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## FISCAL IMPACT REPORT

ORIGINAL DATE 1/31/08  
 SPONSOR Varela LAST UPDATED 2/05/08 HB 517/aHHGAC  
 SHORT TITLE Information Technology Equipment Replacement SB \_\_\_\_\_  
 ANALYST Aubel

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY08	FY09	FY10		
	(\$1,002)*	(\$1,002)*	Recurring	Information Technology Fund
	(\$4,750)*	(\$4,750)*	Recurring	Communications Fund
	\$5,752	\$5,752	Recurring	Equipment Replacement Funds

(Parenthesis ( ) Indicate Revenue Decreases)

\*Based on FY08 billing rates.

Relates to appropriations made to the Department of Information Technology in the General Appropriation Act.

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)\*

	FY08	FY09	FY10	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
<b>Total</b>		(\$3,000.0)		(\$3,000.0)	Non- Recurring	Communication Fund
		\$3,000.0		\$3,000.0	Non- Recurring	Equipment Replacement Funds

(Parenthesis ( ) Indicate Expenditure Decreases)

\*Updated to incorporate new information from the Department of Information Technology

### SOURCES OF INFORMATION

LFC Files

Responses Received From

Department of Information Technology (DoIT)  
Higher Education Department (HED)  
Department of Public Safety (DPS)

**SUMMARY**

Synopsis of HHGAC Amendment

The House Health and Government Affairs Committee Amendment adds the Information Technology Commission to the list of agencies for reporting purposes.

Synopsis of Original Bill

House Bill 517 amends the Department of Technology Act to establish a method for equipment replacement to ensure uninterrupted enterprise service delivery. The bill creates equipment replacement funds for each enterprise function; requires the agency to prepare an equipment replacement plan that is submitted to the Department of Finance (DFA) and to the Legislature by December 1 of each year; authorizes expenditures from these revolving funds to be made, subject to legislative appropriation, for acquiring and replacing capital equipment in accordance with the equipment replacement plan; and requires a reconciliation report of the preceding fiscal year reflecting the financial activity in each of the equipment replacement funds. HB 517 authorizes the department to make initial transfers from operating funds to establish beginning equipment replacement fund balances on July 1, 2008.

**FISCAL IMPLICATIONS**

HB 517 directs DoIT to transfer the correct amount each fiscal year from the enterprise function's operating account to its equipment replacement revolving fund, based on the amount of the depreciation applicable to each enterprise service as reflected in the department's published cost structures and service rates. The total estimated annual amount, which would most likely increase as newer equipment replaces older equipment, is \$5.8 million. This estimate is based on the approximate FY08 depreciation amounts for information technology and communications provided by DoIT.

<b>Operating Funds</b>	<b>Projected Revenues/Billings (In thousands)</b>	<b>Est. Depreciation % (In thousands)</b>	<b>Est. Transfer (In thousands)</b>
IT	\$18,929.3	5.4%	\$1,002
Communications	\$27,457.9	17.3%	\$4,750
<b>Total</b>			<b>\$5,752</b>

The appropriations of revenues collected for depreciation contained in this bill are a recurring expense to the enterprise funds. Any unexpended or unencumbered balance remaining at the end of fiscal year shall not revert to the enterprise funds.

This bill creates new funds and provides for continuing appropriations. The LFC has concerns with including continuing appropriation language in the statutory provisions for newly created funds, as earmarking reduces the ability of the legislature to establish spending priorities.

However, this concern is mitigated by the requirement that expenditures from the fund shall only be made pursuant to an appropriation from Legislature and only for the purpose specified. In addition, the depreciation portion of revenues would be collected regardless of this bill. HB 517 allocates this amount to the purpose of equipment replacement rather than using these revenues to fund operations.

The current operating budget for FY09 contained in House Bill 2 includes \$3 million for equipment replacement. ~~Although the agency did not specify this would provide a beginning fund balance for the Communications enterprise revolving replacement fund, it is a reasonable assumption that the final appropriation made for this purpose may be transferred.~~

Because the General Services Department (GSD) 2006 and 2007 audits have not yet been completed, the amount of fund balances available to transfer to establish beginning equipment replacement fund balance is uncertain.

### **SIGNIFICANT ISSUES**

DoIT provided a list of equipment needs totaling \$5.9 million for FY09 (Attachment A). A fund was established at General Services Department in the mid-1980s with a \$1 million appropriation. Monthly revenues, based on depreciation amounts, were deposited into the fund and then used for equipment replacement. The fund was later dissolved, although the exact details remain unknown. HED states that this bill would re-establish an equipment replacement fund process as well establish the “best practice” of system life-cycle planning, including equipment upgrades and replacements.

