended funding options to pursue

Implementation Process

Define IT Spend/Budgets	Update Funding Model Components	Standardize Spend and Purchasing Behavior	Review Model Effectiveness

Define IT Spend/Budgets
- Review agency IT spending to scope consolidated IT budget
- Confirm appropriate areas of spend for inclusions in consolidation for each agency
- Review all agency contracts and expenditures and determine which will remain with the agencies vs. move to central IT organization (See slide with Contract

Update Funding Model Components
- Plan for consolidation of IT funds and define interim funding approach
- Conduct initial administrative consolidation of IT funds through IAT
- Update SWICAP and CAFR (as necessary)
- Notify appropriate parties (e.g,. DHHS-DCA, federal government, contractors and vendors) of changes
- Eliminate existing funding processes (e.g., IT-0 submission) no longer needed in the consolidated model

Standardize Spend and Purchasing Behavior
- Develop a standardized budgeting process
- Build out enterprise agreements for identified technology areas
- Begin to implement sourcing and procurement strategy (concurrent with standard setting by Governance Boards)
- Develop RFI for out tasked services (as appropriate)
- Develop RFP for out tasked services (as appropriate)
- Implement out tasked services (as appropriate)

Review Model Effectiveness
- Enhance and mature IT funding model (as appropriate)
- Enhance and mature rate setting processes
- Carefully monitor consolidated IT spend for cost allocation, Federal, grants, and other required reporting and compliance activities

Implementing Process: Contract Migration Process Detail

In order to manage IT spending effectively, the State needs to understand what contracts it currently has. Each contract will be reviewed during the administrative consolidation phase to determine if it remains with the agency or is centralized.

Identify Contract

Select contract for review

Identify contract owner

Apply Decision Criteria

FY

Does the contract expire this fiscal year?

N

Y

Will moving the contract allow for operating/business continuity?

N

Y

Can the contract legally be transferred to another party?

N

Y

Determine Ownership

Move contract to Central IT

Keep contract in agency

Recommended Policy Changes

Recommendations	Alignment with Framework			
	1	2	3	4
Centralized Ancillary Agency – Create single ancillary agency funded through an internal service fund with authority to control all IT assets and make IT decisions on behalf of executive branch departments.	■	■		
Eliminate IT-0 Process –With all IT budgets consolidated to a central ancillary agency, the IT-0 process becomes obsolete and will be replaced by a new IT planning process.	■			
Evaluate Pricing Against the Market– Develop baseline costs for IT asset and services spend and conduct annual benchmark study to compare central prices with those of outside services providers to ensure competitiveness.		■		
Rate Setting – Establish IT finance group within centralized ancillary agency to develop cost / rate modeling analytics to enable more dynamic price setting for chargebacks.		■		
Overhead Allocation – Develop process for allocating overhead spend among departments.			■	
Capital and Supplemental Funding – Request statutory dedications for Louisiana Technology Innovation Fund to spend on large or innovative projects that improve overall IT State operations.				■
Fund Reserves – Create approach to carry capital fund reserves across fiscal years.				■
Require use of state systems and services—Establish a "central first" policy whereby agencies are required to use central systems and services rather than build new systems or buy new tools, if a similar option already exists.				■

Legend

1 Operating Model   **2** Chargeback   **3** Human and Technology Assets   **4** Capital Funds

Appendix

IT Financial Management Vendor Landscape (1 of 2)

Vendor	Company Overview	Product and Pricing	Strengths	Considerations
Apptio	**Headquarters**: Bellevue, WA **Ownership**: Private **Revenue (2012)**: $50 - $70M **Employees**: 325	**Technology Business Mgmt Suite** ▪ SaaS: Price based on the amount of IT spend under management; per-user pricing component for the planning software	▪ Well-designed executive dashboards ▪ Strong visualization capabilities to simplify the process of creating service-level cost models	▪ Products designed for organizations with more advanced ITFM practices ▪ Clients report complex pricing models ▪ Often contract partner service providers for implementation
BMC Software	**Headquarters**: Houston, TX **Ownership**: Public **Revenue (2012)**: N/A **Employees**: N/A	**IT Business Mgmt Suite** ▪ On-premise: Combination of cost per module and per end user (per production instance) ▪ SaaS: Per-end-user subscription fee and a one-time activation fee	▪ Easy integration with other BMC products ▪ Easier to deploy than other solutions for organizations new to ITFM	▪ Product not as rich in features ▪ Recent ownership change creates uncertainty about investment in innovation
Cloud Cruiser	**Headquarters**: Roseville, CA **Ownership**: Private **Revenue (2012)**: $5 - $10M **Employees**: 50	**Cloud Cruiser** ▪ On-premise: Licensing based on operating system instance ▪ SaaS: Pricing information not available	▪ Able to capture data about IT assets, regardless of delivery or support models ▪ Easier to implement than other solutions ▪ Advanced process costing feature	▪ Primary focus on costs and reporting, with limited capabilities in turning insights into actions ▪ Some capabilities not graphically based or intuitive to use
ComSci	**Headquarters**: Iselin, NJ **Ownership**: Private **Revenue (2012)**: $5 - $10M **Employees**: 35	**ComsSci ITFM** ▪ On-premise: Pricing information not available ▪ SaaS: Unlimited number of users for a single monthly recurring service fee	▪ Strong domain knowledge ▪ Offers ITFM process support for organizations without internal resources to perform operational tasks (e.g., data loads) ▪ Dashboards provide configurable views	▪ Limited market share growth in recent years ▪ Cost capture and data cleansing capabilities less clear than other solutions

Source: Gartner. "IT Financial Management Vendor Landscape." 2013.

IT Financial Management Vendor Landscape (2 of 2)

Vendor	Company Overview	Product and Pricing	Strengths	Considerations
HP	**Headquarters**: Palo Alto, CA **Ownership**: Public **Revenue (2012)**: $20 - $50M (ITFM only) **Employees**: N/A for ITFM	**IT Executive Scorecard** ▪ On-premise: Licensing based on named (registered) users ▪ SaaS: Licensing based on two tiers and priced per user per month	▪ Integration with HP's IT asset management provides more detailed cost and pricing info to manage asset life cycles ▪ Large service team to assist with implementation	▪ Unclear commitment to building a stand-alone ITFM product ▪ Lacks out-of-the-box integration with third-party asset management products
Nicus	**Headquarters**: Salem, VA **Ownership**: Private **Revenue (2012)**: $5 - $10M **Employees**: 30	**Nicus M-PWR** ▪ On-premise: Enterprise or single instance (no fee for nonproduction instances); pricing is not based on the number of users or seats ▪ Saas: Annual term or monthly subscription	▪ One of oldest players in the ITFM market ▪ Provides advanced computational and reporting capabilities	▪ User interface, dashboards and reporting not as intuitive as other solutions ▪ Granular data detail presentation may not fit the needs for IT managers regularly working with business stakeholders
VMware	**Headquarters**: Palo Alto, CA **Ownership**: Public **Revenue (2012)**: $20 - $50M (ITFM only) **Employees**: 85 (IT Business Mgmt)	**VMware ITBM** ▪ On-premise and SaaS: Base cost plus per end user	▪ Showback feature allows IT managers to share a transparent, fact-based chargeback mechanism and logic to their business stakeholders ▪ Tailored data displays and decision making tools to end-user's role and profile	▪ Analysis-based decision processes and actions that can lead to cost savings not as advanced as other solutions ▪ Opportunity for improvement in the latency and treatment of data ▪ Unclear commitment to building a stand-alone ITFM product

Source: Gartner. ─IT Financial Management Vendor Landscape." 2013.