Fiscal Note – 2011-12 Session

Bill #: H0418-0 **Complete Date:** 03/10/11

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Title: BACK OFFICE CONSOLIDATION ACT

Fiscal Impact	Yes	No
State	X	
Local		X
Fee/Departmental Earnings	X	
Tax Revenue		X

Agency Name: Administration Dept

This table reflects fiscal impact to state government. Local government impact is reflected in the narrative only.

Dollars (in thousands)	FY11	FY12	FY13	FY14	FY15
Expenditures					
General Fund	146	10,676	9,488	9,488	
Less Agency Can Absorb					
-- No Impact --					
Net Expenditures					
General Fund	146	10,676	9,488	9,488	
Revenues					
-- No Impact --					
Net Cost <Savings>					
General Fund	146	10,676	9,488	9,488	
Total Cost <Savings> to the State	146	10,676	9,488	9,488	

	FY11	FY12	FY13	FY14	FY15
Full Time Equivalents					
General Fund	0.99	92.00	92.00	92.00	
Total FTE	0.99	92.00	92.00	92.00	

Bill Description

HF 418-0, the Back-Office Consolidation Act, transfers responsibility for state accounting, payroll, financial reporting, procurement, fleet services, and human resources from executive state agencies to the Department of Administration (Admin) as of July 1, 2011. This includes powers, duties, assets, personnel and unexpended appropriations for these functions. Admin must complete service-level agreements and reorganization orders with each agency governing provision of services. Agencies may choose to obtain services from an outside vendor, if cost effective. The requirement to enter into service-level agreements is effective the day following final enactment.

The commissioner of Admin must submit a bill to the legislature by January 15, 2012 making statutory changes in line with the reorganization orders issued in 2011.

Assumptions

- Back-office consolidation affects all cabinet agencies (22) and all non-cabinet executive branch agencies (57) resulting in 79 agencies merging into one unit/agency.
- The type and scope of services provided by Admin to executive agencies would not exceed those currently provided by the agencies themselves. All of the assets, personnel, and unexpended appropriations will transfer to support the services at these levels. The resources that will be transferred are not included in this fiscal note. The proposed legislation requires changes in statute to redirect statutory appropriations from various agencies to Admin and may result in complications including action by the federal government to redirect federal funds from one agency to another agency along with the potential loss of federal funds.
- Statutes requiring all agencies to use current employees who are able and available would require modification to allow agencies to choose vendors for services rather than Admin.
- Memoranda of understanding or statutes governing staffing levels or layoff prohibitions for specific agencies would be modified to allow agencies to contract with vendors, if cost-effective.
- Economies of scale cannot be achieved until agency work can be fully assimilated within Admin.
- Economies of scale will be affected by the degree to which agencies choose to use the consolidated enterprise services rather than contract alternatives.
- Consolidation of accounting services would await the full implementation of the SWIFT project to ensure SWIFT is successfully implemented.
- Lean tools and methodologies would be deployed to improve performance and results.
- A well-defined communication plan would be required to ensure employees, supervisors, managers, prospective employees, and vendors receive the information they need.
- Given the significant changes, it will be important that time is dedicated to listening to agencies business requirements to ensure agencies needs are met and that they have confidence in the project implementation plan.
- Agency subsystems will not require any modifications but if required would be presented as future initiatives.
- The proposed legislation will impact the cost structure of multiple agencies. Changes in cost structures affect fees/departmental earnings. Until the impact on the cost structures is known, it is not possible to assess the impact on fees/departmental earnings.
- A study would need to be completed to understand the implications of an indirect cost plan that encompasses all support functions identified in the proposed legislation. It is unknown what these implications may be for the agencies affected by the consolidation.
- The current decentralized service delivery model may change as a result of the study and would involve costs related to business process reengineering and training that are difficult to quantify. Costs related to changes in the service delivery model are not included in this fiscal note.
- A charge-back arrangement or another method to differentiate work performed on behalf of non-general fund programs would need to be implemented when consolidated staff work on programs funded from a variety of sources. This would be completed upon final restructuring.
- Admin anticipates that the majority of Minnesota Management and Budget (MMB) personnel will remain at MMB to carry out their mission of increasing state government's capacity to manage and utilize financial, human, information, and analytical resources. MMB would continue to provide fiscal and human resource planning and strategy as well as work with agencies on budgets and expenditures.
- How the "transfers" of employees would 'trigger' layoff costs and/or relocation costs are unknown. Until the details of the restructuring are developed, it is not possible to project these costs.
- Staffing resources will be required beginning in FY 2011 to enter into service level agreements.