The equipment replacement funds would be started by transferring operating funds on July 1, 2008. Subsequent funding would occur from allocating the depreciation portion of the billed rates to these funds. DoIT provides the following analysis regarding this process:

The basis for depreciation expense is the purchase price for the piece of equipment or software that is being depreciated. The amount of the depreciation is a function of both the purchase price and the useful life of the equipment or software. Most equipment and software used by information processing and telecommunications enterprise services have useful lives ranging from three to seven years, depending on the type of equipment and how it is used. DoIT follows industry standards for determining useful life.

The amount of depreciation expensed in any given fiscal year is based on the “straight line” method, which is simply the percent of useful life lost in a year. For example, a piece of equipment that has a five year useful life would lose 20% of its useful life each year for five years. The amount of depreciation expensed in one year would therefore be 20% of the original purchase price.

The actual amount of depreciation assessed to agencies is based on the un-depreciated value of assets recorded on DoIT’s fixed asset records.

The DoIT assessment for FY08 includes approximately \$1.0 million of depreciation expense for information processing and \$4.5 million for telecommunications. This represents only 5.4 % of total information processing billings and 17.3 % of telecommunications billings.

The extremely low percentage for information processing depreciation expense is the result of having old equipment that has substantially passed its useful life.

### **PERFORMANCE IMPLICATIONS**

DoIT and HED suggest that creating equipment replacement funds as required by this legislation should improve the planning process and make it more transparent. DPS maintains the bill does not require DoIT to consult the user-agencies regarding future equipment replacement needs, which may suggest an underlying assumption that only existing equipment needs to be replaced. However, DPS points out that the communications field has experienced significant technology changes in recent years and that needed replacements could be quite different than existing equipment.

Furthermore, DPS suggests that the equipment replacement plan should be accompanied by a mechanism that audits and assures that equipment replacement actually occurs in a measure equal to the fees assessed by the DoIT.

### **ADMINISTRATIVE IMPLICATIONS**

The State Treasurer would need to establish and account for the funds.

### **TECHNICAL ISSUES**

Part (D) of the bill allows the department to make initial transfers from its operating funds to establish the beginning fund balances as of July 1, 2008. It is unclear whether the language is referring to fund balances or budgeted revenues. As noted above, availability of fund balances will not be determined until General Services Department completes the audits for 2006 and 2007.

Another technical issue arises regarding the availability of the funds transferred to the new funds as of July 1, 2008. This issue is whether they would be subject to legislative appropriation the following 2009 Session or if DoIT has access to the funds for needed equipment replacement prior to that time through appropriate Budget Adjustment Request (BAR) authority.

A similar issue arises for replacing equipment that was not included as part of the equipment replacement plan submitted the prior year.

The FY09 operating budget utilizes almost all of the projected revenues for operations, with only \$3.0 million appropriated for equipment replacement -- \$2.9 million short of identified needs.

### **ALTERNATIVES**

DoIT notes it could establish a separate cost center within each enterprise fund and set aside the amount of revenue realized by charging for depreciation expense in agency fees. The total amount for equipment purchases would still have to be appropriated by the Legislature.

One option would be to appropriate sufficient general fund into the new funds directly. The Information Technology replacement fund, in particular, appears to have insufficient funding source.

Another option would be to temporarily raise rates that agencies pay to “seed” the new funds. The advantage to this option is that agencies pay these fees with various funding sources, including general fund, federal funds and other state funds. DoIT suggests that using this indirect method of establishing a fund balance would be less than a direct general fund appropriation, assuming the total fund balance targets remained the same.

### **WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL**

DoIT would not be required to prepare an equipment replacement plan and would not be required to report to the legislature on a regular basis on the department’s equipment needs or the status of previous proposed purchases if this legislation is not enacted. In addition, the transparency relating to equipment purchases would most likely be lost.

### **POSSIBLE QUESTIONS**

1. How many equipment replacement funds will be established?
2. What are the projected operating funds that will be allocated to “seed” each fund?
3. How will the FY09 operating budget be impacted and re-aligned with any reduction in budgeted revenues for operations due to the deposit of the depreciation amounts into the new funds?
4. Will rates need to be raised to fund agency operations in FY09 to replace the depreciation percentage of billings?
5. Will rates need to be raised to fund agency operations in subsequent years to replace increasing depreciation percentage of billings (as newer equipment is brought on-line)?
6. Will the \$3.0 million appropriated to the DoIT budget in HAFC House Bill 2 for equipment replacement be transferred? What will be the allocation to which fund?
7. Will DoIT need to wait until the annual plan is submitted in December 2008 and the Legislature appropriates these funds, according to the plan, in the 2009 Session to replace any equipment? Or will FY09 BAR language allow emergency transfers for equipment?
8. Will DoIT be able to replace equipment to continue uninterrupted services if the equipment is not on the equipment replacement plan?
9. What are the latest projections for equipment replacement needs?
10. Will the operating funds provide sufficient funds to address these equipment needs or do the equipment replacement funds require a general fund “start-up” capital?
11. How will the information technology (IT) replacement fund be initiated and then funded with a low IT fund balance and low depreciation contributions?
12. Will the new funds be included as part of future HB 2 bills in a separate section from the programs?

