



Call for Action

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Federal Regulatory Reform Needed to Support State IT Modernization Efforts

Background

State governments, in partnership with federal agencies, deliver and support an array of federally funded programs that enhance the quality of life for our citizens. All of these programs are enabled by state information technology (IT) solutions and services. For nearly a decade, states have been optimizing these IT investments through consolidation strategies and leveraging common services to be more efficient and cost effective. Supported by federal funding, state agencies utilize these IT services, which must be allocated and accounted for under 2 CFR Part 225, Principles for State, Local, and Indian Tribal Governments (OMB Circular A-87). This complex IT business environment in state government presents a host of challenges that must be addressed by the state IT organization and the various agencies delivering programs.

State CIOs have an obligation to ensure that state IT services are delivered in the most efficient and cost-effective manner possible. Enterprise consolidation focuses on how the state organizes delivery of IT services to agencies: combining existing organizations, services or applications into a single operation. National surveys of state CIOs reveal a continued progression toward more IT consolidation in the future.¹ The direction of state government is clear – enterprise IT consolidation and shared services is the strategic direction and favored approach by elected state leaders.

The Problem for States

The guidance attached to federal funding does not promote IT shared solutions, infrastructure optimization or the integrated channels of services sought by citizens. The state IT landscape has changed significantly, yet grant funding guidelines do not reflect this new environment. Federal regulations on cost allocation principles do not acknowledge this evolution in state IT business models. Clarity, consistent interpretation and flexibility in the use of federal funds for IT acquisition, operation and delivery of IT services is lacking. The general experience of State CIOs is frustration with federal funding constraints that are at odds with the realities of IT modernization and shared services. An obvious example is the treatment of financing costs and interest under federal grants. Software development projects are intangible assets and thus are not specifically addressed as “allowable” types of assets. Federal agencies interpret 2 CFR Part 225 guidance as disallowing financing costs (including interest) for software development. States cannot afford the capital to finance all the IT projects and the federal government should share in the risk and financing with the states. Increasingly, public-private partnerships are being used for IT initiatives with private capital as a supplement and interest is an integral part of the equation as well. With the reality of multi-million projects and phased implementation timeframes, this financing and interest disallowance hampers state IT modernization initiatives.

¹ NASCIO's *Survey on Enterprise Data Center Consolidation in the States: Strategies and Business Justification*, National Association of State Chief Information Officers, (NASCIO), August 2007 and *NASCIO's Survey on IT Consolidation and Shared Services in the States: A National Assessment* (May 2006)

As millions of new federal dollars are spent on IT that supports human services, public health, justice and homeland security, reforms are needed to support state enterprise IT solutions and flexible commingling guidelines with specific cost-allocation options. This could greatly improve the return on every federal dollar spent on IT in the states. This flexibility could also prevent the creation of new “stovepiped” systems, or systems with rigid boundaries that only allow for the transmission of information along strict vertical agency lines rather than a horizontal exchange of information across state organizational lines.

In addition to federal cost allocation interpretation, one of the foremost barriers to implementing an enterprise consolidation and best practices in the states lies in the often inconsistent application of federal programmatic regulations and funding for IT. This inconsistency results in a process by which each state must negotiate how IT investments are applied culminating in a variety of different interpretations and outcomes. It is imperative that a process to harmonize federal programmatic rules, directives and mandates for IT investments by the states be undertaken. Through program funding to multiple state sources, federal agencies often impose regulations, prescriptive mandates and technology requirements on states that are not coordinated at the federal level. The result is a proliferation of diverse IT environments, services and staffing and inability to leverage a state’s shared services architecture. Although federal guidelines may be used as the rationale, specific technology requirements are interpreted and applied in an inconsistent manner by federal agencies and imposed on the states. This prohibits states from leveraging existing technology investments and implementing cost-saving enterprise services. States end up with costly stovepipe programs and mismatched technology solutions due to the lack of federal coordination.

How Congress and the Administration Can Help

Regulatory reform and revised guidance is needed to resolve these issues, however the approach must be collaborative. NASCIO recommends Congress establish a joint federal-state advisory committee to propose reforms to federal cost allocation regulations and reconcile other inconsistent federal guidance and technology directives. The advisory committee should collect, review and analyze and propose revisions to relevant sections of 2 CFR Part 225 (OMB A-87). This must include specific recommended language changes or deletions linked to each provision. Other federal regulations that inhibit a state IT consolidation strategy or adoption of best practices must be identified and reviewed. The membership should consist of the federal CIO, other representatives from OMB, federal agencies and the state CIO community. Not later than 6 months after the date on which the advisory committee is established, the committee should submit to Congress a report on its findings and recommendations for regulatory reform.

Contact: Pam Walker, NASCIO Director of Government Affairs, (202) 624-8477, pwalker@AMRms.com