

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: June 8, 2007

IBA Report Number: 07-62

City Council Docket Date: June 11, 2007

Item Number: 201

Subject: Selection of Enterprise Resource Planning (ERP) System Software and Establishment of CIP

OVERVIEW

This item authorizes the Mayor, or his designee, to make draws against the IBM Credit Facility, for the purpose of financing the cost of acquiring the equipment, software and services selected by SDDPC for the implementation of the City's ERP Project. Additionally, it authorizes the City Auditor and Comptroller to add CIP-92-000.0, Enterprise Resource Planning System Core Capital Project to the Fiscal Year 2007 Capital Improvements Program, and to increase appropriations and authorize expenditures in the amount of \$5 million for Fiscal Year 2007.

FISCAL/POLICY DISCUSSION

The ERP Project was approved, in concept, by the City Council on February 5, 2007. At the City Council meetings of April 24 and May 15, 2007, the City Council approved the lease purchase agreement with IBM Credit to finance the costs related to ERP, in an amount not to exceed \$29.5 million, with the condition that the Mayor or his designee shall not be authorized to make an initial draw on the credit facility until the City Council has affirmatively voted on the acquisition of equipment, software and services as selected by the San Diego Data Processing Corporation (SDDPC). In addition, the City Council authorized the establishment of an ERP Fund (50071) and the transfer of up to \$3.5 million from the City's A-List Fund (50066) to the ERP Fund. At that time, the City Council also requested that the Independent Budget Analyst and City Attorney obtain monthly progress reports on the status of the project, and that the CIO provide an opportunity to the City Council to meet the vendors and provide quarterly reports to the Rules Committee.

Following a six month requirements and selection process, SAP AG was unanimously recommended by the Evaluation and Selection Committee to supply the City's ERP software. The staff report provides a detailed review of the process used to select the software, including an overview of the capabilities of the selected software and the

project management processes that will be used to manage the implementation project following selection of a System Integrator.

On May 12, 2007, the SDDPC Board of Directors authorized the President and Chief Executive Officer, Chief Financial Officer, and Corporate Legal Counsel to negotiate and execute a contract with SAP (contingent upon affirmation by resolution from the City Council) to provide software and maintenance support for the City's ERP Project. In addition, the SDDPC Board authorized the use of \$3.5 million of its equity for various SDDPC expenses related to the City's ERP system implementation, as originally proposed.

The capital cost for the ERP Core Implementation Project has been added to the FY 2008 budget as a CIP as part of the Mayor's May Revision. The FY 2007 portion of the CIP is being added in this request. The total amount that will be budgeted in the CIP project is \$29.5 million. These amounts match the projected fiscal year draws from the Lease Purchase Agreement with IBM Credit LLC.

ERP Budget Add For Lease Financed Costs	
Fiscal Year	Amount
FY 2007	\$5.0 million
FY 2008	\$16.3 million
FY 2009	\$8.2 million
TOTAL	\$29.5 million

The term of the proposed software and maintenance contract with SAP AG is for two years with eight one-year renewal options. The software and first year maintenance cost is \$4,575,883. Initial project estimates for the ERP software were in the range of \$4 - 5 million. The negotiated contract price for the ERP software, including SAP licenses and 3rd party software licenses, as currently proposed, is \$3,757,250. Initial project estimates for the ERP software annual license maintenance were in the range of \$1 - 2 million. The negotiated price for the ERP software annual license maintenance, including SAP license maintenance and 3rd party license maintenance, is \$818,633. To date, project savings total \$2.4 million for these components of the project, though more significant cost items are still to come and an evaluation of the project budget will be ongoing.

ERP Item	Initial Estimate	Negotiated Price	Savings to Date
Software, including SAP and 3 rd party licenses	\$4-5 million	\$3,757,250	\$1,242,750 max
Annual License Maintenance	\$1-2 million	\$818,633	\$1,181,367 max
TOTAL	\$5-7 million	\$4,575,883	\$2,424,117 max

Next Steps

The Request for Proposal (RFP) for the System Integrator was released June 1, 2007. Proposals are due July 9, with evaluation and interviews to occur in the weeks that follow. SDDPC Board approval is expected by the end of July. Project cost estimates for the System Integrator are in the range of \$16 – 18 million.

The first phase of the ERP project, comprised of core financials, was targeted for completion by July 2008, though some tasks have already required more time than originally estimated, and may postpone completion of this phase. Following the selection of the System Integrator, the project schedule will be further evaluated and it will be determined if the overall project schedule will be delayed.

Periodic Updates

In an April 2007 memo, the Mayor provided a periodic update to the City Council on the ERP project, and committed to providing future updates according to the schedule, as shown here.

ERP Periodic Updates to City Council per Mayor's 4/12/07 Memo	
System Integrator Selection	July 2007
Pre-Launch Finance	June 2008
Post Finance Completion	Sept 2008
Pre-Launch Human Resources	Dec 2008
Post Human Resources Completion	Mar 2009
Periodic Updates	Quarterly (or as needed)

The CIO has indicated that the next briefing to the City Council on the status of the ERP project is now expected to occur just before or just after the August 2007 recess.

Internal Controls

The Mayor issued Kroll Remediation Status Report Number 5 on April 9, 2007 which was discussed by the City Council on April 23, 2007. This status report provided an update on a Kroll Report recommendation that the Audit Committee retain a reputable independent auditing firm to, in connection with the annual audit of the City's financial statements beginning in FY 2008, conduct an audit of the City's internal controls and issue a report. With respect to this recommendation, the Mayor's Status Report stated "City management believes audit of the City's internal controls by a reputable independent auditing firm should not take place until the City's new ERP system has been implemented". Although the Independent Consultant recently acknowledged this statement in his report to the SEC, he also indicates that "it is imperative, however, that the City make progress in improving its internal controls over financial reporting as rapidly as feasible, and it may be possible to undertake interim external checks to help assess and accomplish this objective short of a full audit."

On June 11, 2007, the Audit Committee has scheduled a presentation by the CIO and the ERP system vendor to discuss implementation of the ERP system as it relates to addressing internal controls.

CONCLUSION

The ERP project is the largest City information technology project ever undertaken, and will enable responsible financial management and improve overall City efficiency. It is designed to meet the objectives of the City’s remediation efforts, and establish the City’s information technology architecture for the next 15 years and beyond. Because of the importance and magnitude of this project, the interest level is high on the status of the project’s progress, especially as key milestone dates are reached.

The staff report provides thorough information regarding the ongoing status of the ERP project, particularly regarding the lengthy and complex process utilized to select the software vendor. The IBA supports the commitment of the Mayor and the CIO to regularly update the City Council and the public of all significant developments related to ERP implementation, in keeping with the schedule.

The IBA recommends that the City Council approve the actions related to the software vendor selection and the addition of the ERP project to the City’s Capital Improvement Program. However, our office remains concerned about any possible delays in the evaluation or implementation of internal controls until the ERP system is in place, and will work to identify interim measures to ensure progress is made during this period.

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