13. How will DoIT assess agency equipment replacement needs and incorporate a prioritized list as part of the plan?

14. Would a deadline date of September 1 for the annual equipment plan be more useful to make it a part of the normal budget cycle analysis? What is the purpose of a December 1 date?

MA/bb

**DOIT NEEDED HARDWARE PURCHASES FY09**

<b>Description</b>	<b>Program</b>	<b>Amount</b>	<b>Justification</b>
Storage Switches	Enterprise Operations	90.0	Three switches that connect servers to back-up units, storage units, other servers and other switches. Current switches exceed useful life and maintenance agreements. These fiber switches move data between machines using only a single path. The additional switches will replace old switches and provide a duplicate path. If these switches go down, many applications would cease.
Storage Core Switch	Enterprise Operations	200.0	One new central Core Switch through which other switches flow. Provide redundancy that currently does not exist. Nine agencies down for four days. Maintenance agreement has expired on current Core Switch. If the core switch goes down, so too will the entire network.
Operations Center Equipment	Enterprise Operations	50.0	PCs, monitors, racks, console to monitor operations of servers mainframe, etc. This will allow operators to see immediately if equipment fails, if the data center is at the correct temperature, etc. Without this equipment, equipment malfunctions will result in operations being interrupted for longer period of time.
Integrity Networking Sun	Enterprise Operations	34.0	Additional equipment needed to operate existing STK backup system that is currently idle. This equipment (servers) needed to move the robotic arms in the backup systems that move the tape storage cartridges. DoIT currently does not have this equipment and consequently the backup system is not operational.
Windows Hardware	Enterprise Operations	500.0	60 new servers to support all Windows applications that are past useful life and off warranty. All current servers are 4 to 5 years old. If any of these servers malfunctions, agencies applications are affected.
Unix Hardware Replacement	Enterprise Operations	500.0	60 new Unix servers that maintain the state network core services (web). Existing servers past useful life and off warranty. Current servers are 4 to 5 years old. If any of these servers malfunctions, web services would be interrupted.
DX Replacements	Enterprise Operations	150.0	Switches at the front-end of networks that control and route traffic. These switches balance the load to the network and distribute it in the most efficient manner. If problems occur with these switches, applications being run by agencies will slow down significantly or in some cases cease.
E-mail equipment	Enterprise Operations	500.0	Replace 10 servers and disc storage units that are four years old and are off-warranty. Upgrade e-mail software from Exchange 2003 to Exchange 2007. The use of e-mail is expanding. Additional storage units are needed to store and backup e-mail and old servers need to be replace so that e-mail service is not interrupted.
Disaster Recovery Equipment	Enterprise Operations	500.0	Redundant equipment for off-site disaster recovery for open systems including windows and Unix servers, backup, storage, etc. The current DR system involves transferring backup tapes to Philadelphia, assembling necessary equipment and running applications currently on the main frame. It would take two to three weeks under this scenario and SHARE is currently not part of this agreement with the vendor. Servers that run agency applications are not properly backed up. This equipment (servers, switches, etc) would allow the state to restart operations much faster than the current disaster recovery model.
	Enterprise Services	299.0	PCs and IVR system for help desk. DoIT needs to provide more help desk services to agencies. Without upgrading some PCs and acquiring an Interactive Voice Response system, this will not be possible.
	Program Support	15.3	PCs
Radio base stations	Enterprise Operations	400.0	Replace 40 radio base stations (two-way) to conform to FCC standard to operate at new narrow band frequencies. This equipment is used for radio communications state-wide. If any of it fails, public safety could be jeopardized.
Routers and switches	Enterprise Operations	1,000.0	Old routers and switches that support the state enterprise data network. This equipment is the back-bone of the state system for data communications. Existing routers and switches are old and off warranty and maintenance. Data communications would be interrupted if any of the routers or switches fail.
Telephone equipment	Enterprise Operations	1,600.0	Telephones, telephone equipment including PBX switches and voice mail equipment for the enterprise voice network. This equipment is needed to maintain operation of the state's voice communication system. Much of the existing equipment is old and unreliable. New equipment is needed so that the state's voice communication system operates efficiently.

<b>Total Equipment</b>	<b>5,838.3</b>
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