- Authority for employees in other agencies would move to Admin on July 1, 2011. Physical consolidation and co-location is not included in the cost projections and would be reviewed after final restructuring. In the meantime, the agencies' current organization structures for support services would remain intact with direction from Admin.
  1. *Scope of transfer:*
     The transfer of employees would be extremely complex. There are 881 employees in accounting classifications (and a further 189 in "accounting, audit, and financial careers" as MMB defines them) and 364 in human resources classifications statewide. Although these numbers may include employees from non-executive state agencies, the overall number of accounting positions will be very close to the number of employees listed in MMB reports. The number of procurement staff is more difficult to estimate because there is no one classification sequence for the jobs. However, one indication is that there are 558 employees who have authority for purchases up to $10,000 and 85 employees with $25,000-$50,000 purchasing authority. The number of fleet management staff cannot be readily determined from any one measure but would likely exceed one hundred employees. Conservatively then, there are at least 1,900 employees who would be transferred to Admin, even if Admin did not ultimately provide the services.

     Oversight of positions performing these duties to Admin requires the Department to:
     1) establish an organizational structure to encompass the variety and breadth of services now performed by agencies;
     2) investigate individual agency support operations to create service level agreements;
     3) over time, evaluate opportunities to co-locate staff performing similar functions while ensuring agency business needs can be successfully performed; and
     4) ensure performance and results are maximized.

  2. *Co-Location Studies and Experience:*

     Information technology (IT) consolidation study: Asked by the legislature to determine the costs and benefits of IT consolidation, the Office of Enterprise Technology (OET) commissioned a study released in July 2010. The study compared the risks and benefits of moving all IT employees into OET; outsourcing some IT services and retaining the remainder within the OET; and outsourcing all IT services. The consolidation model, which is most applicable to this context, envisioned 879 IT employees from agencies becoming part of OET. The OET consolidation proposal is similar to the Back-Office Consolidation Bill except that it involved only one service area rather than several and would affect about the same number of employees as those found in state agency accounting alone.

     The consolidation study analysts believed that centralization of IT functions could save the state about 16% in costs over a seven-year period with a $65 million investment in the first two years of the transition. Savings would be achieved through economies of scale, a 25% reduction in the number of staff, a 5% cut in compensation, a salary freeze for years two and three, and displacement of staff to obtain employees with higher-level skills. How much savings could be attributed to more efficient use of equipment, rather than staff, is unclear from the study results.

     The information from the IT study is instructive, but can only be used to a certain degree. Although there would be economies of scale with a back-office consolidation, much as there would be with an IT consolidation, there is little savings to be realized in this case by pay cuts because IT professionals are typically paid about 29% more than their counterparts in other classifications. Savings in the back-office consolidation will more likely be accrued as veteran support staff retire and are replaced by staff with fewer years experience and lower salaries. About 14% of the state's accounting staff and about 12% of human resource staff are 60 or older.

     The study also evaluated the risks of consolidation. The authors indicate that the "size and complexity of the changes, the significant investments in years one and two, the length of the change window, the need for additional expertise, statutory and union agreement limitations to the ability to undertake staffing changes and reductions, and the difficulty of examining all changes on time and on budget" all pose significant risks to achieving a consolidation. These risks are amplified by the greater complexity of moving six different kinds of services (accounting, payroll, financial reporting, human resources, procurement and fleet) without a long-term transition window.

Iowa's Department of Administration (DAS) consolidation. The back office consolidation is similar to the current structure of Iowa's Department of Administration. Created by legislation in July 2003, DAS provides human resource, accounting, finance, as well as IT and other service operations for Iowa's state agencies. There was a transition period of two years, during which the agency was responsible for conducting a pilot in one of the service areas.

The difference is in the scope of the operations – the DAS employs 400 staff members involved in all of these services, including IT and capital complex maintenance and repairs. This is consistent with the differences in the states' populations – Minnesota's population is 43% larger than Iowa's (July 2009 census figures). In addition, DAS was created by combining four agencies which already provided services to other state agencies, not disparate staff from all Iowa state agencies. Consolidation of existing operations that are already organized to provide statewide services is more straightforward than setting up an organizational structure from scratch.

Expenditure and/or Revenue Formula

There would be four major components to a consolidation effort – data collection and analysis, project management for the consolidation, and internal restructuring. The IT consolidation report anticipated transitional costs for that consolidation effort at $65 million.

Data Collection and Analysis:

This includes:

1) Surveying all executive branch agencies to determine how many employees are involved in accounting, human resource, payroll, fleet, finance, and procurement responsibilities;
2) Establishing baseline costs for all agencies for the service areas;
3) Identifying current level of service and specific support requirements for each agency such as type and distribution of funding, including collection of fees, existence of lawsuits and complaints, legislation that affects human resource actions, how agencies handle travel and fleet arrangements, and the kinds and frequency of purchases;
4) Identifying opportunities for improvements and economies of scale in each service area;
5) Reviewing existing data and documents (financial reports, numbers and classifications of employees, etc.); and
6) Review all existing indirect cost plans and develop an executive branch comprehensive indirect plan that includes clarity concerning revenue implications.

Cost: Approximately $600,000
Estimated contract cost to complete the data collection and analysis, and to prepare a report of the consolidation activities identified in HF 418.

The analysis of IT resources in state agencies by a consultant cost $463,000. A similar report involving the six separate services outlined in the Back-Office Consolidation Act would be broader in scope, but would not involve reviewing outsourcing options.

Project Management:
As consultants are mapping the current resources, a team of Admin employees would be performing the following activities:

1) Defining metrics of acceptable performance and best practices in the major subsets of each service area;
2) Meeting with agency staff to investigate and negotiate service level agreements with Admin and alternative private sector service providers;
3) Setting up an organizational structure for each service area and determining the sequential movement of services and staffing;
4) Developing requests for proposal in multiple service areas to determine the costs and benefits associated with private sector alternatives;
5) Reviewing policies, statutes, and business processes to identify opportunities for efficiencies and economies of scale, including use of Lean tools and methodologies;
6) Appraising agency subsystems and identifying any potential concerns;
7) Evaluating vendor responses and awarding and managing resulting contracts; and
8) Finding appropriate space to accommodate staff in a common setting and planning moves.

This work would be done by a project team for a three year period. The team would consist of a project manager, four project coordinators (one for accounting and financial reporting, one for human resources and payroll, one for procurement, and one for fleet), two project specialists, a human resources specialist, two Lean process improvement facilitators, a space planner, and a clerical employee. MMB will also be on the Project Planning team for strategic input and oversight in finance/human resources responsibilities. The project coordinators would be responsible for conferring with the consultants and the agency staff in their areas of expertise. Project specialists and the clerical staff member would assist the coordinators. The human resource specialist for the project would provide HR expertise; the space planner would be involved with defining space needs and availability from the time staff needs are defined. The Lean facilitators would work across all areas to help the teams improve organization performance. The project manager and two of the four project coordinators would be hired in FY 2011 (following bill enactment) to begin work on the service level agreements.

Cost: Approximately $146,000 in FY 2011; $1,340,000 in FY 2012; and $1,264,000 in FY 2013.
In addition to salaries and benefits, operating costs such as rent, communications, technology, travel, supplies and equipment are included for the project management team.

Internal Agency Teams:
In addition, agencies would require staff to assist or represent the agency regarding the transition who are subject matter experts for their areas of expertise. On average, the note assumes three subject matter experts per cabinet agency.

Cost: Approximately $8,158,000 in FY 2012 and $7,678,000 in FY 2013.
In addition to salaries and benefits, operating costs such as rent, communications, technology, travel, supplies and equipment are included for the commissioners' teams.

***Internal Restructure**:*
Admin's commissioner's office, directors and staff from fleet, human resources, procurement, and financial management would be critical participants in the implementation and ongoing success of the consolidation. They would work closely with the contractor on the analysis and the project management team on implementation as well as develop financial projections, ensure effective communications, and meet as needed on critical, high priority issues. The volume of decisions, questions, and communications that will require response by each of these units would create a need for staff to take over some of the director's duties or to perform some of the project duties. Costs have been estimated for staff who can take over some of the director's duties. These employees would have to be very experienced in state service operations and would have correspondingly high classifications.

These supplemental staff would include four State Program Coordinators, one each for Financial Management and Reporting, Fleet, Human Resources, and Materials Management. An additional Information Officer for the Commissioner's Office would be necessary. These would be three-year, temporary, unclassified positions.

Cost: Approximately $578,000 in FY 2012 and $546,000 in FY 2013.

In addition to salaries and benefits, operating costs such as rent, communications, technology, travel, supplies and equipment are included for the internal restructure.

Long-Term Fiscal Considerations

There are several significant variables for this project:

- The number of executive state agencies that would obtain services from Admin and the types of services they require would affect future cost.
- Since similar large-scale government restructuring efforts were not identified, the range of savings/costs is not known. The success will depend on the project team's ability to successfully estimate where there is duplication of effort and where economies of scale may be obtained, and the willingness of staff to view the consolidation project positively which will lead to an improvement overall results.
- The changes resulting from the consolidation is long term and the outcomes in terms of savings/costs/results will be unknown for several years.

Local Government Costs

None anticipated.

References/Sources

"Legislative Report on the Centralization of Information Technology"; The Office of Enterprise Technology, July 1, 2010.
"State of the Agency: A 100-Day Review Report"; Iowa Department of Administrative Services, December 2007.

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EBO Comments

I have reviewed this Fiscal Note for accuracy and content.

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